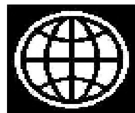
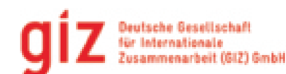
Policy Paper Series, 2011

The Global Best Banking Practices in Micro, Small and Medium Enterprises (MSME) Financing and Development

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.





Visit **www.msmefdp.net** to know more about the project.

Department for International Development

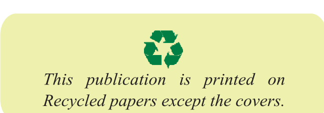
The Department for International Development (DFID) is the British Government department responsible for Britain's contribution towards international efforts to eliminate poverty. DFID works in partnership with developing country governments towards poverty alleviation. DFID supports long-term programmes to help tackle the underlying causes of poverty. DFID recognizes that the development of MSMEs is key to creating jobs and income needed to reduce poverty. DFID is supporting the development of the MSME sector in India through MSMEFDP being implemented by SIDBI.

THE GLOBAL BEST BANKING PRACTICES
IN
MICRO, SMALL AND MEDIUM ENTERPRISES
(MSME)
FINANCING AND DEVELOPMENT

DISCLAIMER

This document is an output from a project funded by the Department for International Development (DFID), United Kingdom, and being implemented by Small Industries Development Bank of India (SIDBI). The views expressed are not necessarily those of DFID/SIDBI. The contents, views, comments, etc. contained herein are mainly based on collation of different information available from sources such as online, network links of "Deloitte Touche Tohamatsu India Pvt. Ltd." - the consulting agency (which has undertaken the study), in person and other resources – both globally and nationally. While every effort has been made to avoid any mistake or omission, SIDBI /DFID/ Deloitte would not be, in any way, liable for the authenticity of information, data, views, opinions, comments etc. and for any mistake/ omission or defect in the publication of any nature, whatsoever.

No part of this publication can be reproduced in any form or by any means without the prior written permission of Small Industries Development Bank of India (SIDBI).



FOREWORD

The Micro, Small and Medium Enterprises (MSME) Sector is an important pillar of Indian Economy as it contributes greatly to growth of Indian economy with a vast network of more than 29 million units, creating employment of over 66 million, manufacturing more than 6000 products, contributing about 45% to manufacturing output and more than 50% of exports (directly and indirectly). Notwithstanding the sector's vibrancy and significance, the MSME sector faces a number of challenges, the leading one being making available adequate, timely and affordable credit by banks and financial institutions.

In order to harness the growth potential of the MSME sector and to make it more competitive as well as to address the issue of credit, the Government of India has initiated a number of facilitating measures to create an enabling environment for MSMEs. Some of the important measures during the last few years are: MSMED Act in 2006, MSE Promotional Package in 2007, Prime Minister's Task Force Recommendations, National Manufacturing Competitiveness Programme (NMCP), etc. Notably in terms of recommendations of the Prime Minister's Task Force Report on MSMEs, banks were advised to achieve a 20% annual growth in outstanding credit to micro and small enterprises. These short term and long-term measures resulted in the increase in credit flow to the MSE sector by around 5.5 times (from ₹ 746 billion as at end 2004-05 to ₹ 4079 billion as on November 19, 2010). However, in order to maintain the momentum of credit flow to the MSME Sector, it is required on our part to constantly engage in financial innovations, by adopting the international best banking practices for the MSME Sector. Various Stakeholders, viz. Banks / FI, Business Development Services providers, etc. need to proactively adopt the best practices in MSME financing & development for upscaling their business opportunity in the present challenging and dynamic environment.

On its part the Small Industries Development Bank of India (SIDBI), being the principal financial institution for the MSME Sector, has regularly been initiating a number of innovative financial products and mechanisms to accelerate the credit flow to the sector. SIDBI is also undertaking a number of Policy Advocacy measures to strengthen the credit enhancing eco-system. The present book "The Global Best Banking Practices in MSME Financing and Development" is an attempt by SIDBI in this direction. The book documents important innovative financial practices and mechanisms of the banks/ FIs of the advanced economies in providing credit to their MSME Sector. The book has also suggested

different framework for implementation in the Indian context. The various best practices documented in this book have been assimilated under key themes identified as Risk Capital, Credit Delivery, Cluster Financing, Credit Guarantee, NPA Management, Marketing, Micro Enterprise Development / Rural MSME Development, Securitization, Credit Advisory and Forex /International Funding.

This endeavour has been supported by the Department for International Development (DFID), UK under the MSME Financing and Development Project (MSMEFDP) being implemented by SIDBI along with other international partners, viz. the World Bank, KFW and GIZ, Germany. The Department of Financial Services, Ministry of Finance, Govt. of India is the Nodal Agency of the Project. I express my sincere gratitude to our international partners and the Ministry of Finance, Govt. of India for continuous support and guidance in the implementation of the Project. I also compliment Deloitte Touche Tohamtsu India Pvt. Ltd. for undertaking this project and bringing out the researched study which is expected to usher in some of the global best banking practices in India. Last but not the least, I congratulate the SIDBI Team led by Shri K. G. Alai and Shri. R. K. Das in successfully overseeing the assignment.

Rakesh Rewari
(Deputy Managing Director)

PREFACE

The Micro, Small and Medium Enterprises (MSME) Sector has emerged as an important contributor of India's ongoing growth story. The MSME sector contributes more than 45 per cent of country's manufactured output and around one-third of its exports. It also provides employment to about 66 million persons through 29 million enterprises, manufacturing more than 6000 products.

While the MSME sector is the engine of faster and inclusive growth, balanced regional development and employment creation, it is finance that acts as the fuel for speedy growth, vibrancy and buoyancy of the sector. The credit demand of the sector has diversified from simple term loan and working capital to varied forms like venture/ risk capital, factoring services, derivatives, industry specific and cluster specific financial products, as also various credit delivery channels. While the demand for credit has increased, it is the purveyors of credit like banks / FIs who have to adapt to the changing dynamics and continuously evolve tailor-made, innovative financial products.

It has been the endeavour of SIDBI to promote, finance and develop the sector through various financial instruments, information dissemination and policy advocacy measures. As a part of such initiatives, SIDBI is publishing this book on, "The Global Best Banking Practices in MSME Financing and Development". The book draws upon some of the innovative, modern financing practices by banks/FIs in developed economies. These international best practices can act as guide-posts for Indian banks/FIs for credit enhancement to the MSME sector. I am sure that the innovative banking practices delineated in this book will encourage our banks/FIs to replicate such practices for the benefit of Indian MSMEs. This will ultimately help develop an enabling banking environment to meet the emerging credit requirements of the sector, which will, in turn, contribute further to national development and economic growth. On this occasion, I extend my best wishes to all the stakeholders and entrepreneurs in the MSME sector.

N K Maini
(Deputy Managing Director)

TABLE OF CONTENTS

S. NO.	CONTENT	PAGE NO.
	GLOSSARY	**1**
	EXECUTIVE SUMMARY	**5**
1.	**CHAPTER 1: INTRODUCTION**	**13**
2.	**CHAPTER 2: SECURITIZATION**	**15**
2.1.	Best Practice S1: Using public sector guarantees for encouraging MSME Securitization	18
2.2.	Best Practice S2: Pooling of assets through multi-originator structure	22
3.	**CHAPTER 2: RISK CAPITAL**	**29**
3.1.	Best Practice RC-1: Formation of Business Angels Network (BAN) to link angel investors and MSMEs	31
3.2.	Best Practice RC-2: Development of public-private partnerships with incentives for participation of business angels in form of public guarantees & preferential returns	37
3.3.	Best Practice RC-3: Integrated lending comprising sub-ordinate debt and refinancing of senior debt portion of partner banks, with appropriate risk-reward sharing mechanism	41
3.4.	Best Practice RC-4: Diversification of investor profile with greater participation from pension funds in risk capital of MSMEs through venture capital funds	45
3.5.	Best Practice RC-5: Establishment of investment vehicles in form of Mutual Funds through public-private partnerships for channelizing venture capital funds into risk capital of MSMEs	47
3.6.	Best Practice RC-6: Strengthening the MSME sector by encouraging Foreign Direct Investments (FDI) and fostering linkages between foreign investors and local MSMEs	50
4.	**CHAPTER 3: CREDIT DELIVERY**	**53**
4.1.	Best Practice CD-1: Deployment of web-based application for loan processing and risk management through analysis of financial parameters updated in real-time	54
4.2.	Best Practice CD-2: Deployment of a web-based auction-based mechanism for identification of lenders offering the most competitive rates	56
4.3.	Best Practice CD-3: Leveraging the deployment of web-based warehouse receipt system with underlying physical inventory to increase on-lending to MSMEs	61

4.4. Best Practice CD-4: Appointment of trained “MSME Account Managers” to facilitate credit delivery to MSMEs 64

4.5. Best Practice CD-5: Introduction of credit scoring / rating tool to reduce turnaround time associated with MSME lending 66

5. CHAPTER 5: CLUSTER FINANCING 71

5.1. Best Practice CF-1: Leveraging value-chain linkages among cluster participants for credit appraisal, loan disbursement and collections 72

6. CHAPTER 6: CREDIT GUARANTEE 77

6.1. Best Practice CG-1: Extension of multi-level partial guarantees to increase on-lending to MSMEs 79

6.2. Best Practice CG-2: Partial guarantees to mutual guarantee societies and banks / FIs to facilitate direct on-lending to MSMEs or through MFIs 83

7. CHAPTER 7: NPA MANAGEMENT 91

7.1. Best Practice NPA-1: NPA management though formation of government supported Asset Management Company (AMC) 93

8. CHAPTER 8: MARKETING PRODUCTS & INFORMATION DISSEMINATION 97

8.1. Best Practice MP&ID-1: Appointment and capacity building of intermediaries for marketing of products & information dissemination 97

8.2. Best Practice MP&ID-2: Monitoring & evaluation of performance of Business Member Organizations (BMOs) with respect to services offered 102

9. CHAPTER 9: MICRO ENTERPRISE / RURAL MSME DEVELOPMENT 109

9.1. Best Practice ME/RMSMED-1: Introduction of branchless banking through deployment of “prepaid cards” for purposes of loan disbursement 111

9.2. Best Practice ME/RMSMED-2: Facilitating branchless banking through “mobile branches” 115

9.3. Best Practice ME/RMSMED-3: Introduction of branchless banking through deployment of Mobile Banking for facilitating financial transaction 117

9.4. Best Practice ME/RMSMED-4: Working capital funding using derivatives-based financial instruments (“certificates of rural product”) as collateral with cash-based settlement 122

9.5. Best Practice ME/RMSMED-5: Leveraging access to information on markets to develop partnership between buyers and sellers, along with development of partnerships for underlying working capital finance 125

10. CHAPTER 10: CREDIT ADVISORY 131

10.1. Best Practice CA-1: Leveraging credit advisory expertise to establish partnership with localized financial institutions to increase outreach 132

11. CHAPTER 11: FOREX / INTERNATIONAL FUNDING 137

11.1. Best Practice F/IF-1: Loan against foreign currency deposit to hedge the foreign exchange fluctuation risk 138

12. TIP SHEETS 143

13. REFERENCES 191

GLOSSARY

Term	Definition
Anti Money Laundering (AML)	Describes the legal controls that require financial institutions and other regulated entities to prevent or report money laundering activities.
Asset Backed Security (ABS)	A security whose value and income payments are derived from and backed by a specified pool of underlying assets, which typically cannot be sold individually.
Bond	Debt security, in which the issuer owes the holder of the security a debt, and depending on the terms of the bond, is obliged to pay interest and / or to repay principal at a later day.
Capital Adequacy	Ratio of bank's capital to its risks used to track ability to absorb a reasonable amount of loss and compliance with statutory capital requirements. Measure of bank's core capital expressed as a percentage of its assets weighted credit exposures.
Capital Allocation	Division of financial resources and other sources of capital to different processes, people and projects so that it generates as much wealth as possible for the concerned stakeholders.
Capital Gains Tax	Tax charged on capital gains, i.e. the profits realized on sale of a non-inventory asset that was purchased at a lower price.
Capital Market	Market for securities (debt or equity) which are used to raise long term funds from investors by businesses or Government.
Capital Structure	Combination of equity, debt or hybrid securities used by a company to finance its assets and business.
Collateral	Properties or assets that are offered by the borrower to the lender to secure a loan or other credit and serves as a protection in case of default.
Collateralized Loan Obligation (CLO)	Form of securitization where payments from multiple loans are pooled together and passed onto different class of owners in various tranches.
Convertible Bonds	A bond that can be converted into a predetermined amount of the company's equity at certain times during its life, usually at the discretion of the bondholder.
Counter Guarantee	Back-to-back guarantee given by an obligor to indemnify a surety in a three-party contract. A counter guarantee is cashed in the unexpected event the obligor fails in the performance of a contract and the obligee calls upon the surety to honor the bond (guaranteed by the surety on behalf of the obligor).
Credit Appraisal	Process by which a lender appraises the technical feasibility, economic viability and bankability including creditworthiness of the prospective borrower in terms of ability to repay the loan amount within a stipulated time.
Credit Bureau	Company that collects information from various sources and provides consumer credit information on individual consumers for a variety of uses. Provides information on individuals' borrowing and bill paying habits which helps lenders assess credit worthiness, the ability to pay back a loan, and can affect the interest rate and other terms of a loan.

