Policy Paper Series, 2011

Feasibility Study – MSME Credit Card

Small Industries Development Bank of India (SIDBI)

About this report...

This report has been written as part of Ernst & Young's (EY) engagement with Small Industries Development Bank of India (SIDBI) under MSME Financing and Development Project (MSMEFDP) to conduct a feasibility study on introducing a credit card type product for the Micro Small and Medium Enterprise (MSME) segment in India.

MSME Financing and Development Project [MSMEFDP]

SIDBI is implementing a multi-agency, multi-activity Project on Financing and Development of MSMEs. The Department of Financial Services, Ministry of Finance, Government of India is the Nodal Agency for the Project. The World Bank, Department for International Development (DFID) UK, KFW Germany and GIZ Germany are the international partners in the Project. The Project is aimed at making MSME lending an attractive and viable financing option as also facilitate increased turnover and employment in the sector. The Project has three major components: (A) Line of Credit from World Bank and KFW, (B) Risk Sharing Facility, and (C) Technical Assistance (TA). The Project addresses demand side issues of credit and streamlining access to qualitative financial and non-financial enterprise oriented services. Technical Assistance (TA) from DFID is being utilized for strengthening the credit information system, credit rating, structuring of innovative products, capacity building of the participating banks, policy and regulatory issues and promotion of market oriented business development services for the sector. Overall, MSMEFDP has been creating an enabling and sustainable environment for the growth and development of competitive MSME sector in India.

The objective of the engagement is to gain an understanding of the MSME segment and its credit needs, evaluate various similar credit card products in India and abroad, the regulatory aspects in the Indian context and finally evaluate the potential and viability of Credit Card type product and provide a framework for the proposed product.

The report consists of the following five chapters:

Chapter 1 – Assessment of MSME Sector & Credit Requirement (Assessment of the size and dynamics of MSME Sector in India and an overview of the nature of credit requirements of the MSME segment).

Chapter 2 – Evaluation of similar global and domestic credit card product or schemes for MSMEs, their key features and success factors.

Chapter 3 – Overview of regulatory requirements for credit card operations in India.

Chapter 4 – Design of product framework and credit assessment methodology.

Chapter 5 - Understanding of the potential partners for implementation of the product scheme as well as identification of information support to be provided to them.

This report has been compiled on the basis of secondary research and discussions with leading players in MSME finance segment and MSME players themselves. Data sources include research reports, sector related various database, annual reports of organizations, research reports and working committee reports published by regulators and news articles. Further, inputs of various market players gleaned during interviews & discussions, have been taken into consideration while formulating the report.

Contents

Abbreviations used in this report

- ACC - Artisan Credit Card
- ANBC - Adjusted Net Bank Credit
- BCSBI - Banking Codes and Standard Board of India
- BNDES - Banco Nacional de Desenvolvimento Econômico e Social
- CA - Current Account
- CAGR - Cumulative Annual Growth Rate
- CBS – Core Banking Solution
- CGTMSE – Credit Guarantee Fund Trust for Micro and Small Enterprises
- CRAR - Capital to Risk Weighted Asset Ratio
- EMI - Equated Monthly Installments
- FG - Finished Goods
- KCC - Kisan Credit Card
- LUCC - Laghu Udyami Credit Card
- MITC - Most Important Terms and Conditions
- MSE - Micro and Small Enterprises
- MSME - Micro Small and Medium Enterprises
- NABARD - National Bank for Agricultural and Rural Development
- NBFC - Non Banking Finance Company
- NEFT - National Electronic Fund Transfer
- NMDFC - National Minority Development Finance Corporation
- NSBA - National Small Business Association
- OECD - Organization for Economic Cooperation and Development
- RBI - Reserve Bank of India
- RM - Raw Material
- RPCD - Rural Planning and Credit Department
- RTGS - Real Time Gross Settlement
- SA - Saving Account
- SBA - Small Business Administration

- SCB - State Cooperative Bank
- SCC - Swarojgar Credit Card
- SFURTI - Scheme of Fund for Regeneration of Traditional Industries
- SHG - Self Help Groups
- SME - Small and Medium Enterprises
- SSI - Small Scale Industries
- STPI - Software Technology Park of India
- UNIDO - United Nations Industrial Development Organization
- UP -Uttar Pradesh
- WC - Working Capital
- WIP – Work In Progress

Executive Summary

Micro Small and Medium Enterprise (MSME) segment plays a critical role in the Indian economy accounting for 45% of manufacturing output and 40% of the national exports. An estimated 285.16 lakh MSMEs operate in India as of FY2009. Often MSMEs producing a range of similar or same products are found to co-exist in typical geographical areas forming a cluster. Based on the nature of operations, these clusters can be categorized into three categories of Hi-Tech, traditional manufacturing and micro enterprise clusters which differ in nature of activity, size of enterprise and adoption of technology.

Units forming the micro clusters use simple manufacturing processes and are labour intensive whereas traditional manufacturing clusters are skill based. The High technology clusters are specialized suppliers in technology industry. Micro clusters have the lowest requirement of credit but suffer most from financial exclusion, while registered units in technology clusters have benefited from some government schemes

One of the major challenges faced by the MSMEs, particularly during the start up phase is access to timely and adequate credit. Some of the reasons for lack of adequate credit from formal channels include high customer risk perceived by banks, lack of appropriate credit assessment methods, and lower suitability of product features as per varied customer requirements. Due to restricted access to finance, MSMEs resort to informal sources such as personal savings, business related savings and personal borrowings.

There have been multiple schemes/products launched by several financial institutions, government funded agencies etc. targeted at this segment. Some of these products include Laghu Udyami Credit Card (LUCC)- targeted towards existing MSEs, Swarojgar Credit Card (SCC) – targeted towards service sector entrepreneurs, self employed persons etc. and Artisan Credit Card (ACC) – targeted towards artisans involved in production of handicrafts , handlooms etc. These cards have met with limited success. On the other hand the Kisan Credit Card (KCC) - targeted towards farmers (launched by NABARD) has met with reasonable success.

The KCC has been the most successful due to factors such as –availability of standard data for credit assessment and ease in monitoring due to low mobility of customer. The report assesses feasibility of a credit card type product based on the lines of KCC for the MSME segment.

A study of international practices in credit card financing reveals that globally, there are two main categories of credit cards for MSME borrowers.

- MSME cards issued by development agencies/banks.
- Small Business Credit Cards issued by commercial banks (for purpose of making profit).

The MSME cards offer revolving credit facilities to enterprises which may or may not be restricted to certain use. These cards may or may not be used in the actual sense of a credit card but offer the enterprise the same freedom in withdrawal of money and use as a conventional credit card. The primary motive in issuance of such cards is not profit making but ensuring easy access to credit for a MSME.

Small Business Credit Cards are largely used in developed countries and have similar features to personal credit cards. They are however, issued in name of the organization with sub limits for employees and primarily used for sundry expenses or as a credit line in case of emergencies. The limit granted is higher than a personal credit card and is granted keeping in mind the working capital and investment needs of a business.

It is proposed that the credit product thus developed can be implemented as a bank scheme which adopts the credit card features or as a card based product.

In case of implementation in form of a bank scheme, parameters such as the tenure of card, quantum of limit to be sanctioned, fees to be charged, target customer etc. would be stipulated by the scheme guidelines.

In case of launch of a card based product, there are several regulatory restrictions pertaining to issuance of credit cards that apply. The key ones include requirement of prior approval (if bank sets up a separate subsidiary or plans to launch a co-branded card), requirement of minimum net owned funds, adherence to fair practice code, and appropriate internal control and monitoring mechanism. Prudential norms like grievance redressal mechanism, customer confidentiality, debt collection also become critical in this case. However, in India, the regulator has not yet permitted public sector banks to introduce plastic credit cards for MSME segment due to concerns on end usage monitoring. It is expected that the regulator may provide flexibility in these restrictions or encourage the formulation of schemes with better mechanisms for end user monitoring. In case MSMEs, regulations & guidelines pertaining to priority sector lending such as limits for collateral free loans, debt restructuring, composite loans etc. would be needed to be adhered to.

Due to the regulatory requirements governing lending to the MSME sector, operational challenges on the monitoring and recovery front, and the fact that the size of demand, nature of requirements, usage of credit etc. varies across industry types/clusters one cannot design a common standard product that would cater to the entire MSME segment.

Two different products have been recommended, one catering to units with gross output less than ₹25 lakh (which form 99 % of the MSME universe) and other of units above ₹25 lakh gross output. The product features such as eligibility criteria, collateral requirements, valuation method adopted, credit limits etc. have been designed in line with the nature of requirements of the target segment.

From a borrower's perspective the key considerations that have been looked at during the design of the product include easy approval process, ease of documentation, automatic credit enhancement (with exceptions), payment flexibility (Monthly, EMI), and staggered late payment structure with varying grace period.

The usual practice followed by the various banks for lending to MSME sector in the working capital segment is to base credit assessment on the Nayak Committee recommendations. The primary objective of a credit assessment framework should be to provide basic and broad guidelines to build a credit rating/assessment model for lending to small business with poor or no credit history and where existing credit rating models may not bring out the true picture. Thus the final credit assessment model to be adopted by the banks should be a judicious blend of the quantitative and qualitative model. For the proposed credit card, a broad credit assessment framework is developed which is based on both quantitative and judgmental parameters. The quantitative parameters used for scoring can be classified under financial performance, business performance, industry outlook, quality of management, and conduct of account. The judgmental model of credit assessment is based on qualitative parameters such as character of borrower, capacity of repayment, capital (liquid assets/savings) in case of disruption of regular income, collateral and other economic and market conditions.

Similarly, the lending institutions need not follow a onetime disbursement mechanism for the sanctioned amount. A controlled disbursement mechanism, especially for new borrowers with poor or no credit history may be considered to reduce the risk.

As the scheme would be launched through the banks with a view to cater mainly to credit-starved segments, it is important that Financial Institution (FIs) identifies the suitable banking partner to associate with for the successful administering of this product. The key aspects to consider in identifying a potential partner include the banks size of MSME operations, geographic presence and distribution penetration, the bank's financial performance, IT infrastructure, and reputation.

Apart from partnering with the right bank, appropriate support measures shall play a key role in the success of the scheme. These include both

a) Support Measures expected from regulator/government, and

b) Information support to be provided to participating banks

Support measures expected from the regulators include modifications in the CGTMSE scheme, greater emphasis on standardization of information and assessment, establishment of training modules for micro and small enterprises etc. On the other hand , information support to be provided by FIs include design of simple and standard application forms , development of training modules to sensitize bank staff , assistance in developing mechanism to support customers.

Chapter 1 - Assessment of MSME Sector & Credit Requirements

Highlights

⇒ **This Chapter provides an overview of the MSME segment from perspective of their definition and segmentation and an analysis of their credit requirement.**

⇒ **The Chapter seeks to aid understanding of the MSME segment which varies considerably in its characteristics from other industry segments. The nature of credit requirement can only be understood through a detailed analysis of the MSME Sector. Thus the Chapter serves the purpose of understanding the target segment and its requirements in order to design an effective product for them.**

The Chapter consists of two sections:

- Section A – Assessment of MSME Sector (This section provides information on the definition, segmentation and size of the MSME segment)
- Section B – Analysis of nature of credit requirement (This section provides information on the nature of credit requirement for different segments)

Section A – Assessment of MSME Sector

This section comprises the following:

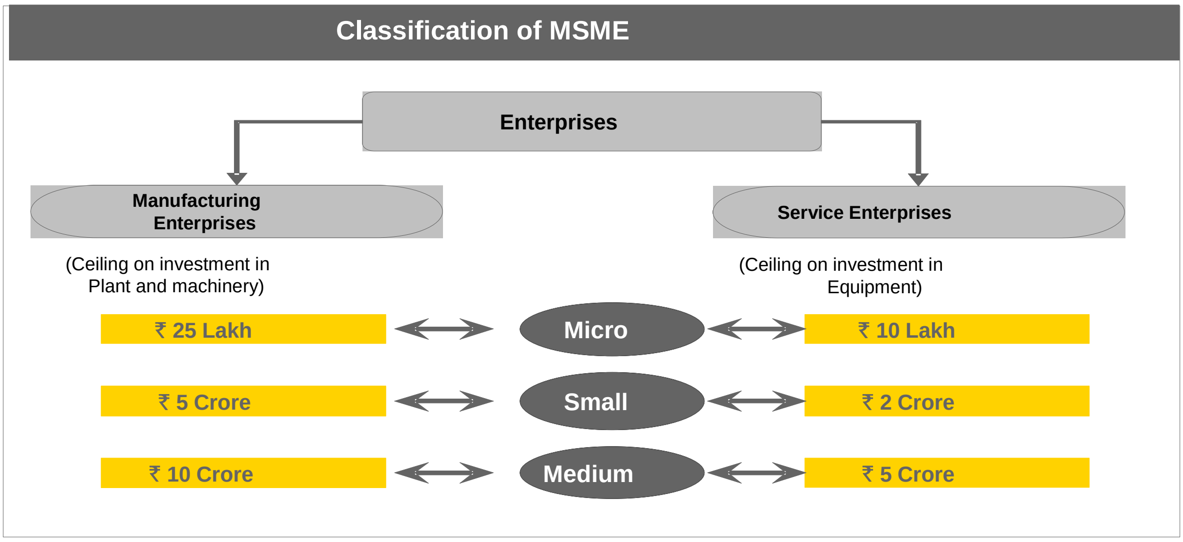
- **Definition of MSMEs** – This part of the section deals with the definition of the MSME segment in the Indian context
- **Segmentation of MSMEs** – Classification of MSME sector on the basis of nature of business (industry-wide classification) and size of business enterprises (volume-wise classification)

The purpose of this section is to provide in-depth understanding of the potential size and variations in the target segment which will be vital in designing product features as per the categories within the customer universe.

A. Definition of MSMEs

With enactment of Micro, Small and Medium Enterprises Development Act 2006, there has been a paradigm shift as it includes all business enterprises and not just manufacturing enterprises (earlier most service enterprises were not covered under the definition of Small Scale Industries). The enterprises are now grouped under two major heads namely manufacturing and service enterprises. As per the MSMED Act, the definition of MSMEs is given in Figure 1.

Figure 1



Source: MSMED Act, 2006 (Ministry of MSME)

MSMEs play a pivotal role in overall growth and development of the nation's economy. In the last 8 years, the MSME sector has grown at a higher average growth rate compared to the industrial sector, the difference between the two rates being in the range of 1-3%. Statistics published by the Ministry of MSME indicate that during 2006-07, the MSME sector in India registered a growth rate of 12.6%, as compared to the overall industrial growth of 11.5%. In FY 08; the MSME sector in India registered a growth rate of 13%, as compared to the overall industrial growth of 8%.

Growth pattern of MSMEs across the country

The absolute number of medium enterprises has been increasing consistently over the years. It was 7,828 in the year 2000 which increased to 11,447 in the year 2005 and 17,467 in the year 2008 which represents a CAGR of approximately 10.5 % from 2000 to 2008.

On the other hand the number of MSEs has grown at a CAGR of about 4.1 % per year in the same period. The total number of MSEs grew from 97.2 Lakh in 2000 to 133.5 Lakh in 2008. The census conducted in 2001- 2002 found that close to 99 % of total MSE were tiny enterprises. Similarly, the quick results of the 4th census conducted in 2007 indicate similar proportions.

The table below (Table 1) gives the growth in numbers of MSE units and medium size enterprises in the past 5 years.

Table 1

Year	MSE (in ₹ akh)	MSE Growth (%)	Medium enterprises	Medium Enterprise Growth (%)
2004	114.0	4.11%	10425	9.74%
2005	118.6	4.03%	11447	9.80%
2006	123.4	4.04%	12760	11.47%
2007**	260.7	--	27,778	--
2008	272.5	4.51%	30,278	9%
2009	284.8	4.53%	33,306	10%

Source: Annual Reports Ministry of MSME 2004-2010, 4th All India Census for MSMEs, EY analysis

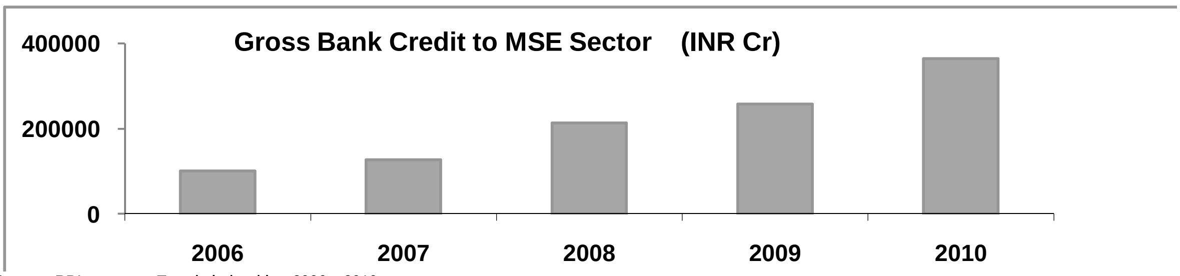
** Data from 2007 onwards reflects the 4th All India MSME Census data and as a result growth of 2007 over 2006 has not been considered

The large majority of MSEs are unregistered (approx. 85% are unregistered) and have an average fixed investment of ₹ 1 Lakh while the Registered units have an average fixed investment of ₹ 6.5 Lakh. The Medium enterprises have an investment of approximately ₹ 7 Crore.

One of the most common challenges faced by MSMEs is easy and ready access to finance. Multiple issues on the MSMEs part such as lack of sufficient data, poor quality of collateral, lack of professional management impair their credit history and hence increase reluctance to approach banks / FIs for credit. However, with initiatives taken by the government, under the 'Millennium Mission' for MSMEs along with various financial schemes for MSMEs, has attracted several new players public, private and international banks and FIs to come in the foray. After the creation of the erstwhile Ministry of Small Scale Industries & Agro and Rural Industries in 1999, a Mission for Millennium[1] giving a blue print for small scale and village industries was announced. This in turn lead to the Comprehensive Policy Package for Small Scale and Tiny Sector, Some of the prominent initiatives under this policy package included capital subsidy schemes, to conduct third census for MSMEs, increase in limit of composite loans, credit guarantee schemes, formation of committees by RBI for rehabilitation of sick MSMEs etc. As a result of the various initiatives undertaken by the government and RBI over the years, the credit to MSMEs increased from ₹ 84,000 Crore in March 2004 to ₹ 259, 998 Crore in March 2009 at a cumulative annual growth rate (CAGR) of 26%. But, this number is still significantly lower as compared to the overall credit requirement which becomes essential for sustained and continuous growth of the MSME segment. The overall credit requirement is estimated at ₹ 900,000 Crore in the next 10 years (estimated on the basis of the annual working capital and fixed investment requirements of the MSMEs detailed in the subsequent sections)

The chart below (Figure 2) gives the Total gross Bank credit outstanding in the MSE sector

Figure 2



Source: RBI report on Trends in banking 2006 – 2010

[1] http://www.dcmsme.gov.in/policies/policypkg.htm

B. Segmentation of MSMEs

Cluster based segmentation of MSMEs

MSMEs exist almost across all industry types. The MSME sector produces a wide range of products, from simple consumer goods to highly precision and sophisticated end-products. As ancillaries, it produces a variety of parts and components required by the large enterprises. The sector has emerged as a major supplier of mass consumption goods like leather articles, plastics and rubber goods, fabrics and ready-made garments, cosmetics, utensils, sheet metal components, soaps and detergents, processed food and vegetables, wooden and steel furniture and so on. More sophisticated items manufactured by the MSE sector now include components for television sets, electronic desk calculators, microwave components, air conditioning equipment, electric motors, auto-parts, drugs and pharmaceuticals.

However, it has also been recognized during the last two decades that, often MSMEs producing a range of similar or same products are found to co-exist in typical geographical locations for decades and even centuries in many countries. This phenomenon is referred to as clustering of MSMEs. The table below (Table 2 – As an example, handloom sector is selected being one of the largest employers in the country. As per Integrated Handloom Cluster Development Program estimates it employs more than 65 Lakh workers. Besides the sector has a widely dispersed presence across the country. Considering the increasing competition being faced by this sector, the government has undertaken several initiatives to develop this sector) gives the definition, of clusters as defined by various institutions for the purpose of identifying clusters.

Table 2

Institution	Definition
▸ Integrated Handloom Cluster Development ▸ Programme (IHCDP), Ministry of Textiles	A handloom cluster has been defined as one having a minimum of 500 looms
▸ National Minority Development Finance Corporation (NMDFC)	Handloom cluster, which has more than 75% of the population as “minorities”
▸ Scheme of Fund for Regeneration of Traditional Industries (SFURTI) ▸ Ministry of MSME	A micro village industry cluster having 500 beneficiary families of artisans/micro enterprises, suppliers of raw materials, traders, service providers etc., located within one or two revenue sub-divisions in a district (or in contiguous districts).
▸ DC(Handicrafts), Ministry of Textiles	Agglomerations having 100 artisans. In case of North East Region, Jammu & Kashmir and other hilly terrains, the clusters will have a minimum of 50 artisans
▸ NABARD, Cluster Development Programme	Micro enterprises and household units functioning on SHG mode and having a minimum of 50 beneficiaries' upto a maximum of 200. In intensive clusters, the number of beneficiaries may go up to 500-700 and can even extend over a block or Taluka
▸ Government of Gujarat	A minimum of 50 industrial units, indulging in the manufacture of the same or related products and located within a radius of 10 km in a particular location
▸ Government of Orissa Handicraft cluster	At least 100 traditional artisans practicing the same craft for non-KBK districts and at least 50 traditional artisans in KBK districts and situated within a radius of 3 – 5 kms

▶ UNIDO- CDP	At least 100 MSME units or 50 handicraft units in a town city of few villages and their surrounding areas for an industrial (traditional/manufacturing) or an artisanal cluster respectively. Further a minimum of 500 handlooms for a handloom cluster.

Source: Policy Paper published by Foundation of MSME clusters (November 2007)

Under the MSME Financing & Development Project, SIDBI has selected the sub-sectoral approach in clusters. For this project, 10 sub-sectors were identified through independent study. Within these clusters, the Adapted Revealed Comparative Advantage (ARCA) method was utilized. The ARCA method focuses on competitiveness and sustainability approach. These were further approached through concept of “tradable” (signifying global competitiveness) and “non tradable” (signifying unorganized sector offering domestic competitiveness). The aim was to strengthen the internal and external value chains. In addition, through BDS market development, an impetus was provided to bring the clusters in the identified sub-sectors at par in terms of competitiveness. The BDS market development is being implemented in 19 clusters (pan India basis) falling under seven sub sectors which include pharma, engineering, floor-coverings, knitwear, dyes and chemicals, leather, and fruits and vegetables sub-sectors.

Broadly a cluster (of enterprises) may be defined as a typical geographical concentration of micro, small, medium and large firms producing same or a similar range of products (goods or services). Typically, units in a cluster face same or similar set of threats (e.g. product obsolescence, lack of markets, etc.) and opportunities (e.g. increasing turnover through quality up-gradation or introduction of new products or markets, etc.)

Since a large majority of units in a cluster produce similar goods or related products, the nature of their credit needs are also similar. Based on this commonality, the clusters can be segmented into three categories.

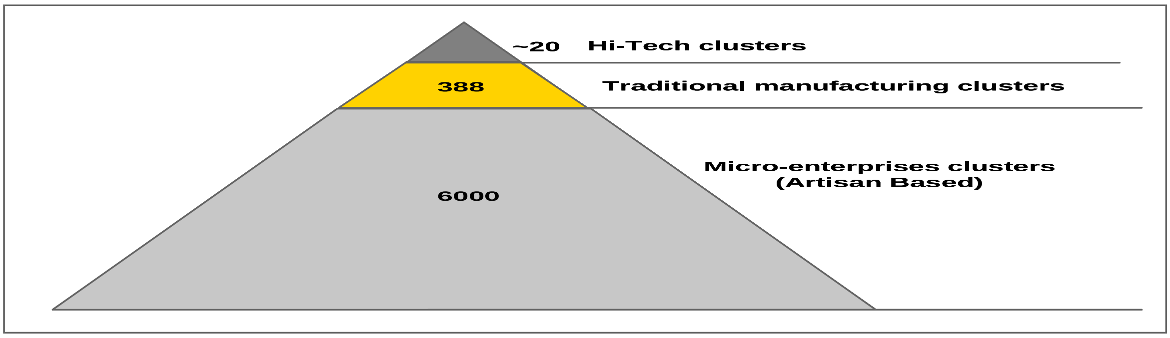
- Hi-tech Clusters (such as, those in IT and IT enabled services, biotechnology, avionics, precision instruments etc.)
- Traditional manufacturing clusters (non-high tech and non-micro clusters engaged in manufacture of a variety of products)
- Low-tech poverty intensive micro enterprise clusters (Handlooms, handicrafts and other micro enterprises)

Based on the above classification of clusters in India, the real challenge is to obtain a reliable database for the same. It needs to be noted that no official statistics is yet available which provides cluster level information. However, independent survey/study by various ministries /agencies /institutions suggests that India has around 6600 goods based clusters. It would, nevertheless, be safe to estimate that close to 6000 of these clusters would fall in the third category, namely low-tech micro enterprise clusters (mostly artisanal – handloom, handicraft etc.). Of the remaining clusters, over 99 % are traditional manufacturing clusters and the rest account for high–tech clusters. Though, there exist very few concentrations of IT, bio-technology and other hi-tech firms in India such (mostly) policy promoted clusters is on the rise. However, no database of services clusters exists (e.g. Tourism, education etc.).

According, to the survey (the data was collected during the UNIDO Cluster Development Program (CDP) on an ongoing basis from 1996 onwards, the latest data is available as of 2003) conducted by UNIDO [with support from implementing agencies referred to as Cluster Development Agents (CDA) by UNIDO and Foundation of MSME Clusters (CDAs who are responsible for the implementation of the progamme)] there are 388 MSME clusters having 4.9 Lakh enterprises, employing 75 Lakh persons and generating an estimated output of ₹ 160,000 Crore. Also, an estimated 6,000 Micro and Artisan Enterprise Clusters exist in India. This survey (in form of a mapping study) was undertaken under the UNIDO CDP (1996) which was implemented in partnership with the Government (represented by the Development Commissioner, MSME. Initial results of the study identified 138 clusters. Subsequently, as information became available the number was updated and as of 2006, the programme had identified 388 clusters.

Given the distribution of such clusters, the following pyramid (Figure 3) indicates the predominance of micro-enterprise clusters.

Figure 3



Source: Foundation of MSME clusters, UNIDO CDP , (data as of 2003)

Almost all units falling under Artisans clusters are Micro – Enterprises, while on the other hand, the remaining two categories of clusters (Traditional manufacturing and Hi-tech clusters) have all Micro, Small & Medium sized enterprises each engaged in similar product related or allied activities.

Section B – Analysis of Nature of Credit Requirement

This section comprises the following

- **Nature of credit requirement** - Analysis of various conditions of credit requirement, current ways of supplementing the credit needs etc.
- **Analysis of credit requirement** – Analysis of credit disbursements to MSMEs, type of MSME segments and their credit needs, monitoring mechanisms.

The purpose of the section is to provide an analysis of the credit requirements of the target segment, their current sources of credit and need for credit.

A. Nature of Credit Requirement

The credit needs of individual MSME in the clusters vary depending on the industry type and size of operations. Some units like those involved in production of auto components, industrial equipment etc. are more capital intensive and require large amount of fixed investment while the units engaged in activities like manufacture of wooden articles, handloom etc. have higher working capital needs as compared to fixed investments.

MSMEs finance their operations with a wide range of financial instruments which can be broadly categorized as formal or informal. Formal types of financing are instruments obtained from external suppliers / sources which are in the business of providing financing. Informal types of financing are obtained from suppliers / sources that are not in the business of financial lending or are funds acquired from the businesses' activities (e.g. retained earnings) or derived from the owners (e.g. personal savings, capital from relatives etc.).

Although, MSMEs prefer commercial financing products over all other forms of financing, they also make substantial use of informal personal financing instruments when access to formal financing is not easy.

As observed from multiple news reports, surveys (Milagrow Survey, 3rd Census for MSMEs) and reports (Kohli Committee Report for rehabilitation of sick MSMEs), a large % of MSMEs finance their operations with personal savings or by the businesses retained earnings which suggest that MSMEs use personal sources of financing to provide a "bridge" until more permanent financing is available, or they may be related to some financial institution's bundling of commercial and personal banking.

1. Micro Clusters

These units use very simple, manufacturing processes and techniques. The capital requirement of these units is minimal, and most of the initial investment is made by the entrepreneur from his personal savings or with financial support from friends or family members.

The working capital requirements are largely met with credit availed from informal channels or from retained earnings of the enterprise. One of the primary reasons for availing credit from the informal channels is low levels of awareness (amongst the entrepreneurs) about the various policy initiatives of the government to promote MSMEs and lack of quality collateral as required by banks and other formal institutions.

2. Traditional Manufacturing Clusters

The large majority of MSMEs are unregistered (approx. 85% are unregistered) and have an average fixed investment of ₹ 1 Lakh. The primary source of finance is through informal channels due to reasons such as lack of quality collaterals (as needed by the formal financial institutions), awareness of various developmental credit programs, etc. One of the major causes for low availability of bank finance to this sector is the high risk perception of the banks in lending to MSEs and consequent insistence on collaterals which are not easily available with these enterprises. The problem is more serious for micro enterprises requiring small loans and the first generation entrepreneurs.

While, the registered MSEs have an average fixed investment of ₹ 6.5 Lakh, the medium sized enterprises have an average fixed investment in the range of ₹ 6.5 - 7 Crore. Although these units too are primarily proprietary or partnership based, a large majority of these units have access to formal finance through developmental banks, other similar government backed finance agencies, government schemes etc.(For example, MSME – Development Office (earlier referred to as SIDO) has undertaken MSME Cluster Development Programmes (National Programmes) for development of selected sectors namely toy, stone, machine tools etc. The scheme include funding for technology / quality up-gradation, certification, market support, Common Facility Center, testing and training centre, skill up-gradation etc.). As per the Ministry of MSME Annual Report for 2009, an expenditure of ₹ 12.59 Crore has been incurred on the scheme during the financial year. Similarly, registered MSMEs in other sectors like Textiles also benefit from various governments backed schemes like Technology Up-gradation Fund Scheme for Textile Industries (TUFS). The scheme intends to provide timely and adequate capital at internationally comparable rates of interest in order to upgrade the textile industry's technology level.

Some of the key financial institutions which are into MSME financing include:

- Export Import Bank of India (EXIM Bank)
- IFCI Venture Capital Funds Ltd.
- Industrial Finance Corporation of India (IFCI)
- Industrial Development Bank of India (IDBI)
- Infrastructure Leasing and Financial Services Ltd. (IL&FS)
- National Bank for Agricultural and Rural Development (NABARD)
- National Small Industries Corporation (NSIC)
- National Co-operative Development Corporation (NCDC)
- Shipping Credit and Investment Corporation of India (SCICI)
- Small Industries Development Bank of India (SIDBI)
- Tourism Finance Corporation of India (TFCI)
- State Financial Corporations (SFCs)
- State Industrial Development Corporations
- State Industrial Investment Corporations (SIICs)
- State Small Industries Development Corporations (SSIDCs)

3. High-tech clusters

The High-tech clusters consist of units engaged in those in the IT and IT enabled services, computers, biotechnology and related services, precision instrumentation or avionics. These Hi-tech units have large fixed investment needs due to the requirement of advanced and state of the art modern equipments. Also, the working capital requirements are relatively higher due to R&D investments and higher wage levels of its employees (to retain their human resources). Being knowledge based industries they require substantial investments at the initial stages through Venture Capital /Risk Capital / Mezzanine Finance /PEs etc. Thus overall the financial requirements of these units are relatively much higher than units of comparable size in any other industry segment.

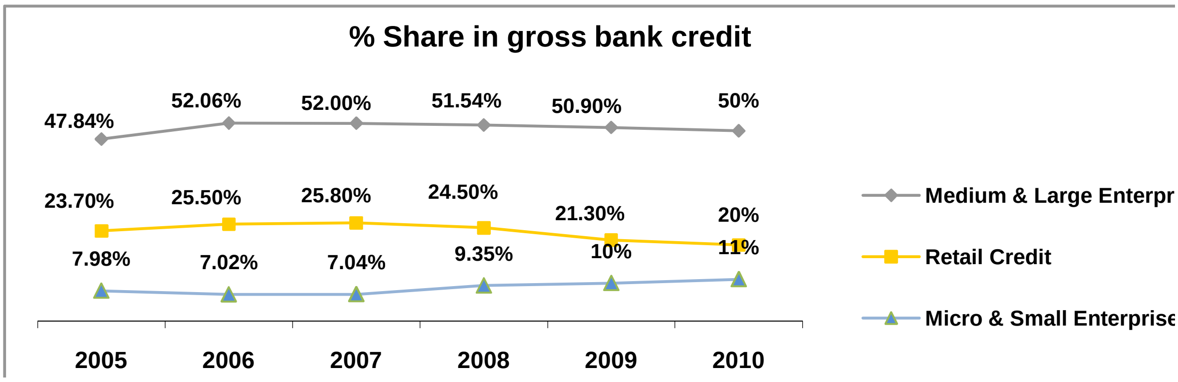
B. Analysis of Credit Requirement

The micro and small enterprise segment suffers highly from financial exclusion. The Third Census of small enterprises conducted during 2001-02 estimates a 95.5% exclusion rate in this sector. The government policy package for stepping up credit to MSMEs of 2005 encourages banks to increase lending to MSMEs by a minimum of 20% every year. The package also encourages the banks to add 5 new MSME units per branch in the rural or semi-urban area as customer every year. On basis of the number of MSME accounts of leading public sector banks, the current rate of exclusion can be estimated optimistically at 70% (considering 4th Census data, the estimate is revised upwards to 86%). The Fourth Census estimates that 87% of registered and 92% of unregistered MSMEs either do not have access to finance or rely on self-financing.

Even the analysis of the disbursement of credit to small enterprises shows that the share of small enterprise credit was falling till 2007. While there was consistent increase in both gross bank credit and credit to small enterprise sector, the share of small enterprise credit decreased. The increased gross bank credit was mainly on account of increase in retail lending as well as infrastructure sector. After the package for promotion for small enterprises in 2007, government and RBI encouraged banks to increase lending by 20% every year with the result that the share improved.

The chart below (Figure 4) provides information on the share of MSEs in gross bank credit across the years.

Figure 4



Source: RBI Trends and Progress in Banking Reports, 2005 – 2010, EY Analysis

The share of credit to micro enterprises as a percentage of total credit to small enterprises has decreased from 40% in 2004 to 34% in 2009. The Working Group for Rehabilitation of Sick SMEs states that the share of micro enterprises in the total bank credit has been falling. To overcome this shortage, several financial institutions including micro finance institutions, development banks like SIDBI, NABARD and other commercial banks have designed new schemes. RBI guidelines stipulate that 60 % of the total lending to small enterprises under priority sector lending should go to the micro enterprises in this segment. With efforts underway to increase bank lending to MSME sector, it is expected that banks will soon meet these targets successfully and profitably

Assessment of Credit Requirements

As analysed in the above section on nature of credit requirements, micro enterprises suffer from lack of collateral and low awareness about such financial products. Banks have also been reluctant to lend to these segments due to high perceived risk of customer default. Considering this situation, RBI made it mandatory for banks to lend loans below ₹ 5 Lakh to MSME units free of any collateral. Also the Credit Guarantee Trust for Micro and Small Enterprises offers 80% coverage on loans below ₹ 5 Lakh made to micro enterprises to incentivise the banks to increase lending to this segment. Nayak Committee set up by RBI has made recommendations in connection with working capital finance, wherein banks have been guided to calculate working capital requirement as 20% of annual turnover. Assuming that a unit avails the entire collateral free loan for its working capital consumption, following the Nayak Committee recommendation, such a loan could be granted to a unit with maximum ₹ 25 Lakh turnover. The limit for lending to units collateral free loans was further increased to ₹ 10 Lakh in the Master Circular of July 2010 released by the RBI.

In continuation with this logic, the entire universe of MSME units have been categorised according to their gross output. As the Nayak Committee recommends working capital requirement to be calculated as a percentage of turnover, this categorisation will better help understand the credit requirements of the target segment. On analysis, it was found that majority of the MSME units lie in the below ₹ 25 Lakh gross output segment.

An over view of Monitoring / Repayment Mechanism adopted by Banks / FIs towards MSME Financing

Monitoring Mechanism

Monitoring mechanism is of the support activities carried out for any product /scheme which is critical to the success of that product or scheme. The product features may be the best but if the lending institution does not have a robust mechanism to ensure effective monitoring, it may be reluctant to sell the product to the customer. In case of MSME customers, banks / FIs have traditionally deployed several mechanisms to ensure that the credit is being utilized only for its intended purpose and not siphoned off for any personal consumption.

Banks / FIs generally prefer to have a relationship based lending methodology as far as MSME units are concerned. As the MSME customers widely vary in their business type and credit requirements, it is seen that banks find it difficult to develop expertise in the business types of all customers. In such cases, it was preferred that the loan officer visited the MSME unit premises, understood client requirements through discussions and kept a regular tab on the client operations. With increase in number of borrowers and banks facing shortage of manpower, this monitoring mechanism is somewhat lagging behind. It is expected that an innovative approach be developed for this purpose.