Term	Definition
Credit Default Swap (CDS)	Bilateral contract between the buyer and seller of protection wherein the buyer makes a series of payments to the seller and in exchange receives a payoff if the underlying credit instrument experiences a credit default.
Credit Guarantee	A guarantee offered to a lender, usually by the government, that a borrower will repay a sum even without security to cover it.
Credit Linked Notes (CLN)	A security with an embedded credit default swap allowing the issuer to transfer a specific credit risk to credit investors without worrying about any obligation to repay in case of default.
Credit Risk	The risk of loss of principal or loss of a financial reward for a lender / investor stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation.
Credit Rating Agency	Company that assigns credit ratings for issuers of certain types of debt obligations as well as the debt instruments themselves. In some cases, the servicers of the underlying debt are also given ratings.
Credit Score	Numerical expression based on a statistical analysis of a person's credit files, to represent the creditworthiness of that person. Primarily based on credit report information typically sourced from credit bureaus.
Credit Spread	Difference in yield between different securities due to different credit qualities
Delinquency Rate	The percentage of loans within a loan portfolio that have delinquent payments.
Derivative	A financial instrument that has a value, based on the expected future price movement of the underlying asset.
Development Capital	Equity funding for expansion of established and profitable firms which is generally less risky and more rewarding than funding new ventures.
Due Diligence	An investigation or audit of a potential investment in order to confirm all material facts in regards to a sale and prevent unnecessary harm to either party involved in a transaction.
Equifax	Equifax Inc. is a consumer credit reporting agency in the United States, considered as one of the three largest American credit agencies along with Experian and TransUnion.
Factoring	Financial transaction whereby a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount in exchange for immediate money with which to finance continued business.
Foreclosure	Legal process by which a mortgagee or other lien holder, usually a lender, obtains a court ordered termination of a mortgagor’s equitable right of redemption.
Forex risk	Risk of an investment's value changing due to changes in currency exchange rates.
Future	A financial contract obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange.
Growth Capital	Type of private equity investment, most often a minority investment, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a significant acquisition without a change of control of the business.

Term	Definition
Hedging	Establishing position in a market in an attempt to offset exposure to price changes or fluctuations in some opposite position with the goal of minimizing exposure to unwanted risk.
Know Your Customer (KYC)	Due diligence and bank regulation that financial institution and other regulated companies must perform to identify their clients and ascertain relevant information pertinent to doing financial business with them in order to prevent identity theft fraud, money laundering and terrorist financing.
Letter of Credit	Document issued mostly by a financial institution guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the financial institution will be required to cover the full or remaining amount of the purchase.
Mezzanine Financing	Refers to unsecured funding that represents a claim on a company's assets which is senior only to that of the shareholders and junior to the senior debt providers.
Mutual Funds	Professionally managed type of collective investment scheme that pools money from many investors and invests in investment securities like stocks, bond etc.
Net Interest Margin	Measure of difference between the interest income generated by financial institutions & banks and the amount of interest paid out to their lenders, relative to the amount of their interest earning assets.
Over Collateralization	Process of posting more collateral than is needed to obtain or secure financing and is often used as a method of credit enhancement by lowering the creditor's exposure to default risk..
Pension Fund	Any plan, fund or scheme which provides retirement income.
Primary Market	Part of capital market that deals with issuance of new securities via underwriting.
Prime Lending Rate	Reference interest rate that commercial banks charge their most credit-worthy customers.
Private Equity	Asset class consisting of equity securities in operating companies that are not publicly traded on a stock exchange.
Public Private Partnership	Public–private partnership (PPP) describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies.
Purchase Order based financing	Facilitating financing of raw materials to fill orders from buyers by assignment of the purchase order by the seller to the lender.
Quasi-equity	A category of debt taken on by a company that has some traits of equity, such as having flexible repayment options or being unsecured. Examples of quasi-equity include mezzanine debt and subordinated debt.
Refinancing	Replacement of existing debt obligation with a debt obligation under different terms & conditions.
Regulatory Capital	Amount of risk capital held by a financial institution in order to meet the net worth criterion and risk weightage framework as laid down by the applicable regulatory agency.
Risk Capital	Refers to unsecured funds in form of pure equity and quasi equity / mezzanine financial products.

Term	Definition
Secondary Market	Capital market where existing securities are sold and bought among investors or traders.
Seed Capital	Initial capital used to start a business, which often comes from the company founders' personal assets or from friends and family. Primarily needed for research & development, to cover initial operating expenses until a product or service can start generating revenue, and to attract the attention of venture capitalists.
Single Window Clearance	Mechanism for increasing the efficiency through time and cost savings for investors in their dealings with various government authorities for obtaining the relevant clearance and permit(s) for establishing industries.
Soft-loan	A loan with an interest rate which is below prevailing market rate.
Special Purpose Vehicle (SPV)	Also referred to as a "bankruptcy-remote entity" whose operations are limited to the acquisition and financing of specific assets. The SPV is usually a subsidiary company with an asset/liability structure and legal status that makes its obligations secure even if the parent company goes bankrupt.
Sub-ordinate Debt	A loan (or security) that ranks below other loans (or securities) with regard to claims on assets or earnings. In the case of default, creditors with subordinated debt wouldn't get paid out until after the senior debt-holders were paid in full thereby making it more risky than unsubordinated debt.
Technology Transfer	Process of sharing of skills, knowledge, technologies, methods of manufacturing, samples of manufacturing and facilities among governments and other institutions to ensure that scientific and technological developments are accessible to a wider range of users who can then further develop and exploit the technology into new products, processes, applications, materials or services.
Tranche	Tranche is a term often used to refer to one of a number of related securities offered as part of the same transaction, with different levels of credit rating.
UID Project	Project aimed at issuing every resident a unique identification number linked to the resident's demographic and biometric information, which they can use to identify themselves anywhere in India, and to access a host of benefits and services.
Underwriting	Underwriting refers to the process that a financial service provider (bank, insurer, investment house) uses to assess the eligibility of a customer to receive their products (equity capital, insurance, mortgage, or credit).
Venture Capital	Venture capital (VC) is financial capital provided to early-stage, high-potential, growth startup companies who have not reached the point where they are able to secure a bank loan or complete a debt offering.
Warehouse Receipt based financing	Working capital financing based on warehouse receipts, issued against deposit of physical inventory, acting as the underlying collateral for the lender.
Warrant	Security that gives the holder the right to purchase securities (usually equity) from the issuer at a specific price within a certain time frame.
Zero Coupon Bond	Also called a discount bond or deep discount bond which is bought at a price lower than its face value, with the face value repaid at the time of maturity. It does not make periodic interest payments, or have so-called coupons.

EXECUTIVE SUMMARY

INTRODUCTION

One of the key goals of the MSME Financing and Development Project (MSMEFDP) is to make MSME financing & development an attractive and viable option for banks / financial institutions in India to increase their outreach in the MSME sector. Considering the existing issues & constraints impacting the ability of MSMEs in accessing finance, markets, inputs etc. for optimum development, this initiative is likely to be a key driver for ensuring growth of the MSME sector which has been estimated to contribute to around 45% and 40% to the industrial output and national exports respectively.

Considering the significant impact of this sector in ensuring inclusive growth of the Indian economy; Small Industries Development Bank of India (SIDBI), as the implementing agency for MSMEFDP, has mandated Deloitte Touche Tohmatsu India Private Limited (Deloitte) to conduct a study on the global best banking practices in MSME financing and development as part of this project. The key areas of the study include:

- Identification of issues/ constraints in MSME's access to financing & development based on assessment of policy & regulatory framework and understanding of current practices of banks/ FIs for MSME financing & development.
- Study and documentation of best practices including high level assessment of risk management practices in MSME financing for the benchmarked banks/ FIs, both in India and comparable economies.
- Identification of areas of intervention in terms of policy/ regulation support from Government, introduction of new financial instruments & modes of credit delivery and portfolio monitoring along with allocation of roles & responsibilities among key stakeholders.
- Recommendations on strategy for periodic update and dissemination/ sensitization of identified best practices.

The outcome of the study is this compendium on best practices which attempts to not only document these but also identifies critical policy & regulatory enablers which can facilitate implementation of the respective best practice in the Indian context.

APPROACH & METHODOLOGY

Given the objective and scope of the study, Deloitte adopted the following approach and methodology:

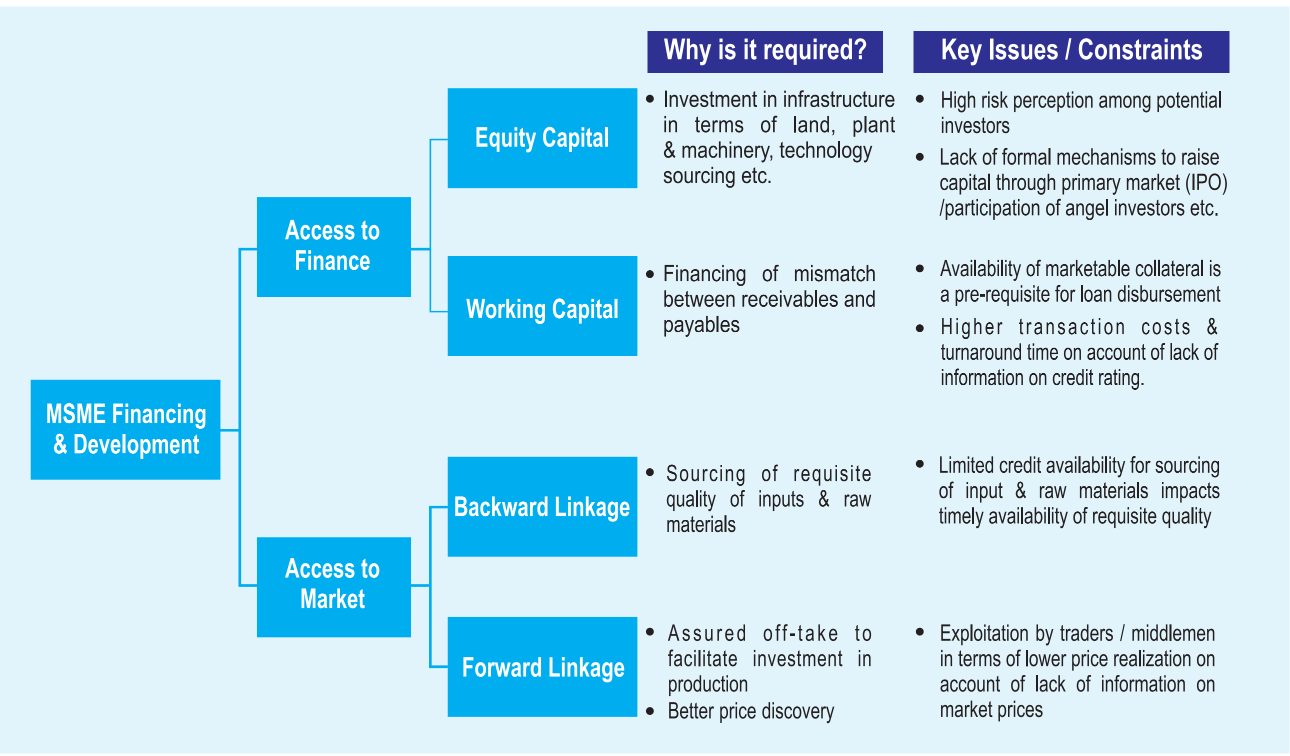
- Identification of best practices in the context of financing & development of MSMEs based on

analysis of applicable case studies from economies comparable to India for the specific MSME financing & development related themes.

- Identification of critical success factors and key enablers which facilitated the adoption of the respective best practice in the associated countries.
- Assessment of the adaptability of identified best practices in the Indian context and development of illustrative route map in terms of identification of requisite interventions by concerned stakeholders, including support from Government in terms of formulation of policy & regulatory enablers.
- High-level cost-benefit analysis for select best practices recommended for implementation in the Indian context.

KEY FOCUS AREAS IN MSME FINANCING AND DEVELOPMENT

In spite of the diversity associated with the Indian MSME sector in terms of product / service offerings, size of enterprises, varying levels of technology adoption, focus on domestic vis-à-vis export markets etc; it is found that the issues & constraints impacting the MSME financing and development can be mainly categorized under the following generic themes:



It has been attempted to identify the applicable best practices in order to address the representative issues and constraints identified above for the key financing & development related themes identified. Highlights of the findings have been presented in the subsequent sections.

ACCESS TO EQUITY / RISK CAPITAL

Highlights of the best practices

Risk capital in the MSME context refers to the unsecured funds in the form of pure equity or quasi-equity / mezzanine financial products with features of both debt & equity for meeting the seed, development and growth capital requirements at respective phases of life-cycle of an MSME. There have been various initiatives taken across the globe to facilitate greater access to risk capital by diversification of the existing investor profile along with grant of requisite fiscal & monetary benefits for potential investors. Highlights of the respective best practices are detailed below:

	Highlights of best practices	Illustrative examples
Diversification of investor profile	● Participation of angel investors in the seed and start-up capital of MSMEs through formation of Business Angel Networks (BANs) which match the investment preferences of angel investors with equity requirements of MSMEs. ● Matching of respective preferences facilitated leveraging an online platform supported with physical presence in vicinity of MSMEs.	● NatWest Angels Service of NatWest Bank in UK. ● Online platform of California Investment Network Inc in USA. ● BAN of Gavea Angels in Brazil.
	● Participation from Government pension funds in venture capital funds, established as public private partnerships with participation from other private investors as well. Fund management, including fund raising, allocated to professional fund managers registered with respective Regulatory body. ● Regulatory support in terms of authorizing pension funds to invest a certain proportion of their equities in these venture capital funds.	● Fundo Mútuo de Investimento em Empresas Emergentes ("FMIEE" – venture capital investment vehicles) in Brazil. ● Fondo Transandino Peru ("FTP" – venture capital investment vehicle managed by a venture capital firm) in Peru.
Fiscal & monetary benefits for potential investors	● Establishment of "seed capital" funds as public-private partnership involving public sector FI (Financiadoras de Estudos e Projectos – "FINEP") as the key promoter. Fund structure to be proposed by professional fund managers who are responsible for fund raising. ● Fund Structure: FINEP to have a maximum stake of 40%, angel investors to have minimum stake of 20% with the balance to be funded by locally based development focused banks. ● Up to 20% of the principal investment by angel investors guaranteed by FINEP in event of default along with grant of preference to angel investors in distribution of profit.	● INOVAR Semente project by FINEP (Brazilian Innovation Agency – public sector financial institution) in Brazil.
	● Sub-ordinate debt advanced by the German Government development bank (KfW) was matched by partner banks in form of senior debt, which in turn was refinanced by KfW through a soft loan. ● Deal origination role assigned to partner bank with incentive in form of "success fee" on complete repayment. In event of default, partner bank was obligated to repay the soft loan advanced by KfW, leveraging the liquidation of underlying collaterals.	● Entrepreneurial Capital Mezzanine Financing (ECMF) model adopted by KfW in Germany.
	● Enactment of requisite policy & regulatory enablers in forms of tax incentives, single window clearance mechanisms, infrastructure development etc to attract Foreign Direct Investment in MSMEs.	● Various countries like China, Malaysia, Singapore etc.

Critical Success Factors

Some of the key critical success factors which have contributed to the successful implementation of the above best practices in the respective countries include the following:

- Government support in form of enactment of requisite policy & regulatory enablers like provision for pension funds to invest in equities, grant of capital protection to angel investors through "guarantee funds", taxation related incentives etc.
- Development of implementation framework, with allocation of responsibilities to respective stakeholder in line with their core competencies. For example, i) banks with access to MSMEs were given role of deal origination based on their due-diligence & credit worthiness of the borrowers in ECMF model, ii) professional fund managers were given responsibility of fund raising & structuring along with ongoing management in Brazil etc.
- Information availability in terms of i) transparent sharing of relevant investment requirements & preferences with concerned stakeholders, ii) knowledge of applicable rules & regulations governing FDI norms etc.

ACCESS TO WORKING CAPITAL

Highlights of the best practices

Availability of working capital loans for MSMEs is typically characterized by relatively high interest rates along with requirement of pledging marketable collaterals with the lender. On account of the limited scale of operations & financial resources available with the MSMEs, timely availability of working capital impacts the ability of MSMEs to make the requisite investments in production of goods / rendering of services as per the requisite quality norms. This timely availability of working capital is further impacted with the lack of deployment of innovative credit delivery mechanisms to increase outreach among the MSMEs. In order to address these issues, the key aspects of select global best practices have been highlighted below.

	Highlights of best practices	Illustrative examples
Collateral free lending	• Underlying commodity product is deposited with warehouse of a central regulatory body against issue of online warehouse receipt, which is leveraged for availing financing by producer. • Formation of a closed user group governed by rules of central regulatory body ensures quality monitoring of underlying produce. • Treatment of warehouse receipt as a negotiable receipt with provision for transfer, subject to registration with a central regulatory body for purposes of monitoring & tracking. Cancellation of receipt on repayment by producer to financer.	• Web-based warehouse receipt system deployed by Dubai Metal & Commodity Centre.

	Highlights of best practices	Illustrative examples
Collateral free lending	• Financer leverages relationship with key buyers in the value-chain of respective commodities to finance the suppliers to the respective buyer. • Rights secured on sellers' receivables from the buyer on account of sale of produce by the respective seller. Before disbursement by the buyer, the loans due for the respective seller are netted off and transferred by the buyer to the financing institution directly. • Credit worthiness assessment and requisite due-diligence is conducted by the financing institution in partnership with the respective buyer.	• Financing for soybean clusters by Financiera El Comercio (MFI) in Paraguay. • Financing for coffee growers by FIE (MFI) in Bolivia. • Financing by Tribanco for retailers associated with largest wholesale distributor in Brazil. • DrumNet model in Africa (Kenya).
	• Introduction of financial instruments (Certificate of Rural Products – CPRs) in form of derivatives with underlying asset corresponding to agricultural produce. • Contractual agreement with loan advancement by lender to producer against commitment to repay the loan through proceeds from liquidation of the produce specified in terms of quantity, quality, date and price. • Treatment of CPR as a negotiable receipt with provision for transfer, subject to registration with a central regulatory body for purposes of monitoring & tracking. Cancellation of CPR on repayment by producer to financer.	• Working capital financing by Bank of Brazil leveraging the CPRs.
Reduction of cost of borrowing	• Development of an integrated web-based application for facilitating loan processing, including origination & underwriting. • Provision for submitting requisite details for availing credit through online application along with integration with risk management tool to identify acceptable profiles for credit disbursement. • Continuous monitoring of key financial parameters to assign dynamic "credit" limits, with exception-based monitoring.	• Web-based application developed by SMEloan in China. • Application Process System (APS) operated by United Bulgarian Bank.
	• Web-based auction-based mechanism for identification of most competitive rates from interested lenders for respective loan requests, usually applicable primarily for micro enterprises. • Access to credit related information on respective borrower to individual lenders. • Loan administration responsibilities taken up by the respective agencies operating the web-based mechanisms.	• Prosper in USA • Zopa in UK

	Highlights of best practices	Illustrative examples
Reduction of cost of borrowing	• Multi-level guarantees with the first level of guarantee offered by the local association of MSMEs / regional guarantee funds to ensure lower borrowing costs. • Second level of guarantee offered by national-level aggregation of the local MSME associations / centrally sponsored Guarantee Funds with private participation in select cases.	• CONFIDI model in Italy • Mutual Guarantee Societies along with SPGM in Portugal • Fondo Nacional De Garantias ("FNG") model in Columbia.
	• Issue of HSBC "prepaid cards", electronically loaded with cash derived from a central pooled account managed by FINCA (Foundation for International Community Assistance International), for which FINCA holds a line of credit with HSBC. • Cash credit for individual MSME corresponds to loan limits recommended by FINCA based on past credit history assessment. Helps MSMEs avail of loans as per specific requirements in stages, based on approved credit limit, at conveniently located ATMs without need to visit physical bank branches.	• Project launched by FINCA International in Mexico.
	• Introduction of mobile vans equipped with requisite infrastructure to increase outreach of financial services to MSMEs. These function as "mobile bank branches" with presence of bank officials for addressing specific queries.	• Mobile vans deployed by Opportunity Bank of Malawi.
	• Development of mobile based transaction platform in collaboration with telecom service providers with requisite security authentication for each transaction. • E-money credit to respective users account, based on physical cash deposited with the network operated by the transaction platform provider / loan sanctioned by the bank associated with the platform. • Loan repayment enabled through the transaction platform with direct credit to the unique account number of the loan provider.	• M-PESA programme in Kenya. • G-Cash services in Philippines.

Critical Success Factors

Some of the key critical success factors which have contributed to the successful implementation of the above best practices in the respective countries include the following:

- Government support in form of enactment of requisite policy & regulatory enablers like grant of licenses for mobile banks, permission for conducting financial transaction over the mobile network, facilitating negotiability of warehouse receipt & CPRs, defining the scope of "guarantee funds" to include funding to MSME clusters / groups etc.
- Investments in requisite technology to support the interventions aimed at reducing loan processing time & costs, including transaction platform for mobile-based banking, web-based auction system

to identify the most competitive rates from potential lenders, integrated web-based application for loan processing etc.

- Capacity building for the key intermediaries in form of cluster level agents / business development service providers to ensure information dissemination on various credit delivery channels among the MSMEs to increase outreach of financial services.

ACCESS TO MARKET

Highlights of the best practices

Access to markets in terms of requisite backward and forward linkages is imperative for MSMEs in order to meet the specific customer requirements in terms of quality, quantity and delivery deadlines along with assurance on relatively fixed price. On account of limited reach and knowledge of MSMEs with respect to national & international markets, they are often exploited by traders / middlemen in terms of price realization for product / service offerings. The highlights of select global best practices implemented in various countries to address these key issues have been highlighted below.