Currently, when a term loan is disbursed for fixed asset creation purpose, banks disburse the loan in kind. The borrower is expected to provide the details of the supplier from whom he is purchasing the machinery/asset and the deal details. After analyzing this information and verifying the supplier credentials, the bank issues a pay order in the name of the supplier. In case the supplier is located outstation, a demand draft is issued. Some banks make use of online transfers. Once the supplier receives the payment, he releases the machinery in name of the borrower. Also banks expect the branch staff to carry out regular inspections on the factory premises of the MSME borrower to ensure that the fixed asset has been installed and is being to put to its intended use. This also ensures the bank of the capability of the MSME borrower to repay his loan on a regular basis.

In case where working capital loans have been disbursed, some banks utilize the same process as for term loans for disbursement in kind. It is widely seen, that most working capital disbursements happen through cash credit accounts and for monitoring these, banks require the MSME borrowers to submit their stock statements at regular frequencies. This provides information to the bank of the actual working capital utilization. Most banks penalize borrowers for non submission or delayed submission of these stock statements. This serves as a deterrent for the borrower. Bank staff may also carry out surprise inspections on the warehouse/godown premises to verify the veracity of the stock statements.

Banks also try to keep a regular tab on the financial health of the MSME borrowers. This is to identify a potential sick unit and try and intervene before the situation becomes unmanageable.

The future requirement of any monitoring mechanism is devising one such that banks have a ready database on the borrower performance and can perform effective monitoring without incurring significant costs.

Repayment Mechanism

The repayment mechanism for MSME credit is a function of the type of credit extended to the customers. The monitoring mechanisms also indicate the linkage with repayment mechanisms. Banks have a fixed term repayment for term loans or loans extended for a longer duration. In such a case, the customer is required to make fixed payments to the bank at fixed intervals. Such fixed intervals are most likely to be quarters. In case of long duration loans, banks also offer a moratorium period depending upon the reputation of the borrower, its prior relationship with the bank or its past financing performance. In situations where, a working capital credit has been extended to the customer, repayment is flexible. An illustrative of the different repayment mechanisms as per product type for a public sector bank is listed below:

⇒ Repayment for a bill discounting scheme – On repayment of the bill
⇒ Repayment of a term loan for MSE – Duration of 3 years and repayment to be made every quarter
⇒ Repayment for a working capital scheme – Limit outstanding to be adjusted/repaid anytime within three months
⇒ For a loan scheme for medium enterprises – repayment to be made after a moratorium of six months and to be paid thereafter at fixed intervals within 5 years

Repayment mechanisms for schemes are detailed in Chapter 2.

The table (Table 7) below provides information on the categorisation of MSMEs according to gross output

Table 7

Segment	Gross output (`)	Number of MSME Units (Million)			% of MSME segment
		Registered	Unregistered	Total	
A	Up to 2 Lakh	1.29	26.15	27.44	96.2%
B	2 Lakh – 5 Lakh	0.12	0.41	0.53	1.9%
C	5 Lakh – 10 Lakh	0.09	0.14	0.23	0.8%
D	10 Lakh – 25 lakh	0.09	0.07	0.120.16	0.6%
E	Above 25 Lakh	0.1	0.04	0.14	0.5%

Source: 4th and 3rd All India Census of MSMEs, EY Analysis

This table provides information on the entire universe of MSMEs. As seen from the data, ~99% of the MSMEs lie in the below ₹ 25 Lakh segment. For registered units, the same percentage is 94% while for unregistered units, it is 99%. Thus it is essential that any scheme or product take into consideration the different nature of requirements of these segments. As majority of these units are unregistered, their basic credit requirements are not being catered to by the formal sector. The analysis also indicates that small and medium enterprises lying in Segment E are being served by banks to a higher extent that the first four segments and require additional credit lines in situations of emergency.

The potential of each segment for the proposed framework can be determined by estimating its annual working capital requirement as well as investment in plant and machinery. On the basis of unorganized data sources, the annual credit requirements of the above segments have been arrived at. For analysis purpose, gross output has been taken as an indicator of total turnover.

The tables (Table 8 and Table 9) provide information on the total credit requirements of the Registered and Unregistered units in MSME sector.

Table 8

(All amounts in ₹ '000 Crore)

Registered units					
Segment	**Gross output**	**Total number of units (₹ Lakh)**	**Fixed Capital Investment**	**Gross output**	**Working capital requirement**
A	Up to 2 lakh	12.9	94.5	31.9	6.4
B	2 lakh – 5 lakh	1.2	34.6	16.1	3.2
C	5 lakh – 10 lakh	0.9	38.8	22.9	4.6
D	10 lakh – 25 lakh	0.9	62.7	45.2	9.0
E	Above 25 lakh	1.0	314.9	657.7	131.5
Total		**16.9**	**545.5**	**773.9**	**154.8**

Source: 4th and 3rd All India Census of MSMEs, EY Analysis

(As data on gross output slabs is not published in the publicly available 4th Census results, it is assumed that the 3rd census data on division of enterprises into gross output slabs is applicable. Total number of enterprises is as per 4th Census data)

Table 9

(All amounts in ` '000 Crore)

Unregistered units					
Segment	**Gross output**	**Total number of units (₹ Lakh)**	**Fixed Capital Investment**	**Gross output**	**Working capital requirement**
A	Up to 2 lakh	261.5	70.3721.6	644.5	128.9
B	2 lakh – 5 lakh	4.1	55.1	80.1	16.1
C	5 lakh – 10 lakh	1.4	32.6	54.4	10.9
D	10 lakh – 25 lakh	0.7	23.1	59.4	11.9
E	Above 25 lakh	0.4	31.2	288.4	57.7
Total		**268.2**	**863.6**	**1126.8**	**225.3**

Source: 4th and 3rd All India Census of MSMEs, EY Analysis

(As data on gross output slabs is not published in the publicly available 4th Census results, it is assumed that the 3rd census data on division of enterprises into gross output slabs is applicable. Total number of enterprises is as per 4th Census data)

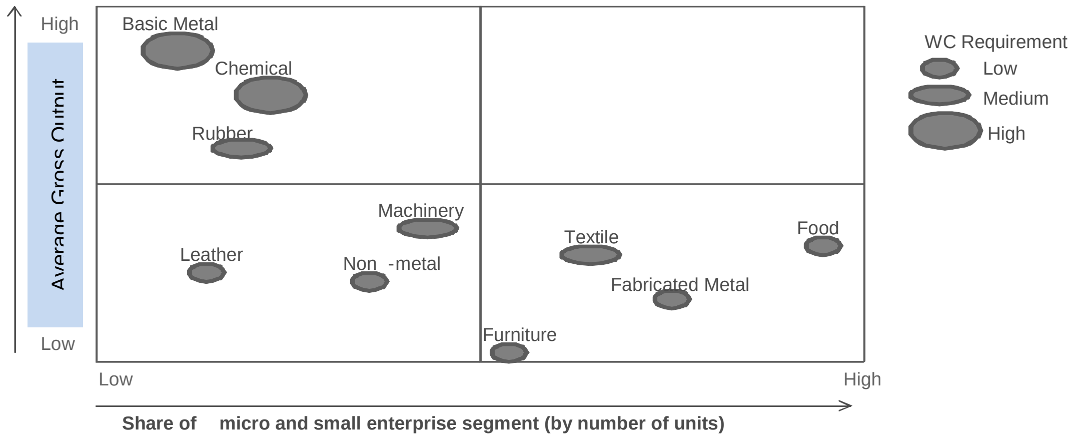
The above analysis indicates that there is substantial demand for working capital and fixed asset loans from the micro and small enterprises, particularly in the category of gross output less than ₹ 25 Lakh.

The entire MSME customer universe can be further segregated according to industries, to identify the sectors which constitute major chunks of the micro and small enterprise segment. The purpose of this exercise will be to provide banks an indicative list of industry segments which can be targeted first. The bank can then choose its strategy as per its convenience and focus area. For a second stage classification of this segment, the following parameters can be considered.

- Size of the segment – The higher the share of the industry segment in the overall MSME universe, the bigger will be the market share
- Average gross output – This indicates the position of the industry according to the five segments above
- Working capital requirement – This will be indicative of the credit requirement of the industry segment

On the basis of the two parameters above, the various industry segments can be plotted as shown in Figure 5

Figure 5



Source: Report titled "Small Sector in India:Status, Growth and De-reservation" A Study conducted for Rajiv Gandhi Institute of Contemporary Studies (August 2006), EY analysis

The working capital requirements vary as per industry segment. On the basis of analysis of unorganized data, it was derived that working capital requirements show wide variations across industry types from a minimum of 15% to a maximum of 47%. By utilizing the analysis results, the annual working capital requirements for top 15% of industry types in MSME segment (by number of units) can be estimated as indicated in the Table 10 below:

Table 10

Industry type	Gross output (₹ '000 Crore)	Annual Working Capital Requirement (₹ '000 Crore)
Food Products & Beverages	41.35	7.69
Fabricated Metal	16.34	3.26
Textiles & Apparel	21.15	5.71
Furniture; Manufacturing	5.13	.97
Machinery & Equip. N.E.C.	17.70	3.98

Non-Metallic Min. Products	8.14	1.62
Wood & Products	3.10	.59
Chemicals & Products	19.53	3.47
Recorded Media	3.95	.65
Rubber & Plastic	13.61	2.72
Leather & Products	4.76	.95
Basic Metals, metallurgy related activities	18.72	3.52
Sale, Maintenance And repairs	.67	.13
Paper & Products	3.77	0.65
Construction	.94	.11

Source: Report titled "Small Sector in India:Status, Growth and De-reservation" A Study conducted for Rajiv Gandhi Institute of Contemporary Studies (August 2006), EY analysis

Chapter 2: Evaluation of global and domestic credit card models and schemes

<u>**Highlights**</u>

⇒ **This Chapter provides an overview of the presence of various credit card schemes internationally.**

⇒ **It identifies economies wherein such credit card schemes are present, the penetration of such schemes, operating models, features and key success indicators.**

⇒ **The Chapter also seeks to provide an assessment of various domestic credit card schemes catering to specific sectors viz. Agriculture, Artisans etc., their important features, performance and key success factors if any.**

⇒ **The Chapter thus serves to understand the key parameters and best practices in similar schemes which can then be utilized in the design of the proposed framework.**

The Chapter comprises two sections as follows:

- **Section A** – Overview of such products available globally – Small Business Credit Cards, MSME Credit Cards etc.
- **Section B** – Cards Evaluation of similar domestic products /schemes – Kisan Credit Card (KCC), Laghu Udyami Credit Card (LUCC), Artisan Credit Card (ACC), Swarojgar Credit Card (SCC) and SME Credit schemes of State Bank of India and Bank of Baroda (branded as Credit Card schemes)

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Section A – Overview of global models

This section comprises the following:

- **International practices in Credit Card financing**
  - Selection of economy for study of Credit Card products
  - Overview of such products being used for MSME financing
- **Selected Case Studies**
  - Product - Small Business Credit Cards (Features, utilization etc.)
  - Product - MSME Credit Cards (Features, utilization etc.)

The purpose of this section is to analyze the global scenario in MSME and small business credit cards, their different features and innovations, their use according to the type of economy and study case studies to identify which features can be adopted for the proposed product.

International Practices in Credit Card Financing

Selection of economy for study of Credit Card products

Different countries around the world have devised a range of schemes and products to aid MSME financing. One of these schemes is the extension of credit through credit cards, either by development banks or commercial banks in the country.

For analysis of such international practices, countries were selected on the basis of two parameters. These parameters were as follows

- Type of economy – Apart from South Asian economies, other developing and developed economies were selected from across the globe. This would help judge the financing activities and features based on type of economy. This classification is based on the country data published by International Monetary Fund (IMF). The key factors utilized by IMF for this classification include per capital income level, export diversification for the country and degree of integration into the global financial system[2]
- Level of entrepreneurship activity – This parameter was important to understand the importance of MSME finance in the economy and the corresponding level of products available. This classification is based on the entrepreneurship index published by Global Entrepreneurship Monitor (GEM), an international research organization

On the basis of the above criteria, a list of countries were identified and analyzed for MSME credit card products. The Figure 6 and Figure 7 indicate the selection of countries on the above parameters.

Figure 6

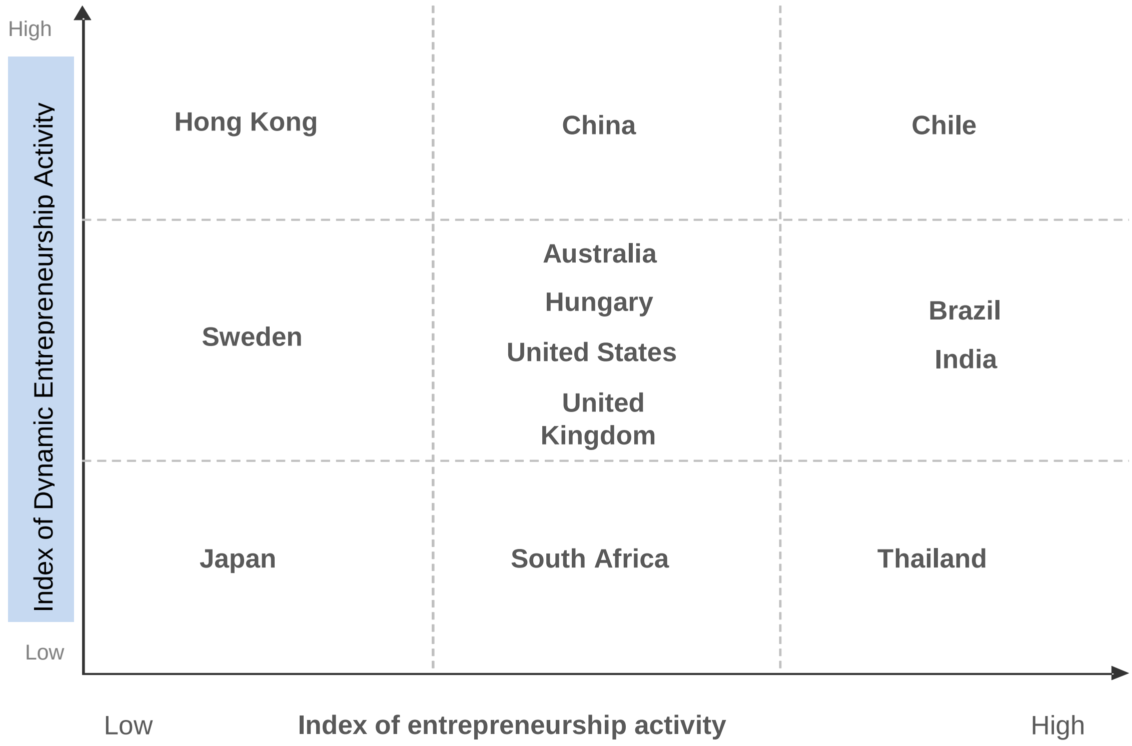
South Asian Economies	Developing Economies	Developed Economies
Bangladesh	Brazil	Germany
Indonesia	Chile	Japan
Malaysia	Hungary	United States
Nepal	Kenya	United Kingdom
Vietnam	South Africa	Australia
Sri Lanka	Peru	Sweden
Thailand		

Classification based on the Type of Economy

[2] World Economic Outlook publications of the IMF

Figure 7

- Communication and Awareness Creation



Classification based on Nature of Entrepreneurship Activity

Source: IMF, Global Entrepreneurship monitor (Published in Discussion Paper for Workshop on Public Policies for Small Enterprises, August 2006)

For each country, where the MSME institutions are present in the country, various form of MSME financing and the credit card product for MSME financing were studied. This provided information on the position of credit financing as compared to overall MSME financing in the respective country. A snapshot of the country wise analysis (each has been chosen from different economies classified at Figure 6) is provided below.

Table 11

Analysis of International MSME credit products			
Country	**MSME Institutions**	**General MSME financing products**	**Type of credit card**
Bangladesh	Bangladesh Bank, BASIC Bank, BRAC Bank	Term loans, Micro Credit, collateral free working capital loans	Personal credit cards present in the market
Brazil	SEBRAE, BNDES, Banco do Brazil, CEF	SME Lending Guarantee, Working Capital Lines, Leasing	SME Card issued by BNDES (Brazil Development Bank)
United States	Small Business Administration, Commercial banks	Small business Investment Company program, loans, Angel networks, Guarantees	Business credit cards issued by all leading commercial banks

For information on all countries under study

On analysis of the MSME Credit Card products in these countries, it was found that there are two important categories of products used across countries. These are known as Small Business Credit Cards (in countries like United States, United Kingdom, Australia, South Africa) and MSME Credit

Cards (in countries like Brazil, Hungary, Peru). The products differ on their terms of conditions although the end motive is the same for both.

Credit Card type Products for MSMEs

Small Business Credit Cards

Entrepreneurs with access to personal credit cards have often used these to tide over short term credit requirements. In some cases personal credit cards have been used for investment spending also. Taking into consideration this need, many commercial banks introduced business credit cards for MSMEs.

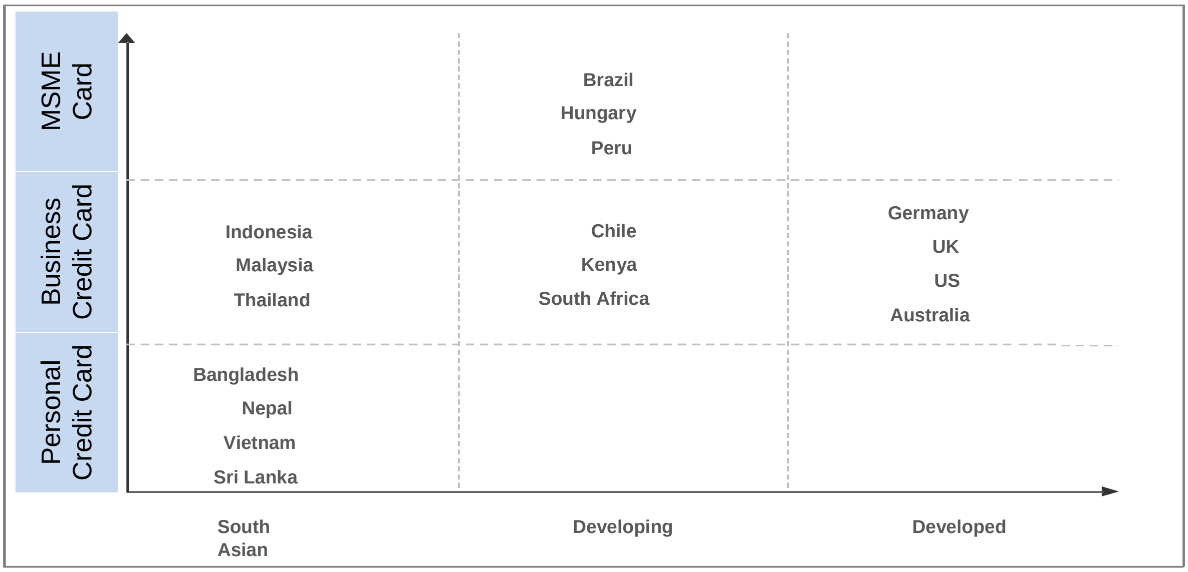
Small Business Credit cards are similar to personal credit cards in how they are obtained, how they are used and how they work. The difference lies in the credit limit granted on the card, purpose for which cards are utilized and the number of cards issued. The limit granted is higher than a personal credit card and is granted keeping in mind the working capital and investment needs of a business. Banks may issue multiple cards for a single enterprise for several employees up to a single limit for the enterprise.

MSME Cards

Some development banks have devised credit products on the concept of a credit card. These are known as MSME cards and are revolving credit facilities granted to enterprises which may or may not be restricted to certain use. These cards may or may not be used in the actual sense of a credit card but offer the enterprise the same freedom in withdrawal of money and use as a conventional credit card. In most cases, the cards are issued by development banks, the charges and interest rates on such cards are low and in some cases subsidized by the government. The primary motive in issuance of such cards is not profit making but ensuring easy access to credit for a MSME.

The country-wise usage of these cards can be seen as follows from Figure 8

Figure 8



As the level of development in the economy increases, the usage of small business credit card also increases. MSMEs in developed economies have been generously exposed to business credit cards. In the South Asian economies which are lesser developed as compared to their counterparts, personal credit cards are used by MSMEs. Where personal credit card markets have developed, business credit cards have been introduced in recent years.

Developing economies which have experienced the usage of small business credit cards have introduced MSME cards based on the principle of small business credit cards. The aim is to make available additional avenue of MSME financing at lower rates than the conventional credit cards.

Selected Case Studies

A. Product - Small Business Credit Cards

Small Business Credit Cards for MSMEs are being increasingly introduced by commercial banks across the world. These provide a small business with a revolving credit facility, allow cash withdrawals up to a certain proportion of the credit limit and provide discounts, reward schemes on use of the card. Certain banks issue multiple cards under one account for a company but sanction a single overall limit.

Banks have also started offering value added features like insurance coverage, online business accounting modules in order to attract more customers. In developed economies, small business credit cards are widely used by small businesses to supplement their credit needs.

The following case studies provide additional information on the features of small business credit cards:

► United States of America

In the broad sense, small business in USA is defined as an independent entity having fewer than 500 employees. According to U.S. data, small business totalled 27.2 million units in 2007.

The importance of small business to the U.S economy can be gauged by the fact that these small firms:

- Represent 99.7 % of all employer firms
- Employ about half of all private sector employees
- Pay nearly 45 % of total U.S. private payroll
- Made up 97.3 % of all identified exporters and produced 28.9 % of the known export value

Small Business Credit Card usage

A survey conducted by the National Small Business Association (NSBA) in 2009 found that:

- 59% of the respondents had used credit cards for financing as compared to 45% who availed of a bank loan.
- Out of the small businessmen using credit cards, 23% owned single card while the remaining 77% had multiple cards.
- 25% or more of the debt outstanding for small businesses was due to credit card.
- Credit cards were primarily used to leverage the already existing business loans that these enterprises had.

These small business credit cards are provided by commercial banks. The top 100 small business lenders had a total of $ 309 billion outstanding credit card loans in 2008.

Small business credit cards operate in a very similar way to personal credit cards. Small business cards still have an application and approval process, still include an interest rate on purchases, and still have an impact on credit scores, only of the business rather than the owner generally. This is because, rather than applying for a small business credit card with a social security number, a business owner would apply under their business federal EIN (an identification number for businesses provided by the IRS).

An example of Small Business Credit Card features can be considered as follows:

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Purpose The card is issued in the name of the business. Multiple cards can be issued for a single business firm each having sub-limits and the total limit being fixed for the business.

Interest Rates Separate interest rates are charged according to the type of transaction.

(Comparison of interest rates charged by Well Fargo, a commercial bank – as of 11th September 2009)

Indicators	Small Business Platinum Card	Unsecured line of Credit	SBA Line of Credit
Target	Businesses with annual sales up to $2 million	New for-profit businesses	For profit businesses
Credit line	Up to $50,000	From $5,000 to $100,000	$100,000 to $350,000
Annual fee	$0	$150	-
Interest rate	Prime+4% to Prime+14%	Prime+1.75% to Prime+6.5%	Prime + 4.5%
Grace period	21 days	NA	NA
Underwriting requirements	NA	Personal guarantees by all owners of 20% or more	Personal guarantees by all owners of 20% or more

Prime or Prime rate as on 11th September 2009 was 3.25 %. The United States Prime Rate is a commonly used, short-term interest rate in the banking system of the United States.

SBA Line of Credit is a subsidised credit line from the federal government and refinanced by US Small Business Administration (SBA).

- A grace period is given to the cardholder to repay the balance on purchases.
- An annual fee can be applied depending on the type of card.
- Fees are applied as a percentage of the transaction amount or a minimum standard fee, for e.g. for cash advance, 3% of the cash advance withdrawn is charged as fee with a minimum of $ 5.
- Cash back reward points are offered on office supply purchases, motor fuel purchases, travel bookings, etc.
- Facilities are provided for online record keeping, categorized statements and protection in form of fraud liability guarantees.

United Kingdom

Typically a MSME is defined as an enterprise having less than 250 employees. According to the Department for Business Innovation and Skills, there were a total of 4.67 million MSMEs in UK as of 2007. The classification is given as follows

Type	Number of Employees
Micro	1-9
Small	10-49
Medium	50-249

Source: SME Statistics for UK and Region, 2007, Department of Business Enterprise & Regulatory Reform

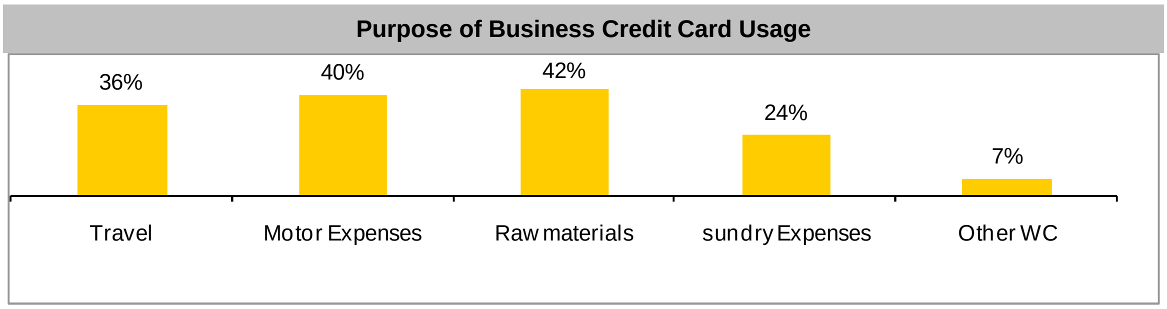
The importance of these organizations can be understood from the following:

- Represent 99.8 % of all the enterprises
- Contribute to 48.6 % of the total employment
- Represent 49 % of the total turnover of all enterprises

Small Business Credit Card Usage

A study conducted in UK mapped the usage of small business credit cards by MSMEs as shown in the Figure 9

Figure 9



Source: Warwick Business School, 2004 Survey

Thus, the use of small business credit card is majorly made for paying off day to day expenditures (travel, motor expenses, sundry expenses etc). 12 % use these credit cards for purchase of movable assets like equipments while 5 % use them for fixed asset purchase. For MSMEs using small business credit cards, surveys estimate monthly expenditure at 1.4 million pounds per month. Also 95 % of the credit card owners pay off business expenditures on small business credit cards in full at the end of each month.

In comparison, the total lending by banks to MSMEs is an average of 366 million pounds for term loans and 25 million pounds for overdrafts. Four banks (HSBC, Lloyds TSB, Barclays and Royal Bank of Scotland) dominate MSME lending in UK accounting for 80 % of the market.

The features of small business credit cards are similar to the credit card products offered in US market. A comparison of the various MSME lending products of Lloyds Bank TSB (data retrieved from bank site as of October 2009) is as follows

	Small Business Credit Cards	Small Business Overdraft
Credit Limit (in GBP)	Minimum 1,000 to a maximum 10,000	Minimum 1,000
Interest Rate	1.109 % per month	Varies from 0.63 to 0.83 % per month
Grace Period	45 days	NA
Security	None	Fixed Assets
Annual Fee	28	NA

► Qatar

Tatweer Debit/Credit Card

Doha Bank is one of the largest private commercial banks in the state of Qatar. It has won awards for best commercial bank in Middle East for several years now. The bank is known for offering innovative products in the Middle East region including services for SME customers. (The bank refers to the MSME segment as only SME and hence the usage of SME term)

SME financing solutions of the bank are branded under the name Tatweer. Under the SME schemes, the bank offers financing for daily business operations, import credit and short to medium term loans. Other value added services offered to SME customers include trade finance services, electronic banking facilities and insurance services.

The bank launched credit and debit card products for SME customers in April 2010. These card products are linked to the business bank account of SME customers. Also the card products are available only to the existing Tatweer customers. For availing services under the Tatweer solution offering, a SME has to satisfy the following criteria:

- The company has to be registered as a partnership, proprietorship or a limited liability company
- It should have been in operation for atleast 3 years
- Minimum capital of QR 200,000 (₹ 25 lakh)

Apart from the above minimum requirements, the bank also requires SME customers to submit following information to assess its credit worthiness

- Registration documents and ID of all partners/owners
- Audited financial statements for past 3 years, if available
- One year account statements from all the banks with which the SME does business
- Brief description of the company activities

The SME Company selected as a Tatweer customer can avail of more than one service subject to bank approval.

Tatweer Card features

- The Tatweer Card has been designed in the form a business credit card (ATM or debit cards are also offered under this scheme)
- The card can be utilized for payment of business related transactions
- The card is issued in the name of the organization while selective employees can be nominated by the SME to hold these business cards in their names
- The bank provides monthly statements to the company which helps keep track of business expenses as well as monitor card usage by employees
- The bank also provides the facility to cancel the card if it is stolen or lost
- In order to encourage card usage, discounts schemes or reward points are offered on electronic transactions. The bank has also introduced a loyalty program for credit card customers

From the above examples, a comparative analysis can be made of the benefits accrued and disadvantages of the use of such credit cards. A look at the typical advantages and disadvantages of such business cards will provide an overall perspective.

Advantages	Disadvantages
It can be easier for business owners to qualify for a credit card rather than a traditional line of credit.	Banks typically levy variable interest rates, high default charges and credit limit as per the borrower type.
Credit is disbursed by banks without the requirement of any security or collateral.	The interest rate on small business cards is usually higher than a bank loan or fixed line of credit.
Credit cards can be used to supplements loans from banks in times when credit is tightened.	Most small business cards require a personal liability agreement to repay debt. A late or non payment can result in negative credit report and the inability to borrow money.
Increasingly transactions with suppliers and customers are shifting online; credit cards can come handy in such cases.	Often small business credit cards do not carry the same protection as consumer cards, for example in case of disputed billing same assured service may not be provided
Most credit card companies provide value added services like online tools for account management, rewards and incentives.	Interest rates are variable and can be reset by the credit card company depending on the borrowing habits.

B. Product - MSME Credit Cards

The case studies have been selected across economies on the basis of type of economy, implementing agency and basic card features. The aim is to understand in each case study, the operating model of the card, features unique to the card, critical factors responsible for the success of the card. The key takeaway of this Section is a detailed understanding of how MSME cards have been developed in different economies and the best practices which can be adapted to Indian conditions.

A number of countries were studied for the credit card products and schemes offered to MSMEs. The study indicated that in most countries under study, commercial banks had launched credit card products for their MSME customers. However in 3 of the countries under study, a central agency/development bank was leading the implementation of a physical credit card scheme for MSMEs. In addition, support was provided to lending institutions and MSMEs in the form of an enabling environment by regulatory authorities, policy makers, etc. These three case studies are from Hungary (Széchenyi Card), Brazil (BNDES Card) and Peru (MiBanco Distribution card) respectively.

► Hungary

MSMEs in Hungary

Hungary is categorized as an "Upper Middle Income" economy by the World Bank. Its economy is dominated by small and medium enterprises. These are defined on the basis of number of employees in the firm (all definitions have been obtained from IFC SME database to maintain consistency in comparison)

The classification of MSME in Hungary is as follows:

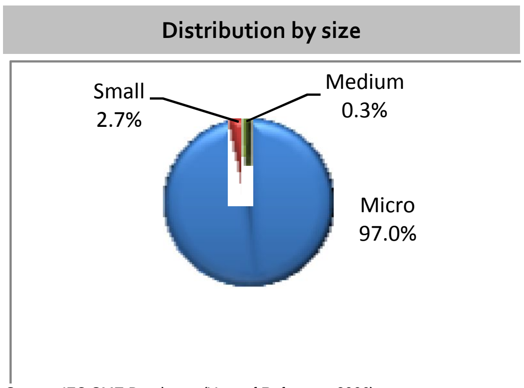
MSME Definition	
Type	**Number of Employees**
Micro	0-9
Small	10-49
Medium	50-249

Source: IFC SME Database (Year of Reference 2006)

According to the data of the Hungarian Central Statistical Office, the number of active MSMEs in 2006 amounted to 1.2 million. This accounts for 99 % of the total enterprises. MSMEs play an outstanding role in the economy, contributing 77 % to the total employment and produce 51[3] % of the GDP of the country.

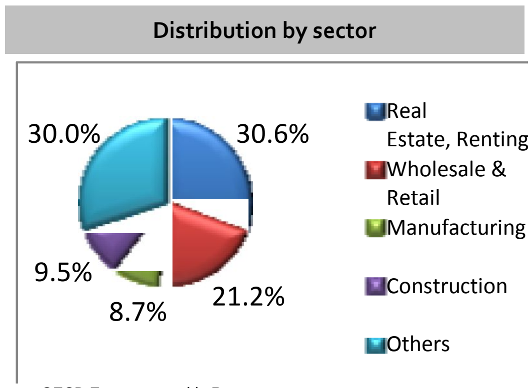
The distribution of MSMEs as per sector and size is as shown below in Figure 10 and 11

Figure 10



Source: IFC SME Database, (Year of Reference 2006)

Figure 11



Source: OECD Entrepreneurship Report

Széchenyi Card

[3] SMEs in Hungary, Sandor Czirjak, Hungarian Development Bank, 2005

MSMEs are characterised by heavy presence of micro enterprises. These firms do not have sufficient material collateral to access the various products offered by banks. Government schemes had a limited reach and had limited success in addressing the complete credit requirements of the enterprise. As a result, the government formulated the four pillar credit plan which was to be implemented in partnership with the commercial banks. Széchenyi Card was one of the pillars of the scheme, the others being Micro Credit Programme, Midi Credit (composite loan) and Europe Credit (development project funding).

The Széchenyi Card was introduced in 2002 to tackle the issues faced by MSME of lack of collateral and access to banking services. It is a revolving overdraft credit and has simplified the application procedure and credit is not restricted to any particular usage. The scheme aims at providing MSMEs with unrestricted-use of credit for managing liquidity risks.

Institutions involved in the scheme

The Széchenyi Card scheme is operated by KA-VOSZ Plc., an association established by the National Association of Employers and Entrepreneurs (VOSZ) and the Hungarian Chamber of Commerce and Industry. These are the two largest entrepreneurial business federations in Hungary. The KA-VOSZ association was established with support from the erstwhile Ministry of Transport and Economy.

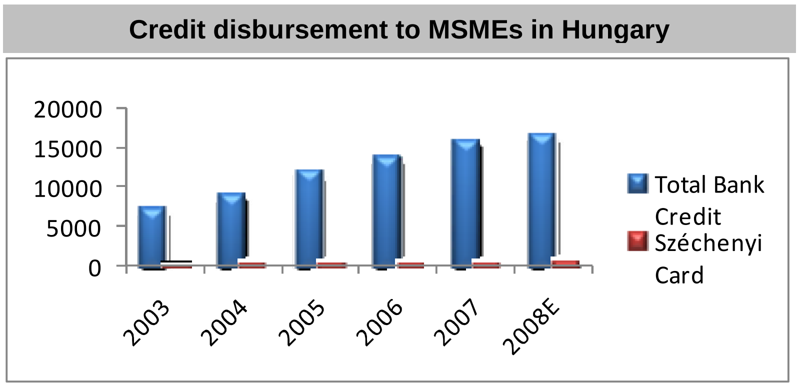
The other institutions include Commercial Banks, Cooperatives, Credit Guarantee Companies and the Government. Commercial Banks and Cooperatives grant credit and operate the scheme. Credit Guarantee Companies provide credit guarantees while the government provides support in form of interest rate subsidies and guarantee fee support.

Progress

The scheme has proved to be very popular amongst the enterprises. The product reached 20 % of the MSME loan customers in 2007. A total of 85,000 cards have been handed over. Euro 1.67 billion has been granted under this scheme as of 2007. The number of new applications has increased by 2000 per month. The card has high renewal rates and clients using the card report an increased turnover of 11 % since 2006.

The credit disbursed through this scheme as a %age of the total MSME credit disbursement of banks in Hungary is substantial as can be shown from Figure 12

Figure 12



Source: KA-VOSZ website, Hungarian Central Bank

Some highlights of the credit disbursement for the time period 2003-08 are as follows:

- CAGR for total bank credit to MSME sector is 18.32%
- CAGR for credit disbursement through card is 44.5%
- Average share of card disbursements in total bank credit is 2.9%

The scheme was granted the prestigious “European Enterprise Award” for *Red Tape Reduction* in 2007.

Advantages

The card has becomes successful in a short duration due to the adoption of innovation and use of creative solutions while designing the product.

Simplification	▶ Standard and simplified applications were developed to increase the mass appeal of the card ▶ Low interest rates and fees were charged
Collateral requirement	▶ It did away with the need of collaterals, the liability of the owner as the principle debtor was considered sufficient ▶ It also speeded up the process as MSMEs had to spend significant time in obtaining property deeds for collateral
Usage of technology	▶ It made use of completely automated systems for management and assessment of credit applications to speed up the process ▶ It also ensured a central database on the credit history of enterprises
Unique channel	▶ It did away with the traditional distribution channel of bank branches and made use of the business federation offices ▶ These offices had a better reach than the banks and also had a better understanding of the business ▶ This also helped the banks to focus on financial activities.
Target segment	▶ It made enterprises with only a year of operation eligible for finance thus promoting entrepreneurship in the country

Card Features

The features of the card are as follows:

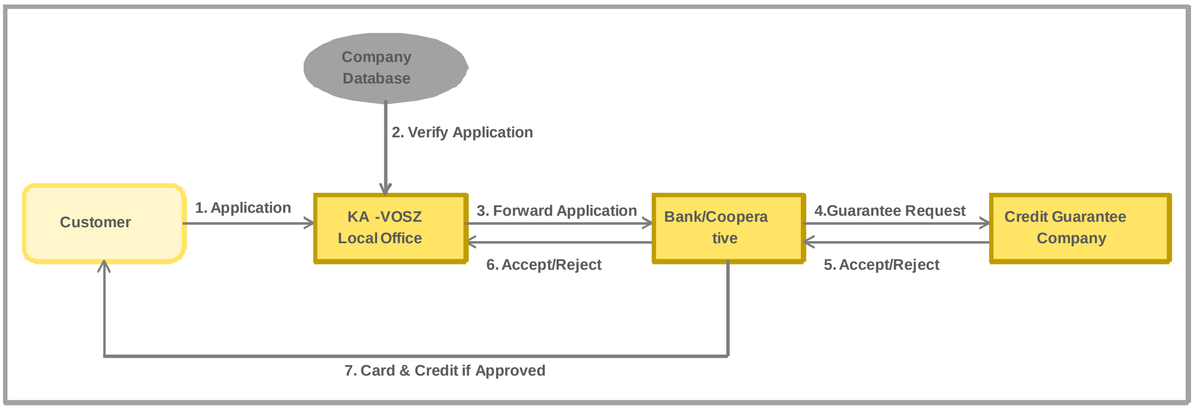
Eligibility – The card is applicable for enterprises that possess either an annual report for a whole year (365 days) or a private entrepreneur with a tax report for one whole year (365 days).