	Highlights of best practices	Illustrative examples
Backward & Forward Linkages	• Establishment of linkages with "reputed" buyers in form of underlying purchase order / contract with specification on quality, quantity, delivery deadlines and pricing. • Organization of producers into self-guaranteed groups focused on specific commodities. • Provision for supply of requisite quality of agri-inputs like fertilizers, seeds, equipments etc from empanelled input suppliers on credit with the underlying purchase order / contract serving as the collateral. • Rights secured on producers' receivables from the buyer on account of sale of produce by the respective producer. Before disbursement by the buyer, the loans due against input supply for the respective producer is netted off and transferred by the buyer to the financing institution. • Credit worthiness assessment and requisite due-diligence is conducted by the financing institution in partnership with the respective buyer. • Appointment of specific intermediaries (post training) to provide hand-holding support during the entire production cycle.	• DrumNet model in Africa (Kenya). • Financing for coffee growers by FIE (MFI) in Bolivia. • Financing by Tribanco for retailers associated with largest wholesale distributor in Brazil
	• Capacity building of key cluster based intermediaries like business development service providers to offer marketing support in terms of establishment of backward and forward linkages. • Development of monitoring & evaluation framework for these cluster based intermediaries to assess their effectiveness in offering market development related services.	• PEAC project in Indonesia. • Monitoring of BMO performance in South-East European countries

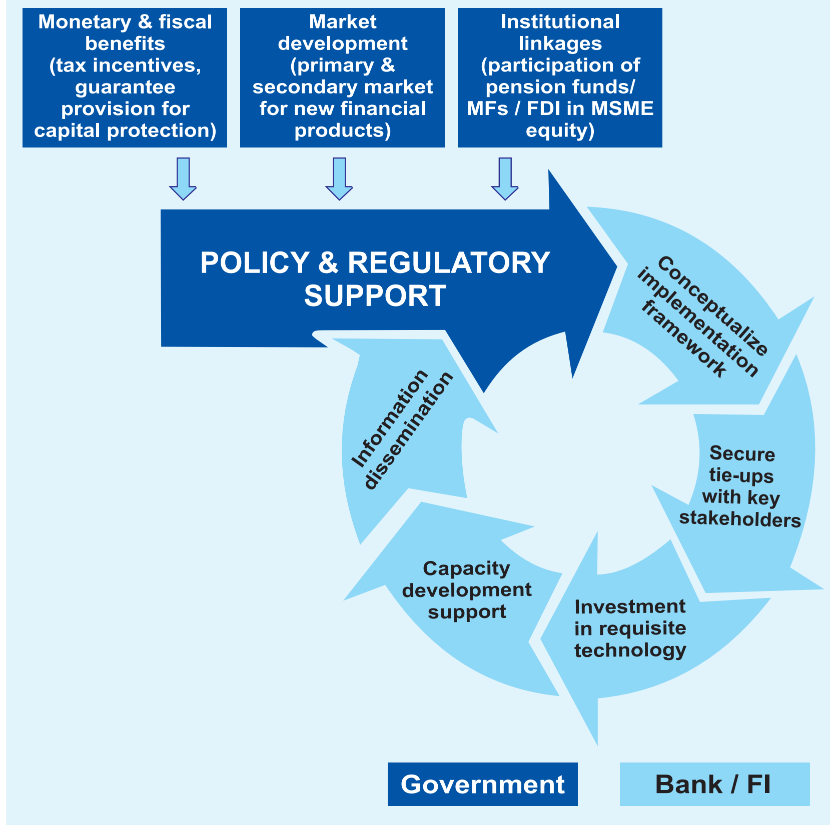
Critical Success Factors

Some of the key critical success factors which have contributed to the successful implementation of the above best practices in the respective countries include the following:

- Ability to source purchase orders / contracts with reputed and credit-worthy buyers, leveraging past business relationships, contacts and association with international development oriented agencies working in area of MSME development.
- Ensuring production in line with customer requirements by providing requisite inputs, including hand-holding support through market development intermediaries. These intermediaries are appointed based on a selection process which involves gauging their existing ability to provide requisite inputs along with training / capacity development requirements.
- Ensuring transparency in price realizations from the underlying contract / purchase order.

INTRODUCTION OF THE IDENTIFIED GLOBAL BEST PRACTICES IN INDIA

Having reviewed the highlights of the key global best practices associated with MSME financing and development along with the associated critical success factors for their implementation, it is envisaged that the Government would have to play a key role in facilitating the replication of these global best practices in India by putting in place the requisite policy & regulatory enablers. The adjoining figure captures the proposed framework, highlighting the specific role of Government and banks / financial institutions, for facilitating MSME financing and development in India.



It is evident from this figure that the Government support would be a pre-requisite for making MSME financing & development an attractive and viable option for banks / financial institutions in India. With the creation of an enabling environment through Government intervention in form of policy & regulatory enablers, it is envisaged that the banks / financial institutions in India would be incentivized to make the requisite investments in resources and personnel to ensure the successful replication of the global best practices detailed in this report.

CHAPTER 1

INTRODUCTION

One of the key goals of the MSME Financing and Development Project (MSMEFDP) is to make MSME financing an attractive and viable option for banks/ financial institutions in India. The project also aims to facilitate growth and employment in the sector. Small Industries Development Bank of India (SIDBI) is the implementing agency for MSMEFDP. With the view to popularizing MSME financing & development by banks/ financial institutions in the country, SIDBI has undertaken a policy advocacy project on global best banking practices in MSME financing and development under MSMEFDP. The key objectives of the study include:

- Identify issues/ constraints in MSME's access to financing & development based on assessment of policies and regulatory framework and understanding of current practices of banks/ FIs for MSME financing & development.
- Study and document best practices including high level assessment of risk management practices in MSME financing for the benchmarked banks/ FIs in India and comparable economies.
- Identify areas of intervention in terms of policy/ regulation, new financial instruments, modes of credit delivery and portfolio monitoring.
- Recommendations on strategy for periodic update and dissemination/ sensitization of identified best practices.

The outcome from the study is a compendium on global best banking practices which can be leveraged for financing and development of the MSME sector in India. Leveraging SIDBI's policy advocacy role, it is expected that critical policy & regulatory enablers for introducing identified best practices would be followed up with policy makers and banking practioners for creating an enabling environment for the growth of the MSME sector.

Scope of Work & Deliverables

In line with the objectives of the project, the following key themes had been identified as focus areas for purposes of identification of best practices associated with financing & development.

Table 1: Key Thematic Areas and representative products / issues

Thematic Area	Representative Standard Products & Issues
Securitization	True Sale and Synthetic Sale Securitization
Risk Capital	Venture Capital, Mezzanine Financing
Credit Delivery: Lending models, Risk Management	Relationship based / scoring based lending models and risk measurement (segment wise scoring & rating)
Cluster Financing	Cluster-specific intermediaries for risk profiling and financing in order to reduce transaction costs
Credit Guarantee	Portfolio Model, Intermediary-Wholesale Model and Reciprocal Guarantee Societies
NPA Management	Asset Management / Reconstruction Company
Marketing Products & Information dissemination on the same	Product outreach, Channel development
Micro Enterprise/ Rural MSME Development	“Prepaid Card” based loan disbursement
Credit Advisory	Syndication advisory, business advisory
Forex/ International Funding	Foreign Currency Loan, External Commercial Borrowing

The report details 26 best practices for the above-specified themes. The report also incorporates the Tip Sheets for the best practices.

CHAPTER 2

SECURITIZATION

Highlights

- A form of financing which, in its true form, involves the pooling of financial assets and sale to a third party for mobilizing resources.
- Risk Transfer mechanism that allows loan originators to optimize Regulatory Capital requirements.
- Provides the flexibility to enhance the risk profile of a loan portfolio through suitable credit enhancement wraps from third parties.
- A rapidly growing asset class with proven benefit for emerging market borrowers.

Theme Description & Benefits to MSMEs

Securitization is defined as financing or refinancing of the income-yielding assets by packaging them into a tradable, liquid form through the issuance of bond or other securities (known as Asset Backed Securities or ABS) that are repaid from the cash flows generated by these assets.

This is generally accomplished by sale of the assets to a bankruptcy remote Special Purpose Vehicle (SPV) which finances the purchase through the issuance of bonds which are backed by the future cash flows of the asset pool. This achieves the outcome of creating a class of securities for which the underlying risk is independent from that of the originating institution.

Benefits from the viewpoint of MSMEs access to finance

- Augmentation of resources through refinance which could be used for additional funding of MSMEs.
- Potentially lower cost of refinance through the portfolio approach and credit enhancements.
- Potential relief from capital charges through reduction in risk weights for securitized portfolios.

Variants

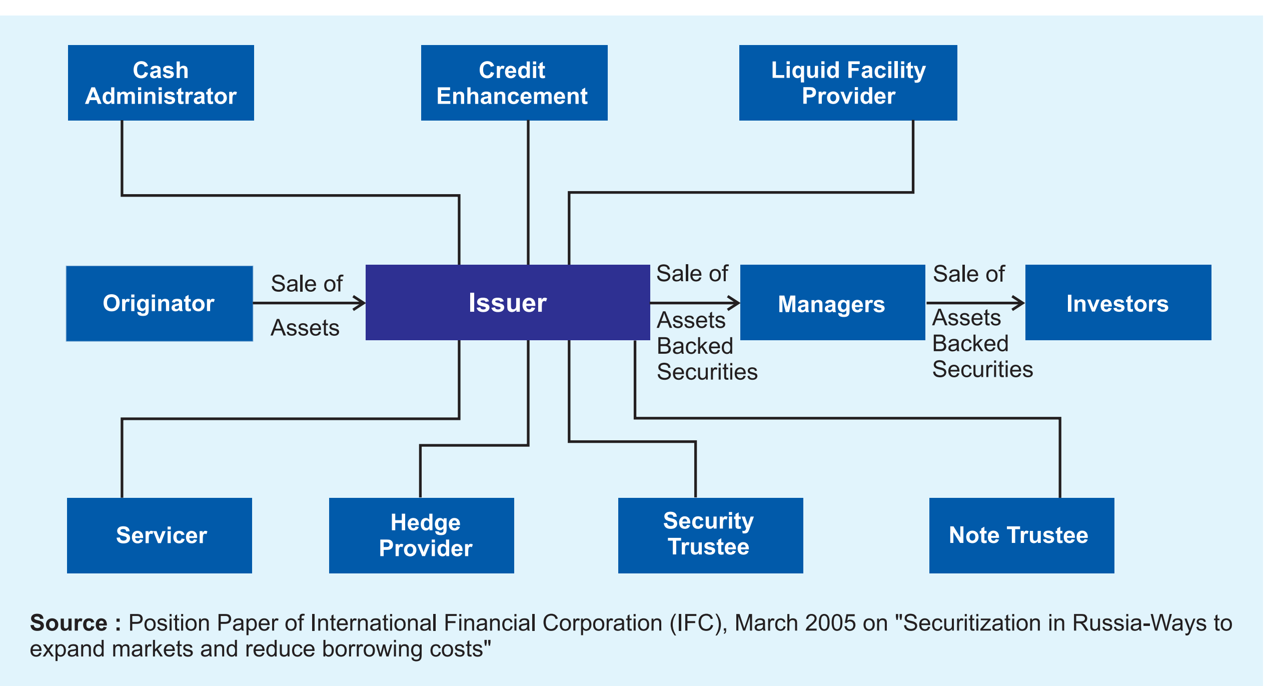
True Sale Securitization

The typical steps in True Sale securitization are as follows (please refer Figure1 in the next page):

- The Originator (owner and generator of the asset to be securitized, usually a bank) sells specific loan portfolios to the Purchaser.
- The Purchaser/Issuer is usually a Special Purpose Vehicle (SPV) which funds the purchase price by

issuing asset-backed securities in the capital markets. The main purpose of SPV in a securitization transaction is to separate the asset from the obligations of the originator, and take it out from its Balance Sheet.

- The assets securitized will be serviced by the Servicer (often the Originator retains this role). For instance with respect to loans sold to the Purchaser, the Originator will continue, on behalf of the Purchaser, to collect principal and interest from the borrowers on such loans and wherever appropriate, take enforcement action in respect of defaulted loans.
- The Purchaser will appoint a Cash Administrator to make all relevant payments on its behalf and it is also likely to appoint a company to provide company secretarial and other administrative functions.
- The Purchaser funds the purchase of the above-mentioned assets by selling asset-backed securities (whose performance is dependent on the performance of the assets securitized) to investors through identified investment bankers (also known as Lead Managers). Depending on the depth of capital markets in the specific country, a public issue of asset backed securities may also be arranged for placing these with institutional and retail investors.