Usage - The credit can be used for expenditure like purchases, cash withdrawal, wire transfer, collection and activities for enterprise improvement (e.g. implementation of accounting standards). However the credit cannot be used for activities related to export activities (including dealing with goods to be exported, constructing a distribution network and financing any costs related to export activities).

Credit Institutions - 5 commercial banks and 130 savings cooperatives are involved in the program and represent 75% of the Hungarian banking sector.

Approval procedure - The applicant has the right to choose the bank to contract with. The steps involved are:

Figure 13



- The card is claimed by handing over the necessary documents to the Registration Offices of VOSZ, local chambers of trade and commerce and KA-VOSZ. Direct online applications on an internet portal have now been introduced.
- The registration office has online access to the company registration documents and can immediately verify the applicant status.

- The application entry is made into an IT system and application details are sent electronically to the card issuing bank chosen by the applicant.
- After verifying the documents, the Bank delivers the cash guarantee request electronically to the credit guarantee company which in turn decides about the guarantee. The time period for issuance can be as low as a working day.
- The bank then opens an account for the applying Enterprise to record the credit based on the Széchenyi card and transactions performed with the card.
- The credit duration and credit limit of the current credit agreement can be modified by initiating a new procedure at the Registration Office.

Credit limit and duration – The credit limit is based on the applicant's choice for amount of credit (up to a maximum of 25 million HUF or 100,000 Euro), qualification criteria of KA-VOSZ and the Bank's customer qualification. Interest is charged on the current debt and calculation is based on daily loans outstanding. Interest is debited quarterly. The credit duration is 365 days. The customer can request for extension of credit duration and such requests are evaluated and granted on merit basis.

Fees and costs – Various categories of fees are charged at different stages of the card life cycle. These are as follow:

- Registration fees are charged to enterprises which are not members of the VOSZ. The Registration Office collects such fees.
- For card issue, the enterprise has to pay the issuing bank an annual fee which is determined based on the credit limit.
- For the guarantee, Credit Guarantee Company charges a cash guarantor's fee of 1.5% based on 80% of the credit defined in the credit agreement.
- The Banks do not charge any fee or costs associated with the disbursement, disposability and redemption of credit other than the credit fee and default interest.
- The credit fee consists of the base interest, the extra interest and the handling fee to be calculated interest-wise. The base interest is variable and is set as the 3-month BUBOR (Budapest Interbank Offered Rate). The extra interest rate and handling fee are fixed for the year.
- The credit fee is to be paid quarterly, at the end of each calendar quarter. The enterprise has to pay the amount above the state support.

Collateral – The unique feature of this scheme is that it does away the requirement of collateral guarantee.

- For private entrepreneurs or companies, guarantee of an adult Hungarian citizen or European Union citizen (with atleast 3 years permanent residence in Hungary and who is direct or indirect owner of the company) is required.
- The credit guarantee company guarantees the redemption of an amount equalling 73% of the employed capital and interest from the credit available for the Enterprise.

State Support – Government provides interest subsidy for the credit disbursed on the card. Subsidy is also made available on guarantee fee (about 50%) of the Credit Guarantee Company.

Brazil

MSMEs in Brazil

Brazil is categorised as a "Lower Middle Income" economy by the World Bank. Brazil is also one of the BRIC nations. In Brazil, different criteria and thresholds are used for defining MSMEs for different legal, fiscal and international trade purposes. The Status of Micro and Small Enterprise in 1999 uses the criterion of annual gross revenue, whose values has been updated by Decree No. 5028/2004 of 31 March 2004 and are as follows:

- Micro Enterprise: Annual gross revenue equal to or less than $ 433,755.14.
- Small Businesses: Annual revenue exceeding U.S. $ 433,755.14 and less than or equal to $ 2,133,222.00.

It is important to emphasize that the simplified system of taxation - SIMPLE, which is a law of a strictly tax, adopts a different criterion to frame micro and small business. Limits as prescribed in the Provisional Measure 275/05 are:

- Micro Enterprise: Annual gross revenue equal to or less than R $ 240,000.00

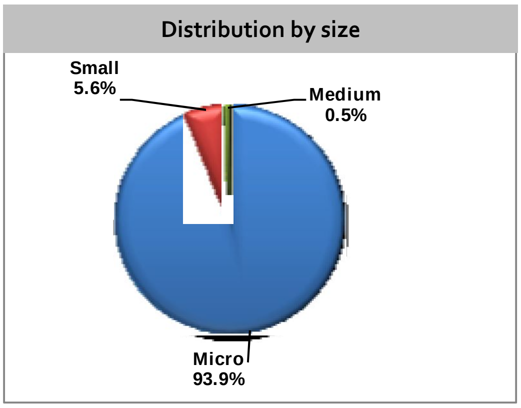
  - Small Businesses: Annual revenue of more than R $ 240,000.00 (two hundred and forty thousand reais) and less than or equal to $ 2,400,000.00.

In addition to the criteria adopted in the Statute, SEBRAE1 – an NGO also uses the concept of employees in enterprises. It is considered a micro firm those with up to 19 employees for the industrial field and up to 9 employees for the service providers; small firms hold from 20 to 99 employees in the industrial field and from 10 to 49 for service providers; medium firms hold from a 100 to 499 employees in the industrial field and from 50 to 99 for service providers. For tax regulation and credit concession purposes, the firm's classification is based on its revenue. Micro firms hold operating revenue up to R$ 700 thousand; up to 6 million are small firms and up to 35 million are medium.

MSMEs contribute to more than 99 % of the total number of enterprises in the country. There were 5.6 million MSMEs in Brazil as on 2005. These MSMEs employ two-thirds of the total labour population and contribute to 40.6 % of all wages paid. However the contribution of MSMEs to industrial GDP is 31 %.

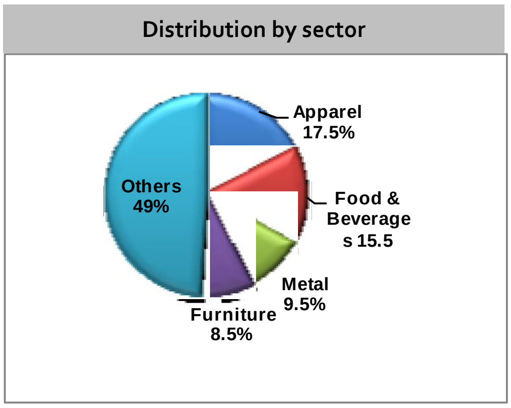
The distribution of MSMEs as per sector and size is as shown below in Figure 14 and Figure 15.

Figure 14



Source: IFC SME Database, 2002

Figure 15



Source: Brazil-Germany Economic Report, 2007

Cartão BNDES

The BNDES Card was introduced in 2003. It is a revolving overdraft credit which aims at providing MSMEs access to a pre-approved and automatic use credit line. The credit is to be used by the enterprises for productive investments.

Institutions involved in the scheme

The scheme is operated by the Brazilian Development Bank Banco Nacional de Desenvolvimento Econômico e Social (BNDES). It is Latin America's largest development bank and Brazil's main provider of long term financing. This scheme has successfully helped the bank to cater to the MSME segment.

The other participating institutions in this scheme are commercial banks Banco do Brasil, Caixa Econômica Federal and Bradesco. These banks ultimately issue the credit to the MSME. The credit card industry participates by enabling the card transactions on an online platform maintained by BNDES.

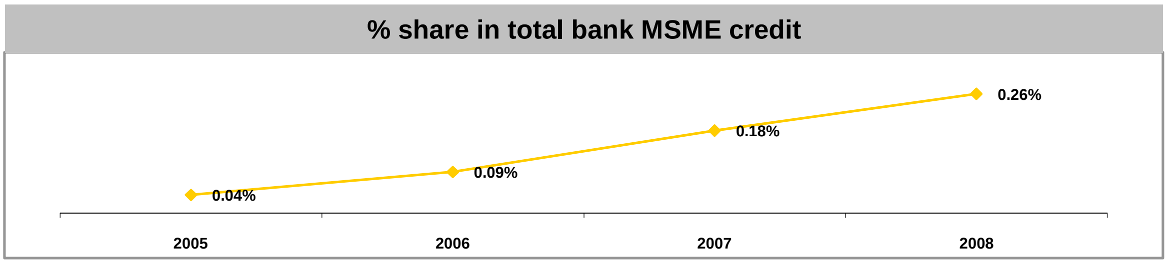
Progress

As of January 2009, 165,000 cards have been issued for MSMEs (since its creation in 2003). Around 97 % of these cards have been issued for micro enterprises. The number of card transactions has reached 135 million totalling credit availment of Rs 1.9 billion. A total of 10.9

thousand suppliers are now registered on the BNDES website and these provide a total of 101.8 thousand financeable items to MSMEs.

The share of BNDES card in total MSME disbursement by banks in Brazil over the years is as shown below in Figure 16.

Figure 16



Source: BNDES, Brazilian Central Bank

Some highlights of the credit disbursement for the time period 2005-08 are as follow:

- CAGR for total bank credit to MSME sector is 19.04%
- CAGR for credit disbursement through card is 127%
- Average share of card disbursements in total bank credit is 0.26%

The card was bestowed with the "Innovative Financial Product" award by the Latin American Association of Development Financial Institutions.

Advantages

The card has made available ready credit to the MSMEs in the country and has helped resolve purchasing issues.

Purchase	▶ The card was created so that MSMEs could purchase production, machinery and equipment goods that could improve the overall performance of the business. ▶ The scope which was limited to products has been expanded to include services (e.g. certification, laboratory tests etc.) provided by accredited companies. ▶ BNDES expands the product list considering the future needs (e.g. introduction of intellectual property registrations).
Standard platform	▶ The presence of a standard platform ensures the companies do not suffer from information asymmetry about suppliers and have choice of variety of products at competitive rates. ▶ The process is speeded up by use of automated systems.
Suppliers	▶ For the supplying company, the card platform provides it access to multiple customers and secure business transactions with guaranteed payments after 30 days from the sale. ▶ Also it favours local industries, with only suppliers manufacturing fully or partially in Brazil eligible.
Monitoring	▶ As all transactions and usage of credit happens on an automated platform, it is easier for issuing banks to monitor card usage.

Card Features

The features of the card are as follows:

Eligibility – All micro, small and medium enterprises are eligible to apply for the card. They have to register themselves on the card website.

Usage – The credit is provided for purchase from BNDES approved suppliers. The approved products include anything from construction materials to innovation services. The sales can be made by manufacturers as well as authorized distributors. Also the resale of goods purchased by using BNDES card is allowed before the payments have been made.

Credit institutions – The two largest federal banks and the largest private bank in Brazil are involved in this scheme.

Operations – The entire operation takes place through the BNDES credit card portal right from card request, calculation of installments, and purchase of products to repayments. The suppliers as well as the purchasing enterprises have to register on the site. The various steps involved in the issuance of card are mentioned below:

- The purchasing company has to be register itself on the website
- It then requests for a card from a bank of its choice
- It has to also submit the details of purchasing orders if any and future requirements
- The issuing bank then analyses the order, company details and if found suitable issues the card to the MSME.
- The repayment schedule is worked out with fixed monthly instalments
- The MSME can use the card on the website

Fees and costs – An annual fee for card usage is charged by the issuing bank. Also interest rate is fixed and decided by BNDES and charged on a monthly basis. The current interest rate is 1% p.m.

Credit limit and duration – The credit limit is decided by the issuing bank and can be a maximum of Rs 500,000 per bank. If the credit requirement exceeds this limit, the MSME is free to avail credit from other sources and also request for a card from another issuing bank. The repayment period extends from a minimum of 3 to a maximum of 48 months. The repayments are to be made in fixed monthly installments.

Collateral – The collateral is to be negotiated between the issuing bank and the enterprise.

► Peru

MSMEs in Peru

Peru is categorized as a “Lower Middle Income” economy by the World Bank. Enterprise definition is based on number of employees in the firm. The classification is as follows:

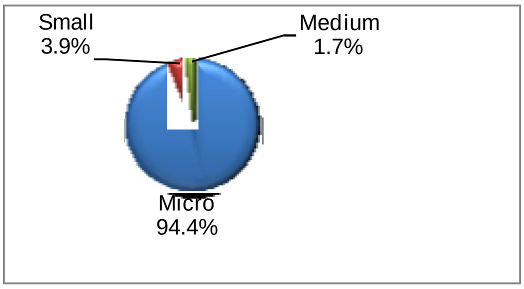
MSME Definition	
Type	**Number of Employees**
Micro	0-10
Small	11-50
Medium	51-199

Source: IFC SME Database, Year of Reference 2004

MSMEs contribute to 98 % of the total number of enterprises in the country. There were more than 0.6 million such enterprises in Peru in 2004. These MSMEs provide 78 % of the total employment and contribute 42 % to the GDP.

The distribution of MSMEs by size is as shown below in Figure 17

Figure 17



Source: IFC SME Database, 2004

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MiBanco Card

MiBanco (Banco de la Microempresa S.A.) was established as Peru's first for-profit, fully regulated private commercial bank. MiBanco was established by Acción Comunitaria (Communitarian Action), a non-government organization which supported entrepreneurs of small and micro enterprises and was present in Peru since 1969.

MiBanco targets the micro and small enterprise sector in Peru. It has focused on widening its reach through use of technology and innovative products.

Operation

The card is granted to MSME clients with a specific line of funds to pay a certain supplier. Each card may contain multiple credit lines. Each individual credit line corresponds to a supplier. The supplier visits the client and the latter pays for products with the credit card and specific line assigned to that supplier. Technological support is provided in the form of wireless hardware POS terminals which are issued to the supplier's sales force.

The benefits for the customer under this system are:

- Customer obtains credit immediately from the bank
- Supplier benefits through assured payments and development of business by reduced account receivable cycle
- The bank benefits through a recording of credit usage and risk reduction

Summary

A summary of the different contributing factors for the success/failures and corresponding lessons learnt from the various international credit card products is presented below. The lessons learnt have been incorporated in the design of the proposed credit card/scheme.

Success Factor	Concern Areas	Lessons to be adopted
Product Features		
▶ Provision of collateral free credit possible through presence of credit guarantee corporations in the eco-system.	▶ In Hungary, it was observed that credit guarantee was to be mandatorily applied for by the banks before offering credit under the credit card scheme. Similar pre-requisite criteria are not observed in the domestic scenario.	▶ Explore options for provision of collateral free credit. ▶ Explore options for popularising use of Credit Guarantee Corporations.
▶ Customers only a year into the business were eligible for credit.	▶ Micro customers with no audited financial statements may not be able to access credit.	▶ Explore the options of extending reach to all types of customers.
▶ In case of BNDES Cards, a standardised platform made available to suppliers and buyers. Credit made available to be utilized only on the platform. ▶ Monitoring possible through use of credit on the online	▶ Credit restricted to purchase from suppliers available on the platform.	▶ Explore options of providing transactional flexibility through an online platform. ▶ Explore usages of credit for supporting purchase of materials through online platform/instruments. ▶ Explore options of monitoring usage through the disbursement mode.

platform.		► Explore option of EMI payments as made available.
Process Features		
► Simplified and standard application procedures were developed.		► Explore option for a uniform application and assessment procedure.
► Involvement of business federation offices for promotion of scheme and acceptance of application forms.	► Fees waived off only for members of the business federation.	► Explore multiple options like Business Facilitator model, NGOs for promoting the scheme.
► Complete automated system for assessment of credit applications. ► Use of standard database for customer information.	► It was critical that customers register themselves in the system.	► Explore option of encouraging sharing of customer information through a centralised agency or verification of financial statements through an external agency.
► Subsidy in fees and charges	► Subsidy to be reduced over period and banks free to charge rates.	► Explore option for a low fee product.
Small Business Credit Card Features		
Features which can be adopted		Features which can be avoided
► Made available to all type of business entities ► Any time usage of credit line ► Automatic replenishment of credit ► Provision of grace period for repayment and penalty on default ► Provision of collateral free credit ► Reward points on transactions ► Spend analysis statements and employee cards		► High interest rates and charges ► Requirement of personal liability on default ► Variable interest rates and subject to change without prior intimation ► Fees for each transaction conducted using the card

Section B – Evaluation of Domestic Credit Card Schemes / Products

The purpose of this section is to analyze the experiments in similar type of products / schemes in the Indian financial services domain, identify which products / schemes have been successful and determine the key success factors as well as pitfalls to be avoided.

This section comprises the following

- **MSME related credit cards / schemes –** Description of schemes like Laghu Udyami Credit Card, Swarojgar Credit Card, Artisan Credit Card etc.
- **Kisan Credit Card (KCC) -** Overview, progress, issues addresses by KCC, operating features of KCC andcritical success factors and concern areas

MSME related Credit Cards / Schemes

The success of KCC scheme (which has discussed subsequently in section B) inspired the formulation of similar schemes for the non-farm sector. The new schemes designed based on the KCC features aimed at providing easy access to credit for their respective target segments. The three such products are:

- Laghu Udyami Credit Card (LUCC) – This scheme formulated by the Indian Banks Association in 2001. It was introduced by public sector banks. The primary aim was to provide access to working capital funds for their Small Scale Industry (MSE) borrowers. The initial credit limit of ₹ 2 lakh was later raised to ₹10 lakh in 2004 considering the increasing credit needs of the sector. National level data on progress of LUCC cards is not available in the public domain however, on a state wise basis; some SLBCs publish data on their website periodically. For, instance, in FY2010, a total of 4288 LUCC[4] cards were issued by banks in West Bengal.
- Swarojgar Credit Card (SCC) – This scheme formulated by NABARD in 2003. It aimed at taking care of investment and working capital requirements of small borrowers especially in the non-farm and service sectors both in urban and rural areas. NABARD provides refinance to banks under the Enterprise Loan Scheme. In FY2010, 1.02 Lakh SCC cards were issued in India.
- Artisan Credit Card (ACC) - This scheme which was formulated by the Ministry of Textiles and is being implemented by the Office of the Development Commissioner (Handicrafts) since in 2003. The objective of ACC was to meet the investment, working capital and a part of the consumption needs of the artisans and micro-entrepreneurs in a cost-effective and flexible manner. National level data on progress of ACC cards is not available in the public domain. However, on a state wise basis; some SLBCs publish data on their websites periodically. For, instance, in FY2009, a total of 3384 ACC[5] cards were issued by banks in West Bengal.

Progress

As of March 31, 2010 a total of 10.86 Lakh SCC have been issued involving an aggregate credit limit of ₹ 4,411 Crore. The annual progress of SCC in terms of number of cards issued and amount sanctioned is as seen in the charts below (Figure 18 and Figure 19)

Figure 18

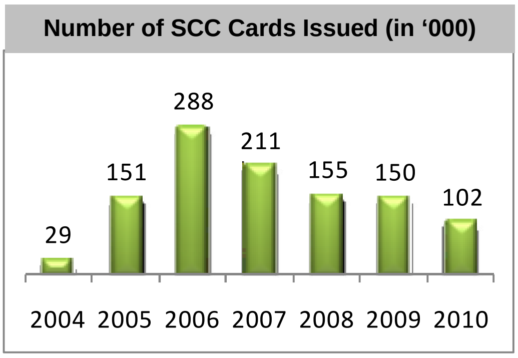
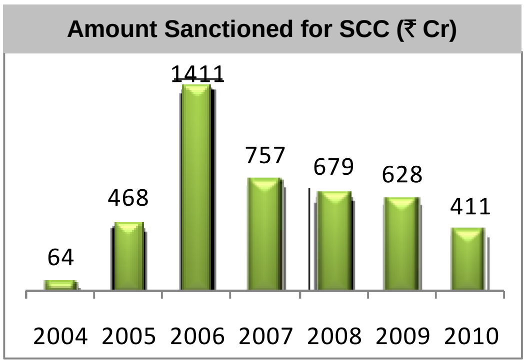


Figure 19



[4] www.slbcbengal.com

[5] www.slbcbengal.com

For LUCC and ACC, no national data is published by the regulators on the progress of the cards.

Source: NABARD Annual Reports

o ensure implementation targets are met. The progress of the implementation of these schemes is on agenda of some State Level Bankers' Committees (SLBC) and some banks report data in their annual reports.

Even though these cards have been modelled after the KCC, their reach and popularity has been limited due to both demand side and supply side constraints which will be explained in detail in the following sections.

Comparison of Scheme Features

a) Based on Operational Features

A comparison of the scheme features of these cards (LUCC, SCC and ACC) has been presented below:

Parameters	LUCC	SCC	ACC
Eligibility Criteria	▶ Existing MSE borrowers who enjoy a credit limit of ₹2 lakh and have satisfactory dealings for 3 years.	▶ Banks are free to select customers	▶ All artisans involved in production and/or manufacturing. ▶ Preference for artisans registered with Development Commissioner (Handicrafts). ▶ Existing artisan borrowers who enjoy a credit limit of ₹ 2 lakh. ▶ Beneficiaries of other govt. sponsored loan schemes are not eligible.
Type of facility	▶ Composite loan or only cash credit	▶ Composite loan	▶ Composite loan
Borrowing Entity	▶ MSEs	▶ MSEs ▶ SHGs can also avail for redistribution to their group members	▶ Artisans and micro-entrepreneurs. ▶ Thrust on financing clusters of artisans.
Activities to be funded	▶ Working capital finances ▶ Plant and machinery	▶ Term Loan ▶ Revolving cash credit ▶ Personal consumption component	▶ Term Loan ▶ Revolving cash credit ▶ Personal consumption component
Purpose of usage	▶ Business activities	▶ Business activities	▶ Business activities
Upper Limit	▶ ₹ 10 lakh	▶ ₹25,000	▶ ₹ 2 lakh
Assessment methods	▶ Annual turnover ▶ Past & projected cash flows	▶ Initial investment in fixed assets or working capital or both. ▶ Working capital limit is on basis of turnover and number of operating cycles.	▶ Annual turnover
Processing Fees	▶ Bank discretion	▶ Bank discretion	▶ Bank discretion
Interest	As per RBI stipulations and other MSME segment interest rates	▶ As per RBI stipulations	As per RBI stipulations and other MSME segment interest rates.
Penal charges	▶ Bank discretion	▶ Bank discretion	▶ Bank discretion
Primary collateral	▶ Hypothecation of assets ▶ Sufficiency of existing collateral	▶ Bank discretion	▶ Hypothecation of assets financed

Parameters	LUCC	SCC	ACC
Margin	▶ 25% for above 25000	▶ NIL	▶ 25% for above 25000 limit
Margin assessment	▶ For limit >25000	▶ NA	▶ For limit > 25000
Maximum Tenure	▶ 3 years	▶ 5 years	▶ 3 years
Repayment mechanism	▶ Flexible for Working Capital	▶ Flexible for Working Capital	▶ Flexible for Working Capital
Monitoring	▶ Bank discretion ▶ Some monitoring modes are operation of account like a Current Account, disbursement in kind, monitoring of account transactions	▶ Same as LUCC	▶ Same as LUCC
Renewal	▶ Annual for WC	▶ Annual for WC	▶ Annual for WC
Enhancement of credit limit	▶ At bank discretion	▶ Bank discretion	▶ Bank discretion
Mode of disbursement	▶ Kind for TL, Cash/kind for WC	▶ Cash for WC, kind for TL	▶ Cash for WC, kind for TL
Mode of transactions	▶ Cash/cheque from branch	▶ Cash/cheque from branch	▶ Cash/cheque from branch

b) Based on Other Specific Areas

A comparison of the other key areas and supporting activities of the above schemes is as given below:

Parameters	LUCC	SCC	ACC
Customer Type	▶ MSEs ▶ Variations in industry type, size, credit requirement ▶ Higher mobility ▶ Wider choice of banking avenues	▶ Type of livelihood finance ▶ Micro entrepreneurs	▶ Artisans ▶ Low familiarity with banking system ▶ ACC is typically the first interaction
Perceived customer risk	▶ High	▶ High	▶ High
Process	▶ Case by case assessment ▶ Time consuming process ▶ Documentation requirements as for other loan products	▶ Case by case assessment ▶	▶ Case by case assessment
Promotional Activities	▶ Only for existing customers ▶ No other such promotional activities ▶ Low focus ▶ No annual reporting	▶ NABARD circulars to bank ▶ Annual reporting of statistics	▶ Use of government camps in some cases ▶ No annual reporting
Risk Reduction	▶ Some banks operate through current accounts ▶ Some banks disburse only in kind ▶ Use of CGTMSE	▶ At bank discretion ▶ Use of CGTMSE	▶ At bank discretion ▶ Use of CGTMSE

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Issues	▶ Low awareness ▶ No additional benefit over existing products ▶ Difficult for new customers to avail facility ▶ Banks find difficult to monitor end usage ▶ Highly variable segment ▶ Difficult for banks to scale due to man power requirement and lack of availability of standard data ▶ Low familiarity with customers unlike in the case of KCC

Concern Areas

On analysis of the various existing schemes, it was seen that these schemes like SCC, LUCC had a limited success rate. Further through study of the product features as well as the support mechanisms, the following concern areas have been identified on both the supply and demand side.

Supply side issues	Demand side issues
▶ Time spent on and difficulty of credit limit assessment ▶ Difficulty in monitoring credit usage ▶ Insufficient protection from risk of customer default ▶ Customer awareness and financial knowledge	▶ Low awareness ▶ Lack of collateral ▶ No previous banking relationship ▶ Bank's limited knowledge of business ▶ Suitability of credit

Through secondary research and discussions with bank officials, the key factors for bank's reluctance were found to be based on the following obstacles:

- Systematic
  - ⇒ Default Risk: Lack of sufficient collateral increases the risk of default and resulting loss for a bank especially as the ticket size increases.
  - ⇒ Low Customer Awareness: Low customer awareness pertaining to various schemes and financial terms and terminologies hinders the information exchange and relationship between the bank and the customer. The individual bank may have to spend considerable time/effort in educating the customer.
- Structural
  - ⇒ Assessment for Credit Limit – As each unit is different from the other in terms of activity, location, size; assessment is done on a case by case basis. Lack of any standardised model /parameters complicates the procedure. As a result, the number of cards issued cannot be scaled significantly and also the manpower expense for the bank increases.
  - ⇒ Monitoring – In traditional loans, the end usage of credit is known when the credit is extended, this makes monitoring easier by requiring submission of receipts or site inspection visits. In case of an unrestricted use credit card, such an option does not exist and monitoring becomes difficult.
- Policy related
  - ⇒ Regulatory concerns regarding end usage monitoring exist in the system.

On analysis, it was found customer issues in accessing products have been due to:

- MSME borrowers often have low awareness of the various products being offered by financial institutions as well as the various features of such products. In many cases, they find it difficult to get precise information on solution for their credit needs and understand technical terms
- Lack of strong collateral and appropriate documentation delays the approval process and increases the bank reluctance to lend to the borrower
- Most banks are reluctant to offer such cards to new customers (only LUCC is officially for existing customers) thus making it more difficult as many micro entrepreneurs are not in the formal system
- Most scheme features were common and did not cater to differences between segments. As a result, the amount and frequency of repayments were not suited to the MSME borrower needs.

As also the bank personnel may not have in-depth knowledge of the business processes of every MSME borrowers. Most MSME borrowers also lack access to scientific methods for business projections and base their credit request on intuition and inherent knowledge of the market. The bank may not always agree with such projections and credit limit granted is lesser than the required amount

In addition, to the above issues, some of the key success factors of the international schemes were also found to be missing in case of the domestic schemes. These can be listed below:

▶ Presence of credit guarantee corporations	▶ Even though the option of CGTMSE is available for all three domestic schemes, concentrated efforts are required to popularise its usage by lending institutions.
▶ Availability of credit to new customers	▶ LUCC is restricted to existing customers of the bank. ▶ SCC and ACC are available to new and small customers however low level of promotional activities, lack of awareness of customers, lack of expertise and financial knowledge on use of such products, lack of sufficient documentation for availing products seem to have restricted their spread.
▶ Usage of technology	▶ Minimal usage of technology is made in either of the 3 cards (usage of technology refers to facilities such as online platform for fund transfer, online and customized statements, payment modes, etc.).
▶ Simplified and standard procedures	▶ A standard and simplified credit assessment framework was found to be lacking in all 3 cards increasing time required for assessment and thus restricting scaling efforts of lending institutions. ▶ It is essential that usage /establishment of centralized repository on MSMEs be encouraged to benefit all lending institutions. ▶ In the international case studies, usage of disbursement mode was made effectively to monitor accounts for e.g. proactive monitoring of credit usage.
▶ Involvement of multiple agencies	▶ While IBA was involved with LUCC, it was found that other relevant agencies such as rating organizations, credit bureau such as CIBIL, MSME federations and organizations working for the welfare of MSMEs etc were not involved to a great extent for improving features and usage of these cards.
▶ Support measures	▶ Support measures which were found to be limited include support to MSMEs in application submission, usage of credit, simplified forms, clear and regular communication, spend analysis, training for bank staff and promotional activities.

In addition to the above schemes, some of the commercial banks have formulated and introduced their MSME credit card schemes. Three such schemes introduced by the State Bank of India (SBI) and Bank of Baroda (BOB) are described below.

MSME Credit Schemes introduced by Indian Banks

In this section, the credit card schemes offered by State Bank of India (SBI) and Bank of Baroda (BOB) have been described in detail. These schemes are aimed at making available hassle free credit for MSME customers. While the schemes have been labeled as Card schemes, the banks do not offer any debit/credit card facility under the scheme. The schemes aim to reflect the easy disbursal of credit as with card usage and hence the name.

MSME Credit Card scheme of SBI

The Credit card scheme offered by SBI is a hassle free credit scheme launched by the bank for its MSEs customers including enterprises in retail trade and professionals. The scheme is known as the Small Business Credit Card scheme. The micro segment customers form the majority segment for this credit scheme. As on March 2009, there were 1.8 Lakh Small Business Credit Card scheme customers in SBI (compared to 14 Lakh total MSME accounts).

The key features of the scheme are:

- Eligibility criteria: The card scheme is offered to MSE customers subject to a satisfactory track record of atleast 2 years. The new units are considered depending on the owner credentials and other bank records.
- Maximum credit limit: The maximum credit limit sanctioned under the card was earlier ₹ 5 Lakh which has since been increased to ₹ 10 Lakh.
- Assessment: It is based on the Nayak committee criteria of 20% of projected annual turnover. The card is also offered to professionals/self-employed wherein limit is based on 50% of gross annual income.
- Form: Credit on the card is in the form of composite loan which can be used for purchasing equipment also. The repayment is in the form of monthly installments. For micro units, the limit sanctioned on the card is sufficient to meet their working capital requirements. If a card is sanctioned to a particular unit, the unit cannot avail of any other working capital product. The card has a feature of auto renewlon annual basis.
- NPA status: The non performing account norms are the same. The percentage of NPLs in these cards is around 4 to 5 %. It is slightly higher than the non performing assets for SMEs.
- Validity: The tenure is of 3 years subject to satisfactory conduct of the account. Annual review based on conduct / operation of the account. The term loan component can be paid in 5 years
- Security: For enterprises engaged in services, charge over property or third party guarantee is required if credit is above ₹ 25, 000
- Waivers: The customer is waived off submission of stock statement, audited balance sheets though half-yearly inspection is conducted of the business operations and premises
- Interest rate: The rate of interest varies from 1.25% below State Bank Advance Rate (SBAR) to 1.5% over SBAR depending upon the credit limit

MSME Credit Card scheme for Bank of Baroda

Bank of Baroda offers two credit card schemes to its MSME customers. While one scheme is offered under the LUCC, the second scheme is an additional working capital scheme for its existing customers. The details of both these schemes have been highlighted below:

a) Baroda Laghu Udyami Credit Card

This credit scheme is intended to provide hassle free credit to small business units. The category of customers covered under the scheme include retail traders, artisans, village industries, small scale industrial units and tiny units, professionals, self employed persons etc

The key features of the scheme are:

- Eligibility criteria: All existing customers of the bank which fall under the occupation criteria as mentioned above are considered eligible. The customer should have a satisfactory track record/dealing with the bank for the previous 3 years.
- Credit limit: The maximum credit limit sanctioned to the customer is ₹ 10 lakh per customer.
- Validity: The maximum tenure is of 3 years. The tenure is subject to satisfactory performance on the internal review conducted by the bank.
- Margin: The bank requires mandatory margin of 25% of the credit limit sanctioned.
- Security: The security can vary from hypothecation of stock receivables to office equipment etc depending on the limit.

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b) Baroda SME Gold Card

This credit scheme is also offered to the existing MSME customers of the bank. The purpose of the scheme is to meet the unexpected and unplanned working capital needs of MSME customers of the bank. Under this scheme, the bank aims to provide on the spot assistance to enable customers to tackle temporary mismatch in liquidity. The bank provides an additional limit of 10% of original assessed banking finance eligibility for the borrowing unit. The borrower is permitted to withdraw as and when required this additional 10% limit whenever the need arises.

The key features of the scheme are:

- Eligibility criteria: All existing customer units of the bank with satisfactory performance for atleast 2 years and with a credit rating of BOB-4 and above. The units should be already be sanctioned a credit limit of ₹ 25 lakh and above. Only customers having sole banking arrangement with the bank are considered.
- Credit limit: A maximum of 10% of the assessed working capital eligibility of the customer is provided under the scheme apart from regular working capital finance.
- Validity: The withdrawal is to be repaid within 12 months. The customer is allowed 4 withdrawals within a period of 12 months. It is also specified that a minimum duration of 15 days between 2 withdrawals.
- Interest & Security: The same interest rate as applicable to the regular cash credit facility is applied. The security as applicable for the cash credit facility is considered. The maximum interest rate applicable at any point of time is BPLR+maximum spread of 3% + maximum penal interest of upto 2%.
- Security: The security can vary from hypothecation of stock receivables to office equipment etc depending on the limit.

The Gold Card also serves as recognition of satisfactory dealing of the customer with the bank. These card customers are offered discounted credit (up to 25 basis points depending upon the credit rating of the borrowing entity) for export related finance.

The comparison of key features of the three schemes is presented below:

Parameter	SBI Small Business Card	Baroda Laghu Udyami Card	Baroda SME Gold Card
Purpose	► Composite loans for typically micro and small enterprises	► Composite loans for MSME customers	► Finance to meet emergency requirements or temporary liquidity constraints
Eligible customers	► Existing MSEs customers with a satisfactory record of minimum 2 years ► New customers with satisfactory performance	► Existing MSME customers with a satisfactory record of minimum 3 years	► Existing customers with 2 year record ► Minimum credit rating criteria ► Minimum working capital eligibility of ₹ 25 lakh
Credit limit	► Maximum ₹ 10 lakh	► Maximum ₹ 10 lakh	► 10% of already approved working capital limit
Repayment	► Monthly instalments	► As for existing loan scheme	► As for existing cash credit scheme
Tenure	► 3 years subject to annual review	► 3 years subject to annual review	► 12 months (as for cash credit)
Restrictions	► Cannot avail other working capital products	► None	► Maximum 4 withdrawals in a year ► Sole banking relationship
Interest rate (As of 21 June,	► 1.25% below SBAR to	► As specified by the bank	► Maximum BPLR+3%+penal

2010 on bank website)	1.5% above SBAR	for MSME loans	charge of 2%

Kisan Credit Card

In order to address the problems faced by banks in disbursing agricultural credit, Reserve Bank of India (RBI) set up the Gupta Committee in 1997 to suggest measures for improving delivery systems as well as simplification of procedures for agricultural credit. The committee recommended several measures like provision of cash credit facility, composite loans, simple loan procedures etc. The recommendations made by the Gupta Committee paved the way for Kisan Credit Card (KCC). The announcement to this effect was made in the 1998-99 budget speech.

Overview

National Bank for Agricultural and Rural Development (NABARD) formulated the model scheme for design of KCC in consultation with the major banks. The scheme aimed at adequate and timely support from the banking system to the farmers for their cultivation needs and other ancillary needs.

Kisan Credit Card (KCC) caters to various credit needs of its target customer segment. The credit components are as follows:

- Short term credit for crop loans
- Medium term credit for purchase of assets e.g. farm machinery, tractors, etc.
- Long term credit is given for investment credit purpose for e.g. installation of water pump, construction on the farm land, etc.
- A minimal amount is granted for personal consumption purpose like illness, educational loans etc. It is charged at agricultural credit interest rates only

An actual plastic credit card is not provided to the customer, rather the scheme draws on the concept of a credit card, allowing the customer to borrow as well repay at his own convenience subject to a repayment period and the total credit limit.

KCC Features

The basic features of the scheme are explained as follows:

Eligibility – Initially only farmers eligible for a production credit of ₹5000 and above were considered eligible. This limit was lowered in June 2000 and then finally abolished. Currently, government has made all categories of farmers including tenant farmers, share croppers, oral lessees, and Joint Liability Groups eligible.

Assessment mechanism – The financing bank is required to take into account the entire agricultural requirements of the customer for the full year including any ancillary activities related to crop production. Credit limit is determined on the basis of

- Land size
- Season wise crop to be cultivated
- Number of crops to be cultivated in the year
- Scale of finance for each crop

The information on scale of finance is obtained from reports published by Task Force Committee/ Lead Bank for each district. The finance requirement covers all activities from seed purchase to marketing. For medium term and long term credit, the farmer has to submit his plans for the financial year.

Disbursement mechanism – Credit is in form of revolving cash credit facility for short term credit and working capital loans. Typically the cash is disbursed through the branch which issues the card. In some cases the bank may permit the disbursal through certain other branches. In case of cooperatives, the Primary Agricultural Credit Societies are also eligible for cash disbursal. The farmer has to only produce receipts from the vendor where he has utilized the loan amount for purchase/service as a proof of loan utilization.

Interest rate - Interest rate is a function of quantum of loan and purpose of the loan. The interest rates are as follows:

- For short term credit up to ₹3 Lakh, 7% interest rate (crop loan interest rate) is charged.
- For Medium Term loans, up to 2 Lakh rates are fixed by RBI. Banks are free to charge any interest above ₹ 2 Lakh.

  Interest rates are fixed for the credit limit. Interest is not compounded until after the loan has become overdue. For small and marginal farmers, the interest accrued cannot exceed the principal. Interest is also payable to the borrower on the surplus balance at a rate equal to the Saving Accounts interest rate then applicable.

Charges - No charges or fees of any type are applied for loan amount up to ₹ 25,000. Beyond that, the bank may apply its service charges however the penalty charges cannot exceed ₹ 25,000.

Collateral and Margin - Banks may insist on collateral security by way of mortgage of land or third party guarantee in case of credit limits above ₹25,000. Margin requirement is also to be decided by the banks for limits above ₹25,000 (typically 15 to 25%).

Tenure – The tenure of the card is for 3 years after which it can be renewed. Each credit component has separate repayment duration.

- For short term credit, the typical duration is of one year which can extend to 18 months depending on the type of crop.
- For medium term credit, the repayment duration is from 1 to 3 years.
- For long term credit, the repayment duration is more than 5 years.

Operating Model - Each beneficiary is issued with a credit card and a pass book which also serves as an identity card. The photograph and signature/left thumb impression of the account holder is required on the card.

- The issuing branch maintains the ledger account in respect to each KCC account and all operations are generally transacted through this branch.
- Once the credit limit is sanctioned, the card holder can withdraw money as and when required and make repayment into the account whenever there is cash surplus.
- Withdrawal is done through withdrawal slips/cheques and there is no limit on the number of transactions.

Additional Features – Additional benefits provided with the card are:

- Personal Insurance of ₹ 50,000 is provided to all the KCC customers.
- Crop loans disbursed under KCC for crops eligible under Crop Insurance Scheme are covered under Rashtriya Krishi Bima Yojana.
- The bank at its discretion can sanction 10 to 15% additional credit to the farmer depending upon his past banking relationship, requirement of credit for advanced agricultural techniques etc.
- Use of Business facilitator model for expansion of this scheme. Such agents can assist farmers in completion of application procedure as well as carry out inspection for the bank. This helps bank to reach a larger customer base with limited number of employees.

Progress

The total number of farmers in the country is estimated at 119 million. Out of these, 97.7 million farmers come under the small and marginal farmer category. KCC has spread rapidly since its induction and as at end of financial year 2009-10 (as per RBI Trends and Progress in Banking report); 93 million cards have been issued. Thus 26 million farmers still remain outside the purview of the scheme.

Cooperatives and commercial banks lead in issuance of KCC cards. More than 75% of the KCC customers are in Andhra Pradesh, Orissa, Tamil Nadu, Maharashtra and Uttar Pradesh (UP).

The charts (Figure 20 and Figure 21) below provide information on the share of banks in total number of cards issued (by bank type) and the state wise share of cards.

Figure 20

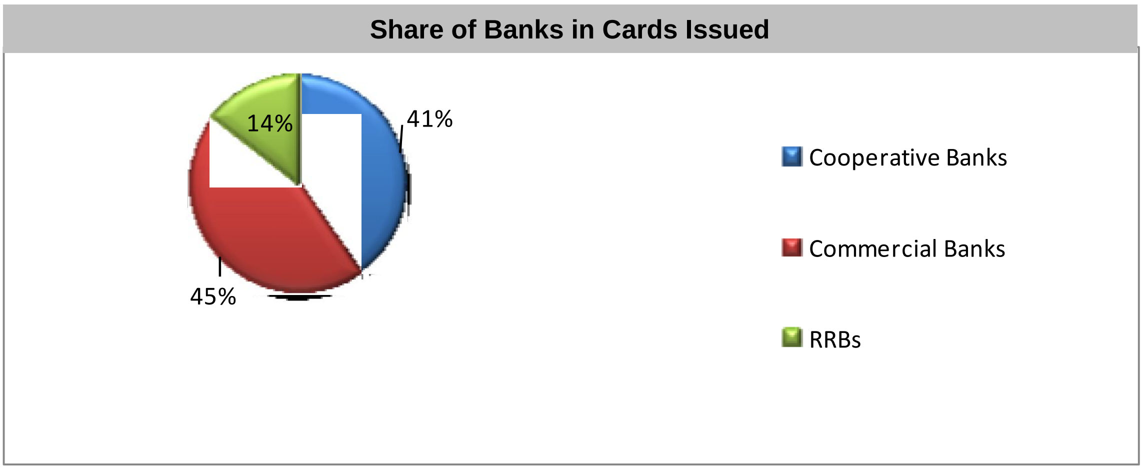
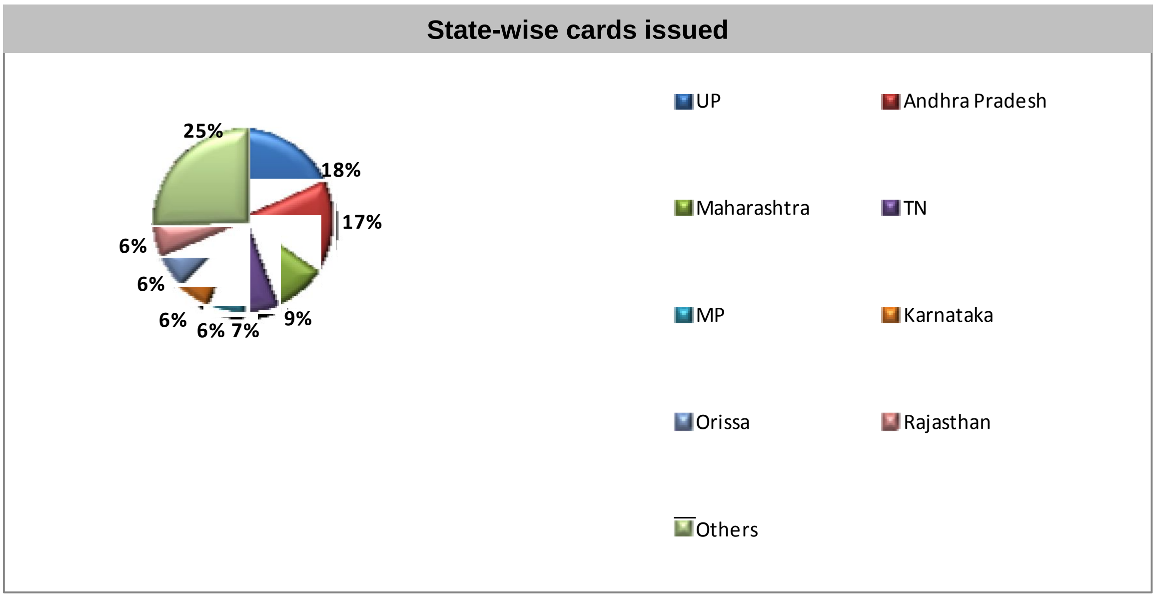


Figure 21



Source: RBI Trends and Progress in Banking 09-10

Issues addressed by KCC

An agricultural credit card was not a novel concept in India. Some commercial banks had already implemented similar products for their existing customers but had met with limited success. One reason for the universal appeal of KCC was the way it addressed issues faced by such schemes.

Issue	Method
Customer Issues	
Processing Time	▶ Introduced one-time credit verification for the tenure of the loan ▶ Abolished annual re-application and re-assessment of loan
Vulnerability of Customer to Money lenders	▶ Inclusion of all type of credit requirements (including personal consumption) for determining credit limit thus leaving no need for approaching an informal source ▶ Inclusion of buffer months in determination of repayment period thus giving sufficient time to the customer ▶ Flexible repayment systems at customer's convenience unlike fixed scheduling under term loans

	▶ Loan restructuring available in case of inability to repay (e.g. in natural calamities) ▶ KCC card to serve as an identity and assurance of payment while dealing with vendors
Cost of loan	▶ Interest calculation is based on simple interest resulting in lower costs for the farmer ▶ Compounding is introduced only in case of default thus making the customer aware of high cost of delayed payments
Bank Issues	
Customer awareness & reach	▶ Use of different information sources such as cooperative societies, farmers clubs, Gram Panchayat workers, Rural Development Officer, Village Knowledge Centres to spread customer awareness. ▶ Inclusion of lowest level of banking system (in form of Primary Agricultural Cooperative Societies) to increase reach ▶ Use of Business Facilitator model (these agents help farmers in application procedures and banks in carrying out inspection)
Information asymmetry for bank	▶ Reports published on crop scale of finance by Lead Bank/Task Force for every district ▶ Credit assessment based on standardised formulae and data
Customer monitoring	▶ Restriction on customer that he can avail card from a single bank ▶ Disbursal in cash but requirement of submission of receipts for transactions made using the availed credit ▶ Facility of future loan available only on complete repayments of outstanding borrowings, thus reducing default
Manpower requirement	▶ One-time credit assessment, use of supporting agencies (e.g. business facilitator) help reduce the number of man hours ▶ Continued relationship reduces need for inspections ▶ Better record-keeping as a single product provides multiple functions

Critical success factors

From the features of the card and the manner in which lacking of previous schemes were handled, the critical success factors of KCC scheme have be identified as follows from the Figure 22

Figure 22

Customer	? Customer occupation is standard and not subject to immediate change ? Customer has low mobility ? Availability of an identity card in form of KCC
Product	? Designed to cater to almost all credit needs of the target customer segment ? Designed to ensure continual relationship with banking institution ? Introduction of additional benefits like insurance from time to time
Process	? Availability of standard data for assessment of credit limit ? Improvement in speed & reduction in man hours spent by one time assessment ? Use of Business Facilitator, other avenues to expand the scheme
Policy	? Support from government for interest subsidy ? Expansion of scheme by substituting it for other similar products ? Reduction of risk for bank by allowing to set season-wise sub limits

Concern Areas

Even though KCC scheme has been successful, there are certain issues which the customers face. Understanding of these concern areas will help prevent their recurrence in any future schemes.

These are:

- Documents required/application procedures vary from bank to bank.
  - Even though assessment is based on data published by the Lead Bank, the banks have designed their own application forms and procedures.
  - These vary from bank to bank and customer feedback in some cases found them to be complicated and time consuming.

- Banks do not have access to any repository on land documents, customer data. Hence in case of new customers, certain banks require customers to submit multiple documents. The customer has to spend substantial time and money in acquiring such documents.

- Vulnerability to brokers
  - In regions where official intermediary channels are not available to assist farmers in the application process, it has been found that brokers/unofficial agents charge farmers high amounts to obtain a KCC Card.
- Mode of usage of card
  - Even though the facility of as and when withdrawal is available to farmers, it has been found in certain cases that farmers tend to withdraw the entire amount at one time and make a single total repayment.
  - This behaviour is seen to emerge from lack of awareness of all features as well as lack of trust that cash will be available at all times in the bank branch. It is seen specially in remote areas and for small and marginal farmers who grow subsistence crops.
  - Distance also plays a role. Many a times the villages are situated far from the nearby bank branches and the farmer in most circumstances cannot afford to travel frequently to the branch.

Comparison of Scheme Features

a) Based on key operational features

An analysis of the key features of these schemes in comparison with KCC will provide clarity on the target segment and purpose of these cards:

Parameters	KCC	LUCC	SCC	ACC
Eligibility Criteria	▶ All farmers, landless labourers, sharecroppers	▶ Existing MSE borrowers who enjoy a credit limit of ₹ 2 Lakh and have satisfactory dealings for 3 years.	▶ Banks are free to select customers	▶ All artisans involved in production and/or manufacturing. ▶ Preference for artisans registered with Development Commissioner (Handicrafts). ▶ Existing artisan borrowers who enjoy a credit limit of ₹ 2 lakh. ▶ Beneficiaries of other govt. sponsored loan schemes are not eligible.
Type of facility	▶ Composite loan	▶ Composite loan or only cash credit	▶ Composite loan	▶ Composite loan
Borrowing Entity	▶ Farmers	▶ MSEs	▶ MSEs ▶ SHGs can also avail for redistribution to their group members	▶ Artisans and micro-entrepreneurs. ▶ Thrust on financing clusters of artisans
Activities to be funded	▶ Crop loan ▶ Purchase of machinery ▶ Personal consumption	▶ Working capital finances ▶ Plant and machinery	▶ Term Loan ▶ Revolving cash credit ▶ Personal consumption component	▶ Term Loan ▶ Revolving cash credit ▶ Personal consumption component
Purpose of usage	▶ Cultivation	▶ Business activities	▶ Business activities	▶ Business activities
Upper Limit	▶ ₹ 5 Lakh, can be higher	▶ ₹ 10 Lakh	▶ ₹ 25,000	▶ ₹2 Lakh

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Parameters	KCC	LUCC	SCC	ACC
Assessment methods	▶ Entire financial requirements for year, ▶ Standard method based on land size, season, number of crops, scale of finance	▶ Annual turnover ▶ Past & projected cash flows	▶ Initial investment in fixed assets or working capital or both. ▶ Working capital limit is on basis of turnover and number of operating cycles	▶ Annual turnover
Processing Fees	▶ Nil for limit < ₹ 25,000/-, beyond that bank discretion	▶ Bank discretion	▶ Bank discretion	▶ Bank discretion
Interest	▶ Short term – crop loan interest rate ▶ Medium term bank discretion above ₹ 2 Lakh ▶ Simple interest calculations till loan becomes overdue	▶ As per RBI stipulations and other MSME segment interest rates	▶ As per RBI stipulations	▶ As per RBI stipulations and other MSME segment interest rates
Penal charges	▶ Bank discretion	▶ Bank discretion	▶ Bank discretion	▶ Bank discretion
Primary collateral	▶ For limits > ₹ 25,000/- mortgage of land or third party guarantee at bank discretion	▶ Hypothecation of assets ▶ Sufficiency of existing collateral	▶ Bank discretion	▶ Hypothecation of assets financed
Margin	▶ 15 to 25%	▶ 25% for limit above ₹ 25,000/-	▶ NIL	▶ 25% for limit above ₹ 25,000/-
Margin assessment	▶ Limit > ₹ 25,000/- based on land	▶ For limit >₹ 25,000/-	▶ NA	▶ For limit > ₹ 25000/-
Maximum Tenure	▶ 3 years	▶ 3 years	▶ 5 years	▶ 3 years
Repayment mechanism	▶ Flexible for crop loan	▶ Flexible for Working Capital	▶ Flexible for Working Capital	▶ Flexible for Working Capital
Monitoring	▶ Customer an avail card from a single bank ▶ Term loan is disbursed in kind ▶ Receipts to be submitted for cash disbursals	▶ Bank discretion ▶ Some monitoring modes are operation of account like a Current Account, disbursement in kind, monitoring of account transactions	▶ Same as LUCC	▶ Same as LUCC
Renewal	▶ Annual for crop loan	▶ Annual for WC	▶ Annual for WC	▶ Annual for WC
Enhancement of credit limit	▶ At bank discretion, 10-15%	▶ At bank discretion	▶ Bank discretion	▶ Bank discretion
Mode of disbursement	▶ Cash for crop loan, kind for term loan	▶ Kind for TL, Cash/kind for WC	▶ Cash for WC, kind for TL	▶ Cash for WC, kind for TL
Mode of transactions	▶ Cash/cheque ▶ Pilots for smart cards	▶ Cash/cheque from branch	▶ Cash/cheque from branch	▶ Cash/cheque from branch

b) Based on other specific areas

A comparison of the other key areas and supporting activities of the above schemes is as given below:

Parameters	KCC	LUCC	SCC	ACC
Customer Type	▶ Standard occupation ▶ Restricted access to banking	▶ MSEs ▶ Variations in industry type, size, credit requirement ▶ Higher mobility ▶ Wider choice of banking avenues	▶ Type of livelihood finance ▶ Micro entrepreneurs	▶ Artisans ▶ Low familiarity with banking system ▶ ACC is typically the first interaction
Perceived customer risk	▶ Low	▶ High	▶ High	▶ High
Process	▶ Standard data for assessment ▶ Faster process ▶ Use of intermediaries like business facilitators	▶ Case by case assessment ▶ Time consuming process ▶ Documentation requirements as for other loan products	▶ Case by case assessment	▶ Case by case assessment
Promotional Activities	▶ Large scale promotional campaign ▶ Use of cooperatives ▶ Use of BF model ▶ High govt, RBI, bank focus	▶ Only for existing customers ▶ No other such promotional activities ▶ Low focus ▶ No annual reporting	▶ NABARD circulars to bank ▶ Annual reporting of statistics	▶ Use of government camps in some cases ▶ No annual reporting
Risk Reduction	▶ Interest subsidy ▶ New crop loans only through KCC ▶ Season wise sub limits	▶ Some banks operate through current accounts ▶ Some banks disburse only in kind ▶ Use of CGTMSE	▶ At bank discretion ▶ Use of CGTMSE	▶ At bank discretion ▶ Use of CGTMSE
Issues	▶ Brokers present in some places ▶ One time withdrawal and use by customers	▶ Low awareness ▶ No additional benefit over existing products ▶ Difficult for new customers to avail facility ▶ Banks find difficult to monitor end usage ▶ Highly variable segment ▶ Difficult for banks to scale due to man power requirement and lack of availability of standard data ▶ Low familiarity with customers unlike in the case of KCC		

A summary of the different contributing factors for the success/failures and corresponding lessons learnt from the various domestic card products are presented below. The lessons learnt have been incorporated in the design of the proposed credit card/scheme. As the KCC scheme has been more successful as compared to the other domestic credit card schemes, multiple success factors have been derived from this model. For the other domestic credit card schemes, key concern areas have been identified and listed below:

Success Factor	Concern Areas	Lessons to be adopted
Customer Type		
▶ In KCC, the customer occupation is standard and not subject to immediate change. ▶ Also due to land ownership/type of occupation, the customer mobility is low ▶ Customer receives an identity card in the form of KCC.	▶ In case of MSME cards, the customer segment has relatively higher mobility. ▶ The customer also has access to a wider choice of credit products and banks. ▶ Some products are made available only to existing	▶ It is important to restrict customer mobility/flight to other banks in case of payment default. ▶ Efforts have to be made to improve customer loyalty to the bank issuing the card. ▶ Considering the variation in target customers, essential to identify various

	customers.	customer segments and design product features accordingly.
▶ Customer occupation being standard across a particular area, it is relatively easier to assess credit requirements.	▶ Customers in a same area may be involved in multiple occupations requiring specialised knowledge on all industries.	▶ Information relating to different industry types and occupations can be made available to the lending institutions by a third agency.
Product Features		
▶ KCC was designed to cater to comprehensively meet credit requirements and provide flexibility of repayment. ▶ KCC and other cards include a component for personal consumption.	▶ Different assessment methods may result in credit sanctioned to be lower than MSME requirements. ▶ Mode of disbursement in other cards is decided by the lending institution and may not always be flexible.	▶ Personal consumption component can be retained. ▶ Customer to be provided multiple options in disbursement while retaining credit monitoring concerns of lending institution. ▶ Inclusion of flexibility in modes of repayment as well.
▶ Cards include additional benefits in the form of insurance. ▶ KCC provides also provides loan restructuring.	▶ All products may not offer additional benefits.	▶ Explore option of including insurance and other benefits for customers especially for smaller units.
▶ Cost of loan to customer was effectively low in KCC	▶ Interest rates and charges vary for different banks in MSME cards	▶ Explore option of reducing cost through charges or interest rates
▶ For a cultivator, collateral is present in the form of land.	▶ For MSMEs, collateral may not always be present or be insufficient to meet bank requirements.	▶ Explore the option of offering credit collateral free under the current framework.
Process Features		
▶ Increase in customer awareness through use of multiple channels for KCC.	▶ For other cards, promotional activities were limited in nature	▶ Explore option of support to banks for conducting promotional activities ▶ Explore channels for implementation and promotion of scheme
▶ Simplified and one-time credit assessment process for KCC ▶ Improvement in speed of process.	▶ Case by case assessment in case of MSME cards.	▶ Explore option of a standard assessment method to be developed by a centralised agency. ▶ Explore avenues for training of staff ▶ Develop guidelines for broad credit assessment framework.
▶ Easier monitoring of end-usage of credit through receipts of purchase and sub-limits.	▶ Monitoring is required through submission of stock statements or disbursement in kind.	▶ Explore options of monitoring

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Chapter 3: Study of regulatory requirements for Credit Cards in India and possible implementation framework

Highlights

⇒ **The Chapter provides an overview of the regulations applicable for MSME finance in India. Also it provides an overview of the various regulations applicable to a bank planning to conduct credit card operations in India.**

⇒ **The Chapter seeks to aid understanding of implementation models which are possible from a regulatory perspective and ease of implementation for them. Also it will help in understanding the limits within which**

The chapter consists of two sections:

- **Section A –** Regulations pertaining to credit card operations in India – Approval, Fair practice code, interest rates and implementation of MSME credit cards.
- **Section B –** Possible implementation frameworks from a regulatory perspective and comparison of applicable regulations.

Section A – Regulations pertaining to Credit Cards in India

In order for successful and sustainable implementation of a credit card product, it is essential that an encouraging regulatory and policy environment be present in the country. At the same time, the regulatory guidelines should be stringent enough to protect customer rights and provide enough confidence to the lender to introduce a certain product.

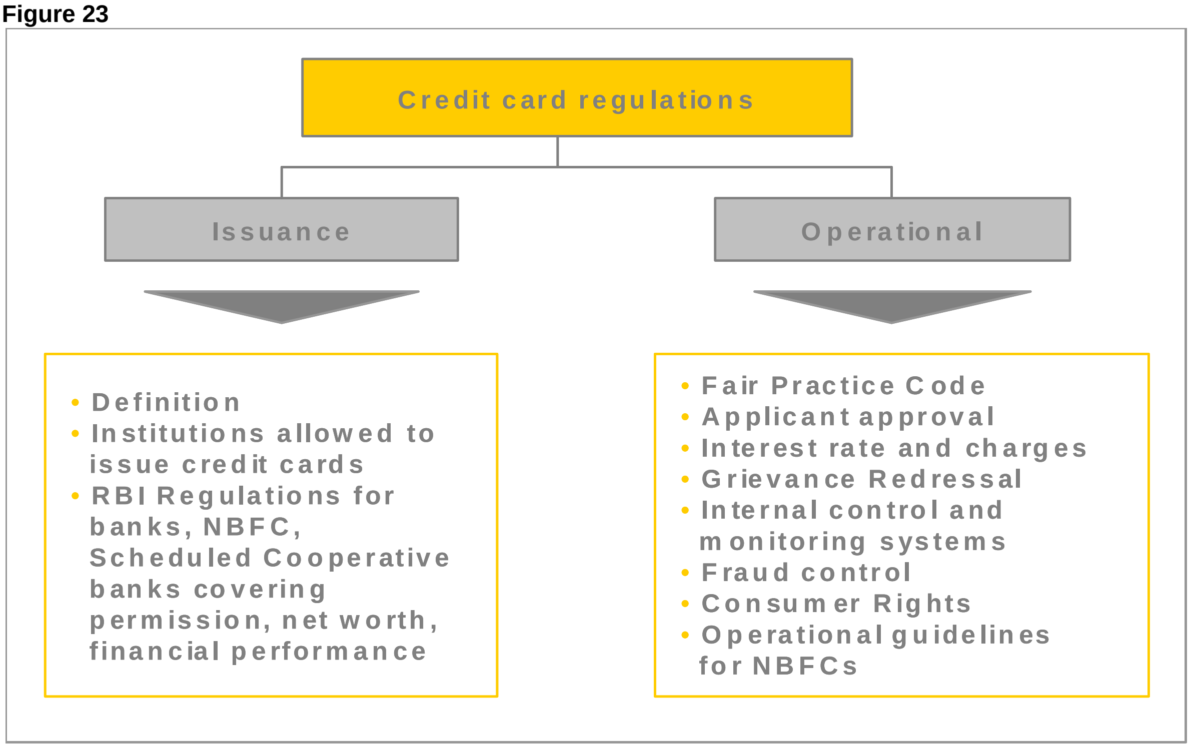
Some of the key regulatory requirements for implementation of a successful product are:

- Clarity on the type of financial institutions which can implement a credit card product and/or participate in the credit card business in partnership with other institutions.
- Guidelines pertaining to financial strength/performance well being of the participating institutions to prevent financially weak institutions from participating in this business.
- Guidelines pertaining to fair practice code.
- Guidelines for protection of customer rights like privacy, information, confidentiality, recovery measures, etc.
- Guidelines related to operations for the lending institutions.
- Guidelines related to interest rates, processing fees and any other charges.
- Guidelines for end usage monitoring.
- Policy decisions/measures for encouraging usage of credit guarantee, increasing awareness of schemes, etc.

RBI has formulated detailed regulations related to credit card operations in India. These govern all categories of credit cards whether personal or business. Regulations covering credit card operations have been divided into two categories. The first category details regulations regarding the issuance of credit cards and the second category provides information on regulations governing the operation of credit card issuing institutions.

The following schematic provides information on the regulations covered in this section

Figure 23



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Definition of Credit Card

The term “Credit Card” usually/generally refers to a plastic card assigned to a cardholder, usually with a credit limit, that can be used to purchase goods and services on credit or obtain cash advances.

A credit card

- Allows cardholders to pay for purchases made over a period of time,
- Allows cardholders to carry a balance from one billing cycle to the next, and
- Normally becomes payable after a period, during which no interest or finance charge is imposed.

Institutions allowed issuing credit cards

RBI permits Commercial Banks to issue credit cards. Non Banking Financial Companies are allowed to issue co-branded credit cards with Commercial Banks. Similarly State Cooperative Banks are allowed to issue co-branded credit cards with Commercial Banks.

The following options are possible

- The card issuing bank can setup a department for implementing this scheme.
- The implementing bank may form a new subsidiary to enter into the credit card business.
- A bank which wants to enter into this segment may partner with another bank which already has credit card issuing capability.
- Once the issuing bank has entered into the credit card business through either of the possible alternatives listed above, it may partner with NBFC and/or SCB to issue co-branded credit cards.

The regulations relating to RBI approval for each of the above institution type is specified below:

RBI approval for Commercial Banks	Banks can undertake credit card business either departmentally or by setting up a subsidiary for the purpose. They can also enter into a tie-up arrangement with another bank which already has in place arrangements to issue credit cards. The minimum net worth requirement of a bank desirous of entering into the credit card business is ₹100 Crore. No prior approval of RBI is necessary for banks which want to enter credit card business ▸ independently or ▸ In tie-up arrangement with other card issuing banks. Approval is required for banks setting up separate subsidiaries for undertaking credit card business. In addition all the banks have to comply with the various guidelines issued by RBI regarding credit card operations.
RBI Approval for NBFCs	NBFCs can participate in credit card business with prior approval of RBI. Also NBFCs registered with RBI have been allowed to issue co-branded credit cards with Commercial Banks without risk sharing and with prior approval of RBI. In either case, the NBFC should satisfy the conditions of: ▸ A Certificate of Registration apart from specific permission to enter into this business ▸ Minimum net owned fund of ₹100 crore In addition to the above two criteria, NBFCs participating in co-branded credit card business have to satisfy the following minimum criteria: ▸ The company should have made net profit as per last the two years audited balance sheet. ▸ The percentage of net Non Performing Assets to Net Advances of the NBFC as per the last audited balance sheet should not be more than 3%. ▸ The non-deposit-taking NBFCs should have CRAR of 10% and deposit-taking NBFCs should have CRAR of 12% or 15%, as applicable to the company.
RBI approval for scheduled state	SCBs are allowed to undertake without risk participation, co-branded domestic credit card business with commercial banks which already have an arrangement of issue

co-operative banks	of credit cards. Such SCBs have to satisfy the following conditions for RBI approval: ▸ The SCB should have a minimum positive net-worth of ₹ 50 Crore as per the latest NABARD inspection report. ▸ The SCB should have earned net profit for last three years and should not have accumulated losses. ▸ Gross NPA of the SCB should not be more than 10%. ▸ The SCB should have compiled with RBI/NABARD instructions on loans to directors, their relatives/friends etc and not violated prudential norms. ▸ The SCB should submit an undertaking that their business will not be affected by the co-branded credit card operations. In addition to satisfying the above conditions, the SCB has to obtain prior permission from RBI, Rural Planning and Credit Department (RPCD), Central Office (CO) before commencing the co-branded credit card business. The application should be recommended by the concerned Regional Office of NABARD and routed through the concerned Regional Office of RBI. The permission granted to the SCB is valid for 2 years, subject to review.

Regulations governing operations

⇒ Fair practice code	Each bank must have a well documented policy and a Fair Practice code for credit card operations. The banks' Fair practice code should at minimum include guidelines contained in the RBI Master Circular.
⇒ Credit card applicant approval	▸ Banks/NBFCs should ensure prudence and independently assess the credit risk while issuing cards to customers and communicate to main reason for rejection, if any to applicant. ▸ Banks/NBFCs should assess credit limit of a customer with regards to credit limits enjoyed by the cardholder from other banks. ▸ Conditions such as KYC requirements, Most Important Terms and Conditions should be satisfied.
⇒ Interest rate and charges	Credit card dues are considered to be in the nature of non-priority sector personal loans and as such banks/NBFCs are free to determine the interest rate to be charged on credit card dues. However they should prescribe to a maximum ceiling rate of interest. In case a bank/NBFC charges variable interest rate for different customer types, the information about such rates should be sufficiently publicised. Banks/NBFCs should step up their efforts on educating cardholders regarding payment of dues and all possible repercussions. Changes in charges (other than interest) are to be made only with prospective effect and by giving a notice of one month. There should be transparency (without any hidden charges) in issuing credit cards free of charge during the first year.
⇒ Redressal of grievances	▸ A time limit of 60 days may be given to the customers for preferring their complaints. ▸ Bank/NBFC should constitute Grievance Redressal machinery. ▸ If complaint is not resolved within 30 days, complainant has the option of approaching the Office of the concerned Banking Ombudsman. ▸ The bank/NBFC will have to compensate the complainant for any loss of time, expenses, financial loss as well as for mental anguish suffered by him for the fault of the bank and where the grievance was not addressed in time.
⇒ Internal control and monitoring systems	▸ Internal control should include monthly review by Bank/NBFC's Standing Committee on Customer Service, quarterly analysis reports for top management and mechanism to check genuineness of merchant transactions.

⇒ **Fraud control**	▶ Banks may consider introducing, at the option of the customers, an insurance cover to take care of the liabilities arising out of lost cards. ▶ Banks may implement mechanism to implement advanced technology for advanced use and preventing online frauds. ▶ RBI has the right to impose any penalty on a bank/NBFC for violation of guidelines.
⇒ **Consumer rights**	Consumer rights in relation to credit card operations primarily relate to personal privacy, clarity regarding rights and obligations, preservation of customer records, maintaining confidentiality of customer records and fair practices in debt collection. RBI has formulated guidelines as follows: **Right to privacy** o Bank/NBFCs will be held responsible for any misuse of unsolicited cards. o Prior consent of cardholder is required before any enhancement of the card and credit limit. **Customer confidentiality** o Bank/NBFCs should not share information obtained from the customer at the time of opening the account or issuing the card with other parties without prior consent of the customer. o Disclosure to Direct Selling Agents/ recovery agents should also be limited to the extent necessary. **Debt collection** o Banks as well as their agents should adhere to Fair Practices for lenders and BCSBI's Code of Bank's commitment to customers. o Banks /NBFCs/their agents should not resort to intimidation or harassment of any kind against a customer in their debt collection efforts. o The bank should also comply with guidelines in respect of engagement of recovery agents issued by RBI.

Operational guidelines for NBFC in co-branded Cedit Card Business

NBFCs participating in co-branded credit card business also have to adhere to stipulations related to operational aspects which are specified as follows:

- The role of NBFC should be limited only to marketing and distribution.
- The card issuing bank will be solely responsible for fulfilment of KYC requirements.
- The risks involved in the credit card business should not get transferred to the business of NBFC.
- The credit card account is to be maintained by the card issuing bank and all payments made in the name of the bank; account if any maintained by the user with the NBFC should not be debited for the settlement of credit card dues.
- NBFC should maintain confidentiality of customer accounts.
- Customer complaints will be responsibility of the issuing bank.
- Legal risk shall be borne by the issuing bank.

In addition, NBFCs participating in the co-branded credit card business are subject to the following stipulations:

- NBFC should have in place guidelines on fair practices code.

- NBFC should adhere to the KYC guidelines and provisions of preventing Money Laundering Act.
- The NBFC should be complying with Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and/or Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998, any other instructions and provisions of RBI Act, 1934 to the extent applicable to the NBFC concerned.

Section B – Comparison of implementation frameworks from regulatory perspective

Having analysed the regulations pertaining to MSMEs and credit card operations, it is important to understand the possible implementation modes for the proposed product from the regulatory perspective. This section provides information on the possible implementation frameworks and a comparison of the applicable regulations.

From a regulatory perspective, the proposed model can be implemented as a scheme or as a credit card product. The two options can be described as

- In the first option, the disbursements are based on credit card features but no actual credit card is issued to the customer. This is similar to the implementation of Kisan Credit Card options by banks. As implementation is in form of a scheme, all relevant regulations pertaining to MSMEs will be applicable
- In the second option, a small business credit card is issued to the customer. The card is issued in the name of the MSME entity. As the product is a credit card, all the current regulations pertaining to credit card products will be applicable

In both the options, since the end user is a MSME entity, all the MSME regulations mentioned in Appendix 6 will also be applicable.

The domestic credit card schemes analysed in Chapter 2 cover the entire universe of such similar schemes present in the Indian market. An analysis of the rules and regulations related to such cards will give an idea of the regulations, which will also be applicable in case the proposed model is introduced as a scheme.

Approval	▶ In the model scheme (the proposed scheme), RBI can restrict the type of banks which are allowed to operate such a scheme ▶ No restrictions regarding minimum net owned funds are applicable
Fair practice code	▶ The fair practice code applicable to the target customer segment, if any is valid. A separate code need not be formulated
Interest rate, security, margin	▶ These are applicable as per RBI norms for the target customer type (e.g. crop loan interest rate applicable for KCC)
Monitoring	▶ The formulating bank may set up monitoring mechanism for performance of banks (e.g. for SCC, a monthly progress report is to be submitted to NABARD)

On the basis of these observations and information from Appendix 6 and Section A, a comparison of the applicable regulations in both options has been detailed below

Prameters	Implementation as a bank scheme	Implementation as a credit card product
Prior Approval	▶ Governed by the model scheme formulation	▶ Approval is required if bank sets up a separate subsidiary for credit card business ▶ Approval is required for NBFCs and SCBs issuing co-branded credit card
Financial performance restrictions for issuance	▶ None	▶ Minimum net owned fund restriction for commercial banks ▶ Restrictions for NBFC, SCB in terms of Net Profit, NPA and CRAR
Undertaking	▶ None	▶ None for Bank ▶ NBFC, SCB have to submit undertaking
Fair Practice Code	▶ Voluntary to adopt code for MSME	▶ Mandatory
Interest Rate,	▶ As per RBI guidelines for the	▶ At the discretion of individual banks

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Collateral, Margin	target segment	
Operational details like tenure, credit limit	▶ Governed by the model scheme guidelines	▶ At the discretion of individual banks
Monitoring	▶ Governed by the model scheme guidelines	▶ Internal control in form of reports to top management/formation of standing committee
Credit Guarantee Scheme	▶ Governed by model scheme guidelines ▶ Guarantee cover made available under CGTMSE – up to 85% for micro enterprises for credit up to ₹ 5 lakh	▶ At the discretion of the individual bank

The information in Bank Scheme column is provided on the basis of similar regulations observed in the schemes observed in the Domestic Credit Card section.

Additionally, if credit cards are introduced, each issuing bank has to separately follow guidelines prescribed by RBI related to Consumer rights.

Thus from a regulatory perspective, implementing the proposed product in the form of scheme is more convenient and less restraining. In order to implement as a credit card, a bank will have to satisfy all the above criteria. Moreover the implementation will depend upon the individual bank's business decision to enter into credit card business.