Source : Position Paper of International Financial Corporation (IFC), March 2005 on "Securitization in Russia-Ways to expand markets and reduce borrowing costs"

Figure 1: Structure for True Sale Securitization

Synthetic Securitization

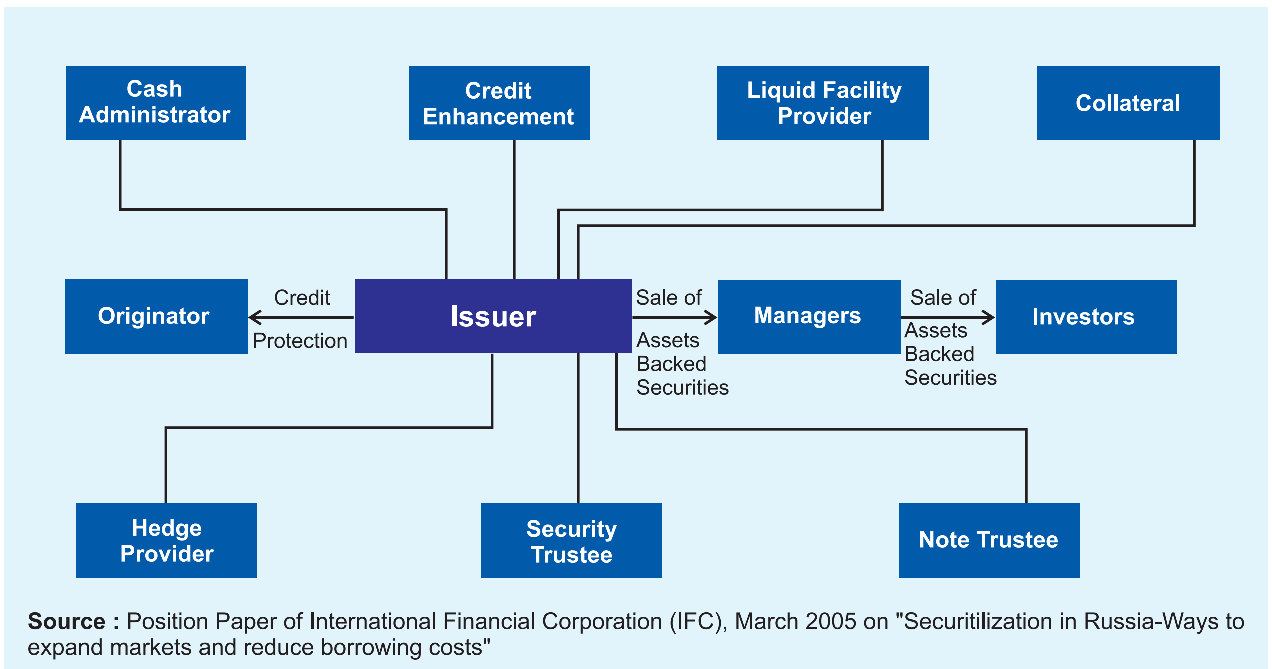
A Synthetic Securitization (schematic overview given in Figure 2 in the next page) is very similar to a “true sale” with most of the structural features being the same. The key differences vis-à-vis the “true sale” securitization model is as follows:

- The Originator (a bank) does not sell any assets to the Issuer (and therefore does not obtain any

funding or liquidity under the transaction). Instead, the Originator enters into a credit default swap with the Issuer in respect of an asset or pool of assets.

- Under this contract, the Issuer pays the Originator an amount equal to any credit losses suffered in respect of such asset or pool of assets (less a minimum threshold amount—similar to an “excess” in insurance). The Originator’s exposure to those assets is therefore transferred to the Issuer for which the Originator pays a fixed amount (premium) to the Issuer.
- The Issuer’s income streams in a synthetic transaction are the fixed amounts paid by the Originator under the credit default swap and interest amounts received on the collateral.
- The Issuer issues bonds to Investors through the Lead Manager. In order to collateralize its obligations under the credit default swap and the bonds, the Issuer usually purchases securities as collateral. These are normally highly rated government debt securities. They also need to be relatively liquid in order that they can be sold and the proceeds used to pay amounts under the credit default swap or bonds as the case may be.

The advantage of synthetic securitization is that it avoids legal transfer of ownership/collateral and removes the intervention between originator and the customer relationship (e.g. notification, consent, etc.). However, it should be noted that multiple pooling and slicing of asset pools through the credit default swaps or other such instruments may increase the complexity associated with such transactions, resulting in a loss of transparency for concerned investors.



Source : Position Paper of International Financial Corporation (IFC), March 2005 on "Securitilization in Russia-Ways to expand markets and reduce borrowing costs"

Figure 2: Structure for Synthetic Securitization

2.1. Best Practice S-1: Using public sector guarantees for encouraging MSME Securitization

The concept of securitization was first introduced in the US in the 1970s and later adopted in the European markets in early 1990s. Other markets like Asia and South Americas introduced securitization during the 1990s. Unlike other asset classes like auto loans, mortgage, etc. it is observed that securitization of SME loan is still evolving in correlation to the levels of maturity of the SME sector in the respective countries. It has been observed that SME loan securitization is relatively focused in the US and select regions of Europe. One of the key drivers for the same can be attributed to the use of public sector guarantees for SME securitization. This has been substantiated by the findings of Global Financial Stability Report 2004, published by IMF along with surveys conducted by Euro Debt Market Association (AMTE) and GBRW in 2004 on asset backed securities. The impact of this best practice adopted in US and Germany has been highlighted as below:

- **US Market**: Value of asset backed securities market in the US was estimated at USD 700 bn[1] (₹ 35,000 bn) in 2006, registering a CAGR of around 11% over the 2000-2006 period. It is estimated that the share of SME loans in this market in 2006 was only around 2%, i.e. around USD 14.5 bn[2] (₹ 725 bn), with a CAGR of around 55% during the 2000-2006 period.

  Hence, it is observed that the growth rate achieved by SME loans is around 5 times the growth achieved by entire asset backed securities market during the 2000-2006 period, primarily on account of lower base of SME loans in late 1990s and early 2000s. Other key driver for the same is the public guarantee role played by the Small Business Administration ("SBA") in the US SME securitization market, which guaranteed around 70% (i.e. USD 10.2 bn or ₹ 510 bn) of the total SME loan securitization transaction value in US in 2006[3].

- **European Market[4]:** Value of asset backed securities market in Europe was estimated at USD 488 bn (₹ 24,400 bn) in 2006. It is estimated that the share of SME loans in this market in 2006 was only around 3%, i.e. around USD 15 bn (₹ 750 bn). However, it is observed that select asset backed securities markets like Germany had a relatively higher share of SME loans in the asset backed securities market of around 27%.

  Hence, it is observed that the share of SME loans in the German market is around 9 times of the aggregate share of SME loans in the European asset back securities market. One of the key reasons for the relatively better performance of the German market can be attributed to the launch of "PROMISE" programme in 2000 by KfW (German promotional bank). Since its inception in 2000, this programme had sealed around 21 SME loan securitization deals, with default risk of around USD 44 bn (₹ 2,200 bn) transferred to investors in the period 2000 - 2006.

The details of the identified case studies along with the corresponding best practices adopted in the US and Germany have been presented in Table 2 in the next page.

---

[1]Source: Presentation on SME Financing and the SME ABS Market in Europe by Michel Noel, Lead Finance Sector Specialist, World Bank
[2]Source: Special Report on Structured Finance by Moody's Investors Service dated August 25, 2006
[3]Source: Report titled "Banking on the SBA" by Veronique de Rugy, Mercatus Center, George Mason University
[4]Source: Final report on SME Securitization, published by European Commission

Table 2: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
USA/SBA (True Sale)[5]	1. SME finance in the US is supported at the Federal level by Small Business Administration (SBA) which is an independent agency. SBA takes care of advocacy and support role for SME including finance support. 2. SBA 7(a) was one such financing initiative for SME where the Federal government guarantees from 50% to 85% based on the size of the loan. 3. Later on, a secondary market for above guarantee loan was developed, supported by legislation (such as SBA Act 2004) which provides central registration and servicing of loans sold by SBA. This allowed pooling, efficiency and liquidity of SBA loans necessary for securitization. SBA guaranteed assets carried zero weighting for regulatory capital purposes. 4. Initially the guaranteed portion of the pool was securitized and unguaranteed portion was retained by lender. 5. Going forward, a specific legislation was passed aimed at encouraging securitization of un-guaranteed portion of such loans with credit enhancement provided by over-collateralization, letters of credit and excess credit spreads on the loans.	1. State participation by way of guarantee on SME loan. 2. Regulatory capital relief which augments the resource base for additional financing. 3. Standardized scoring and rating model across the securitized MSME portfolios for creating homogeneous pool of asset.

[5]http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/EU_study_on_ABSs_impact_on_SME_finance.pdf : Study on Asset-Backed Securities: Impact and Use of ABS on SME Finance?

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Germany/ KfW Entwick-lungsbank (Synthetic Sale) [6]	1. KfW "PROMISE" program for entering into Credit Default Swap agreements with SME Loan Originators for Synthetic Sale. Issue of Credit Linked Notes (CLN) through Special Purpose Vehicle (SPV) for raising resources. 2. KfW plays the role of neutral intermediary in this transaction. They do not keep any default risk i.e. first loss piece is retained by originator and risk on other tranches is transferred to the investor. 3. Loans are retained on the balance sheet of the originating bank but the risk on them is transferred by a credit default swap (CDS) to KfW acting as an intermediate counterparty. Credit risk is transferred by the combination of credit protection contract and credit linked notes (CLN). 4. SPV gives a certificate of indebtedness to KfW against a premium and issues debts in tranches which is rated based on the underlying asset portfolio. SPV in turn invests the proceeds of CLN in highly rated securities. 5. In this case, the funding does not benefit the Originator directly but its main risk purpose is to ensure the strength of the credit risk protection required by KfW. The top slice protection, however, provided by an AAA rated bank is not cash supported.	1. Augmentation of resource base for additional financing by way of regulatory Capital relief due to credit protection from sovereign rated counterparty (KfW carries 0% risk weight as against 20% in case of a bank which is the most common counterparty). 2. Attractive pricing for securitization through state funded subscription for SME asset backed securities. 3. Presence of KfW has succeeded in raising the profile of the SME product in ABS markets.

(The structure of the KfW PROMISE model is given in Figure 3 in the next page)

[6]http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/5709541211578683837/Rahe_KfW_SME_securitisation_market_in_Germany.pdf: SME Securitization in Europe - The German Perspective

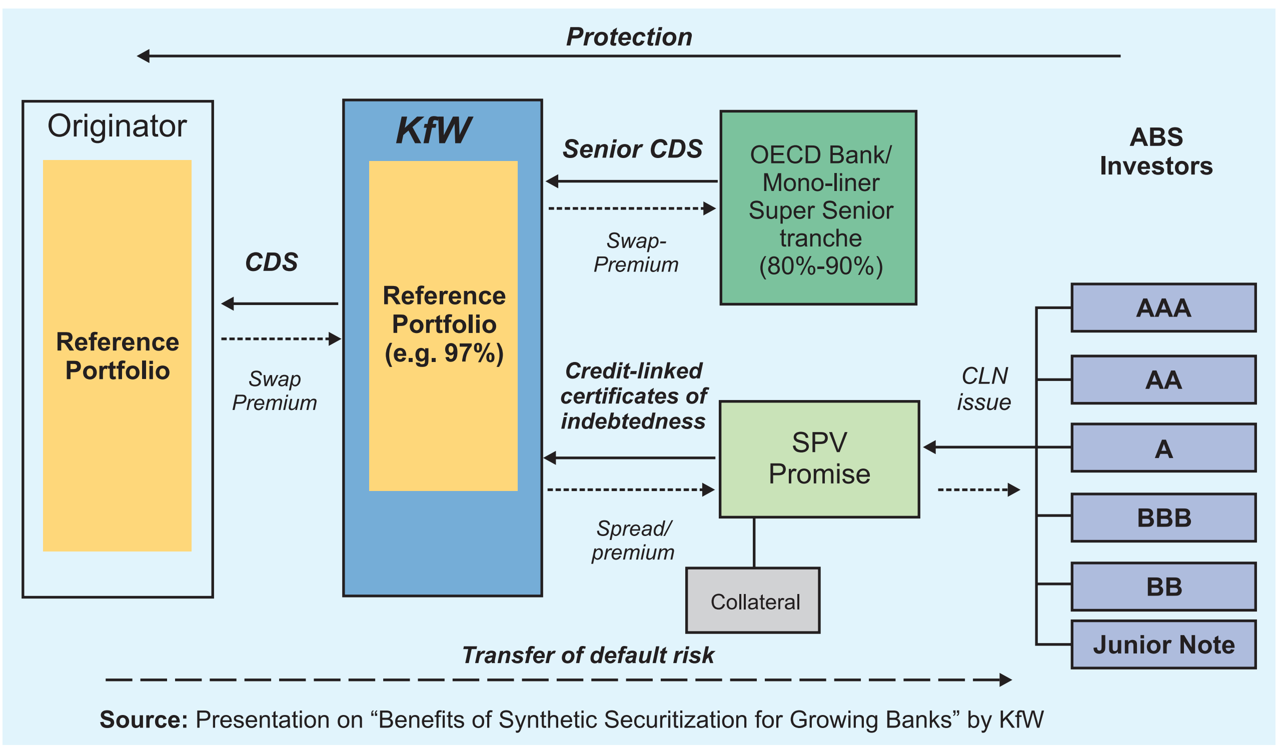


Figure 3: Structure of the KfW PROMISE model

Implementation in the Indian context

The first securitization transaction took place between Citibank and ICICI Bank in 1990 with the first asset-backed securitization concluding in 1991 with Citi Bank securitizing its pool of auto loan portfolio, which was placed with General Insurance Company (GIC) and rated by CRISIL[7] . Since then, the securitization market in India has witnessed a steady progress with the securitization issuance expected to reach ₹ 500 bn in FY08[8]; with auto, housing and credit card receivables category dominating the issuance. Select securitization transactions for the MSME sector include the 2004 deal between ICICI bank and SHARE Microfin Ltd, a large MFI operating in rural areas of the state of Andhra Pradesh[9], where ICICI purchased a part of SHARE's microfinance portfolio against a consideration calculated by computing the Net Present Value of receivables amounting to ₹ 215 mn (USD 4.9 mn) at an agreed discount rate. The interest paid by SHARE is almost 4% less than the rate paid in commercial loans. Partial credit provision was provided by SHARE in the form of a guarantee amounting to 8% of the receivables under the portfolio, by way of a lien on fixed deposit. This deal freed up the equity capital, allowing SHARE to scale up its lending. On the other hand, it allowed ICICI Bank to reach new markets.