Regulatory restrictions for a MSME Credit Card in India

During feedback with leading banks on the limited reach of other domestic credit card schemes like LUCC etc. in comparison with KCC, it came out that the success of any MSME credit card scheme would depend on the aspects of flexibility in the transactions, which shall be allowed in line with KCC with self-declaration of end use by the client as long as the account is regular. In case the account becomes irregular or delinquent and, if regular warning measures are not successful in bringing the account on track, then bank can explore the option of restricting transaction flexibility allowed on the account. However, existing regulatory constraints and concerns (pertaining to design of loan policy for MSMEs, verification of borrowers guidelines under wilful default prudential regulations) pertaining to such schemes targeted at MSME segment do not allow the banks to offer such flexibilities due to concerns of misuse of fund as end use monitoring might become difficult in such instances.

Similarly, regulatory concerns do not permit banks to offer a proper credit card product like 'Small Business Card' due to the same reason of end-use monitoring as well as with the pretext that the bank cannot restrict the customer from withdrawing his entire limit in form of cash and using it for his personal consumption, the regulator did not permit such a product.

On analysis of enabling environment, support mechanisms (also identified in subsequent chapters); the following policy initiatives[6] will be critical in the successful implementation of the proposed credit card scheme. These are:

- End usage monitoring is the major concern in introducing a card based product for MSMEs. It is essential that the regulator/government relax concerns regarding risk involved in monitoring end usage of MSME credit. One option is increasing risk weight on such loans. The other option is to permit banks to introduce the scheme on a trial basis restricting the credit disbursement to a higher limit
- The CGTMSE scheme should be encouraged. The option of mandatory coverage of the card product under a credit guarantee scheme can be explored (as has been explored in the international case study of Hungary). This will provide encouragement to the banks to offer collateral free card credit to more MSME customers

[6] Policy initiative recommendations have also been included in the product features of the new product

- The option of allowing external entities to perform customer audit can be explored in greater detail. Either the funding agency/government ministry can provide support to participating banks in availing services of such external entities by providing subsidies. The central agency responsible for scheme implementation can assist through identification of such suitable audit agencies
- Active role played by the government to spread the message on this card and encouraging end users is another important aspect and essential enabler

There are other hindrances in implementation of this scheme as a credit card. These will be discussed in the next Chapter.

Chapter 4: Design of product framework

Highlights

⇒ **This Chapter provides an overview of the framework design for the proposed scheme as well as credit assessment methodology. The Chapter seeks to incorporate the insights gained from each of the preceding Chapters and develop a comprehensive and suitable framework. It provides information on the various options considered for scheme implementation and finally design of product frameworks as per individual customer segments.**

⇒ **The Chapter also seeks to aid the understanding of parameters to be considered for credit assessment and finally lays down the broad guidelines for assessment as per individual customer segments.**

The Chapter comprises two sections as follows:

- **Section A –** Design of product framework and features – Benefits expected, hindrances to credit card approach, customer segments and product frameworks for individual segments
- **Section B –** Broad credit assessment framework

Section A – Design of product framework

The objective of this assignment was to identify and design a suitable credit facility for the MSME segment on lines of a plastic credit card. Such a credit facility should best enable the facilitation of necessary credit to the MSME sector taking into consideration the challenges in the external environment.

A detailed study on the credit card market, both globally and nationally has been performed to understand the various aspects that needs to be taken into account while developing such a facility. The analysis also involved detailed discussion with major public sector banks and prominent private sector banks to understand the finer aspects, constraints and challenges in such a scheme. While that was essentially the view from the supply side, the demand side view has been derived through detailed group and individual discussion with multiple MSME players geographically distributed across the country.

The analysis involved evaluation of benefits of credit cards to MSME and their suitability in the Indian context. While performing this analysis, the following steps were performed.

A. Benefits of plastic credit cards for MSMEs

Credit cards are being increasingly utilized in day to day transactions in India. As per the RBI Trends and Progress Report (2010), the total credit card receivables for commercial banks stood at ₹ 21, 565 crore at end of FY2010. Credit cards offer the convenience of anytime and anywhere usage to the credit card holder. In addition, features like easy withdrawal of credit within the limit and availability of grace period make credit cards a popular form of unsecured credit.

As seen in the Section A of Chapter 2, plastic credit cards are issued to small business by commercial banks in developed nations. Such credit cards are akin to a revolving credit facility with higher credit limit sanctions as compared to a personal credit card. In addition, such cards have the option of issuance of cards to employees of the business with a pre-set credit limit total of which is equivalent to the business credit limit.

Thus plastic credit cards have the potential to benefit a MSME unit in several ways. Some of these have been listed below;

Conventional /Plastic Credit Card benefits	
Anytime anywhere usage	As long as the credit limit on the card is not exhausted and a merchant terminal is available, the credit card can be utilized by the MSME unit in any geography, for any type of purchase and at any time of the day. Thus a credit card makes available the convenience of usage to the MSME unit.
Revolving Credit Facility	Flexibility is offered to the credit card holder to make repayments as per his cash flow rather than at fixed intervals. The lending institution charges the credit card holder a particular interest on the outstanding credit. In addition, the credit limit is immediately enhanced by the repayments made and the card holder can again avail credit as long as the overall limit is not exhausted.
Collateral Free Credit	Credit cards are mostly offered without requiring the card holder to submit any collateral with the lending institution. Thus it makes available a form of unsecured credit and is suitable for those business units which do not sufficient/ required form of collateral.
Grace period	A credit card holder is made available grace period for repayment. Interest calculation begins on the credit which is outstanding at the end of the grace period.
Cash withdrawals	Most lending institutions allow a sub-limit of the overall credit card limit to be availed in cash thus allowing the card holder additional flexibility in using the card.
Tracking of	Most small business card holders are issued itemized statements which enable them to track

expenses	the card usage in the company and understand the areas of high expense for the company. Card holders are sometimes provided online accounts to track the credit card transactions in real time instead of depending upon the quarterly/annual statements.
Manage employee spending	Most small business cards permit the business unit to nominate certain employees who are then issued credit cards. Such credit cards have limits set a sub-set of the overall business unit credit limit and can be tracked for purchases made.
Rewards and benefits	Reward points are issued by the credit card issuing lending institution to encourage usage of cards at merchant terminals. This enables the card holder to save a certain percentage of transaction spend in the form of reward points which can be redeemed at a later date.
Fraud Protection	Lending institutions additionally offer protection against fraudulent usage of loss of card in the form of insurance coverage to the card holders.
Online Access	Online access can enable card holders to actively monitor card usage and also allow convenience of credit repayment through online transactions as well as permit usage of card for online purchase etc.

The above benefits highlight how a credit card can effectively serve the needs of a MSME unit. Apart from making credit available without typically requiring any collateral and in a hassle free manner, credit cards can permit the MSME units to use the credit at their convenience and keep a tab on purchase.

However, the above listed benefits are dependent upon the presence of certain factors in the external environment. These requirements are vital for the widespread usage of credit cards and have been identified in the subsequent section.

B. Enablers for successful adoption of plastic credit cards

In order for a credit card product to be widely made available by financial service providers and to be accepted by the customers, the following factors have to be present:

- **Infrastructure**
  - Electronic payment network which would support credit card transactions [Online, ATM, Point of Sale (POS) etc.] and be cost effective for financial service providers to issue cards.
  - Availability of POS terminals at as many merchant terminals as possible wherever the target customer segment is expected to transact.
  - Availability of other facilities including connectivity for POS and other channels, adequate investment in software and hardware capabilities by financial service providers to offer credit card services and adequate technical support to merchants.
- **Policy**
  - Regulatory approval and support for introduction of products in the market.
  - Involvement in improving financial literacy and awareness regarding usage of such cards.
  - Encouragement to financial service providers in offering such products and measures to address inefficiencies in the environment.
  - A forum for financial service providers to interact and identify solutions.
- **Practices**
  - Acceptability of credit cards by transacting parties (e.g. by suppliers of MSME units).

- o Large number of financial service providers willing to provide credit card services to the target segment in order to ensure reach of the product.
- o Effective monitoring of usage of card by financial service providers/ customers of cards.
- o Development of adequate supporting measures to encourage wide spread and informed usage of the product.

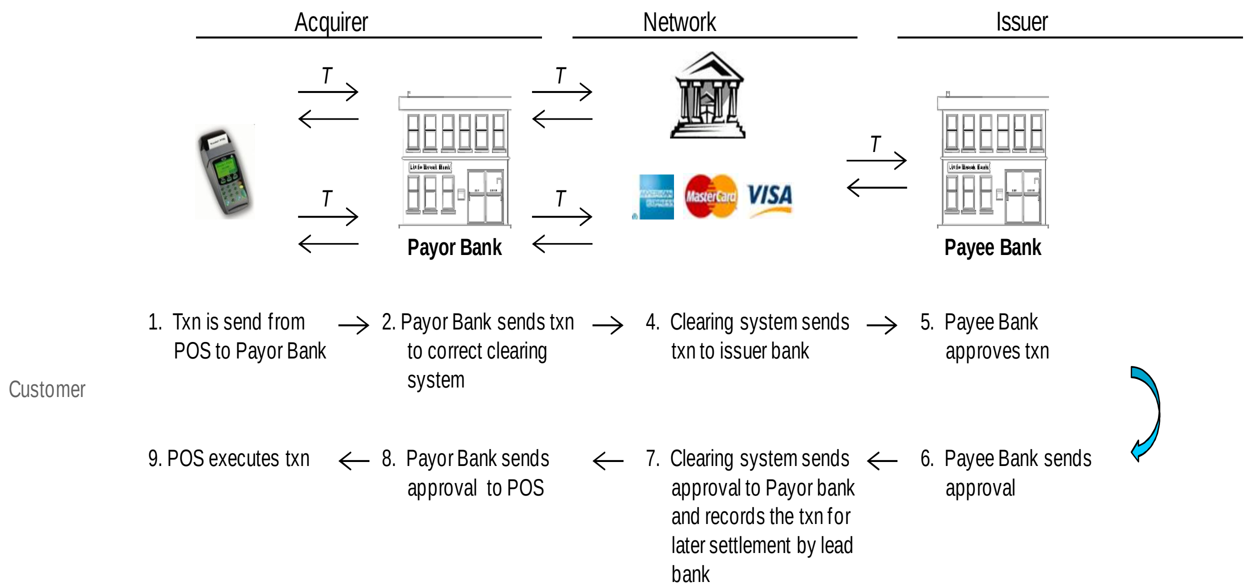
In the absence or limited presence of these enabling parameters, the benefits from a credit card are limited in nature. Analysis of presence of these enabling factors in the Indian environment is presented in the subsequent sections.

C. Constraints in the introduction of a plastic credit card in India

Analysis of the Indian environment led to the identification of significant challenges which act as constraints/impediments in the roll out of a plastic credit card for the MSME sector.

Some of these challenges can be listed below:

- ► *Linkage of card to an electronic payment network:* For the real value of a credit card to be realized, it needs to be linked to a third party electronic payment network. Only then would anytime and anywhere usage of card be possible. The overall electronic payment network including the participants and credit card transaction flow is depicted in the schematic below:



However once the card is linked to an electronic payment network, additional issues arise. Some of these include:

- o As the card holder would be able to execute the card at any merchant POS terminal, it can lead to possible issues like unrestricted usage of card, usage of card for personal expenses etc. If the card has been sanctioned to multiple employees, this would further increase the monitoring efforts for the business unit and would increase the likelihood that the card is used for any unauthorized purposes. Given the higher credit limit sanctions on such cards as compared to personal credit cards, the risk is proportionately higher in the situation that the card issuing bank/ card holding MSME unit is unable to check/monitor the unrestricted usage of card.
- o As depicted in the schematic above, there are multiple parties involved in the credit card transaction. The payer and payee banks involved in the electronic network are required to pay a certain percentage of the transaction amount to the organizations providing clearing service. As the transaction value on a MSME credit card is expected to be higher than a personal credit card, the issuance cost of such credit cards would be higher for the

participating banks. RBI in its report "Payment Systems in India: Vision 2009-12" had specified that it would look into the concept of a domestic payment card and a Point of Sale switch network for issuance and acceptance of cards. The objective was to facilitate an affordable payment mechanism to benefit the common man and help financial inclusion. For this purpose the "National Payment Corporation of India (NPCI)" was incorporated in 2008. The development of such infrastructure would enable the introduction of credit cards on a widespread manner and at reasonable cost.

- *Adequate availability of POS terminals:* In addition to the payment network, it is essential that Point of Sales (POS) terminals be made conveniently accessible to those merchant locations where MSMEs perform their transactions. This would enable MSMEs to utilize the plastic card. In absence of adequate number of POS terminals, the usage of card would not be flexible for the MSME units. Its usage would be reduced to withdrawal of money from the branch and/or ATM. While the number of POS terminals in India is expected to be around 5 lakh (as per Venture Infotek Payment Industry report 2009), the growth has primarily been concentrated in urban and retail centres. It is essential that the growth of terminals occur universally across geographies and across Tier 2 and 3 centres in order for MSMEs to be able to use their plastic credit cards at any time. It is essential to identify centres/locations where MSMEs transact and then make available adequate terminals. In order for any credit card to be made available to the MSMEs by financial institutions, it is required that the locations of concentration of such institutions and their suppliers/buyers be identified and suitable infrastructure be developed for deployment of terminals.
- *Acceptability of card*: Even if the card is linked to an electronic payment network and adequate number of POS terminals is made available, the challenge of acceptability of cards at merchant sites would remain. The acceptability of such a card at the merchant sites where usual MSME transactions take place is low and hence the desired objective/utility of the card would be restricted in nature. A merchant is required to share a percentage of transaction amounts with the payor bank as charges for availing POS services from the bank. With higher transactions amounts on MSME cards, the absolute amount of charge paid by merchant would be higher. Even otherwise, if a merchant is not offering POS service currently and would be required to do so for the credit card, he would have to shell out charges which he wasn't required to do so previously. A MSME supplier/related merchant shall adopt a point of sale machine only if he sees an incremental benefit in terms of sales that shall cover and exceed the charge (1.5% – 3%) and the lengthening of the cash credit cycle. Many of the transactions continue to happen in cash, without any charges and involving flexible payment arrangements. Unless adequate efforts are made to increase acceptability by way of incentives to the merchants, the reach of such a card would be limited in extent.
- *Effective monitoring of end usage of card*: A credit card offers the prime benefit of anytime and anywhere usage and is primarily unrestricted in nature. As discussed before, both the card issuing institution and the MSME would face the challenge of monitoring card usage at card terminals or usage of card for personal expenses. This would remain so till the time cost-effective technology solutions are developed which can permit the card issuing banks to restrict MSME credit card usage at particular type of merchant terminals. Currently, credit cards also permit cash withdrawal from ATMs. While the amount of cash withdrawal permitted can be restricted by the card issuing bank, it poses another challenge in monitoring the usage of cash availed. Also considering that the card is expected to facilitate credit to micro units spread across the country, increasing awareness and educated usage in these micro units is an additional challenge. In the absence of adequate information on how the card is to be utilized and protection measures to be followed, the probability of exposure to fraud and misuse is higher. Low awareness regarding credit card usage, repayment schedules, interest rates and charges can also impact the financial health of the MSME unit in case it is not able to efficiently manage repayment of credit card dues.
- *Reaching out to MSMEs:* In urban centres, largely the medium and large enterprises have access to credit from several financial service providers. These units and their owners being exposed to various financial services and products are better aware of the products in the market and their usage. Some of these unit owners also make use of personal credit cards for their business transactions. The intention of the proposed product/scheme is to reach those

MSME units which have limited access to such multiple forms of financial services. Considering the limited reach of financial services and limited information on the business activities of such units, these units are perceived to be relatively high risk by various financial service providers. In such a situation, these financial service providers should be adequately encouraged (by government agencies, related associations, central scheme implementing agency etc) and their concerns addressed. It would facilitate while ensuring that the reach of such a credit card product if and when introduced is not restricted to customer segments which are being served even now.

- *Legal processes for settlement of repayment dues*: As the legal process and turnaround time in India is considerable, usage of Debt Recovery Tribunals or other similar platforms can be encouraged. In genuine cases of difficulty, debt restructuring can be encouraged.
- *Connectivity and other infrastructure*: Along with the availability of terminals to transact credit card transactions, connectivity is essential to enable the transactions on the electronic network.

Considering these constraints in the Indian environment, it also emerged during discussions with the banks that regulatory concerns currently do not permit banks to offer a plastic credit card product. These concerns evolve around the factors highlighted above and primarily due to concerns of misuse of fund as end use monitoring may become difficult.

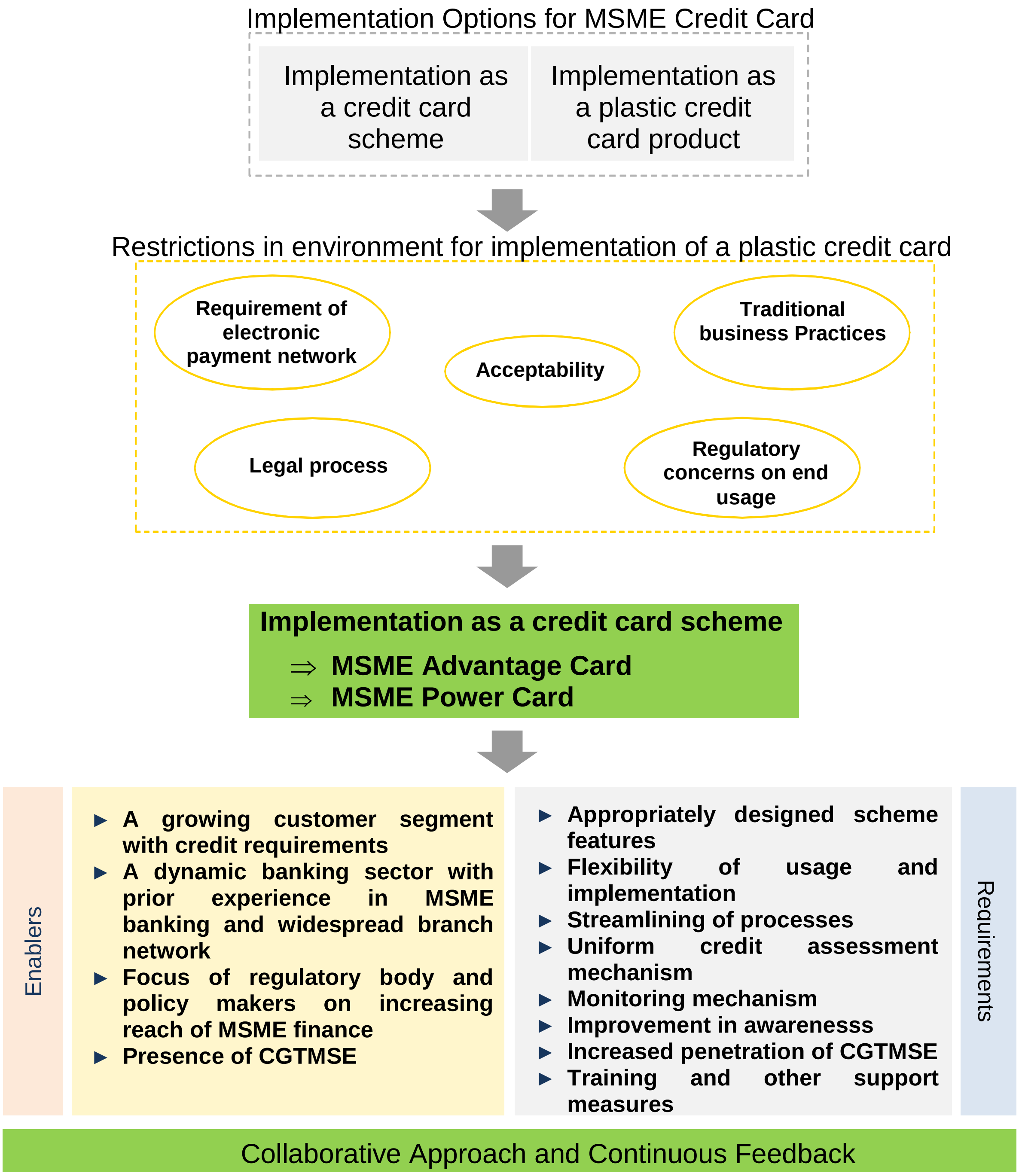
On analysis of enabling environment, support mechanisms (also identified in subsequent chapters), the following policy initiatives will be critical in the successful implementation of the proposed credit card scheme. These are:

- End usage monitoring is the major concern in introducing a card based product for MSMEs. It is essential that the regulator/government relax concerns regarding risk involved in monitoring end usage of MSME credit. One option is increasing risk weight on such loans. The other option is to permit banks to introduce the scheme on a trial basis restricting the credit disbursement to a higher limit.
    - Another option available is to explore and permit the introduction of a credit card on a trial basis. Such a credit card would offer limited usage of card services in the beginning. Over a period of time, depending upon the performance of the card holder MSME units, these credit card benefits can be extended. As an illustration, initially financial service providers could be permitted to introduce credit cards with only 20% of the total credit limit sanctioned to the MSME unit being available for anytime/anywhere usage through merchant terminals or otherwise. The remaining 80% limit would have to be availed as a term loan from the financial service provider. Of the 20% limit for credit card usage, 5% could be permitted to be withdrawn in cash. Thus the exposure of the financial service provider would be limited and the MSME unit would be given partial benefit of credit cards. Depending upon the repayment performance of the MSME unit and credit card transaction history, the financial service provider could be allowed to increase the credit card transaction limit on a gradual basis. For a well performing unit, this limit could be increased to 100% of the total credit limit, over a 5-6 year period by which the term loan would be paid off and the limit could be utilized solely for credit card transactions.
- The CGTMSE scheme should be encouraged. The option of mandatory coverage of the card product under a credit guarantee scheme can be explored (as has been explored in the international case study of Hungary). This will provide encouragement to the banks to offer collateral free card credit to more MSME customers.
- The option of allowing external entities to perform customer audit can be explored in greater detail. Either the funding agency/government ministry can provide support to participating banks in availing services of such external entities by providing subsidies. The central agency responsible for scheme implementation can assist through identification of such suitable audit agencies.
- Active role played by the government to spread the message on this card and encouraging end users is another important aspect and essential enabler.
- Measures towards introduction of infrastructure essential for credit card transactions.

Given these existing factors, an alternative credit scheme may be proposed to be developed and introduced. Such a scheme would function as bank credit scheme rather than a plastic credit card but still incorporate the key beneficial features of a plastic/traditional credit card. This proposed scheme has been designed and elaborated in the following sections.

However In the future, as and when a comprehensive regulatory framework is developed guiding the financial institutions on introduction and implementation of credit cards and necessary infrastructure facilities and enablers are developed and made available to the financial institutions as well as MSMEs, the introduction of a plastic/traditional credit card can be considered.

The process of design of the proposed scheme can be depicted in the schematic below:



D. Proposed MSME credit scheme

The alternative options (to the plastic /traditional credit card) can be designed in a way that shall remain competitively quick & helpful and assist the MSMEs in areas where they currently are not being helped through the existing credit products. These credit facilities shall be more in line of a typical revolving line of credit facility. However, before moving to the detailed view of the product structure, the facilities offered by a conventional business card vis-à-vis the one that is being proposed is presented.

Parameters of Conventional Credit Card	Proposed Credit Card Scheme
Tracking of expenses	Possible through monthly statements; for interim statements, the borrower shall have to pay additional cost subject to the discretion of the issuing agency. Currently lending agencies charge customers for duplicate statements. Banks have the freedom to devise charge schedule subject to approval from the bank board. The information regarding charges for statements has to be displayed by the bank on its website or in its premises. As per RBI guidelines, for priority sector loans, no service charges/inspection charges are to be levied on loans up to ₹ 25, 000).
Building business credit	Yes; a good repayment history shall be reflected in the personal credit rating and shall help to build business credit. Banks may partner with CIBIL/credit bureau for the same. As an illustration, recently CIBIL launched the country's first mortgage repository in consultation with the National Housing Bank (NHB). The repository is expected to assist lenders in making uniform and informed lending decisions. IBA has initiated discussions for formulating standard credit assessment guidelines for mortgage loans.
Manage employee spending	No; the facility cannot be extended to an employee specific level with individual limits.
Rewards and benefits	Possible through lowering of interest rates to a good borrower and other benefits like special rates at selected merchants. However the process would be lengthier and would depend on the discretion of the issuing agency. On the good side, in the Indian scenario it shall be looked at as a more tangible gain than traditional membership reward programs.
Year end accounting	Annual statements shall be provided.
Spend Analyzer	No; the facility shall not be usable directly at merchant sites and hence spend analyzers cannot be provided.
Fraud Protection	This is not applicable as the card shall not be linked to a third party electronic payment network. As online transactions and transactions at electronic terminals are not permitted under the current scheme, fraud protection against misuse of plastic card is not applicable in this case.
Grace Period	Yes; variable flexibility of payment may be provided to borrowers on the basis of their repayment history, amount outstanding and other considerations; will solely be at the discretion of the issuing agency though SIDBI/other banks shall provide a set of guidelines.
Customized reports	Certain reports may be provided at the cost of borrowers and information with the bank; however scope of reports shall be less than that for a conventional credit card.
Online Access	Yes; the scheme may be offered only by partners who have CBS implemented.

Thus, the proposed scheme makes available the MSME borrower considerably relevant key benefits of the plastic / traditional credit card. From a borrower's perspective the key considerations that have been looked at during the design of the product are:

- Easy approval process
- Minimum documentation
- Automatic renewal (with exceptions)
- Automatic credit enhancement (with exceptions)
- Low annual percentage rate
- Payment flexibility (monthly, EMI, anytime) with grace period facility
- Online access (fund check, mini statements)
- NEFT/ RTGS support (critical)
- Collateral requirement/Credit Guarantee
- Annual fee
- Processing fee
- Margin requirements

Consideration has been provided to satisfaction of requirements of both the MSME customers and lending institutions while designing the features of the scheme. The following matrix provides information on these requirements which the proposed scheme aims to satisfy.

Requirements of MSME Customers			
Requirements	**Can be satisfied**	**Comments**	**Scheme Features adopted from any case study**
Easy Approval Process	Yes	Suggestions for standard assessment, documentation procedures	International case studies; KCC in India
Flexibility of Payment	Yes	Multiple options	International case studies; Small business credit card features
Ease of usage	Yes	Provision of online usage, multiple repayment modes, automatic renewal	International case studies; Small business credit card features
Competitive rate	Yes	Low interest rates, Abolition of processing fees, collateral free credit	KCC; International case studies
Support in case of financial difficulty	Yes	Grace period, loan restructuring, longer tenure	Small business credit cards; International case studies
Anywhere usage	No	Currently operated as a scheme	International case studies
Rewards and benefits	No/Yes	Typical cash reward points not offered but benefits in form of personal consumption sub-limit and insurance provided	Small business credit cards; Personal consumption as offered in domestic schemes

Requirements of Lending institutions			
Requirements	**Can be satisfied**	**Comments**	**Scheme Features adopted from any case study**
Lower Attrition	Yes	Customer can avail scheme from a single bank	KCC; Inputs gained through bank discussions
Lower credit risk	Yes	Suggestion for monitoring mechanism, enhanced end usage monitoring through CA/SA, stock statements	International case studies for monitoring through CA/SA; Domestic case studies for stock statements
Flexibility of implementation	Yes	Selection of customer, enhancement of limit, withdrawal of benefits for	International case studies

		defaulters	
Ease of implementation	Yes	Suggestions for promotional activities, documentation, credit assessment, training, automatic renewal etc	▶ International case studies ▶ Inputs gained through bank discussions
Selection of entity type/sector	No	Scheme applicable to all sectors. Entities as defined by MSMED Act	▶ Domestic case studies
Fee and interest income	No	Interest rates within RBI guidelines and competitive, Processing fee waived off	▶ Domestic case studies

In addition to above, the following features and support measures (based on the learnings from various case studies) have been included in the proposed scheme:

- Monitoring mechanism
- Automatic enhancement of limit
- Training
- Collaborative approach

Principles of categorization

On the basis of gross output of sales, the MSME universe can be classified according to the following categories

Segment	Gross Output (Rs)	Number of MSME Units (million)	% of MSME Segment
A	Up to 2 Lakh	27.44	96.2%
B	2 lakh – 5 lakh	0.53	1.9%
C	5 lakh – 10 lakh	0.23	0.8%
D	10 lakh – 25 lakh	0.12	0.6%
E	Above 25 lakh	0.14	0.5%

Source: 4th and 3rd All India MSME Census

Further these segments have been grouped into 2 classes. This is based on the validated assumption of growth without further investment or reorganization of capital structure. In other words, to migrate from class one to class two significant capital investments and capacity build up is required. At that juncture, the need of the enterprise shall change and accordingly the credit facility features need to adopt.

- Class 1: Gross output up to ₹25 lakh
- Class 2: Gross output above ₹25 lakh

Products for each segment

Broadly the products shall be of two categories. For class 1 the product shall be a WC Loan with an upward limit of 25% of gross output. For class 2, the product shall be a temporary OD facility that shall not exceed 20% of sanctioned working capital loan. While the card makes provision for business related expenses of the MSME, a suitable consideration has been given to personal consumption needs of the micro and small enterprise owners and accordingly a suitable sub-limit has been designed for the same purpose.

The analysis revealed that borrowers who fall in class 2 are served better by the existing credit facilities offered by the various lending institutions. However, they are sometimes stuck at the paper work that is required in getting approval for a temporary OD to bridge the gap during their temporary cash-flow mismatch. The proposed product shall help to plug this gap and provide MSMEs access to credit at reasonable interest rates. For Class 1, the findings are different; they still remain credit starved particularly in segments A, B and C; for them it is essential to have a simple working capital facility that shall be flexible, easy to operate, having room/provision for personal consumption and sensitive to their needs so as to help them grow their business.

The above findings form the basis of our identification of specific product features for these two classes.

Segments A-D: Variable features

Product /service features	Segment A	Segment B	Segment C	Segment D
Eligibility criteria	**Gross Output* shall be less than ₹ 200,000**	**Gross Output* shall be more than ₹ 200,000 and less than ₹ 500,000**	**Gross Output* shall be more than ₹ 500,000 and less than ₹ 1,000,000**	**Gross Output* shall be more than ₹ 1,000,000 and less than ₹ 2,500,000**
	All other eligibility criteria shall be in line with the lending institutions' existing parameters			
Upper limit of credit facility**	**₹ 25,000**	**₹ 125,000**	**₹ 250,000**	**₹ 500,000**
	A sub limit ranging between 10% and 20% of sanctioned limit shall be given for personal consumption			

*Gross output has been taken as an indicator for total turnover as the working capital facility may be more governed by the production than the total sales

**The maximum credit limit for Széchenyi card in Hungary is 0.13 million USD while that for the BNDES Card in Brazil is 0.28 million USD. However these schemes do not utilize any specific categorization of MSME customers.

Segments A-D: Product/service features

Product/service features	Segments A – D
Name of the facility	MSME Advantage Card
Type/Nature of the facility	A medium term facility which shall operate like a line of credit; the facility shall enable the borrowers to raise funds for their operating and working capital needs as and when required. There shall be no limit to the number of times the client can transact and withdraw funds in a year provided all previous outstanding balances (related to any previous loans) are cleared in full.
Eligible borrowing entity	All Proprietorship, Partnership, Limited Liability Registered Companies or as decided by the administering lending institutions from time to time shall be eligible borrowing entity. Proprietorships include unregistered companies as well.
Activities/business to be funded	All activities falling within the definition of MSME as per MSMED Act 2006.
Purpose of usage	Any expenses related to the business of the entity except capital expenses requiring long term for repayment (i.e. expenses with repayment period of more than 3 years), can be funded using this facility. The repayment tenure shall be a maximum of 3 years. A minimum of 10% of the limit and a maximum of 20% shall be allowed for personal consumption. The exact limit shall be fixed by the lending institution at its discretion.
Assessment methods for limit	The assessment method shall be based on lending institution's credit assessment method for extending loans for short and medium term for MSMEs. A suitable credit assessment framework has been provided in Section B of this Chapter.
Processing fees	Nil
Interest	Interest rate shall be as decided by lending institution in compliance with laid down norms.
Pre-disbursement conditions/documentation	Pre-disbursement conditions/ Documentation shall be at discretion of lending Institution.
Penal charges	The cumulative penal charges shall be a maximum of 2% pa. There shall be no penal charges for pre-payment or pre-closure of loan/credit facility.
Primary collateral security	Based on the comfort level of the banks, facility may be offered without any collateral or primary collateral security as current assets (unless otherwise additional security was given on request such as plant & machinery/equipments etc.).
Valuation methods of collateral	Valuation methods shall be as practiced by individual lending institutions.
Margin/security cover	The margin/security cover shall be as considered appropriate by the lending institution/s.
Assessment of margin	Assessment of margin shall be at discretion of the lending institution/s.
Maximum tenure	Maximum tenure for the card shall be 3 years with annual review.
Repayment mechanism	► The mode of repayment shall be Equated Monthly Instalments or as normal cash credit facility. The borrower shall have the choice of opting for any of the two methods. ► However, the final decision shall be at the discretion of the lending institution considering various aspects like cyclic nature of cash flow and other business attributes. In case the borrower is given the facility of cash credit mode of repayment, accrued interest on the outstanding amount has to be cleared

	monthly to avoid default and subsequent penalty. ► The lending institution shall reserve the right to withdraw the cash credit mode of repayment at any time giving a minimum of one month notice to the borrower. ► In case the lending institution wishes to adopt the EMI method, the following approach can be adopted: • In case of EMI, the Pre payment of loans shall be encouraged by the lending institution based on stock statements. EMI amount shall change accordingly as and when prepayments are made. • The normal credit card repayment system can be adopted by lending institutions for their well performing MSME borrowers. The normal credit card repayment system allows the borrower to make minimum payment and carry over the remaining payment due to next billing period. The lending institution can offer this feature depending upon its risk appetite. • Different type of repayment mechanisms (for non scheme based / plastic card) has been presented in Annexure 5.
Periodical monitoring	Monitoring shall include quarterly review of the transactions/usages in the CA/SA and annual review of stock position/sales statements.
Stock statement frequency	Frequency for submission of stock statement shall be annual at the time of re-setting limit/limit enhancement.
On-sight stock/current asset audit frequency	Frequency of on-sight audit shall be annual at the time of re-setting limit/limit enhancement and only if considered to be required by the lending institution; however, the lending institution may consider on sight audit as and when they require during the course of the year.
Renewal frequency	Facility renewal shall be every 3 years with annual review of the account conduct and re-setting of limit/limit enhancement similar to cash credit renewal annually.
Replenishment of the paid-up facility	Replenishment shall be once in a year for the amount equivalent to the principle repayment made during the year at the time of annual review and subject to good conduct of the loan repayment account. The replenishment will be automatic.
Enhancement of credit limit	► Enhancement shall be automatic with good borrower at the end of every year ► The enhancement in credit limit will be independent of the borrower's movement from one segment to another. ► Shift to a higher segment would automatically make the borrowing entity eligible for higher credit limits.
Enhancement frequency	Enhancement frequency shall be annual based on the account conduct.
Enhancement limit/%-age	The enhancement limit shall be a maximum of 20% (the segment wise and borrower wise limit would be at the discretion of the lending institution).
Other conditions for facility enhancement	► The conditions for facility enhancement shall be Business Growth, Plan for expansion/increase, Repayment History and/or any other conditions if set by lending institutions. ► Example: Consider the Privileged Customer scheme of SIDBI wherein the annual credit limits to existing well performing customers of SIDBI is provided basis the following eligibility criteria: ▸ 2 years satisfactory payment track record with atleast one year principal repayment track record with SIDBI. ▸ The borrowing entity should have earned net profit in last 2 years of operation and should not be in default of any bank/FI. ▸ Having an internal credit rating (not older than 6 months) of CR3/RAA- and above. ▸ Should not have moved into stress category during the preceding one year from date of sanction.

	► Overall exposure with a borrower under PCS is within ₹ 150 lakh. ► Maximum repayment period of loan under PCS is 5 years, repayment period is fixed keeping in view the cash flows, DSCR ratio and size/nature of loan. ► PCS limits are offered only once a financial year.
Mode of disbursement	Mode of disbursement shall be through crediting the client's CA/SA.
Mode of transactions	The various allowed transactions shall be any branch cash withdrawal from the client's CA/SA, NEFT/ RTGS transfer to registered billers, Cheque Payment, Demand Draft etc.
In-built fungibility of product/facility	None
Disbursement & repayment process	Disbursement shall be made to current account/savings account of borrower; Repayment may be made from savings/current account of borrower, through cash deposits at branch or through any other lending institution branch (with CBS), Post dated Cheque Payment, ECS etc.
Definition of Events of default	The events of default shall be (but not limited to): 1. Annual review not done for on the due date as the client failed to furnish required documents/information and renewal has not taken place on or before the renewal due date 2. Payment of EMI after due date 3. Non Submission of stock statement 4. Any breach of the terms and conditions stipulated in Facility and hypothecation agreement or any other document and any representations or undertakings given by Borrower are found to be false or incorrect. The Events of default refer to possible events/situations due to the occurrence of one or more of which, the borrowing entity can be considered in default by the lending institution.
Consequences of borrower's events of default	On default regarding payment the lending institution shall be entitled to follow one or more of the following course of action: 1. On happening of borrower's event of default, lender shall be entitled to all the rights and remedies as generally available to a lender in such a transaction. 2. Lender shall also be entitled to seize and dispose stocks/goods/services (hypothecated to lending institution) either through public auction and adjust the proceeds against the amount outstanding from the borrower. The price at which the hypothecated goods/stocks/services are disposed by the lender is final and binding on the borrower. 3. However, in case the proceeds from such disposal are not sufficient to satisfy the amount outstanding in full, lender shall be fully entitled to recover the shortfall from borrower. On any other non payment related default, the lending institution shall be entitled to follow the course of action detailed below: - Lending Institution shall charge penal rate of interest with each month of default for three months maximum beyond which recovery mechanism shall be initiated. The recommended penal rate of interest shall be between 1-2% p.a.
Other conditions	► The lending institution shall be free to propose restructuring of loan or foreclosure of loan along with initiation of collection mechanism on an account defaulting for more than three months. ► However, such actions shall be taken by the lending institution based on client's arguments, relation with the lending institution, prevailing economic conditions and future prospects. ► The lending institution can consider restructuring of loan or foreclosure of loan

	along with initiation of collection mechanism on an account defaulting for more than three months only based on client's past repayment history arguments, relation with the lending institution, prevailing economic conditions and future prospects. ► A borrower can avail of this facility from a single bank only; the same facility may not be taken from multiple banks.
Documentations	Documentation process shall be simple and easy which is in compliance with RBI & lending institution's existing process & guidelines.
Insurance facility	Loan insurance facility may be made mandatory to all the borrowers. The scheme should cover risk of borrowers against accidental death or permanent disability. The insurance premium payable to the insurance company may be built in the product pricing.

Segments E: Product/service features

Product/service features	Segment E
Eligibility criteria	Gross Output shall be more than ₹ 2,500,000. All other eligibility criteria shall be in line with the lending institutions' existing parameters.
Name of the facility	MSME power card
Type/Nature of the facility	▶ The facility shall be in principle in line with a Temporary OD Facility. There is no limit to the number of times the facility can be availed. However, there shall be a fixed upper ceiling to the total amount that can be kept outstanding. ▶ Additionally, regardless of the repayments and outstanding balances, the total number of days in a year for which this facility can be utilized shall be fixed at 60 days.
Eligible borrowing entity	All Proprietorship, Partnership, Limited Liability Registered Companies or as decided by the administering lending institutions from time to time shall be eligible borrowing entity.
Activities/business to be funded	All industries/services/trades/activities falling within the definition of MSME as stipulated by the regulatory bodies or as categorized by the administering lending institutions shall be funded under this facility.
Purpose of Usage	Any expenses related to the business of the entity except capital expenses can be funded using this facility. The repayment tenure shall be linked to the working capital facility provided by the lending institution to the borrower.
Upper limit of credit facility	Max 20% of existing working credit facility with final amount at discretion of lending institution
Assessment methods for limit	The assessment method shall be based on lending institution's credit assessment method for extending loans for short and medium terms for MSMEs.
Processing fees	Nil
Interest	The interest rate shall be as decided by lending institution in compliance with laid down norms; cannot be higher than the working capital loan interest rate.
Pre-disbursement conditions/documentation	Pre-disbursement conditions/documentation shall be at discretion of lending Institution.
Penal charges	The cumulative penal charges shall be a maximum of 2% pa. There shall be no penal charges for pre-payment or pre-closure of loan/credit facility.
Primary collateral security	There shall be no additional collateral except the current asset procured with loaned amount.
Valuation methods of collateral	Valuation methods shall be as practiced by individual lending institutions.
Margin/security cover	The margin/security cover shall be as considered appropriate by the lending institution/s. No extra margin may be charged for this facility alone.
Assessment of margin	Assessment of margin shall be at discretion of the lending institution/s.
Maximum tenure	For each disbursement, the maximum repayment tenure shall be 60 days; additional TOD may not be taken till repayment of previous balance is completely done.

Repayment mechanism	The payment mode shall be the practiced working capital repayment mode in parts or in bullets with maximum allowed extension of 2 months.
Periodical monitoring	Stock positions/sales statements need to be submitted within 7 days of the TOD facility and after every month till the due date or full repayment of availed amount.
On-sight stock/current asset audit frequency	Frequency of on-sight audit shall be linked with working capital credit facility.
Renewal frequency	There shall be yearly renewal along with existing CC facility.
Replenishment of the paid-up facility	Replenishment shall be automatic after the complete repayment within the timeline. However, the duration of the facility shall not cross a total of 60 days in a calendar year - the enterprise can not avail of this more than a total of 60 days in a year.
Enhancement of credit limit	• Enhancement shall be linked to the working capital credit facility; if there is an enhancement in the working capital credit facility there can be an equivalent enhancement in the TOD facility with the maximum limit at 20% remaining constant. • In case that the sanctioned facility is less than 20% of the sanctioned working capital facility, then upon request of the borrower, the bank may consider and increase the limit without enhancing the working capital limit. However, the sanctioned limit cannot become greater than 20% of sanctioned working capital.
Enhancement frequency	The enhancement frequency shall be linked with working capital credit facility; in case the sanctioned limit is less than the maximum 20% limit, requests for enhancement shall be considered once every year.
Enhancement limit/%-age	The enhancement limit shall be linked with working capital credit facility and cannot exceed 20% of the sanctioned working capital loan.
Other conditions for facility enhancement	Borrower needs to cite specific reason in line with his business type for enhancement of facility limit.
Mode of disbursement	Mode of disbursement shall be through crediting the client's CA.
Mode of transactions	The various allowed transactions shall be any branch cash withdrawal from the client's CA, NEFT/ RTGS transfer to registered billers, Cheque Payment, Demand Draft etc.
In-built fungibility of product/facility	In exceptional circumstances, where the lending institution is convinced after due diligence that the client is really experiencing cash flow mismatch. However, the lending institutions have to ensure that they have got sufficient cover for the distressed enhancement either through' fresh collateral or hypothecated the current asset created through the additional facility after a stock audit.
Disbursement & repayment process	Disbursement shall be made to current account of borrower; Repayment may be made through deposit or fund transfer in current account from savings account or account of any other lending institution branch (with CBS) or through cash deposits at branch.

Events of defaults	The various events of default shall be: 1. Repayment not made within the due date as stipulated by the lending institutions from time to time within the overall yearly limit of 60 days . 2. Annual review not done for on the due date as the client failed to furnish required documents/information and renewal has not taken place on or before the renewal due date. 3. Non Submission of Stock Statement. 4. Any breach of the terms and conditions stipulated in Facility and hypothecation agreement or any other document and any representations or undertakings given by Borrower are found to be false or incorrect.
Consequences of Borrower's Events of Default	On default regarding payment the lending institution shall be entitled to follow one or more of the following course of action: 1. On happening of borrower's event of default, lender shall be entitled to all the rights and remedies as generally available to a lender in such a transaction. 2. Lender shall also be entitled to seize and dispose stocks/goods/services (hypothecated to lending institution) either through public auction and adjust the proceeds against the amount outstanding from the borrower. The price at which the hypothecated goods/stocks/services are disposed by the lender is final and binding on the borrower. 3. However, in case the proceeds from such disposal are not sufficient to satisfy the amount outstanding in full, lender shall be fully entitled to recover the shortfall from borrower. On any other non payment related default, the lending institution shall be entitled to follow the course of action detailed below: - Lending Institution shall charge penal rate of interest with each month of default for three months maximum beyond which recovery mechanism shall be initiated. The recommended penal rate of interest shall be between 1-2% p.a.
Other Conditions	• The lending institution shall be free to propose restructuring of loan or foreclosure of loan along with initiation of collection mechanism on an account defaulting for more than three months. • However, such actions can be deferred by the lending institution based on client's arguments, relation with the lending institution, prevailing economic conditions and future prospects. • The lending institution can consider restructuring of loan or foreclosure of loan along with initiation of collection mechanism on an account defaulting for more than three months only based on client's past repayment history arguments, relation with the lending institution, prevailing economic conditions and future prospects. • A borrower can avail of this facility from a single bank only; the same facility may not be taken from multiple banks.
Documentations	Documentation process shall be simple and easy which is in compliance with RBI & lending institution's existing process & guidelines.
Insurance Facility	Loan insurance facility may be made mandatory to all the borrowers. The scheme should cover risk of borrowers against accidental death or permanent disability. The insurance premium payable to the insurance company may be built in the product pricing.

The analysis of the various existing credit products targeted at the MSME segment revealed that the cause of limited outreach of these products was not only a factor of the product features themselves but also the associated aspects that need attention. These associated aspects manifest themselves as an important support mechanism for the product success. Hence it is imperative that adequate attention be paid to these support activities as critical success factors for the MSME credit card scheme is offered to the clients. These activities will entail support from the implementing agency, participating banks, regulators and the government. Only in that situation, the product can achieve its desired objective of fostering growth in the MSME segment.

On basis of analysis, the following support activities have been identified which will be critical for the proposed scheme:

- **Uniform Credit assessment Mechanism**

  It is essential that lending institutions acknowledge the sheer diversity within the MSME sector. There are multiple economic activities which are carried out within the broad sectors of manufacturing, services and trading. The characteristics of these businesses differ widely within the segment in the form of cash credit cycle, net income margin, procurement cycles, inventory turnover period, nature of working capital, cyclic nature of business and so on. The lending institutions need to confer on the characteristics of these various segments and also formulate and practice a uniform and transparent credit assessment model. The number of segments should not be in the extremes of too many or too less as in both cases they shall not reflect the true nature of the business.

- **Monitoring**

  Existing regulatory concerns pertaining to MSMEs do not permit banks to introduce more transactional flexibilities due to concerns of end usage monitoring. RBI has advised to banks to devise loan policy regarding lending to the MSME sector. Loan policies of banks specify their end use verification policy for MSME lending. In its notification on preventing wilful defaults, the regulator has advised banks to ensure end use verification through multiple methods. This has resulted in restricted success of MSME scheme. For this purpose, there is a need to initiate dialogue with the regulator so that in the future with sufficient safeguards, such schemes can be popularised.

  Apart from that, the lenders also need to determine an effective way of monitoring the borrowers and the flow of funds. The monitoring mechanism has to be devised such that effectiveness can be ensured without drastically increasing the costs for the lender. The dialogue for this exercise can be undertaken by a central agency like the Indian Banking Association (IBA). The partner institutions and SIDBI can meet to discuss the innovative approaches.

  An innovative way to implement this is to appoint an external agency for monitoring MSME borrower accounts and end usage. Currently, MSMEs approach such external agencies (like accounting firms, CAs for preparation of stock audit statements, financial statements. Banks can explore the option of partnership with such agencies after verifying their credentials and impartiality. This agency will have the mandate of regularly reporting the credit usage to the lender and raising an alarm in case of any irregularities. The benefit of hiring such an agency will be multi-fold if it is appointed by a central organization. Currently, Indian Banking Association (IBA) may be requested to explore this option. Such a centralized service agency can offer its services to all the banks across the nation and will prove to be cost-effective due to bulk operations. The lender can factor in the cost of this outsourcing activity in the loan cost to the borrower. Another additional benefit of having such a centralized agency would be the development of a centralized database on the indebtedness of the sector and the pattern of credit usage which can be then passed on to the central credit bureau. The same agency can be outsourced operations for recovering default loans. In case, no consensus is reached on the appointment of a central agency, banks can explore the option of individually outsourcing their activities to external agencies.

- **Increasing Awareness of the Product**

  This is another critical area which needs continued focus. The players within the MSME sector must be made aware of the launch of the product and these players should be educated about the various benefits of the product. An apt example would be of the promotional mechanisms used in KCC scheme. Banks have promoted this scheme through different channels making use of community platforms, and business facilitator model apart from traditional branch promotion techniques. For the proposed scheme as well, all forms of media communication may be used with an adequate media mix. The branches shall play a key role in increasing the awareness as majority of MSMEs are still making use of branch banking, especially in the small and micro sector where the owners/partners themselves visit the branches regularly.

Risk of default and CGTMSE intervention

Lending institutions have a high risk perception towards extending credit to MSME Sector. It may be assumed for the non-collateralized debts the chances of default may be more. However, being partners (to share the risk on proportionate basis) with Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) which provides a 75-80% guarantee cover on the defaults, banks can avail of guarantee cover. This facility can increase the comfort level of lending institutions in providing higher percentage of non collateralized loans as suggested.

> Besides, the RBI circular dated 24th August, 2009 makes it mandatory for the banks to give loans to the MSME sector up to ₹ 500,000 without any collateral. This limit was later updated to ₹ 10 Lakh in the Master Circular of 2010.

Functioning of CGTMSE

Though CGTMSE has performed creditably from inception, there are a few aspects that need to be considered. These are

- Long lock in period of 18 months before claim settlement makes the lending institutions carry the default loan on its book for more than a year.
- CGTMSE does not allow combination of loans. In other words, the loans with collateral or guarantee do not fall under the credit guarantee scheme. However, this sometimes does not allow the borrower to obtain the required fund even if the lending institution acknowledges the merit and low risk of his project/ business/activity. The borrower may have collateral which can give him loan of a certain amount (X). However, his need (Y) may be more than that (Y > X). Also, his need (Y) is greater than the ₹ 100 Lakh limit that CGTMSE has (Y> ₹ 100 Lakh). However the difference (Y-X) is less than the 100 lakh limit. It might be considered that for this amount only banks may use the CGTMSE scheme for lending to him. Even if, the limit of CGTMSE is increased, this norm shall only add more flexibility to MSME Finance activities.
- Along with the existing procedure of Member Lending Institutions performing their independent credit assessment to determine whether a proposal is investment grade or not, CGTMSE may consider issuing some guidelines on basis of which the assessment may be done to increase uniformity across the appraisal process.

Training

The personnel dealing with these cards need to be trained for sales, monitoring and recovery process. They need to understand the basic objectives, the various good credit practices, the necessity of monitoring and recovery and how to maintain and build relationships with the customers. The training cost may be borne jointly by SIDBI and the lending institution or the responsibilities may be divided. One such way would be the infrastructure being provided by the lending institution and the trainers would be provided by SIDBI.

Application forms, brochures and welcome kit

Considerable effort needs to be put into to develop user friendly application form (dual in English and Vernacular if necessary); brochures that speak about the product in a friendly and easy way and also an attractive welcome kit that shall make the customers feel important and valued.

Collaborative approach and continuous feedback

Ultimately, SIDBI and the lending institutions need to build a collaborative atmosphere in which the product shall be launched and sustained. Quick feedback is needed from the lending institutions that shall act as the point of issue for the facility. Quick intervention shall be required from SIDBI to revise the product/process as per the feedback of the institutions. Working together shall be most imperative to ensure the success of the product.

Proposed frameworks for product rollout (for FIs)

Implementation as a scheme - The first option is to implement the proposed model as a bank scheme which adopts the credit card features. In this option, disbursements are based on credit card features but no actual credit card is given to the customer. This is similar to the implementation of Kisan Credit Card scheme by banks. This option can be further separated into two parts depending upon the implementing body. These are:

- **Implementation through own platform –** SIDBI has retail branches and offices across the nation. The scheme can both be formulated and implemented by SIDBI.
- **Implementation through other banks platform –** In this case, SIDBI can formulate the scheme and it can then be implemented by other banks. This is on the lines of Kisan Credit Card implementation.

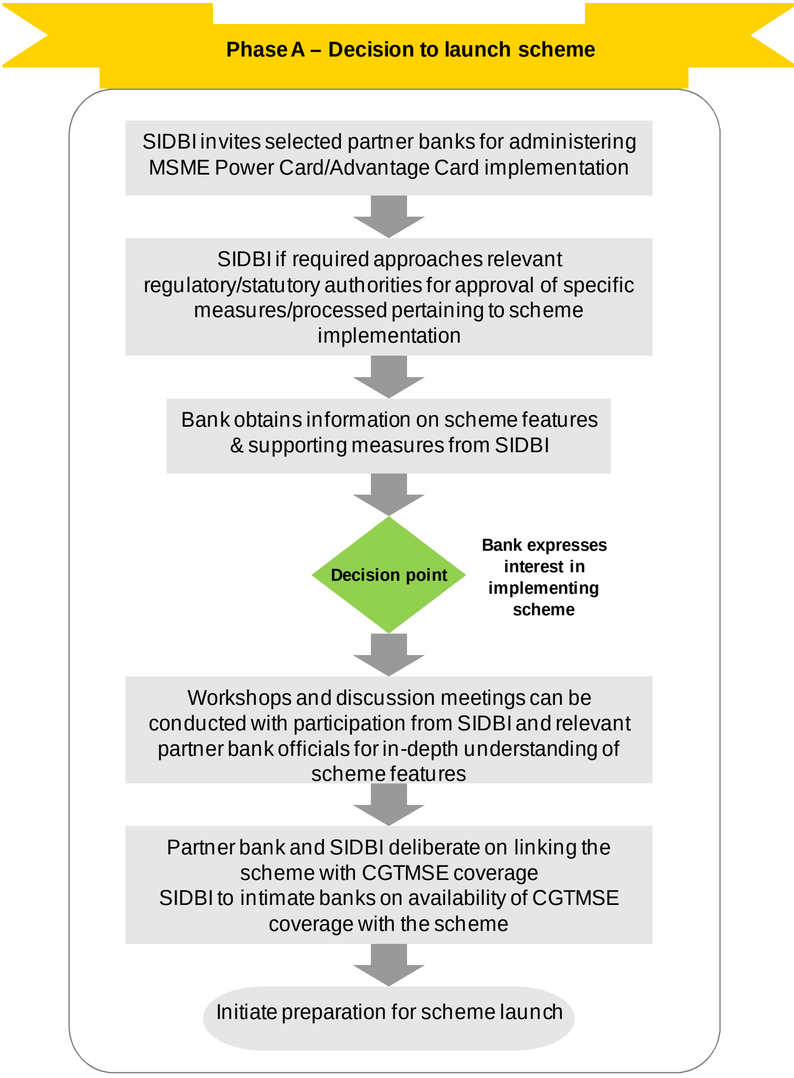
In case, the scheme is implemented through other banks/partner institutions, banks will implement the scheme in line with the features in the proposed framework. However it is essential that a feedback mechanism be developed to maintain a two way dialogue between SIDBI and the partner institutions to receive all the comments/suggestions from the partner banks.

The estimated timeline for implementation of the scheme is given as follows

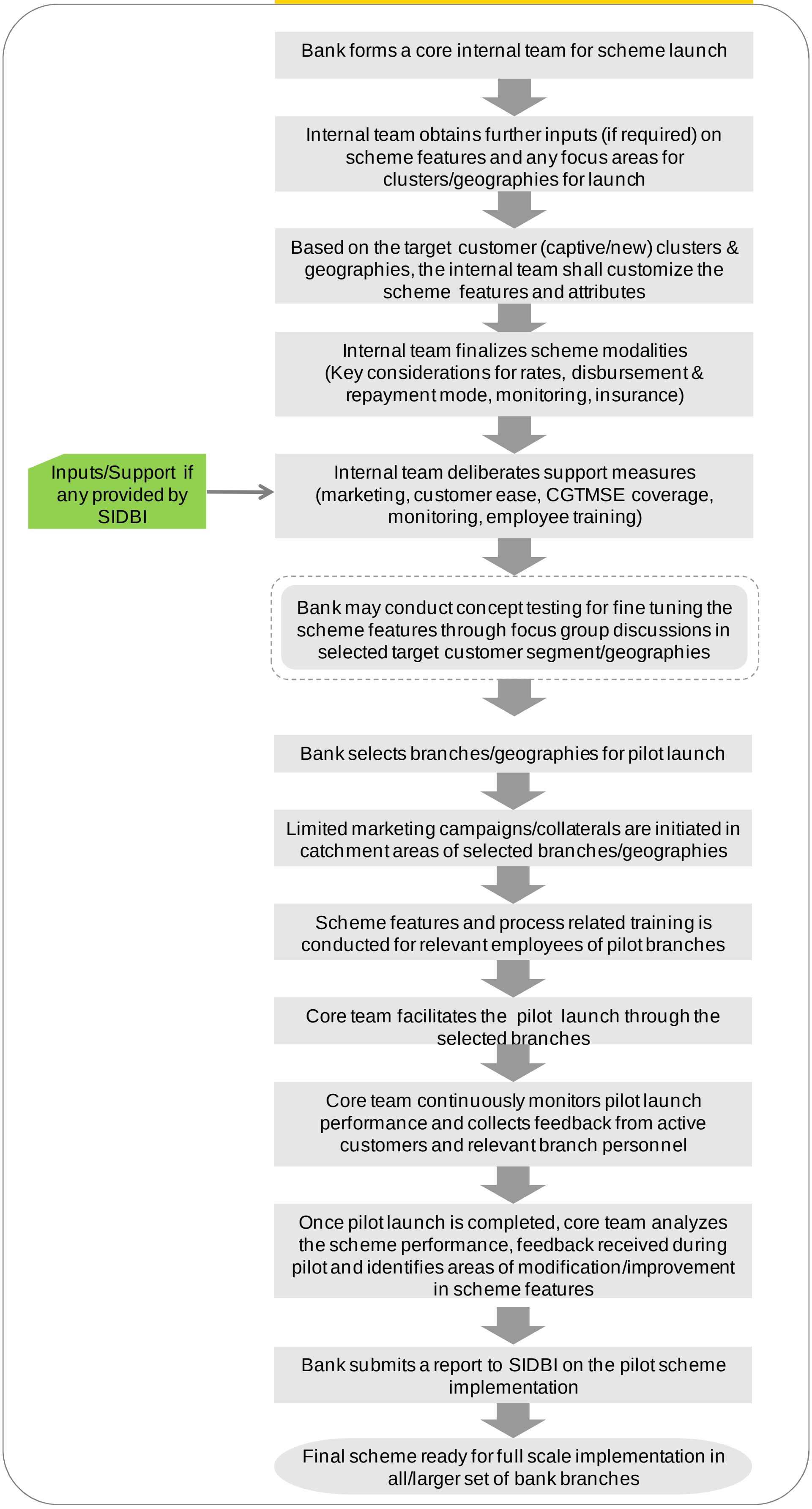
Activity	Estimated Time (in Weeks)
SIDBI to communicate with selected partner banks for purpose of implementation of the scheme. At this stage 5, 6 banks can be selected for initiating discussions on implementation.	02 - 03
Once the discussions are initiated, the next step will involve collating responses from banks, conducting meetings to finalize the scheme details depending upon response of banks. At end of this stage, agreements will be finalized with the partner banks finalized for pilot implementation.	05 – 07
Once the partner banks have been finalized for pilot, work will begin on the finalization of the scheme features for the individual banks. This will be done through meetings and workshops. Three important criteria will be discussed and customized as per the requirements of the banks i.e. product /scheme features, process details and product/scheme pricing.	05 – 07
Once the scheme features are finalized, the pilot launch preparations will begin. Banks will do a pilot launch simultaneously across multiple banks.	08 – 10
Once the pilot is launched, feedback has to be collected on a regular basis. At the end of the pilot phase, this feedback will be analyzed to identify the issues faced during pilot as well as the success factors expected.	02 – 03
Depending on the feedback, the scheme features can be modified as per the requirements of the individual banks. At this stage, the participation of the individual banks, branch representatives and SIDBI officials will be critical.	02 – 03
Once the updated scheme is finalized, preparations have to be made for the commercial launch of the scheme in all the relevant branches (as per the current MSME policy of the bank) of the partner banks.	10 – 12
It is critical that once the scheme has been commercially launched, an analysis be made on a regular basis as well the performance of the scheme measured. This	10 – 12

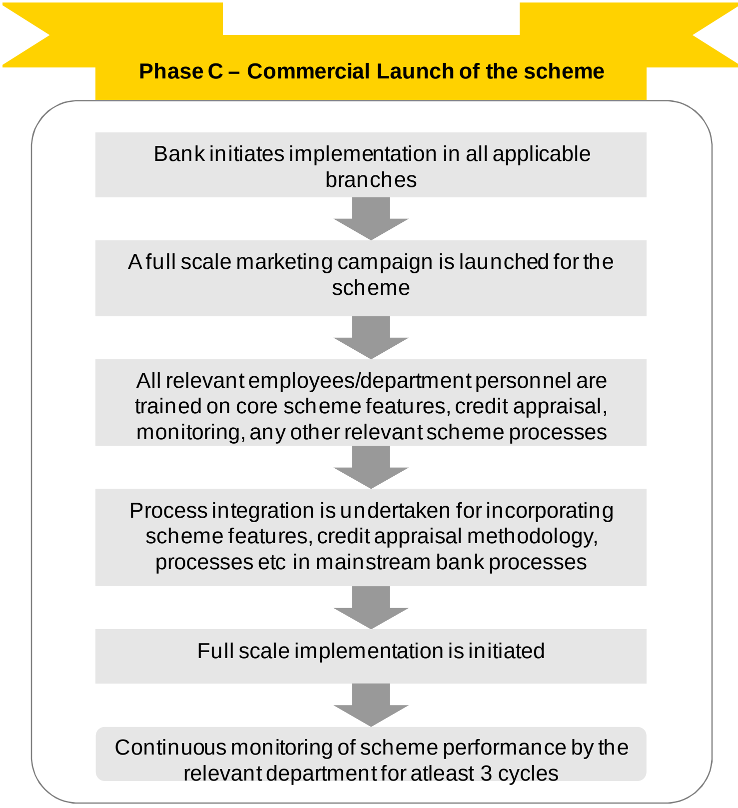
activity has to be co-ordinated across the partner banks.	
Depending on the feedback from the commercial launch in the first set of partner banks, further reforms can be made in the scheme features if required.	02 – 04
SIDBI can now initiate talks with other partner banks and financial institutions for launch of the scheme.	

While the above table captures the estimated timelines for the implementation of the scheme, the flowchart below captures the broad steps to be undertaken by the implementing banks. The flowchart is segregated into 3 phases.



Phase B – Pilot launch of the scheme





Revenue and Cost Projections for the Scheme

The financial projections have been made for the scheme for a five year horizon. Assumptions have been made based on the analysis of the banking industry in India as well as the inputs gained during discussions with banking officials and study of international products.

⇒ Assumptions for MSME Segment

Segment Wise Details	A	B	C	D	E
Number of units (In Million)	27.44	0.53	0.23	0.16	0.14
Upper Credit Limit (₹)	25,000	125,000	250,000	500,000	400,000
Tenure (Years)	3	3	3	3	3
Utilisation of credit limit	100%	100%	90%	90%	75%

Number of MSME units is as per the analysis made in this report and based on the Third and Fourth Census. The credit limits are derived from the product features.

Growth Rates	Year 1	Year 2	Year 3	Year 4	Year 5
Growth Rate of MSME units	0%	4%	4%	4%	4%
Growth Rate for Segment A Cards	10%	15%	20%	25%	30%
Growth Rate for Other Segment Cards	20%	20%	20%	20%	20%
Renewal Rates	0%	0%	0%	75%	75%

The MSME growth rate is based on the current growth rate for the sector. The growth rate of scheme sales is based on growth rate seen in international models and inputs from banks. As per the scheme features, the card holders will come up for renewal after 3 years of tenure.

⇒ Other Assumptions

Income Heads	
Processing Fees	0
Penal Charges	1%
Interest Rate	11%
Cost of funds	6%
NII Rate	5.10%

Assumptions for processing fees and penal charges are based on the scheme features. For purpose of cost of funds and interest rate, the details of the 5 leading banks are considered.

Expense Ratio to Total Advances	
Printing & Stationery	0.06%
Advertising Expenses	0.05%
Communication Expenses	0.10%
Miscellaneous Expenditures	0.55%

The above expense assumptions are based on the cost ratios for the banking sector in India. Provisioning and NPA ratios are as per RBI regulations.

The various revenue and expense projections for the scheme are as follows:

In ₹ Million	Year 1	Year 2	Year 3	Year 4	Year 5
Incremental Net Interest Income	**112**	**303**	**426**	**605**	**868**
Segment A	44	116	159	226	332
Segment B	22	59	83	116	165
Segment C	17	46	65	91	129
Segment D	24	65	90	127	180
Segment E	5	16	30	45	62
Penal Interest Income	**2**	**5**	**7**	**10**	**14**
Processing Fee Income	**0**	**0**	**0**	**0**	**0**
Total Incremental Expenses	**17**	**47**	**67**	**95**	**136**
Advertising Expenses	1	3	4	6	9
Communication Expenses	2	6	9	12	18
Misc Expenditure	13	34	48	68	98
Printing & Stationery	1	4	5	7	11
Incremental Provisioning	**74**	**200**	**130**	**145**	**119**

The final snapshot of the scheme performance is as given below:

In ₹ Million	Year 1	Year 2	Year 3	Year 4	Year 5
Total Card Customers at year end	130,960	282,624	464,621	657,850	910,032
Penetration (Segment A)	0%	1%	1%	2%	2%
Penetration (Others)	2%	4%	7%	9%	12%
Average Gross Advance	2,297	6,225	8,756	12,441	17,848

Average Gross NPA	109	288	401	569	821
Incremental Revenue	113	308	433	615	883
Incremental Expense	17	47	67	95	136
Incremental Provisioning	74	200	130	145	119
Net Margin	22	61	237	376	628
Net Margin (% of Advances)	0.9%	1.0%	2.7%	3.0%	3.5%

The above product has been designed taking into consideration the current (presumed) regulatory / policy constraints as well as absence of other key enablers. However, assuming that in future the required / enabling environment shall get created to offer a real & convenient business credit card product/s to the MSME segment, a detailed business credit card product has been designed for future reference. With conducive regulatory / policy level initiatives and with induction of other key support measures, the suggested product can be offered to the MSME segment in future. The detailed product features have been presented in Appendix 5.

Section B – Broad Credit Assessment Framework

Of all the different types of risks that a lending institution is subject to, credit risk can be defined as the risk of failure on the part of the borrower to meet his obligations towards the bank in accordance with the terms and conditions that have been agreed upon. Inability and/or unwillingness of the borrower to repay his debts may be the cause of such default.

The main goals of credit assessment are to answer the following questions:

- Whether to lend to a particular borrower or not
- What price to charge
- What are the products to be offered to the borrower and for what tenor
- At what level should sanctioning be done
- What should be the frequency of renewal and monitoring

The usual practice followed by the various banks for lending to MSME sector in the working capital segment is to base credit assessment on the Nair Committee recommendations which is simple, easy and effective to implement. This is also the guideline of RBI on this matter.

For the proposed credit card scheme, the banks are at a good position to follow the same norms. The motive for a normal business card (followed globally and also in India as corporate cards) is different. These cards work on the lines of a normal credit card with a certain interest free period ranging between 30 to 60 days. As long as payments are in time for each period no excess interest is charged.

In most cases the flexibility and high limits linked to these credit cards lead to a high percentage of users to revolve their outstanding amount; the issuing agencies earn interest on the same. This is typically a high rate of interest that ranges from 30% to 42% (annualized).

In this proposed credit card scheme, there shall be no zero interest period. Banks may need to focus on ensuring regular and timely payments to ensure that the business entities do not misuse the credit facility or fall in perpetual debt trap.

This is the same objective which guides the assessment & appraisal of any working capital credit application and hence, there is a natural fit in the credit assessment mechanisms. Some key attributes and characteristics that the mechanism should address are given below. This is essentially for illustrative purpose and may be referred to by the banks for guideline purpose only.

Personal information		
Name	DOB	Telephone number
Address	Nature of business	Business premise address
Loan account history		
Total accounts	Open accounts	Closed Accounts
Delinquent account	Derogatory account	Balances
Payments	Inquiries (2 years)	
Public information (Disclosures), if any		
Inquiries details (2 years)		
Individual account performance		
Account type (Revolving/instalment/others)	Account number	Condition
Outstanding balance	Limit	Opened Date
Past Due	Payment History	30 days late
60 days late	90 days late	
Collection accounts (accounts sent for recovery)		
Account type	Account number	Outstanding balance & limit

(Revolving/instalment/others)		
Business assessment		
Gross output (last three years)	Gross earnings (last three years)	Projected output (5 Years)
Projected earnings (5 Years)	Net operating margin (historical and projected)	Capex plan
ROA	Net sales growth rate (%)	Debt equity ratio
Current ratio	Inventory turnover	Working capital cycle
Operating cash flow	Client profile/client risk	Technical and managerial expertise

However, many of these data are available for business enterprises with organized operations and book keeping. The sub segments of MSME with a turnover of less than ₹ 25 lakh may be difficult to be assessed on the basis of ratios and parameters. Additionally, the credit rating infrastructure of India is yet to reach the high global standards. Even if such ratios are obtained from the business entities, it is difficult to trust them without adequate audit and checking.

Thus in addition to these ratios and parameters, the lending institutions have to adopt a more customized approach to assess the credit risk for these borrowers. This should be formulated keeping in mind the following constraints:

- Availability of information: This has already been touched upon. It is extremely difficult to obtain trustworthy information from these business entities.
- Credit scoring limitations imposed by insufficient credit and market information, insufficient sampling time frames and static, data-driven factor selection and weightages.
- Nature of Business: The natures of business vary immensely within the MSME segment. A wholesale cloth merchant may have a working capital that differs by months from that of a small export import player or one who runs a restaurant or a beauty parlor. The cyclic natures of these businesses have no fixed pattern. These can broadly be defined as trading, manufacturing, service and export import. For each one of these the assessment needs to look at various aspects. Again these may be classified as coming under any of the five broad parameters:
  - Financial performance
  - Business performance
  - Industry outlook
  - Quality of management
  - Conduct of account

The assessment shall differ according to the nature of business (manufacturing, service, export).

The broad parameters for each of the segments and business activity types have been listed above. The overall parameters will be common across the business activities but their weightages and importance will vary across each of the activity. Industry outlook for instance will have different significance and sub parameters across segments as well as business activities. Also for each broad parameter, sub parameters and measurable targets will again vary over the activity type. Thus these parameters will be further explored in detail and a comprehensive framework can be adopted.

As the turnover of an enterprise increases, it has access to more resources to produce appropriate financial and performance documents. As a consequence, banks can rely more on such submitted documents. Audit statements shall be available with increase in turnover and output. Previous banking relationships shall make more data available on the particular enterprise. However, for the macro segments the banks have to develop in house models that shall depend more on individual disclosures and validation through local referrals.

For example,

- **Financial performance:** Total transactions from savings account (if any). In case no savings account then disclosure of net asset created.
- **Business performance:** Rough Estimates from the individual along with validation from referrers.
- **Quality of management:** In most cases, weightage given on this may be low for Segments A, B and C and may depend more on subjective assessment of the credit/risk/loan officer.
- **Conduct of account:** Possible only if the individual may have an existing bank history.
- **Industry outlook:** For each identified business segment, the lending institution may need to identify a customised score influenced by the location of industry (e.g. a unit situated in a urban area vis-à-vis a village), past trends of that industry and future expectations.

Banks can follow their own rating grids with different weights attached to specific parameters. They can also follow a variable interest rate model for determining the interest based on the additional risk premium. Thus, the final offered rate shall be the sum of a base rate and the additional risk premium that the lending institution may attach to a particular borrower. This is a global practice and balances the increased risk a bank may take for a borrower with no credit history or poor credit history.

Similarly, the lending institutions need not follow a onetime disbursement mechanism for the sanctioned amount. A controlled disbursement mechanism, especially for new borrowers with poor or no credit history may be suitable to evaluate the creditworthiness of these entities.

The primary objective is to build a comprehensive credit rating/assessment framework for lending to small business with poor or no credit history and where existing credit rating models may not bring out the true picture. The approach should be able to leverage on alternative data and narrow the information gap in loan underwriting and credit evaluation practices.

For this particular sector, relying simply on technology or models may not suffice. The need is to develop a hybrid approach that combines the best that technology can offer with expert human judgment. Some of the limitations of existing credit assessment systems are illustrated below along with possible solutions:

Limitations	Solutions
Reliance only on historical data; no feedback mechanism to adjust factor weights as experience accumulates.	Inclusion of primary predictive factors that cover the full spectrum of relevant qualification criteria and both determines and reveals how they combine to produce outcomes.
Fixed number of factors that have a constant set of point weightings that are automatically applied to every credit applicant regardless of their eligibility.	Customized risk factors pertaining to the lending decision within the context of each borrower's situation and the loan product parameters; subsequent adjustment of the factor weights to produce the right assessment.
Backward looking approach with no simulation model	Forward looking approach with simulation mechanisms integrated in the assessment framework.
Little scope for well defined integration of judgmental components.	Systematic integration of judgmental components and proper context into the modelling process in a complete and transparent manner.

It is extremely important to maintain the proper balance during risk assessment so as to avoid both situations of under crediting and over crediting and thereby creating a sustainable financing atmosphere that shall foster growth for the entire segment in coming years.

The judgmental mode of credit assessment shall be based on the five C's:

- **Character:** considered the borrower's character by evaluating indicators of stability – his/her performance in meeting current and past credit obligations, the liquidation value of any collateral, and the borrower's equity share in cases where the loan collateral was the property being financed—e.g. real estate, automobile, machinery, etc.

- **Capacity:** Capacity of repayment of the borrower from steady income/projected income sources
- **Capital:** In the event of interruption in income, ability to pay from savings/liquid assets
- **Collateral:** Underlying security
- **Conditions:** Related to the general economic climate and the terms of the loan agreement, such as loan amount, interest and fees, and repayment schedule.

The basic problem with a purely judgmental model is that there is a bias and subjective character that would creep in with each individual assessor.

The credit scoring models are more objective and reduce the impact of personal bias. However, the key question here is that whether the factors that the model considers are enough to deliver a proper judgment on the creditworthiness of a small business enterprise.

The need is to take the best of both worlds and use systematic judgment instead of individual judgment.