A more recent deal was executed between IFMR Capital, a Chennai based NBFC and Equitas Micro Finance India Pvt Ltd in 2009 for lending and repayment of funds with principal amount of ₹ 157 mn[10]. However, securitization of MSME loan receivables has been very limited on account of lack of a critical

[7]Source:https://www.financialworld.co.uk/Archive/2005/2005_10oct/Features/mortgage_market_in_india/indias_new_foundations/2611-print.cfm
[8]Source: www.careratings.com/Content/CreditRatings/Securitisation1.pdf - Study titled "Securitization Market in India"
[9]Source: http://www.uncdf.org/english/microfinance/pubs/newsletter/pages/2005_10/news_ICICI.php
[10]Source: http://www.prnewswire.co.uk/cgi/news/release?id=251164

mass, standardized platform & secondary debt market along with associated regulatory issues. Further, it has been observed in the recent past that most of the asset-backed securities market in India is dominated by transactions involving "direct assignments" where banks leverage the same for meeting priority sector lending targets through direct purchase of such asset pools from FIs / NBFCs without going through an SPV. An indicative roadmap for implementing an MSME asset securitization program in India is given in Table 3.

Table 3: Indicative Implementation Roadmap

Action Points
Creation of Credit Guarantees Schemes for MSME portfolios of commercial banks and financial institutions for the specific purpose of securitization of MSME assets through True and Synthetic sales.
Promotion of SPV for purchasing MSME loan portfolio.
Developing due diligence processes & rating methodologies for MSME related asset backed securities (ABS).
Creation of secondary market for trading of MSME ABS.
Creation of conductive environment for subscription to MSME ABS by banks, financial Institutions, other institutional investors, Government, and retail investors through implementation of requisite legal / regulatory enablers.
Putting in place Legal and Regulatory enablers relating to: • Adoption of uniformly accepted definition of securitization. • Permissibility of assignment of future receivables for securitization. • Rationalization of Stamp Duty structure & registration charges associated with securitization transactions. • Credit insurance facilities for providing pool insurance to asset-backed structures. • Clarity on foreclosure laws for transfer of assets in case of default.

It is expected that implementation of this best practice would take around 2 – 3 years based on formulation of requisite regulatory enablers, creation of credit guarantee schemes focused on securitization transactions for MSME ABS and development of secondary market for trading of MSME ABS. The associated costs and benefits with a securitization transaction have been detailed under the heading, viz. "Estimated Costs and Benefits of a typical securitization transaction", later in this section.

2.2. Best Practice S-2 : Pooling of assets through multi-originator structure

Securitization has high set-up costs and relatively high running costs. This means that securitization is only cost effective when there can be suitable economies of scale. Typically, SME portfolio of individual bank / FI may not present the requisite scale to justify the high fixed costs associated with the transaction. Hence, cost effectiveness is ensured through pooling of SME loan portfolio from different bank/FIs to develop the requisite scale which would also be attractive for investors with different risk appetites. Such pooling of assets from different originators is called multi-origination.

As mentioned earlier, SME securitization is relatively focused in the US and select regions of Europe. Among the European countries, Spain has had considerable success in MSME securitization. While the share of Spain in the European securitization market was 13% in 2006; during the same period, it had a share of 37% of all the Europe MSME risk securitization market[11].

MSME ABS issuance in Europe from 1999 to 2004 was Euro 24.57 bn (₹ 1,600 bn) out of which Spain had a share of 46% i.e. Euro 11.45 bn (₹ 750 bn). Total ABS issuance through multi-originated securitization was Euro 4.45 bn (₹ 290 bn) or 39% of the Spanish MSME ABS issuance during the period 1999 to 2004[12]. One of the critical success factors leading to the generation of such volumes was the creation of the special platform named "sociedad gestora de fondos de titulizacion" (SGMT) to pool in assets simultaneously from several originators, commonly referred to as multi-origination. This coupled with government guarantee stimulated the MSME securitization by reducing the funding cost for MSME as the investors were ready to invest at lower credit spread. In a typical transaction, this could amount to a saving of 15-20 basis points per annum on the total financing costs.

The details of the identified case study of multi-originator structure along with the corresponding best practices adopted in Spain and Japan are presented in Table 4.

Table 4: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Spain/FTYPME (Fondos de Titulizacion de Pequenas y Medianas Empresas which means "Securitization Funds for small and medium sized enterprises")	1. Spanish securitization laws permitted the creation of special purpose investment companies for purchasing mortgage loans. The scope of investment was later widened to include MSME assets also. 2. This was followed by a program of MSME securitization based on guarantee provided by the Government, providing the requisite credit enhancement and liquidity support. 3. Government guaranteed the MSME Asset Backed Securitization under the condition that, i. 80% of the sold portfolio must comprise SME loans, and ii. 80% of the securitization proceeds must be invested in new MSME assets within a one year period.	1. Pooling of assets from multi originators to achieve a "critical mass" which makes the legal and transaction cost of MSME securitization economically viable. 2. Centralized collation of data of the portfolio and due diligence function thereby reducing the rating agency cost of portfolio evaluation. 3. Formation of an intermediary to perform the following function i. Implement off-the-shelf SPV structure for transferring the risk/assets for securitization.

[11]http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=1067&userservice_id=1
Roundtable between bankers and SMEs: SME Securitization, EU
[12]http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/EU_study_on_ABSs_impact_on_SME_finance.pdf: Study on Asset-Backed Securities: Impact and Use of ABS on SME Finance

Country/ Organization	Case Study	Best Practices / Critical Success Factors
(True Sale Securitization through Multi Originator Structure)[13]	4. A number of transactions have used MSME portfolios originated from several banks. This type of multi-origination is Spain have been facilitated by a specific platform for delivery of securitized SME products established by an intermediary named "sociedad gestora de fondos de titulizacion" (SGFT). This intermediary plays the following vital roles: i. Makes the transaction economically viable by pooling assets from different originators. ii. Helps in collating data for portfolio and co-ordinate due diligence dialogue with rating agency. iii. Establishes a fund, similar to the role of SPV, for purchasing assets. iv. Manage the fund with regard to collection of performance data on the portfolios and furnish the same to the investor at a regular interval. Also responsible for administrative and payment functions.	ii. Select eligible portfolio from the originator(s) so that the portfolio for securitization is homogeneous. iii. Manage the ongoing transaction reporting and payment flow to the investor.
Japan /JFC (Japan Finance Corporation) (Synthetic securitization through Multi Originator structure)[14]	1. In Japan, 22 Financial Institutions nationwide pooled their SME loan assets and entered into a credit default swap (CDS) with a Special Purpose Company. 2. Regional Financial Institutions pay a premium to the Special-Purpose Company (SPC) according to credit risk involved in the pool of claims, such as claims on unsecured loans securitized. In turn Regional Financial Institutions receive compensation for losses from the SPC in the event the default amount exceeds a prescribed limit. 3. JFC subscribes to the junior tranche of the Collateralized Loan Obligation (CLO) notes issued by SPC and investor gets the senior tranche. (Structure of JFC Multi-Origination is given in Figure 4)	1. The concept of multi-originators securitization solves the boundaries of diversification and scale of finance, if the program participants are small financial institutions. 2. JFC discloses CLO performance data and contributes to investor's understanding of underlying credit risk. 3. JFC's credit enhancement reduces originator's risk and strengthens the structure (multi-originator).

[13]http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/EU_study_on_ABSs_impact_on_SME_finance.pdf: Study on Asset-Backed Securities: Impact and Use of ABS on SME Finance

[14]http://www.c.jfc.go.jp/jpn/summary/disclosure/AR_2007-2008_02.pdf: Role and Characteristics of JASME

In Japan, JFC (Japan Finance Corporation) is a leading financial institution that supports the growth and development of SMEs, based on merger of the erstwhile (Japan Finance Corporation for Small and Medium Enterprises). JFC is also active in securitization market for facilitating SME financing. By appropriately sharing the credit risks, credit analysis and administrative burdens, JFC offers securitization methods convenient for private financial institutions to facilitate unsecured funds to SMEs and to diversify measures to obtain funds. While fulfilling its pioneering roles as a policy-based finance institution, JFC also contributes to the promotion and development of the debt securitization market. One such initiative of JFC has implemented a multi-originator type Synthetic securitization in co-operation with 22 Financial Institutions. With 22 regional financial institutions participating in the program, a total of 1,182 companies were provided with JPY 29.5 bn (₹ 15 bn) unsecured funds in FY 2007.

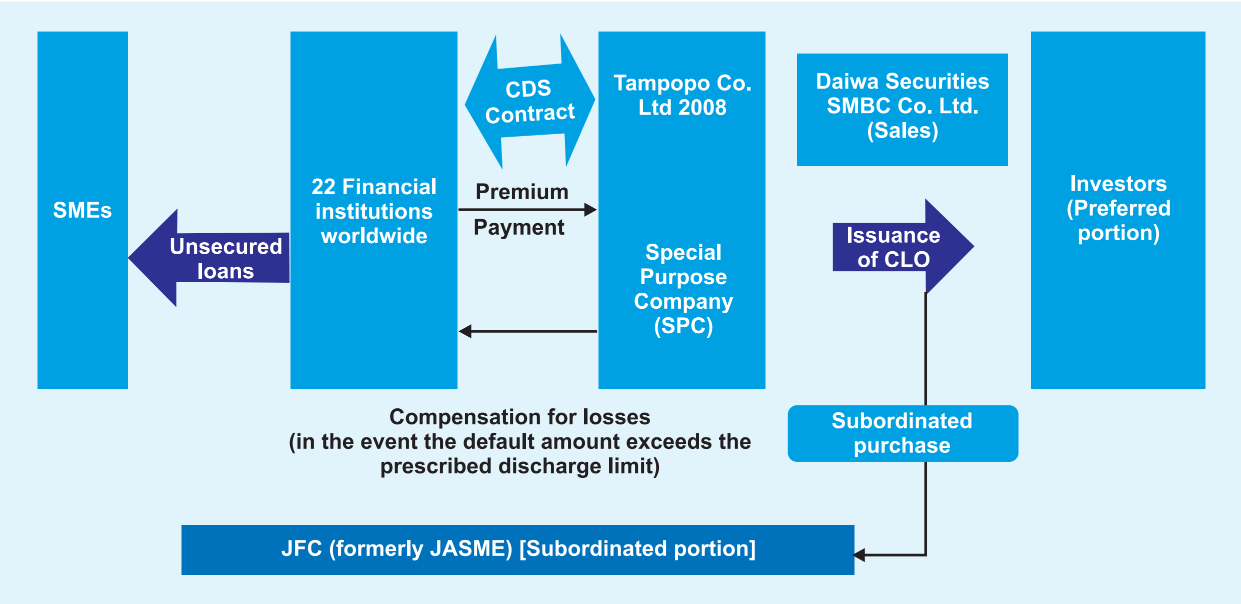


Figure 4: Structure of JFC Multi-Origination model

Implementation in the Indian Context

As discussed earlier, the securitization of MSME loan receivables in India is still very limited with a few key transactions highlighted above. One of the key reasons for the same has been the absence of a standard platform to facilitate pooling of loans from multiple financing institutions to create a requisite scale. However, there has been a transaction in January 2010, wherein IFMR Capital securitized micro-loans by 4 MFIs in India, totaling to ₹ 308 mn (USD 6.5 mn)[15]. This was backed with around 42,000 micro-loans originated by Asirvad Microfinance Pvt Ltd, Sahayata Microfinance Pvt Ltd, Satin Creditcare Network Ltd and Sonata Finance Pvt Ltd. However, this needs to be replicated on a larger scale to ensure that the same is leveraged for purposes of securitization and raising money by the MFIs / FIs / banks dealing with MSME sector in India. An indicative roadmap for implementing an MSME asset securitization program in India leveraging the multi-originator structure is provided in Table 5 in the next page.