It is therefore essential to understand here is the fact that all credit assessment frameworks shall primarily depend on the availability of previous financial transaction history and/or valuation of the available collateral. However this may always not be possible for MSME entities with low credit information and weak collateral. Hence greater emphasis and integration of a set of systematic judgment parameters need to be included that shall put adequate weights on proxy factors and may be used for proper credit assessment. Some of these illustrative factors are detailed below:

- Quality of referrals: Definitive parameters to evaluate the quality of referral. A good reference coming from a trusted individual for the lending institution shall help in obtaining a better credit rating. Crucial here is to evaluate the individual who is providing the reference that forms the basis. The individual needs to be evaluated in terms of several factors like:
  - Knowledge of particular business
  - Business relation with borrower
  - Years of association/knowledge
  - Personal assets/income
  - Own conduct in financial transactions with lending institution
- Drags: This is an evaluation of the total obligatory responsibilities that the borrower may have. The higher or more these are, the less is his opportunity to reinvest and grow his business. Additionally, the higher shall be the probability of using the fund for personal consumption. This can be assessed in terms of factors like:
  - Family Income
  - No of children
  - Financial condition of parents (assets, regular income etc.)
  - Dependent siblings
  - Working status/income of spouse
  - Income/education status of children
- **Ability to collect:** In small business, in many cases rather than the inability to sell it is the inability to collect that leads to closure and subsequent credit default. The lending institution needs to formulate ways to assess the status of his receivables in terms of the turnover period. This shall also depend on the nature of business as with a normal service industry the turnover period shall be low. However for a manufacturing house, this shall form a critical component and should have higher weights.
- **Competitive advantage:** A statement from the borrower that can further be scrutinized by the lending institution that shall create clarity on the business potential of the area where they are operating. Borrowers need to be encouraged to spell out any distinct advantage they may be enjoying in terms of factors like cheaper sourcing, family involvement (cheap human resource)
- Any other significant information that can be collected about the client and his business activities.

All these factors need to have variable weights or a lump sum weight may be assigned which can then be subjectively assessed based on specific guidelines determined by the lending institution. Following the 20% - 25% rule is effective as long as the projections can be evaluated properly. However, with severe demand side challenges in providing correct information the lending institutions need to be more innovative and sensitive so as to avoid the case of under crediting or over crediting the borrower, specifically moving down towards the bottom of the pyramid.

Chapter 5: Partner short listing and information support

Highlights

⇒ **This Chapter provides an overview of the partner search criteria which can be employed to identify suitable partner financial institutions in the implementation of this scheme. The Chapter also provides information on the various information support measures expected from the regulators and the government as well as the supporting measures to be undertaken by SIDBI for the partner institutions.**

The Chapter consists of two sections

- **Section A –** Partner short listing criteria – List and priority of criteria for short listing partners.
- **Section B –** Partner information support – Support measures expected from regulator/government, support information to be provided to partner banks.

SIDBI
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SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

Section A – Partner short-listing criteria

A framework for the proposed scheme was designed in the previous Chapter. The implementation of the scheme will be equally affected by the type of bank implementing the scheme. Though it is envisioned that the scheme should be implemented pan India, at the initial stage select partner banks have to be identified to provide maximum impact. The partner short-listing criterion is affected by multiple parameters. This section aims at identifying a comprehensive list of criteria for partner short-listing.

On basis of analysis of the target segment, product framework and our past experience, the following criteria have been identified for partner short-listing.

Criterion	Importance	Parameters
Size of MSME operations of bank	▶ Presence in MSME segment ▶ Consistency of performance in MSME segment	▶ Current MSME portfolio as a percentage of total lending ▶ Growth rate in MSME portfolio ▶ Lending to units with gross output less than ₹ 25 Lakh (Category 1 to 4)
Geographical presence in MSME markets	▶ If the partner banks have a strong distribution network in areas where MSMEs are also present in large numbers, it will provide easy access to the customer segment	▶ Branch network in states where MSMEs are pre-dominantly present ▶ Number of Specialized MSME branches ▶ Branch presence in areas with concentration of 1-4 enterprises
Financial performance	▶ A stable financial performance will indicate assurance of bank support for new products and schemes	▶ Asset size ▶ Profit after Tax
Focus on MSME segment	▶ This parameter will assess how innovative the bank has been in the MSME segment and whether it is open to new ideas and schemes	▶ Overall MSME strategy ▶ Implementation of government schemes ▶ Prior expertise in micro-enterprise segment ▶ Products/schemes directed at units with gross output less than ₹ 25 Lakh (Category 1 to 4)
IT infrastructure	▶ Since the scheme proposes to provide transfer through RTGS and NEFT, IT infrastructure will be a value addition	▶ Core Banking Solution Implementation ▶ RTGS, NEFT facility etc. ▶ Internet banking, ATM etc.
External validation	▶ This parameter will be an indicator of the reputation of the bank and customers trust	▶ Awards won in the MSME segment ▶ Awards won for overall performance

Section B – Partner Information Support

This section comprises the following:

- **Support measures expected from regulator/government –** CGTMSE scheme, standardization, training and monitoring
- **Support measures to be provided to partner banks –** Standard application forms, targets, awareness campaigns and staff training

The purpose of this section is to understand the support activities which will aid in the smooth implementation of the scheme. This includes the, support expected by the client from regulators/government to ensure higher reach for the scheme. It also includes information support to be provided to partner banks which will address their queries, support their capacities and enable them to scale efficiently.

A. Support Measures Expected from regulator/Government

Suggestions for CGTMSE scheme

The proposed scheme recommends banks to sanction collateral free loans and avail of guarantee cover in cases where the credit limit crosses the ₹ 5 lakh limit. Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) which was established by Government in association with SIDBI makes such cover available. The CGTMSE scheme has grown at a CAGR of 17.76 % over 2004-08. It has covered 1.82 lakh MSE loan accounts with ₹ 626.15 Crore loan disbursements as of March 2009. The trust has increased the coverage for loans disbursed to micro enterprises at 80% to incentivize banks to disburse more loans.

The usage of CGTMSE has yet not been universally made by the banks. Through discussions with leading banks and MSME representatives, the following improvements expected by the lenders and borrowers have been identified.

- **Faster settlement of CGTMSE claims**

  When the loan disbursed under CGTMSE coverage to micro and small enterprises (MSE) is declared as non-performing, the bank can claim cover from the scheme provided it convinces CGTMSE that all efforts have been made to recover the loan. The claim settlement takes place in two phases.

  One of the major issues affecting banks and hindering them from disbursing credit to micro and small enterprises (MSE) is the time taken for settlement of claims under CGTMSE. On an average, it takes a period of 18 months for bank to recover its claim from CGTMSE for such accounts. During this period banks have to carry the NPAs on their balance sheets, reflecting poorly on their overall asset quality. The tying up of bank funds for a long period further accentuates their problem and increases their reluctance to lend to the MSE segment.

  Expediting the claim settlement process by CGTMSE will reduce the risks banks face currently and in turn will encourage banks to increase their lending to the MSME segment. Government and SIDBI can take up this issue with CGTMSE and help in improvement of the existing process.

- **Availability of CGTMSE coverage for additional loans**

  The CGTMSE cover does not allow the combination of collateral already submitted for an existing loan. However in times of urgency, the borrower may demand for an extension over and above the already sanctioned credit limit. In such a situation, the bank demands for a suitable collateral before extending the limit. Given the condition, the MSE unit is in; it may not always be possible for it to render the collateral.

In such cases, it is expected that the CGTMSE cover be made available so that the bank can extend the credit limit. Government and SIDBI can take up this issue with CGTMSE and help in improvement of the existing process.

- **Government subsidy for CGTMSE fees**

  For availing of guarantee cover under CGTMSE, the micro units have to pay a premium in form of 1% as initial fees and 0.5% as annual fees. The micro enterprises often do not have adequate collateral security available. In addition their financial strength is easily susceptible to the changes in economy. The requirement of CGTMSE fees affects their margin viability.

  It has been suggested by the Working Group on Rehabilitation of Sick MSMEs that government could explore the option for bearing the credit guarantee fee for micro enterprises. International experience in MSME credit cards has indicated governments having subsidized such fees not only to encourage banks to increase lending to micro sectors with the assurance of a guarantee cover but also to ease margin pressures on the MSE units. The Government could explore the option of reducing the subsidy with time by linking it to the performance of the micro enterprise.

- **Encourage standardization of information and assessment**

  RBI regulations state that all applications for MSME units up to a credit limit of ₹ 25, 000 should be disposed off within 2 weeks and those up to ₹ 5 lakh within 4 weeks, provided the loan applications are complete in all respects and accompanied by a check list. However various research studies have suggested that delay in processing time is a major deterrent in approaching formal sources of finance. In our discussions with MSME players, this issue was often cited by the respondents. The analysis has revealed that the following measures can be adopted to improve the situation.

Publishing standard information on scale of finance

In our analysis of KCC, one of the factors responsible for rapid growth of KCC was the availability of published information on the scale of finance. This reduced the information asymmetry for the lending institutions and enabled them to determine the credit requirements of the target segment in an efficient manner. As a result, banks could increase the scale of the scheme even with limited manpower. In contrast the other domestic schemes such as LUCC, SCC, ACC which have catered to the non-agricultural segment, lacked similar published information which made it necessary for the bank staff to understand each borrower’s business and accordingly determine the credit limit.

Lack of standardized information brings variations in sanctioned credit limit from bank to bank but also makes the process time consuming. It entails upon the bank staff to have the ability to understand the intricacies of the borrower’s business which eventually results in delays of weeks or even months before a credit request is sanctioned, adversely impacting the perception of a small borrower about formal sources of credit. It inadvertently encourages him to approach informal sources of finance. From the borrower perspective, micro enterprises do not have the sufficient knowledge on preparing financial statements and project plans as per bank requirements. They are forced to seek expensive professional help in this matter. The availability of standard data may enable banks to give such units concessions.

It is recommended that RBI setup a similar arrangement as followed for KCC to publish scale of finance reports industry wise. The Lead bank can be assigned the responsibility of publishing the data as per the common industry in the area or a committee can be formed comprising of district offices and major banks in the area.

Standardized assessment for working capital and term loans

Nayak Committee had recommended a simplified procedure for sanction of working capital for manufacturing units. It had recommended assessment of working capital at 25% of turnover of which 5% may be contributed by the promoters and 20% may be provided by the banks. However as per the feedback from MSME players, banks do not universally follow these recommendations and insist on past cash flow statements, balance sheets etc for determination of credit limit. For expediting credit to micro and small players, it is essential that banks assess the working capital limit as per the recommendations. RBI should ensure that the recommendations are followed by banks especially for the small limits suggested as a part of the proposed scheme.

Currently no such simplified procedure is available for sanction of term loan limits. The Working Group on Rehabilitation of Sick SMEs in its report has suggested a methodology for this purpose.

Key steps have been given below:

- Identification of niche industry or activities having good concentration in the area by banks and Industries Directorate.
- Assessment of model cost of project for different sizes of commonly prevailing industry and overall viability by a Committee.
- Periodic revision of the exercise to factor in changes in machinery price, fixed assets, skilled labour etc.
- Use of these project profiles by small entrepreneurs as well as banks in preparing their study report and determination of instalments on basis of cash flow.

Explore additional avenues for disbursement of credit

A large proportion of small and micro enterprises are located in rural and semi-urban areas. It is necessary to develop the delivery points in these areas in terms of both quality and quantity. Public sector banks have a strong presence in rural (18,972 branches) and semi-urban areas (13,553 branches). Regional Rural Banks (RRB) have a strong presence with 14,832 branches in rural and semi-urban areas.

RRBs may lag in spread but have comparable performance in number of accounts per branch. Also given their nature of business and localized presence, they have a higher degree of familiarity with their customer segment. These RRBs and cooperative banks have played a significant role in the disbursement of agricultural credit. RBI can encourage them to expand credit to MSMEs in their service area. This will benefit the enterprises located in rural and semi-urban areas and ensure a wider reach for the scheme. In terms of quality it is essential that the branch staff for RRBs and cooperative be aware of the intricacies of MSME finance. RBI can initiate training programs to bridge any gap in the knowledge of these employees. Another channel to bring unbanked enterprises under formal finance is encouraging the use of banking correspondents in such areas.

Establishment of training modules for micro and small enterprises

Lack of adequate knowledge about various financial products as well as methodologies of credit management is one of the weaknesses of the MSME sector. Given their small size, it might not be possible for these enterprises to employ skilled manpower to take care of their financial needs. The first time entrepreneurs are more susceptible to this weakness as they may have sound technical knowledge but lack financial management skills.

It is essential that these enterprises be trained in basic accounting principles and credit management. Along with this, knowledge of bank procedures, formalities, products available from financial institutions should also be imparted. This will help them manage their cash flows better and in turn help them avoid situations which lead to asset liability mismatches and hence sudden requirements of credit. These trainings may be organized by the Government through the different directorates. In addition, support of non-governmental organizations already working in this field should be entailed. Collaboration with MSME organizations will be critical as it will provide a wider platform for the training programs. The scheme will be benefited as these can also be utilized to create awareness of the scheme.

Enhanced monitoring of scheme

Another aspect critical to the success of any scheme is the continuous monitoring of performance. This makes information available on the bank wise and region wise performance. Any adverse trends can be identified immediately and issues can be addressed on time.

It is essential that banks regularly report the number of lenders and credit disbursed under the scheme. This will help the regulator as well as SIDBI to track the performance of banks and set suitable targets. RBI can publish these figures annually. These will convey to the banks the seriousness of focus on the scheme as well encourage them to perform better. Currently, RBI has directed banks to make discussion on MSME lending issues a part of the monthly State Level Bankers' Committees. As a part of this, the scheme performance can also be included in the discussions thus providing a platform for banks to put forth their views and problems. This will serve the two-fold purpose of periodical analysis of trends and assurance to banks of having a platform to express their views.

B. Information support to be provided by SIDBI to participating banks

Design of simple and standard application forms

MSME borrowers are often unfamiliar with the banking and legal terms. Their knowledge of the banking procedures is limited and a complicated process may deter them. The first step of this process is the application form. If this application form is complicated and lengthy, the MSME player is discouraged. The enterprise may approach external agency to aid in the application process thus increasing their cost of obtaining funds. Another possibility is that the MSME player may submit an incomplete application increasing possibility of rejection or delay in processing.

The proposed scheme widens the target segment by reaching more players many of whom may not have approached the banking system before. It is essential that a simple and comprehensive application form be designed which will enable the target to submit complete applications in short time and by themselves. SIDBI can take the lead in designing such an application form to ensure uniformity for all participating institutions. This will conserve bank efforts on operational details. The application form should invariably have a checklist for the documents to be submitted before and after the loan is approved. A study of existing simplified forms across sectors can be made before designing the form. The implementing agency can also explore the option of introducing these forms in regional languages.

Design of a comprehensive handbook

As the procedures need to be simplified for the customer, it is essential that the bank implementing the scheme have clarity on the benefits and operational details of the scheme. This will aid faster expansion of the scheme. For this purpose, a comprehensive handbook needs to be designed. This kind of handbook will aim at providing in-depth information on the scheme to the partner institutions beyond the information provided in mandatory notifications and circulars. The handbook should at the minimum include the following sections:

a) **Scheme details –** The segment wise scheme details have to be provided. This will ensure absolute clarity to the participating institution on the features of the scheme and help them understand the difference of the scheme over the existing ones.

b) **Benefits to customers –** This will be an important component of the material provided. It will enable the branch staff to market the scheme to the target segment and increase the reach of the scheme. It will also help them in being better prepared to resolve any customer queries.

c) **Benefits to banks –** The inclusion of this section is to convey to the participating institutions that the proposed scheme not only benefits the borrower but also takes into consideration the progress of the lender. It will be useful in increasing the acceptance of the scheme amongst the participating institutions.

d) **Operational guidelines –** These will include the in-depth operational details and help smoothen the scheme implementation. The branch staff will have a resource to refer to in case of any difficulties at the time of implementation.

For design of the handbook, open discussions can be conducted with the participating institutions wherein their feedback can be obtained on the sections to be included. SIDBI can then take up the activity of designing the handbook and circulating it amongst the participating institutions before the implementation.

Design of training modules to sensitize bank staff

The proposed scheme aims at reaching the smallest of the MSME segment and satisfying their credit requirements. The final execution of the scheme will be carried out by the branch staff and the satisfactory performance of the scheme will hinge on the employees. It is essential that these employees who work at the ground level be sensitized to the requirements of the target segment and develop an open mindset towards lending to this segment beyond a regulatory requirement.

The banks need to develop systems to regularly update the field staff and equip them to appraise financial requirements of the MSMEs and look at them as a profitable customer segment. Since these activities will depend on the individual bank's availability of training infrastructure and material, SIDBI can aid the banks in this respect. SIDBI can assist banks by developing such training modules and conducting training programmes at their regional offices or at partner training institutes. This will ensure uniform training content, access to training infrastructure for all bank staff, development of capacity across banks and help banks which might not be in a position to train the staff.

Establishment of bank wise targets

As mentioned in the above section, it is essential that bank performance in terms of implementation of scheme be regularly monitored. An important pre-cursor to this is the setting of appropriate targets for each participating institution.

As the central agency for this scheme, SIDBI can take on the responsibility of setting targets to be achieved by the banks. Importantly, such targets have to be set for both a short term time horizon as well for the long term. These targets can be revised through regular interactions with the banks. This will help the banks to implement their individual approaches to meet the targets and retain consistent focus on the scheme. An important consideration is maintaining a two way dialogue between SIDBI and the participating bank to ensure the practicality of targets as well as sufficient efforts from the bank side.

Support in increasing customer awareness

It has been observed that MSME players are often unaware of the various schemes that the banks and various agencies have introduced for them. It is one of the factors responsible for the limited success of these schemes.

It is essential that customer awareness be created through different media such as print media, radio, television etc to popularize the scheme. The participating banks may have constraints and can create limited awareness amongst existing customers only or amongst new customers in their service area. In such a situation, SIDBI can step in and conduct awareness campaigns in the regions where it has presence. SIDBI being the nodal agency for MSMEs can engage with the government departments to encourage their support for such activities. On the lines of camps conducted to popularize products, government departments can conduct large scale camps to popularize the scheme. Another avenue is collaboration with the MSME organizations. Awareness campaigns can be conducted in partnership with these organizations to ensure a faster reach in the target segment.

Assistance in developing mechanism to support customers

Banks are comfortable lending to customers when they have suitable collateral available for the risk taken or are assured of the end usage of the product. In case, both these factors are unreliable banks are reluctant to take up the risk.

It is essential that bank comfort level be increased to lend to the target segment. As the funding is largely collateral free and for unrestricted usage, the banks will be comfortable, if they receive regular updates on the usage of credit by the user. The scheme has the flexibility asking the customers to submit their stock statements at regular intervals. However, it has been observed that small players do not always have the expertise and discipline required for generating these statements. They cannot afford the services of professional firms as in the case of large players. In such situations, banks can explore outsourcing this activity to professionals like Chartered Accountants. SIDBI can explore tie-ups with such professionals to serve all banks in a particular area in return for a nominal fee.

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Appendix 1: Discussions with MSMEs /BMOs

An important data source for this project was the feedback and opinion of the target segment, i.e. the MSMEs and other stakeholders obtained through open-ended interviews and discussions with MSME representatives and association members across the nation. The prime purpose of these interactions was to understand the entire range of MSME credit issues and utilize the learning's in designing a comprehensive framework.

The MSME members were selected to ensure a representation of varied mix of sectors and locations. The aim was to avoid any bias in the feedback collection as MSME requirements vary across sectors as well as geography. Feedback and inputs of the individual MSMEs from the following states were undertaken:

- Delhi - 10
- Gujarat - 2
- Maharashtra - 10
- Madhya Pradesh - 5
- Rajasthan - 3
- Tamil Nadu - 2
- West Bengal - 5

Besides above, the following MSME Associations were contacted

- Federation of Indian Micro and Small & Medium Enterprises (FISME)
- India Small Scale Paint Association
- MP Small Scale Industries Association
- Mizoram Entrepreneurship Network
- Thane Small Scale Industries Association
- Tamil Nadu Small and Tiny Industries Association - (Survey circulated to all members of TANSTIA and consolidated responses recorded).

The selection of respondent association was based on the strength of association membership as well as the representative MSME size. The feedback of these associations was considered vital as it was representative of their member segment. The inputs of MSMEs were collected by means of personal, telephonic and written interviews.

The main areas covered through these interactions were as follows:

Areas	Significance
Nature of company activity	To Understand the: ▶ Nature of business and seasonality ▶ Working capital requirements ▶ Current usage of formal credit
Current Credit Usage	To Understand the: ▶ Type of financial services availed in the past ▶ Issues faced by these companies in availing services from banks ▶ Usage of personal credit cards
Expectations from the proposed product	▶ Willingness to use the card scheme ▶ Purpose for which the product would be utilized ▶ Expected features of the card scheme

The feedback received from these MSME stakeholders can be summarised as follows:

Parameter	Key Inputs Received
Source of finance	▶ Majority of the MSME respondents had accessed formal financial services in the past. However, smaller the enterprise, higher was the share of informal source in funds raised for the company. ▶ For companies which had not accessed formal financial services, the constraint was the difficulty for new customers to get access to funds. ▶ The rationale for accessing informal sources were stated as easy and timely availability of funds, relaxed terms of collateral and flexibility of repayment terms.
Current banking relationship	▶ MSMEs which enjoyed current banking relationships availed of services from a limited number of banks (one for most small enterprises). ▶ Majority of the existing relationships were with banks in the public sector. ▶ Having established credibility with the current bank, the respondents were reluctant to shift to a new bank and undergo the same procedure again. Also since **application procedures varied across banks, the MSMEs were reluctant to employ additional manpower on completing bank formalities**.
Issues with banking service	▶ Long processing time and stringent collateral requirements were the most cited issues. Long processing time made timely availability of credit difficult specially for working capital affecting future operations. ▶ **Most respondents also demanded for simplified and standardised documentation requirements for different types of services.** ▶ **Another issue raised was the lack of credible information supply from the financial service provider of the new financial products in the market.**
Use of personal credit cards	▶ A sizeable proportion of the MSME players had utilized their personal credit cards for business purposes in the past. ▶ The usage was made for sundry expenses and mostly unscheduled expenses wherein banks would take time to release funds. ▶ The usage was made only when no other alternative was available as the respondents complained about high interest and penalty rates charged on the cards. ▶ For respondents, who did not have such cards, the reason was rejection of application by credit card companies or fear of card misuse.
Expectations from the proposed product	▶ **The respondents felt the need for a product which would help them meet their unexpected credit needs related to working capital and sundry expenses.** ▶ They demanded flexibility of fund withdrawal as per their convenience and need from the bank and interest calculations based on outstanding limits. ▶ In case of repayments, monthly or quarterly instalments were welcome to instil a disciplined schedule. ▶ **The respondents looked forward to their current banks to provide them with this facility.** ▶ **They did not thrust on the product to be plastic enabled as majority of their transactions happened through account transfers /cheques /cash.** ▶ The respondents felt the bank could renew their credit limits without asking for re-application of facility. ▶ Common incentives expected were an interest free period, lower interest rates, simplified documentation, collateral free loans and acceptance of personal guarantee as security.

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Appendix 2 - Discussions with Banks

An important source of input for this assignment was the feedback and opinion of the leading banks in MSME financing through open-ended interviews and discussions with key personnel from these banks. The prime purpose of the discussions was to understand the lender perspective in dealing with this unique customer segment.

The banks were selected according to their presence in MSME lending market. The selection was also influenced by the reputation of these banks for being innovators in MSME lending. Again, a mix of public, private and foreign sector banks was ensured. This provided a wide variety of perspective and feedback on the experience of dealing with the MSME segment.

The discussions with banks were conducted in two stages:

- Stage 1 – The aim of stage 1 discussions was to understand perspective of banks on MSME lending, nature of the customer segment, issues faced by them, innovations brought by them in their existing products and their experiences in implementing domestic credit schemes. These discussions also provided inputs on the bank expectations from proposed type of product.
- Stage 2 – The stage 2 discussions were conducted as the proposed product framework was being drafted. The purpose of these discussions was to validate the key learnings and assumptions used in the design of the product. The aim was to ensure the practicality of the framework as well as assess the utility of the proposed product.

These discussions provided vital inputs which have been utilised for analysis at several points in the project. The key inputs gained from these discussions can be listed as below:

- Understanding of the issues faced by banks in implementation of domestic schemes such as LUCC, SCC and ACC
- Perceptions of banks about the customer segment
- Requirement of credit product customized according to the wide variety of segments
- Modalities of different schemes implemented by banks
- Regulatory constraints
- Importance of support activities for successful implementation of schemes
- Understandings gained from the past experiments of banks in MSME credit product features
- Challenges in credit assessment of MSMEs with limited/no credit information
- Modalities related to credit guarantee scheme
- Challenges in monitoring end usage

During the second phase of discussions, the willingness of the banks was also gauged. It was found that for all the banks, the willingness to implement new schemes was present and there was readiness to implement a scheme similar to the proposed one as well. However, the banks had requested for the implementing /nodal agency to focus on improving the support measures in the environment as well as provide flexibility to the bank in implementing the scheme and provide for open communication regarding the scheme features.

The list of banks senior officials contacted for the purpose of analysis is given below:

Bank	Official Name	Designation, Place
Bank of India	Mr. B. B. Joshi	Dy. General Manager, C&IC Department Mumbai
	Mr. S.G. Krishna Prasad	Chief Manager, Small & Medium Enterprises SBU Mumbai

Central Bank of India	Mr. S.C.Jhanwar	Dy. General Manager (Now retired) Mumbai
Dena Bank	Mr. G.P.Mohanty	Asst. General Manager, SME Mumbai
State Bank of India	Mr. T.S.Krishnaswamy	Dy. General Manager, SME Mumbai
	Mr. Vinod Amlani	Training Department Bhavnagar (Through Call)
Union Bank of India	Mr. S. Dhikole	Dy. General Manager Rural & Agri Mumbai
	Mr. Prakash Waikar	Asst. General Manager, MSME Dept Mumbai
Axis Bank	Mr. K. H. Prakash	Vice President – SME Mumbai
HSBC	Mr. Jayesh Modi	Sr. Vice President & Head, Priority Initiatives Mumbai

Appendix 3 – International SME credit products

A. Analysis of International MSME Products

Country	SME Institutions	General MSME financing products	Type of credit card
South Asian Economies			
Bangladesh	Bangladesh Bank, BASIC Bank, BRAC Bank	Term loans, Micro Credit, collateral free working capital loans	Personal credit cards present in the market
Indonesia	BRI, Small rural development banks, Cooperatives	Small scale credit, Credit for village units, subsidized credit	Business credit cards by foreign banks
Malaysia	National SME Dev. Corp., SME Bank, Credit Guarantee Corp.	SME Growth Acceleration Fund, SME grants, SME Credit Bureau	Business Credit Cards by leading commercial banks
Nepal	Dept. of Cottage and Small Industry, NABIL, NIC Bank	Term loans, Working capital loans	Nascent credit card industry
Vietnam	Vietnam Development Bank, Asia Commercial Bank	Small Enterprise Development Fund, working capital finance, Factoring	Personal credit cards present in the market
Sri Lanka	Bank of Ceylon, National Development Bank, Hatton National Bank	International schemes in collaboration with Japan and ADB, Micro finance for SMEs	Personal credit cards present in the market
Thailand	SME Promotion Office, SME Development Bank	Village Funds, Portfolio Guarantee Scheme	Business Credit Cards by leading commercial banks
Developing Economies			
Brazil	SEBRAE, BNDES, Banco do Brazil, CEF	SME Lending Guarantee, Working Capital Lines, Leasing	SME Card issued by BNDES (Brazil Development Bank)
Chile	CORFO, Banco de Estada, Banco de Chile, Santander	Guarantee Funds for SMEs, Savings, Insurance, Mortgage based financing	Business credit cards by leading commercial banks
Hungary	Hungarian Development Bank, OTP Bank, MKB, Ex-IM Bank	Micro credit scheme, medium term loans, Euro loans, MSME development credit	Széchenyi Card issued by KAVOSZ, an association formed by trade organizations
Kenya	Kenya Commercial Bank, FINA Bank, Equity Bank, CBA	Small Scale loans, agro-credit loans, Business accounts, Asset finance	Business credit cards offered by niche players (CBA)
South Africa	ABSA, Standard Bank, First National Bank, GroFin Fund for SMEs	Mortgage, Asset finance, Warehouse receipt finance, Sub-contracting finance	Business credit cards by leading commercial banks
Peru	Banco de Credito, MiBanco, ScotiaBank, COFIDE	Micro Credit loans, business accounts, Working capital finance, Leasing	SME Card issued by MiBanco, a private bank focused on micro-enterprises

Developed Economies			
Germany	KfW, Regional and specialized banks	Venture capital funds, Securitization, Government Guarantee, low interest loans	Business credit cards by leading commercial banks
Japan	Japan Finance Corp. for Small Business, National Life Finance Corp., Shoko Chukin	Credit Insurance system, Safety Net Loan, Credit Guarantee System,	
United Kingdom	Small Business Service, Commercial Banks, Enterprise Capital Funds	Small Firms Loan Guarantee, Regional Venture Capital Funds, High Technology Fund	Business credit cards issued by all leading commercial banks
United States	Small Business Administration, Commercial banks	Small business Investment Company program, loans, Angel networks, Guarantees	Business credit cards issued by all leading commercial banks
Australia	Department of Small Business, Invest Australia, Commercial Banks,	R&D Grants, Tax reforms, Pooled Development Funds, Small Business Loans	Business credit cards by leading commercial banks
Sweden	ALMI Business Partner, NUTEK,	Swedish Industrial Development Fund, Loans and guarantees for MSMEs	

SME product analysis for Bangladesh

SMEs in Bangladesh

Share of industry in GDP has increased to 29 % and that of services to 49 %. Small-scale industry is growing at a faster pace with 8.1 % growth rate during 2001-07 as compared to 6.8 % in 1990s. Small enterprises constitute 87 % of the total enterprises while, medium enterprises account for 6 %. Food and textile units (including garments) account for around 60 % of MSMEs.

Access to Finance

The different sources of finance for MSMEs in Bangladesh are: Informal Sector (41%), Family Members (24%), NGOs (17%) and Banks (18%).

Large enterprises in Bangladesh heavily depend on banks for financing leading to crowding out of MSMEs from bank finance. Also lack of credible collateral is another obstacle (15-20% of MSMEs own any immovable property).

Banking System

Bangladesh Bank is the Central Bank of Bangladesh and the chief regulatory authority in the sector. The banking system consists of four nationalized commercial Banks, around forty private commercial banks, nine foreign multinational banks and some specialized banks. The other players include micro-finance institutions like Grameen Bank, non-banking financial institutions like IDLC and IPDC.

Financing products

SME financing activities undertaken by various financial institutions are as follows:

⇒ **Bangladesh Bank**

- Refinance for commercial banks, NBFIs (Tk. 6.21 billion as of March 2008).
- 40 % refinance to be for women entrepreneurs.
- Equity and Entrepreneurship Fund (Tk. 4 billion disbursed as of 2008) to encourage investments in risky and hi-technology ventures.

⇒ **BASIC Bank (> 80%MSME portfolio)**

- Term loan, working capital financing and commercial lending
- Micro Credit for on-lending to NGOs or direct lending to poor entrepreneurs
- Typical interest rates are 12-13 %

⇒ **BRAC Bank (50%MSME portfolio)**

- Collateral free working capital loans, term loans for MSMEs
- Repayment options of monthly instalments or one time, higher interest rates etc.

⇒ **IDLC**

- Leasing (vehicle and equipment) and term loan financing
- Factoring of Accounts Receivable

⇒ **Grameen Fund**

- Venture/Equity Financing Scheme
- Micro-Enterprise Loan scheme (1 to 3 years repayment, monthly installments)
- Loans against deposits (1-2 years, monthly installments)

SME Product Analysis for Sri Lanka

SMEs in Sri Lanka

SMEs in Sri Lanka account for 82 % of all the firms, 20 % employment and 20 % of the GDP.

Access to Finance

Small, urban manufacturing firms pay significantly higher average interest rates large ones. They also pay higher rates than rural enterprises, which benefit from subsidies from some state financial institutions and microfinance institutions. Raising funds is the biggest issue for MSMEs in Sri Lanka.

Banking System

Central Bank of Sri Lanka is the chief regulatory authority. The state banks Bank of Ceylon and People's Banks account for maximum share of the market. The four leading private sector banks are Hatton National Bank, Commercial Bank of Ceylon, Ceylon Bank and Sampath Bank. Specialized license banks have been established for development finance (NDB), housing finance and regional development.

Financing products

SME financing activities undertaken by various financial institutions are as follows:

- Bank of Ceylon, National Development Bank, Hatton National Bank are the major players in the field of MSME finance.
- Various schemes are being implemented by international institutions like Asian Development Bank (SMEDP), Japan Bank for International Cooperation (SMILE), Japan (E-FRIENDS) etc.

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- The state banks and leading private banks offer credit lines (long term) at lower interest rates to MSMEs for developing physical and technical capacity and skills, solutions to enterprise problems.
- Apart from the above schemes, individual schemes implemented by these banks are
  - Bank of Ceylon – Credit finance to agricultural entrepreneurs, loans for enterprises in suburban and rural areas
  - HNB – Micro-finance for rural and semi-urban enterprises
  - NDB – Tie-up with insurance companies to provide services for MSMEs

B. MSME Definitions for Country Case Studies

MSME definitions vary across nations. The most common parameters utilized for MSMEs include number of employees, asset size, turnover and capital and investment. For purpose of the international case studies, the MSME definition as prescribed by IFC was utilized. The purpose was to compare the MSME segments basis a uniform parameter i.e. in this case number of employees as prescribed by IFC.

In addition to that, some of the other definitions used in these respective countries have been specified below for reference purposes.

- **Brazil**

  Number of employees and gross annual revenue are two parameters commonly utilized in Brazil for categorizing MSME units. The Brazilian Institute for Geography and Statistics has adopted the number of employees as basis for MSME definition. It utilizes the following definition for the purpose.

Number of Employees	Type of Unit
0 to 9	Micro
10 to 49	Small
50 to 249	Medium

  SEBRAE is a federation which works for development of enterprises in Brazil. It utilizes gross revenue as a parameter to define MSME units.

Gross Annual Revenue	Type of unit*
Up to R$ 240 thousand (~₹ 8900)	Micro
From R$240,000 to R$2.4 million (~₹ 89,000)	Small

* SEBRAE defines only micro and small units.

- **Hungary**

  The Central Bank in Hungary defines MSMEs as per the number of employees. This definition is utilized for all the government and commercial bank MSME financing activities. The definition provided is

Number of employees	Type of unit
0 to 9	Micro
10 to 49	Small
50 to 249	Medium

- **Peru**

  Multiple definitions are used in Peru. While the National Statistics Institute defines MSMEs on the basis of number of employees, the Ministry of Labour utilizes the annual sales as a parameter. The definition used by National Statistics Institute is provided below:

Number of employees	Type of unit

1 to 10	Micro
11 to 50	Small
51 to 200	Medium

The Ministry of Labour in Peru utilizes the following definition (1 tax unit is defined as S3600 or ~₹ 58,000)

Annual Sales	Type of unit
<150 tax units	Micro
<1700 tax units	Small

Source: MSME Country Indicators, IFC
www.sebrae.com.br

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Appendix 4 – Interest Rates and Charges for MSME Products

Interest rates and service charges for leading public sector banks is as listed below:

Categories (based on loan size)	Advances to Micro Enterprises	Advances to Small Scale Enterprises (SSE)
Advances up to ₹ 50000/-	3.50% below BPLR i.e. 8.25%	2.00% below BPLR i.e. 9.75%
Advances above ₹ 50000/- & up to ₹ 2.00 Lakh	3.00% below BPLR i.e. 8.75%	1.75% below BPLR i.e. 10.00%
Advances above ₹ 2.00 Lakh up to ₹ 5.00 Lakh	1.00% below BPLR i.e. 10.75%	BPLR i.e. 11.75%
Advances above ₹ 5.00 Lakh below ₹ 25.00 Lakh		
a) Working Capital	BPLR i.e. 11.75%	BPLR +0.25% i.e. 12.00%
b) Loans Repayable in instalments beyond 1 year	BPLR + 0.75% i.e. 12.50%	BPLR + 1.00% i.e. 12.75%

A. **Interest Rate on Advances to Micro Enterprises**

Working Capital Advances ₹ 25.00 Lakh and above		
Rating	**Score**	**Rate of Interest**
CR-1	> 90	BPLR-0.50
CR-2	81-90	BPLR-0.25
CR-3	76-80	BPLR
CR-4	71-75	BPLR+0.50
CR-5	66-70	BPLR+0.75
CR-6	61-65	BPLR+1.25
CR-7	56-60	BPLR+1.75
CR-8	55 & below	BPLR+1.75
CR-9	NPA	BPLR+1.75
Loans Repayable in instalments beyond 1 year ₹ 25.00 Lakh and above		
Rating	**Score**	**Rate of Interest**
CR-1	> 90	BPLR
CR-2	81-90	BPL;R+0.25
CR-3	76-80	BPLR+0.50
CR-4	71-75	BPLR+1.00
CR-5	66-70	BPLR+1.25
CR-6	61-65	BPLR+1.75
CR-7	56-60	BPLR+2.75
CR-8	55 & below	BPLR+2.75
CR-9	NPA	BPLR+2.75
Note: For advances above ₹ 2.00 lakh covered under CGTMSE, rate of interest applicable will be 0.50% more the usual rate		

B. **Interest Rate on Advances to Small Scale Enterprises (SSE)**

Working Capital Advances ₹ 25.00 lakh and above

Rating	Score	Rate of Interest
CR-1	> 90	BPLR-0.25
CR-2	81-90	BPLR
CR-3	76-80	BPLR+0.25
CR-4	71-75	BPLR+0.75
CR-5	66-70	BPLR+1.00
CR-6	61-65	BPLR+1.50
CR-7	56-60	BPLR+2.00
CR-8	55 & below	BPLR+2.00
CR-9	NPA	BPLR+2.00
Loans Repayable in installments beyond 1 year Advances ₹ 25.00 lakh and above		
Rating	**Score**	**Rate of Interest**
CR-1	> 90	BPLR+0.25
CR-2	81-90	BPL;R+0.50
CR-3	76-80	BPLR+0.75
CR-4	71-75	BPLR+1.25
CR-5	66-70	BPLR+1.50
CR-6	61-65	BPLR+2.00
CR-7	56-60	BPLR+3.00
CR-8	55 & below	BPLR+3.00
CR-9	NPA	BPLR+3.00
Note: For advances above ₹ 2.00 lakh covered under CGTMSE, rate of interest applicable will be 0.50% more the usual rate		

C. Interest Rate on Advances to MEDIUM SCALE ENTERPRISES (MSE)

Working Capital		
Rating	**Score**	**Rate of Interest**
CR-1	> 90	BPLR
CR-2	81-90	BPL;R+1.00
CR-3	76-80	BPLR+1.50
CR-4	71-75	BPLR+2.50
CR-5	66-70	BPLR+3.50
CR-6	61-65	BPLR+3.50
CR-7	56-60	BPLR+3.50
CR-8	55 & below	BPLR+3.50
CR-9	NPA	BPLR+3.50
Loans Repayable in instalments beyond 1 year		
Rating	**Score**	**Rate of Interest***
CR-1	> 90	BPLR+1.00
CR-2	81-90	BPLR+2.00
CR-3	76-80	BPLR+2.50
CR-4	71-75	BPLR+3.50

CR-5	66-70	BPLR+4.50
CR-6	61-65	BPLR+4.50
CR-7	56-60	BPLR+4.50
CR-8	55 & below	BPLR+4.50
CR-9	NPA	BPLR+4.50
*Inclusive of Term Premium of 1%		

Processing, Documentation and Inspection Charges								
Range of Limits (Amt. In Indian Rupees)		**Processing Charges (Including for NEW Term Loans)**				**Documentation Charges**	**.1.1 Inspection Charges .1.2 per visit**	
		Rural & Semi-Urban Branches		**Urban & Metro Branches**		**Rural , Semi-Urban, Urban & Metro Branches**	**Rural & Semi-Urban**	**Urban & Metro Branches**
From	**To**	**Charges (per Lakh)**	**Max. Charges**	**Charges (per Lakh)**	**Max. Charges**	**Max. Charges**	**Charges Per Visit**	
0	50000	NIL		₹ 100/=		NIL	NIL	₹ 50/-
50000	2 Lakh	₹ 100/-		₹ 125/-		₹ 250/-	₹ 50/-	₹ 100/-
2 Lakh	10 Lakh	₹ 100/-	₹ 600/-	₹ 125/-	₹ 750/-	₹ 1250/-	₹ 100/-	₹ 200/-
10 Lakh	25 Lakh	₹ 125/-	₹ 2,000/-	₹ 150/-	₹ 3,000/-	₹ 1800/-	₹ 200/-	₹ 400/-
25 Lakh	100 Lakh	₹ 125/-	₹ 6,000/-	₹ 150/-	₹ 7,500/-	₹ 3,000/-	₹ 300/-	₹ 500/-
100 Lakh	500 Lakh	₹ 150/-	₹ 60,000/-	₹ 150/-	₹ 75,000/-	₹ 4,750/-	₹ 500/-	₹ 1000/-
Above 500 Lakh		₹ 150/-	₹ 75,000/-	₹ 150/-	₹ 1,25,000/-	₹ 12,000/-	₹ 1,000/-	₹ 2,000/-
Review of Term Loans		₹ 50/- Per Lakh Max. ₹ 60,000/-		₹ 60/- per Lakh Max. ₹ 60,000/-				

Tech. Inspection/ Project Appraisal charges (Inclusive of Service Tax)	
Micro and Small Enterprises (Manufacturing) (Investments in Plant & Machinery up to ₹ 5.Crores)	
Up to ₹ 30 Lakh	NIL
Above ₹ 30 Lakh up to ₹ 50 lakh	₹ 5650/-
Above ₹ 50 Lakh up to ₹ 300 lakh	₹ 5650/- Plus 0.22 % of amount exceeding ₹ 50 Lakh
Above ₹ 300 Lakh	₹ 61,000/- Plus 0.33 % of amount exceeding ₹ 300 Lakh (Max. ₹ 2.25 Lakh)
Medium Enterprises (Manufacturing) (Investments in Plant & Machinery above ₹5.Crores up to ₹10 crore)	0.60% of Aggregate Fund-Based Limits subject to a Min. of ₹ 12,500/- and Maximum of ₹ 6.00 Lakh

Mortgage Fee			
Limits Exceeding ₹ 25 Lakh & Up to ₹ 50 lakh	₹ 3500/-	Limits Exceeding ₹ 50 lakh	Rs. 7000

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Appendix 5 – Business Credit Card Product

Section A: Credit Card Product Features

Product /service features	All segments
Name of the facility	**MSME Vikas Card**
Eligible borrowing entity	► All Proprietorship, Partnership, Limited Liability Registered Companies or as decided by the administering lending institutions from time to time shall be eligible borrowing entity. ► Business license / registration are not mandatory but highly preferred parameter for issuing cards. In initial phase, card may be issued only to registered units (at least as SSI). ► Minimum business history of one year is another important parameter that may decide the eligibility of the borrowing entity. The tenure of one year may need to be extended to three years if the scheme does not get covered under the CGTSME scheme. Business history as a parameter may not be mandatory in the long term but may remain a highly preferred factor. In initial stages, the card may only be offered to enterprises with minimum business history of three years or more. ► Business history may be evaluated in terms of either submission to the revenue department (ITRs) or to the ministry of corporate affairs (in case of individual proprietors – individual tax reports may be considered for same purpose).
Type /Nature of the facility	► A credit facility to primarily meet most of the business requirements of the MSME borrowers except for large cap transactions with typical repayment period of more than three years. ► Cardholders can use the new cards, which are accepted for purchases and for cash withdrawals through ATM & Points of Sales as a substitute for less efficient and more risky instruments like cash and cheques. ► The borrower will be provided a card facility linked to the credit account and allowed to perform electronic transactions. ► The borrower will be also be provided a cheque book facility linked to the credit account in order to enable usage in regions where merchant terminals are not available. ► A fixed proportion of the credit limit will be made available for personal consumption (to provide this facility as also the limit may be decided by lending institution). ► Electronic card will be portable across different bank ATMs. There shall be no limit to the number of times the client can transact in a year, provided the total outstanding does not cross the overall limit.
Benefits	► Access to liquidity reserve through this card shall enhance the level of business stability as it shall help the enterprises to deal better with unplanned events especially in the current challenging economic climate. ► The new card will also provide businesses with ultimate convenience, utility and access to business-related special offers. ► The purpose of providing the card is to enable the borrower to perform

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	transactions anywhere and anytime.
Purpose of usage	► Minimum 70% of the credit limit will be reserved for business requirements: o Objective of the facility is to fund any expense related to the business of the entity except large capital expenses. o To render flexibility to entrepreneur in meeting his expenses and manage business cyclic nature and cash flow fluctuations, the issuing banks may offer the flexibility of EMI for large value transactions; the cap on such EMI convertibility shall be set to a maximum of 50% of the overall limit of the facility; repayment period for the transactions may range from 1 to 3 years depending on the line of trade and the underlying item of transaction. o User shall have the freedom to prepay all or part of the outstanding amount at any point of time without any prepayment or penalty charges. o Rate of interest for the EMI facility and compounding basis (day, month, quarter and year) shall be at the discretion of the issuing bank. o A proportion of credit limit can be made available for export related transactions and products subject to the overall limit and discretion of the lending institution. ► Minimum 10% to maximum 30% of the credit limit will be reserved for personal expenditure (at the discretion of lending institution). o The exact limit will be fixed by the lending institution. o No monitoring of type of expense is required for the set limit for personal expenses – however monitoring for normal fraud detection and other irregularity is required.
Limit	► The maximum limit allowed under the proposed facility for an account shall be set at ₹ 10 Lakh only – the limit denotes the cumulative limit for an entire account regardless of the number of cards being issued.
Issue of card	► The card account shall be issued in the name of the borrowing company / proprietor. ► Key personnel in the borrowing company will be given access to execute the transactions. The number and level of personnel to be provided access will be at the discretion of the lending institution. In case, multiple cards are issued to the employees, the total of the sub-limits will not exceed the overall credit limit sanctioned to the borrowing company at any point of time. ► The name of the borrowing company will be embossed on the card. ► Maximum number of cards under one account shall be 5; upto 2 cards shall be made available free of cost; the issuing agency shall reserve the right to charge processing fees for each additional card beyond the first two cards.
Restriction	► A particular customer / enterprise can have only one such active credit facility or account at any point of time; in case the user wants to change his account and move to a different issuer he shall have to first get the previous facility cancelled – the intimation of which shall happen between the two banks directly. ► A pre-requirement for implementation of the scheme would be that the issuing banks help in maintaining a centralized database of the individuals / companies to which cards have been issued to in close association with

	central credit rating and monitoring agencies like CIBIL.
Assessment methods for limit	▶ The assessment method shall be based on lending institution's credit assessment method for extending loans for short and medium terms for MSMEs. ▶ Illustrative parameters for assessment shall be the size of operations, number of years in operation, profitability of the business, cash credit cycle of the business, nature of clientele, nature of product / service line, vulnerability of business to changing economic conditions and future potential for growth along with over all credit needs. The debt coverage ratios and leverage ratios may also be fundamental in assessing the repayment capacity and hence the credit limits for the enterprise. ▶ To circumvent the problem of opacity of information and the greater credit risk that shall be perceived to be attached with such loans, lending institutions may try and use the CGTSME scheme for extending such cards. ▶ The initial limit of the card may be set low with auto enhancement based on the repayment history, regularity and usage pattern.
Tenure	▶ The card will be valid for a period of 3 years. ▶ The lending institution at its discretion can offer cards valid for more than 3 years (subject to a maximum tenure of 5 years).
Mode of usage	▶ The mode of usage is electronic transaction at merchant terminals, online purchase and cheque transactions. ▶ The lending institution can at its discretion set sub-limit for cash withdrawal at ATM. ▶ The card may be further used for various bill payments for registered billers – may include specifically utility bill payments, insurance premium payments. ▶ Users have to register themselves for each biller for which they want to avail the facility. The bills shall be presented from the next billing cycle against which users can make payment; for certain billers, users can pay any amount in favour of the biller as soon as they register.
Billing options	▶ Individual cardholder billing. ▶ Consolidated bill sent to company administrator. ▶ Specific transactions and fees can be billed centrally.
Mode of card bill payment	▶ The various allowed transactions for repayment from the client's CA/SA through NEFT/ RTGS, Cheque Payment, Demand Draft, cash payment etc. ▶ Banks may also use third party agencies like Bill Desk to process online payments from other banks. ▶ Clients may also provide ECS instructions to banks upto certain limits for bill settlement.
Repayment mechanism	▶ Multiple repayment options have been explored. These have been explained in detail. The appropriate option can be finalized basis the risk appetite of the co-ordinating agency **Option 1** o Billing cycle shall be of a month and a grace period of 21 days will be

	given after the statement generation date for paying the bills. o Interest will be charged to the customer from the date of credit card transaction. o The amount outstanding at the end of any billing cycle will be the sum of transactions made in the cycle, interest on these transaction amounts and outstanding from previous cycle. o Customer has to pay at least 5% of the outstanding amount by the payment due date, failure to do so for 3 subsequent dates can lead to blockage of card facility. o Payment made is first adjusted towards interest and remaining towards principal. Interest shall always be calculated on reducing daily balance outstanding. o Customer can choose to make a full repayment at point during the cycle. o The total outstanding (principal + interest) at any point of time cannot exceed the credit card limit for the customer. **Option 2** o Billing cycle shall be for a quarter and a grace period of 21 days will be given after the statement generation date to pay the bills. o Interest will be charged from the date of transaction. o Interest will be charged on reducing daily balance outstanding. o The amount outstanding at the quarter end will be sum of transactions made during the cycle, interest on these and previous cycle outstanding. o Customer has to pay 5% of the outstanding amount by payment due date, a single failure can lead to blockage of card facility. o Payment is first adjusted towards interest and remaining towards principal. o Customer can choose to make a full repayment at any point during the cycle. o The total outstanding at any point of time cannot exceed the credit card limit for the customer. **Option 3** o Billing cycle is for a month. o Grace period of 21 days from the statement generation date for repayment. o The period from transaction till payment due date is entirely interest free for the customer if he repays in full the transaction amount by the due date. Thus this period can vary from a minimum of 21 to a maximum of 51 days. o The customer has to make a minimum payment of 5% of total outstanding by the payment due date. In case of a default, the bank can decide to withdraw/reduce limit of the customer and in case of repeated offence, block the card facility. o In case the customer fails to repay the total outstanding by due date, interest is charged on the outstanding from the transaction date on daily reducing balance basis. All new transactions by the customer are no

	longer interest free. Once the customer has settled the entire outstanding amount, he can avail of the interest free facility again. o The total outstanding at any point of time cannot exceed the credit card limit for the customer. **Option 4** o Billing cycle is for a quarter. o Grace period of 15 days from the statement generation date for repayment. o The period from transaction till payment realization is charged at a fixed rate of interest. o Interest shall be debited from the funds of the enterprise maintained with the issuing agency. o In case the credit item exceeds 80% of the credit limit provided to the Enterprise on the closing day following the quarterly debit of interest, redemption commitment arises for the Enterprise to be met within 15 days after the quarterly closing. o The complete credit amount is available again following the day of redemption. o In case the credit item does not exceed 80% of the credit limit provided to the Enterprise on the closing day following the quarterly debit of interest, the Enterprise will not have redemption commitments. o In case of a default, the bank can decide to withdraw /reduce limit of the customer and block the card facility. o Late payment / delinquency charges to be paid by the card user. o The total outstanding at any point of time cannot exceed the credit card limit for the customer. **Option 5** o Billing cycle is for a month. o The card shall not have any pre set limit. o Based on the nature of business, expense timings and previous patterns, transactions shall be allowed or disallowed on case by case basis. o There shall be no revolving facility given – at the same time no charges shall be issued on the borrower from the time of transaction till the 21 days of grace period for payment of bill elapses. o If full amount is not received at that point, a delinquency charge shall be charged on the total outstanding balance. o The issuing agency may have a staggered delinquency rate with it increasing for every subsequent non clearance. o There shall be no minimum amount limit exercised under this option. **EMI** o For all the above options (except option 4), the issuing agency may provide the user with the EMI option for large transactions (exceeding ₹ 25,000 – illustrative; actual sum may be higher or lower depending on transaction cost considerations by the issuing agency). o The transaction amount is divided into Equated monthly instalments

	(basis interest rate at discretion of lending institution). o The customer starts making EMI payments from the next payment cycle along with regular payments. o The number of instalments is to be negotiated between the customer and the bank subject to a maximum of 36 monthly instalments. o The total outstanding at any point of time cannot exceed the credit card limit for the customer. **Balloon Payment** o For all the above options (except option 4), the issuing agency may provide the user with the balloon payment option for specific business lines / trade activity. o The card user does not have to make payment each month – tenure for such flexibility shall be based on evaluation of cash to credit cycle of the entrepreneur. o A lump sum payment may be made at the end of such tenure. o The tenure length is to be negotiated between the customer and the bank subject to a maximum of 6 months. o Availing this option shall entail an interest charge as decided between the bank and the card user. o The total outstanding at any point of time cannot exceed the credit card limit for the customer.
Processing fees	► Nil ► The issuing agency may put a slab on the number of cards issued under each account (account specific); while the first slab may require zero processing fees – higher slabs may charge a processing fee for each additional card. 2 cards are proposed within the first slab with the higher slab ranging from 3 – 5 cards.
Annual fee	► Based on the business volume, establishment period and discretion of the issuing agency may range from nil to ₹ 5000 per year.
Transaction fee	► Nil for transactions made through merchant terminals. ► A flat fee or as a % of transaction amount, whichever is lower can be applied for cash withdrawals (subject to a minimum of ₹ 50).
Interest	► Interest rate shall be as decided by lending institution in compliance with laid down norms.
Penal charges	► Delinquency charges, credit revolving charges or late payment charges shall be applicable as per the policy of the issuing agency. ► There shall be no charges for surrendering the card.
Pre-disbursement conditions/documentation	► Pre-disbursement conditions/ Documentation shall be at discretion of lending Institution.
Security	► Collateral security is not to be demanded by the lending institution. ► The option of having the sanctioned limit covered under CGTMSE facility is to be explored prior to implementation of the scheme. ► Any asset (acquired / generated) from the credit provided shall be charged

	to the facility along with receivables from the buyers.
Periodical monitoring	► For monitoring purpose, the bank will conduct an annual review of stock position /sales statements: o The bank can appoint an external auditor to conduct review of its customer operations. o The bank should regularly monitor the card usage to identify potentially riskier accounts. ► The bank shall conduct on-sight audit as and when required. ► The borrower should submit stock statement at the time of re-setting of limit. ► No intensive monitoring of this nature is required for the limit set for personal usage.
Enhancement of credit limit	► Enhancement shall be automatic with good borrower at the end of every year. ► The conditions for facility enhancement shall additionally include (if required) business growth, plan for expansion/increase, repayment history and/or any other conditions if set by lending institutions. ► The enhancement limit shall be a maximum of 20% or as decided by the issuing agency.
Statement Frequency	► The bank shall provide monthly categorized statements to the borrower company. These statements will be categorized as per the purpose of usage, merchant establishment name, the person who has made the transaction etc. This will provide clarity to the company as to which authorized representative has utilized the limit and for what purpose. This will help in timely detection of fraudulent use if any. ► Additionally it shall help the enterprise in reducing its cost for accounting, expense management and provisioning. It would also enable the enterprise in implementing better control through tracking and monitoring major part of their purchases and expenses. ► The bank can also provide the facility of mobile/email alert of transactions to the customers on request and at a nominal fee.
In-built fungibility of product/facility	None
Events of default	► The events of default shall be (but not limited to): o Annual review not done for on the due date as the client failed to furnish required documents/information and renewal has not taken place on or before the renewal due date. o Default in payment of minimum amount due as per the option type. o Late payment of billed amount / delinquency charges. o Cheque bouncing charges. o (Details of cheque bouncing regulations in other nations vis-à-vis India is provided in Section B of Appendix 5) . o Non Submission of stock statement / false submission of stock statement. o Any breach of the terms and conditions stipulated in facility and hypothecation agreement or any other document and any

	representations or undertakings given by Borrower are found to be false or incorrect.
Consequences of borrower's events of default	► On default regarding payment the lending institution shall be entitled to follow one or more of the following course of action: o The card can be blocked by the bank. o On event of borrower's default, lender shall be entitled to all the rights and remedies as generally available to a lender in such a transaction. o Lender shall also be entitled to seize and dispose stocks/goods/services (hypothecated to lending institution) either through public auction and adjust the proceeds against the amount outstanding from the borrower. The price at which the hypothecated goods/stocks/services are disposed by the lender is final and binding on the borrower. o However, in case the proceeds from such disposal are not sufficient to satisfy the amount outstanding in full, lender shall be fully entitled to recover the shortfall from borrower.
Insurance facility	► Loan insurance facility may be made mandatory to all the borrowers. The scheme should cover risk of borrowers against accidental death or permanent disability. ► The insurance premium payable to the insurance company may be charged from client on yearly basis with written consent from the customer on the same. ► The bank can provide insurance against fraudulent use of card or lost/misplaced card.
Card replacement and fraud liability	► Replacement card is expected to reach the customer within 10 working days from the day of report. ► Zero fraud liability from the time the report is lodged.
Rewards & benefits	► There shall be no rewards program membership fee charged on the card. ► The bank can provide benefit points on usage of card for business related expenses. For this purpose, the bank will have to tie-up with providers of these services (e.g. office equipment suppliers, fuel suppliers etc.). ► The issuing bank can also maintain a list of its customer enterprises and offer reward points on purchase from these enterprises. Thus it will facilitate business within the customers of the bank. This will provide an added advantage for the enterprises to become customers of the card. Going further, a centralized agency can develop and maintain a website for allowing transactions between the card customers online. ► Cash back option may be made available to the card user in partnership with specific purchase points under particular agencies; such partnerships may be entered by individual banks or as a consortium of multiple issuing agencies. ► The reward points shall be made redeemable in offers, vouchers or discounts covering business expenses like raw material procurement, stationary procurement and travel expenses. ► Assistance to the customer in the form of online tools for record keeping, cash management, accounting information etc. Free online account access and transaction downloads shall be made available. ► The performance of the customer on the card payment can be linked to the

	credit history of the customer and be considered as a factor while sanctioning term loans to the company.
Promotion	► The bank can tie-up with trade organizations, MSME welfare organizations, other local bodies to implement the Business Correspondence type of model.

The successful launch, implementation and sustenance of this facility require a number of careful considerations from policy perspective, external enablers and imperatives from bank perspective:

Policy Initiatives
► End usage monitoring is the major concern in introducing a card based product for MSMEs. It is essential that the regulator/government relax concerns regarding risk involved in monitoring end usage of MSME credit. One option is increasing risk weight on such loans. The other option is to permit banks to introduce the scheme on a trial basis restricting the credit disbursement to a higher limit.
► The CGTMSE scheme should be encouraged. The option of mandatory coverage of the card product under a credit guarantee scheme can be explored (as has been explored in the international case study of Hungary). This will provide encouragement to the banks to offer collateral free card credit to more MSME customers.
► The option of allowing external entities to perform customer audit can be explored in greater detail. Either the funding agency/government ministry can provide support to participating banks in availing services of such external entities by providing subsidies. The central agency responsible for scheme implementation can assist through identification of such suitable audit agencies.
► Government provision of POS machines and transaction terminals at subsidized rates may prove to be a critical incentive and success factor for the scheme making it more cost effective for the issuing agency.
► Active role played by the government to spread the message on this card and encouraging end users is another important aspect and essential enabler.
External Enablers
► Technology infrastructure shall play a key role in successful roll out of the plan – alternative and innovative technology interfaces, front end and back end supports are essential. Important aspects to consider here is the relatively low level of awareness and comfort of electronic devices with the target audience, the lack of computer knowledge and usage comfort and the perception of risk associated with non cash transactions.
► These can be overcome by following simple interfaces; the mobile telephone sets may be used extensively through appropriate technologies; the process needs to be made simple and comprising of few steps only.
► The card design may adopt multiple technologies to increase the scope and compatibility with different form of readers.
► Banking correspondent may be trained to introduce the human element that would ensure improvement of trust factor within the target audience.
► Small and mini transaction terminals may be stationed to increase the number of possible transaction points.
Imperatives for lending institutions
► It is important for the banks to draw out a cost effective business model for implementation of the

facility.

- Banks may need to form strategic alliances within themselves and share resources to reduce the transaction and operational costs thereby making the model more economically feasible.
- Partnerships with non bank players shall play a key role in deciding the ultimate success of the plan. The banks shall have to forge partnership with payment technology companies like Visa in cost effective fashion. In addition they have to forge partnership with agencies that would act as purchase points and with agencies who would agree to participate in membership reward programs.

Section B: Cheque Bouncing Regulations

Regulations dealing with cheque bouncing involve civil and criminal penalties in most nations. The severity of these punishments varies. An offense is considered to have taken place in the situation of the person who has issued the cheque not having sufficient amount in his account. Details regarding cheque dishonour/ bouncing regulations in US and UK are presented below:

United States

Cheque bouncing regulations typically are subject to civil and criminal penalties in the United States. The party who has signed the cheque is held guilty however additionally any third person who has endorsed the cheque can also face trial in the court. In the United States, civil and criminal penalties/proceedings vary from state to state. Cheque bouncing is considered an offense in case of non sufficient funds in account of the person who has issued the cheque.

All states specify civil and criminal penalties depending upon the degree of offense. In the case of a first offense, most states require the defaulting person to pay the requisite amount to the person to whom the cheque was issued. Additionally, the court would require the defaulter to pay fine/penalties compensating the other party/bank for any legal fees, service charge etc. Such penalties can vary from a minimum[7] of USD 10 (₹ 460) to a maximum of twice/thrice the amount of cheque with a maximum limit of around USD 1,500 (₹ 69,000). Some states specify an upper limit for the service charges that banks can apply for customers whose cheques have bounced owing to non sufficient funds. A maximum service charge limit of USD 20 (₹ 920) is typically specified by such states.

In case if the defaulter is a repeated offender and/ or has not repaid the cheque amount and/or penalties within the prescribed notice period (typically 15 days to a month), criminal proceedings can be initiated against such a person. Criminal penalties again vary from state to state and require the offender to deposit a penalty and/or undergo imprisonment. The amount of imprisonment can go up to 12 months depending upon the cheque amount. The court decides on the penalty that the offender should deposit in the court depending upon the cheque value, loss to the other party, loss to the bank of the offender and any legal fees etc.

United Kingdom

In the United Kingdom as well, cheque dishonour/ bouncing owing to insufficient funds is subject to civil and/ or criminal penalties. In case of cheque dishonour, the creditor (person to whom the cheque was payable) can initiate a bankruptcy petition (if against an individual) or a winding-up petition (if against a firm) if the cheque amount was greater than GBP 750[8] (₹ 52,500) . In case the cheque was lower than this, the defaulter can be served a notice and asked to ensure that the amount is paid within 3 weeks. If the defaulter fails to do so, then criminal proceedings can be initiated against the defaulter.

India

The cheque bouncing regulations in India are comparable with the above two examples. In India, in the situation that a cheque is dishonoured, the payee has the option to represent the cheque or send a written notice to the defaulter within 30 days from being intimated by the bank of the dishonour. The defaulter is required to pay the cheque amount within 15 days to the payee. In case the defaulter fails to pay within 15 days of receiving the notice, then he/she commits an offence under the Section 138 of the Negotiable Instruments Act. Punishment prescribed for such an offence is fine which may extend to twice the amount of cheque or imprisonment for a maximum of 2 years or both.

The payee also has the option of initiating money recovery procedure in a jurisdictional civil court along with the criminal proceedings.

[7] http://www.consumerbadcreditguide.com/badchecklaws.html

[8] http://www.tgcoc.co.uk, http://www.statutelaw.gov.uk/

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Appendix 6 - Regulations pertaining to MSMEs in India

In order to finalize the delivery mechanism most suitable for implementing the proposed scheme, it is imperative to understand all possible implementation frameworks and the regulations pertaining to each of them. The first step is to have an understanding of the regulations governing MSME banking in India. An overview of such regulations has been provided in this section.

Priority sector lending

Lending to small and micro enterprises has been stressed as a priority sector by the regulatory authorities. Sectors defined for priority lending by banks include those which impact large sections of the population, the weaker sections and those which are employment-intensive such as agriculture and, tiny and small industries.

For purpose of priority sector lending, finance to Micro and Small Enterprises is categorised into direct and indirect. Banks lending to medium enterprises is not considered for the purpose of priority sector lending.

Direct finance in small enterprises includes credit to small and micro enterprises (in manufacturing and services). All advances granted to units in the Khadi Village Industries Sector (KVI), irrespective of their size of operations, location and amount of original investment in plant and machinery are eligible for consideration under the sub-target of the small enterprises segment.

Indirect finance to the small enterprises sector includes credit made to:

- Persons involved in assisting the decentralised sector in the supply of inputs to and marketing of outputs to artisans, village and cottage industries.
- Advances to cooperatives of producers in the decentralised sector viz. artisans village and cottage industries.
- Existing investments as on March 31, 2007, made by banks in special bonds issued by NABARD with the objective of financing non-farm sector would be eligible till the date of maturity of such bonds or March 31, 2010 whichever is earlier.
- The deposits with SIDBI by foreign banks, having offices in India, on account of non-achievement of priority sector lending targets/sub-targets and outstanding as on April 30, 2007 would be eligible till the date of maturity of such bonds or March 31, 2010 whichever is earlier.
- Loans granted by banks to NBFC for on-lending to small and micro enterprises.

The total target for priority sector lending is 40 % of Adjusted Net Bank Credit (ANBC) or credit equivalent of Off-balance sheet exposure whichever is higher for domestic banks and 32 % for foreign banks. Under that, the sub-targets for small and micro enterprises are as follows:

	Domestic commercial banks	Foreign banks
Small enterprise advances	Advances to small enterprise sector will be reckoned in computing performance under the overall priority sector target of 40 % of ANBC or credit equivalent amount of Off-balance sheet exposure, whichever is higher.	10 % of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher.
Micro enterprises within small enterprises sector	40 % of total advances to the small enterprise sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to ₹ 5 Lakh and micro (services) enterprises having investment in equipment up to ₹ 2 Lakh.	Same as for domestic banks

	► 20 % of the total advances to the small enterprise sector should go to micro (manufacturing) enterprises having investment in plant and machinery above ₹ 5 Lakh and up to ₹ 25 Lakh and micro (services) enterprises having investment in equipment above ₹ 2 Lakh and up to ₹10 Lakh	

Source: Master Circular – Lending to MSME Sector, RBI, July 2010

Common guidelines for Lending to Small Enterprises Sector

(From Master Circular for Lending to MSME Sector, RBI (July 2010))

- **Disposal of Applications**

  All loan applications for MSE units up to a credit limit of ₹ 25,000 should be disposed off within 2 weeks and those up to ₹ 5 Lakh within 4 weeks provided, the loan applications are complete in all respects and accompanied by a check list.

- **Collateral**

  The exemption limit for collateral requirement for MSME borrower accounts is ₹10 Lakh. Banks may on the basis of good track record and financial position of the MSME units increase the limit of dispensation of collateral requirement for loans up to ₹ 25 Lakh.

- **Composite loan**

  A composite loan limit of ₹ 1 Crore can be sanctioned by banks to enable the MSME entrepreneurs to avail of their working capital and term loan requirement through a single window.

- **Specialised branches**

  Public sector banks have been advised to open atleast one specialized MSME branch in each district. Banks have been permitted to categories their MSME general branches having 60 % of their advances to MSME sector. The existing specialized MSE branches may also be re-designated as MSME branches.

- **Rehabilitation of sick MSE units**

  On the recommendation of the Kohli Working Group, the guidelines have been drawn for rehabilitation of sick MSE units. As per the definition, a unit is considered as sick when any of the borrower account of the unit remains sub-standard for more than 6 months or there is erosion in the net worth due to accumulated cash losses to the extent of 50 % of the net worth during the previous accounting year and the unit has been in commercial production for atleast two years.

The rehabilitation package should be fully implemented within 6 months from the date the unit is declared as potentially viable. The guidelines for revival of such units are specified as:

Interest on working capital	1.5 % below the fixed/prime lending rate wherever applicable
Funded interest term loan	Interest Free
Working capital term loan	1.5 % below the fixed/prime lending rate wherever applicable
Term loan	Concessions in the interest to be given not more than 2 % (not more than 3 % in case of tiny/decentralised sector units) below the document rate
Contingency loan assistance	Concessional rate allowed for working capital allowance

Debt restructuring mechanism for MSMEs

The guidelines issued for debt restructuring are applicable for following entities whether or not potentially viable

- All non-corporate MSMEs irrespective of level of dues to banks.
- All corporate MSMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.
- All corporate MSMEs which have funded and non-funded outstanding up to ₹ 10 Crore from multiple/consortium banking arrangement.
- Account involving wilful default, fraud and malfeasance will not be eligible.
- Account classified by bank as "Loss Asset" will not be eligible.

All banks have been advised by RBI to put in place loan policies governing extension of credit, restructuring/rehabilitation policy for revival of potentially viable sick enterprises and non-discretionary One Time Settlement scheme for recovery of non-performing loans for the MSE sector, with the approval of board of directors.

Committees on Flow of Credit to MSE sector

Various high level committees set up by RBI have made recommendations for improving credit flow to the MSE sector. Some of the important recommendations have been tabulated as follows

Committee to Examine the Adequacy of Institutional Credit to SSI Sector and Related Aspects (Nayak Committee), 1992	▸ Preference to village, tiny and other small scale units in that order. ▸ Working capital limits to be fixed at 20% of the estimated turnover for MSE units with credit limit upto ₹ 5 Crore. ▸ Extend "single window scheme" of SIDBI to all districts to meet financial requirements of MSEs. ▸ No insistence on opening of deposit accounts for sanctioning of credit. ▸ Increase in number of specialised MSE branches. ▸ Standardise loan application forms.
High Level Committee on Credit to SSI (Kapur Committee), 1998	▸ Delegation of more power to branch managers to grant ad-hoc limits. ▸ Simplification of application forms. ▸ Freedom to banks to decide own norms of assessment. ▸ Strengthening the recovery mechanism. ▸ Simplify procedures for handling complaints and grievances and monitoring thereof.
Working Group on Flow of Credit to SSI sector (Ganguly Committee), 2004	▸ Adoption of cluster based approach for financing MSME sector. ▸ Sponsoring projects as well as publicising successful working models of NGOs by Lead Banks which service small and tiny industries and small entrepreneurs. ▸ Exploring new instruments by banks for promoting rural industry and to improve flow of credit to rural artisans, rural industries and rural entrepreneurs.
Policy Package for Stepping up Credit to Small and Medium Enterprise, 2005	▸ Public sector banks were to fix own targets for funding MSMEs to ensure a minimum 20% year on year growth in credit for MSMEs. The objective was to double the flow of credit from ₹67,600 crore in 2004-05 to ₹135,200 crore to the MSME sector by 2009-10, i.e. within a period of 5 years. ▸ Cost of credit to be linked to the credit rating of the enterprise. ▸ All banks to make efforts to grant credit to an average of atleast 5 new small/medium enterprises at each of their semi-urban/urban branches per year. ▸ Banks may ensure specialized MSME branches in clusters/centres with preponderance of small enterprises.

Working Group on Rehabilitation of Sick SMEs (K. Chakrabarty Committee), 2008	► Creation of independent rehabilitation fund for rehabilitation of micro small and medium enterprises. ► Creation of a central registry by State Governments for registration of charges of all banks. ► Formulation of scheme for utilising specialised NGOs in training of MSMEs. ► Score based lending for loans up to ₹2 crore. ► Design of simplified application forms. ► Introduction of centralized credit processing cells.

Source: RBI publications, Master Circular – Lending to MSMEs, 2010

- **Banking codes and standard board of India**

The Tarapore Committee (Committee on Procedures and Performance Audit of Public Services) setup by RBI in 2003 identified the need of measuring bank performance against a benchmark reflecting best practices (codes and standards). The committee recommended the setting up of the Banking Codes and Standard Bpard of India (BCSBI) broadly on the lines of Banking Codes and Standard Board functioning in UK.

Accordingly BCSBI was set up in 2005 as an autonomous board. BCSBI is registered as Society and its aim is to ensure that a comprehensive code of conduct for fair treatment to customers is evolved and adhered to. BCSBI functions as an independent watch agency and is not a department of RBI. BCSBI has as its members 26 public sector banks, 22 private banks, 21 foreign banks and also 8 urban cooperative banks and 14 regional rural banks (As specified by BCSBI on its website as of 24 June 2010). The primary activity of BCSBI is monitoring of Code compliance and dealing with systemic issues arising out of customer complaints.

BCSBI has formulated a Code of Bank's Commitment to Micro and Small Enterprises (MSE). This is a voluntary code which sets the minimum standard of banking practices for banks to deal with MSEs. It provides protection to MSEs and advises banks how to deal with these enterprises in their day-to-day activities and in times of financial difficulties.

The code has been developed to:

- Give a positive thrust to the MSE sector by providing access to efficient banking services.
- Promote good and fair banking practices by setting minimum standards.
- Increase transparency in rendering of services.
- Improve understanding of business through effective communication.
- Encourage market forces, through competition to achieve higher operating standards.
- Promote a fair and cordial relationship between the banks and MSMEs and also ensure. timely and quick response to banking needs.
- Foster confidence in the banking system.

Credit Guarantee Trust for Micro and Small Enterprises:

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) was set up by the Ministry of Micro, Small & Medium Enterprises (MSME), Government of India (GOI) and Small Industries Development Bank of India (SIDBI) in August 2000.The GOI and SIDBI as settlors of the Trust have committed a corpus of ₹ 2,500 Crore in the ratio of 4:1 to the CGTMSE.

CGTMSE operates the "Credit Guarantee Scheme" (CGS) which guarantees grant of collateral-free and/or third party guarantee-free credit facilities to Micro and Small Enterprises by Member Lending Institutions (MLIs). The purpose is to encourage MLIs to appraise credit proposals on the basis of viability of projects rather than merely on the basis of availability of adequate collateral. CGTMSE has 110 Member Lending Institutions (CGTMSE website as of 24 June 2010).

The key features are

- Any collateral/third party guarantee free credit facility extended by eligible lending institutions to MSMEs with a maximum credit cap of ₹100 lakh is eligible for guarantee cover.
- The guarantee cover is available up to 75%/80% of the sanctioned amount of the credit facility with maximum guarantee cap is of ₹ 62.5 Lakh /₹65 Lakh.
- Guarantee commences from the date of payment of guarantee fee and is valid for tenure of loan or 5 years whichever is earlier.
- The upfront fee varies from a minimum of 0.5% of amount sanctioned to 1.5% maximum.
- An annual service fee is also charged as a percentage of the amount sanctioned.

There is a lock in period of 18 months from the date of last disbursement of loan to the borrower or the date of guarantee coming into force whichever is later.