[15]Source: http://www.microfinancegateway.org/p/site/m/template.rc/1.1.4141/

Table 5: Indicative Implementation Roadmap

Action Points
Creation of platforms / facilitate emergence of intermediaries for pooling in MSME assets from various banks.
Initiation of discussions with financial intermediaries like banks / FIs to identify MSME loan portfolios which can be pooled.
Conducting / facilitating due diligence of portfolios identified for pooling prior to purchase by the SPV.
Assisting the SPV in collating data and monitoring performance of the portfolio on a periodic basis.

It is expected that implementation of this best practice would take around 1 – 2 years based on formulation of requisite regulatory enablers and creation of standard multi-originator platforms. The associated costs and benefits with a securitization transaction have been detailed under the heading, viz. “Estimated Costs and Benefits of a typical securitization transaction”, as below.

Estimated Costs and Benefits of a typical securitization transaction

Any securitization transaction involves costs to be incurred by both the Originator and the SPV. Costs can be categorized as fixed and variable costs in the form of one-time upfront or recurring expenses. Table 6 highlights the various types of costs along with underlying nature, associated with a typical securitization transaction involving public sector guarantee.

Table 6: Costs associated with Securitization transaction

Cost Type	Nature	Borne by Bank	Borne by SPV
Fixed	Legal, accounting, consultancy fee to lead manager / tax consultant, etc.	Estimated at ₹ 40 Lakh per securitization transaction.	Not Applicable.
	Guarantee fee payable to entity providing credit guarantee (e.g. CGTMSE).	Estimated at 1.5% of portfolio size.	Not Applicable.
Recurring	Annual service fee payable to entity providing credit guarantee (e.g. CGTMSE).	Estimated at 0.75% of portfolio size.	Not Applicable.
	Administration fee for SPV operations.	Not Applicable.	Estimated at ₹ 1 Crore per annum per securitization transaction.

On the other hand, the underlying recurring benefits from a securitization transaction for the originating bank / financial institution and the SPV formed to buy the securitized MSME loan portfolio has been projected as follows:

Table 7: Benefits associated with Securitization transaction

Benefit	Bank	SPV
Management fee	Estimated at 0.25% of the securitized portfolio, receivable on an annual basis for monitoring and collecting interest on the securitized portfolio on behalf of the SPV.	Not Applicable.
Interest Income	Potential for on-lending the funds received on account of securitization, with the annual interest rate spread on the same estimated at 1%. Underlying assumption that the on-lending is restricted to MSME sector in order to maintain regulatory capital requirements.	Annual interest rate spread estimated at 2% (higher vis-à-vis bank on account of issue of ABS, backed with public guarantee).

However, it should be noted that on account of the nature of "fixed" costs associated with developing a securitization transaction, as detailed above, it is cost-effective only if a "threshold" portfolio size is achieved by the Originator and SPV to apportion the fixed costs appropriately. The indicative "threshold" portfolio sizes for both the Originator and SPV, considering a 5 year time horizon for the securitization transaction has been estimated to be ₹ 50 Crore based on the details provided below:

Table 8: Cost-benefit analysis

Assuming securitization portfolio of ₹ X Crore	Bank	SPV
Annualized Costs	Fixed /One-time Component: (0.4 + 0.015X) / 5 Variable Component: 0.0075 X On account of legal / accounting / consultancy and upfront guarantee fee (Refer Table 6)	1.0 On account of portfolio administration charges (refer Table 6 above)

Assuming securitization portfolio of ₹ X Crore	Bank	SPV
Annualized Benefits	(0.01 + 0.0025) X On account of management fee and interest spread (refer Table 7 above)	0.02 X On account of interest spread (refer Table 7 above)
Computed threshold portfolio size required to achieve a positive return from securitization	X = ₹ 40 Crore	X = ₹ 50 Crore

RISK CAPITAL

Highlights

- Refers to unsecured funds in form of pure equity and quasi equity / mezzanine financial products.
- Debt capital is excluded from the ambit of risk capital.
- Source & quantum of risk capital required depends on the stage an MSME is in its life cycle.

Theme Description & Benefits to MSMEs

Risk capital in the MSME context refers to the unsecured funds in the form of pure equity or quasi-equity / mezzanine financial products with features of both debt and equity for meeting the seed, development and growth capital requirements at respective phases of life-cycle of an MSME.

Mechanism for raising Risk Capital

Risk Capital financing can involve any of the four mechanisms listed below:

- Informal Financing: Equity from informal investors in form of family, friends and angel investors.
- Formal Financing: Equity from formal investors like venture capitalists / private equity firms, etc.
- Quasi-equity / Mezzanine Financing: A mix of debt and equity financing, which allows investors like banks / investment banks / financial institutions to achieve gains through capital appreciation and higher interests on debt-repayment on account of greater associated risk.
- Initial Public Offerings: Public financing through listing on trading exchanges / stock markets.

Figure 5 presents the typical risk capital requirement of an MSME through the various stages of its life cycle along with representative potential sourcing mechanism for the same.

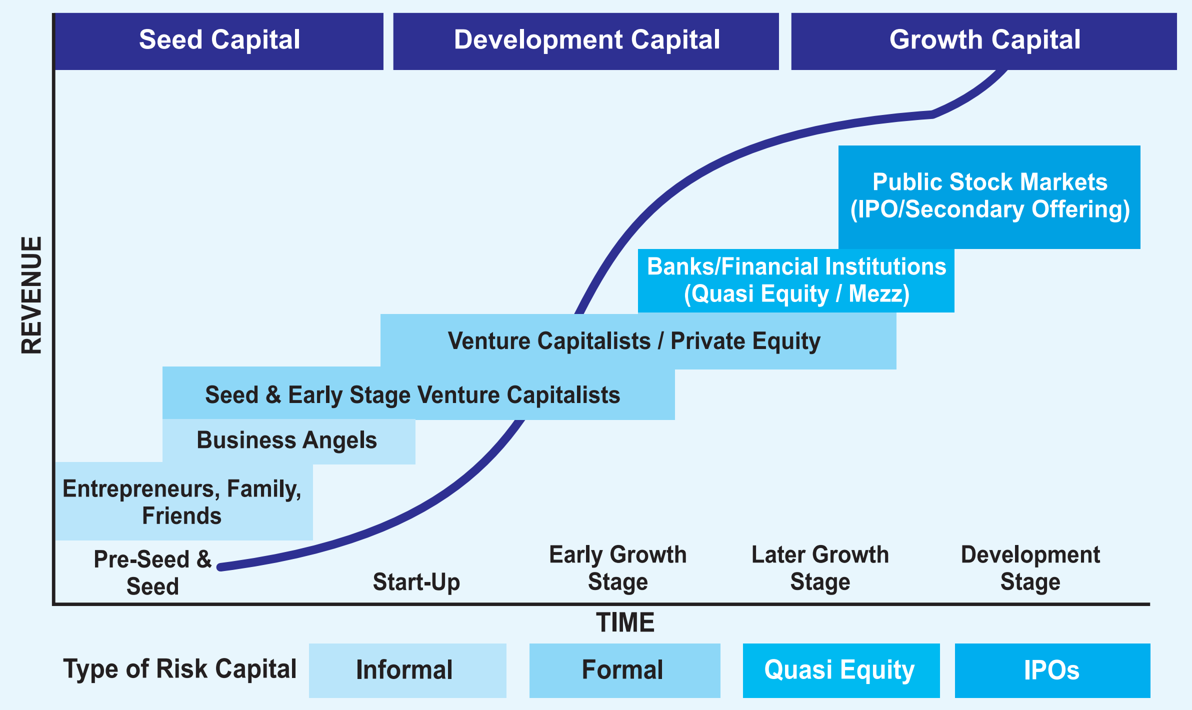


Figure 5: MSME growth & development life-cycle

Informal Risk Capital – Business Angels

Informal risk capital financing primarily refers to equity investments made by entrepreneurs themselves in collaboration with family and friends. Further, it also includes investments made by angel investors, who are typically high net-worth individuals with extensive experience in particular industry sectors. One of the key issues impacting the involvement of angel investors in the risk capital participation is the high search cost associated with identification of a business angel for an entrepreneur and vice-versa. In order to address this issue with view of maximizing participation of business angels in the risk capital of MSMEs, especially at the seed capital stage, banks and financial institutions world-wide have identified the role of Business Angel Networks (BANs)[16] (alternatively known as match-making services) to facilitate information flow between potential investors and MSMEs seeking finance. The typical roles undertaken by BAN could include: (i) identifying investors and MSMEs and developing channels through which the two can meet; (ii) coaching and mentoring MSMEs for successful implementation of respective projects; (iii) providing feedback mechanisms for MSMEs to build on investor comments and suggestions; and (iv) facilitating later rounds of financing by providing linkages with banks and venture capitalists.

The best practices associated with involvement of business angels in risk capital, detailed in this section includes the following: i) physical matchmaking and online matchmaking service models adopted by the BANs established by UK-based NatWest Bank, Brazil-based Gavea Angels and US-based California Investment Network respectively and ii) public sector intervention in form of principal protection through guarantee and design of preferential return mechanism to incentivize business angels in Brazil.

[16]The Bank and Finance Commission in Belgium (CBF) defines a BAN as a “structured network which offers angel investors the possibility to access projects in need of financing”.

Formal Risk Capital – Venture Capital

Venture capital is most attractive for companies with limited operating history in the seed / development stage, as they are too small to raise capital in the public markets and have not reached the requisite scale of operations to secure bank loans or make a debt offering. In exchange for the high risk that venture capitalists assume by investing in smaller and less mature companies, venture capitalists usually get significant control over company decisions, in addition to a significant portion of the company's ownership (and consequently value). On account of the risks associated with investment in a startup, venture capital investments are usually pooled through appropriate investment vehicles which invest in multiple start-up companies to ensure risk diversification.

The best practice describes the participation of venture capitalists in risk capital in MSMEs in Brazil through investment vehicles in the form of mutual funds, established through public-private partnerships.

Quasi Equity Risk Capital – Mezzanine financing in the form of sub-ordinate debt

Mezzanine financing generally refers to unsecured funding that represents a claim on a company's assets which is senior only to that of the shareholders. On account of the unsecured nature of the funding and junior obligation in a company's capital structure vis-à-vis senior debt providers, it is typically more expensive than the senior debt available to a company. Hence, it is typically used to finance the expansion of existing companies, which have achieved a certain threshold, in the form of development capital. Though it can be structured in various ways, it is essentially classified as following:

- Unsecured and sub-ordinate debt, with interest payments during tenure of debt.
- Unsecured debt with i) provision for conversion to equity at a later stage through convertible bonds / warrants, or ii) upfront equity stake with profit sharing right (compensated by a reduced interest rate); with interest payments.

The best practice describes the mezzanine financing model adopted by KfW, Germany through "indirect lending" to MSMEs in partnership with intermediate banks. This "indirect lending" model involved advancement of long-term sub-ordinate debt by KfW along with refinancing of senior debt portion to be provided by partner banks with appropriate risk-reward mechanism.

3.1. Best Practice RC-1: Formation of Business Angels Network (BAN) to link angel investors and MSMEs

In the recent past, business angels have played a key role in providing risk capital to early-stage companies and start-ups in the US and Europe. The Centre for Venture Research estimates that in 2006, US angel investors invested around USD 25.6 bn (₹ 1,280 bn) in 51000 deals, most of which represented investments in early-stage companies and start-ups[17]. Evidence of increased development of BANs along with their role in financing risk capital of early-stage companies can be gauged from an increase in number of such networks with the formation & growth of around a dozen new networks each year during the last 4-5 years in the US and Europe[18]. In the US, the number of business angel networks stood at around 250 in 2007,

[17]Source: FAQ: The Value of Angel Investors and Angel Groups

[18]Source: A Review Of Best Practices In Europe And The USA Angel Networks For The 21st Century

which represents a four-fold increase from 1999 levels. Similarly, in Europe, the no. of angel networks has increased from 66 in the year 1999 to 234 by mid-2007 with a CAGR of around 20%[19].

The impact of this best practice, i.e. formation of angel networks in the US and UK, has been highlighted as below:

- **UK:** The angel networks invested Euro 63.6 mn (₹ 4,134 mn) in 383 deals in the year 2006 with the average deal size being Euro 0.16 mn (₹ 10.4 mn). It has been estimated that the number of investors operating in these angel networks are around 10,000.
- **US:** The angel networks invested USD 445 mn (₹ 22,250 mn) in 1,875 deals in the year 2006 with the average deal size being USD 0.23 mn (₹ 11.5 mn). These angel networks comprise around 11,000 members in the form of investors in early-stage and start-up companies.

The details of the identified case studies along with the corresponding best practices adopted in UK, Brazil and US have been presented in Table 9.

Table 9: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
UK: NatWest Angels Service (NatWest Bank)	1. NatWest Bank established a nation-wide NatWest Angels Service, a private-for-profit BAN in 1995, with a mandate to provide services and opportunities for matching demand for seed capital requirements of SMEs with potential supply of funds from angel investors, leveraging its databases. 2. Apart from the provision of physical match-making service through its network of branches/intermediaries, it developed its proprietary database with details of i) angel investors along with their investment preferences and ii) SMEs with their funding requirements. 3. The SMEs looking for capital have access to the Angels Service through the bank's branch or specific bank promoted intermediaries (e.g. business development services, information suppliers of investment possibilities, etc.), which supply information about the application process.	1. Formation of a database: Through online research, due diligence, surveys and leveraging existing relationship networks; a database of angel investors based on sector preferences, risk appetite; geography, entry and exit preferences, experience, exact type, size, frequency and tenure of investments, etc. was prepared. Similarly, a database of SMEs was developed based on geography, capital requirements/aspirations, financing mode, sector and areas of venture, project profile, management structure, etc. These databases include the name, address and contact details, etc. of the potential investors and MSMEs.

[19]Source: EBAN Statistics Compendium- Based on the information provided by business angel networks having responded to the survey conducted in 2007

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	4. The intermediaries also assist the angel investors in terms of providing investment recommendations based on sector preference, expected returns, etc. and respective financing requirement of a SME. 5. The intermediary also introduces the enterprise to the investor. The intermediary charges fee for its services, while the NatWest Angels Service, i.e. access to database, is free. 6. The operating & revenue model of NatWest Angels Service is depicted in Figure 6.	2. Creation of a secure online platform: Using proprietary database management tool, secure online platform was provided by the BAN which connects SMEs directly with angel investors and helps investors to find suitable investment opportunities. The secure platform ensures that no one has access to personal information supplied by the SMEs & angel investors and the information entered in the website is kept confidential and private. 3. NatWest leveraged its bank branches and also appointed specific intermediaries to facilitate information flow & exchange between the investors and SMEs. 4. Database management: The databases for both potential investors and SMEs were regularly updated, cleaned and checked for accuracy to ensure smooth communication between the potential angel investors and the SMEs.
Brazil: Gavea Angels	1. Established as a non-profit organization by 13 investors in Rio de Janerio to focus on facilitating access to capital for technology related SMEs. 2. Identification of potential projects / SMEs in which the business angels may be willing to invest. 3. Organization of presentation events with investors and promoters to facilitate investments either individually or jointly.	
US: California Investment Network.com (California Investment Network Inc.)	1. California Investment Network Inc had created an online platform / network in 2004 called CaliforniaInvestmentNetwork.com which links informal investors (business angels) with SMEs that need capital and provides them with i) a unique online/web based matching service whereby investment criteria of angel investors are matched with the investment opportunities provided by the respective MSMEs; and ii) sharing of contact details to establish contact. 2. The moment the contact between MSME and angel investor is made, the network's involvement ends. 3. The operating & revenue model of California Investment Network is detailed in Figure 7.	

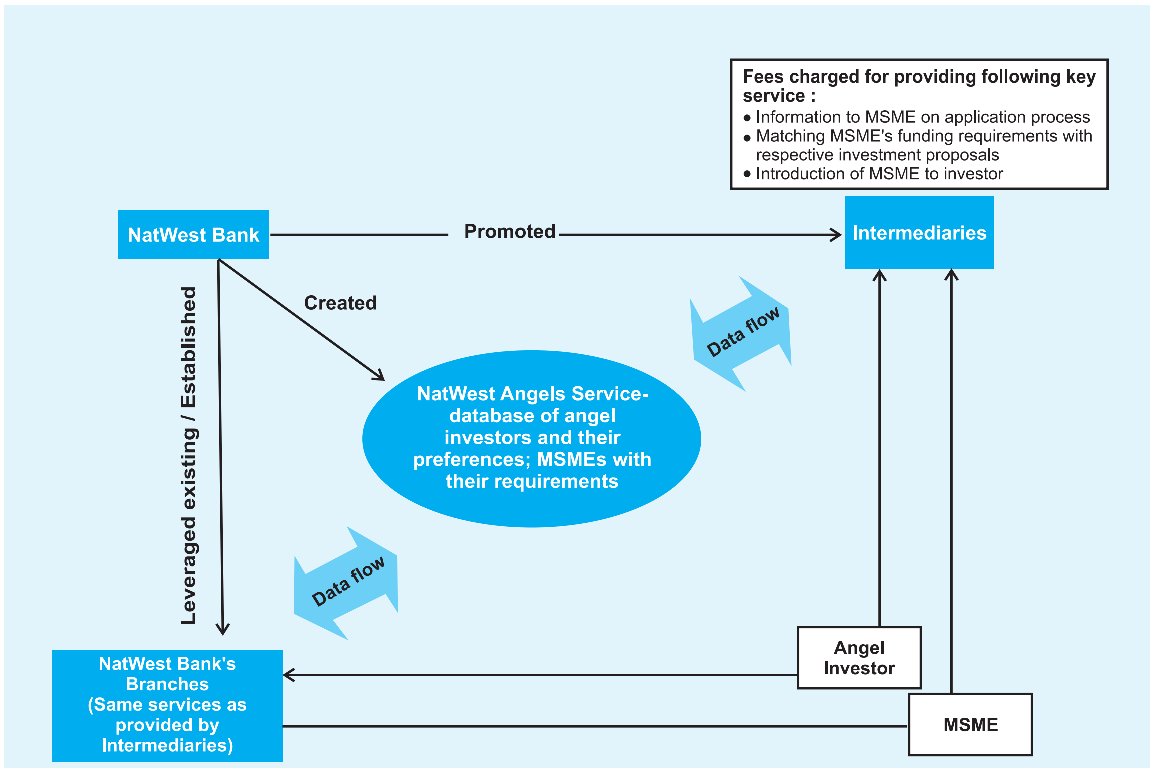


Figure 6: Operating & Revenue model of NatWest Angels Service

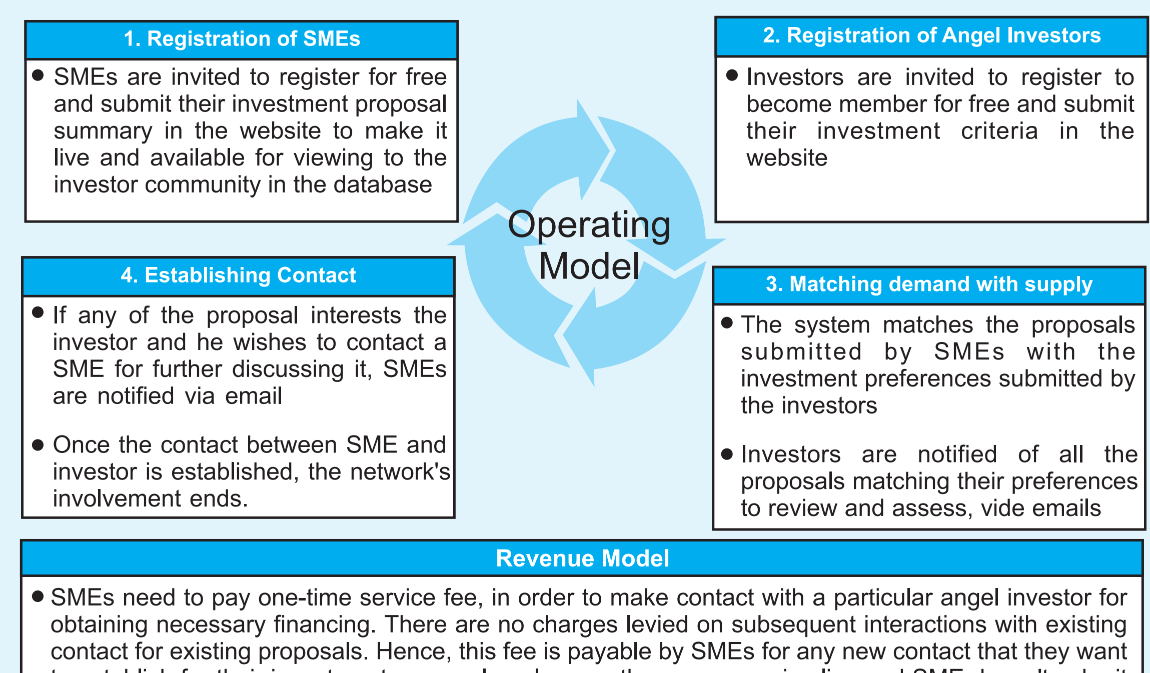


Figure 7: Operating & Revenue model of CaliforniaInvestmentNetwork.com

Implementation in the Indian context

Business Angel Networks (BANs) are a relatively new concept in India, with two organized angel networks (private-for profit) operating in the country viz. Mumbai Angels based out of Mumbai and Indian Angel Network headquartered in New Delhi. Other than these networks, there are individual / group of high-net worth individuals who function as angel investors, relying on their personal contacts / network to source deals.

Further, these networks in India have been mostly in form of informal collection of individual investors, which relies on the network reach to source potential deals involving early-stage businesses with no specific focus on meeting seed capital requirements of MSME sector exclusively. These BANs operate with respective angel investors meeting periodically to consider a few start-ups from among the ones screened to invest in their individual capacities, unlike the models adopted in UK and USA, where there are intermediaries who offer physical and online match making service (via a network of branches and online platform respectively) to link informal investors with MSMEs that need capital.

In absence of a MSME focused BANs in India with single-source consolidated information on potential angel investors along with their investment preferences and enterprises with their funding requirements/ opportunities, there is a potential for developing a dedicated database with an online interface and offline support in the form of intermediaries, etc. to facilitate greater involvement of business angels in seed capital of MSMEs. In this context, an indicative roadmap for setting up an ideal BANs model in India has been proposed in Table10.

Table 10: Indicative Implementation Roadmap

Action Points
Conducting research and surveys to create a database of potential angel investors and their preferences; and MSMEs and their investment opportunities.
Liasoning with the angel forums established domestically / overseas focused on making investments in Indian MSME sector, to facilitate their inclusion in relevant databases. Monitor formation of India specific angel investor groups, e.g. recently formed UK India Business Angel Network through scanning of publicly available information, leveraging participation in trade fairs / industry association meetings / conferences, etc. These would expand the potential investor base to serve as angel investors in Indian MSME sector.
Selecting the principle selection filters to be used in the database with view of reducing the search time and cost associated with matching of investment requirements of an MSME with investment preference of a business angel: ● For potential angel investors, these could include investment preferences in terms of sectors, investment size, expected exit period, risk appetite, etc. Profiling details could also capture details of historical investments in terms of quantum, period of investment retention, project profiles, etc. ● For MSMEs, these could include project profile, quantum of investment required, preferred investment model, geographical location, management structure, etc.

Action Points
Establishing robust & secure online platform with linkages to databases and filters detailed above: ● The database would need regular updation, cleaning and checking for accuracy to ensure smooth and hassle free communication between the potential angel investors and the MSMEs. ● The e-platform needs to be secure and the online interface needs to be developed such that no one has unauthorized access to personal information supplied by the MSMEs and the angel investors in order to maintain confidentiality.
Appointing intermediaries with view of leveraging their physical infrastructure ● Access to above-specified databases and online tool should be made available in the physical branches of respective financial institution to serve as a touch-point with MSMEs familiar with respective branches in close vicinity. ● For MSMEs not conversant with online interface, specific intermediaries may need to be appointed to liaison between such MSMEs and potential angel investors. These intermediaries could be provided read-only access to the online interface so that they are kept updated on available opportunities.

It is expected that implementation of this best practice would take around 8 months – 1.25 year based on design of database and development of online platform for matching of investment opportunities. The associated costs and benefits with formation of BAN have been detailed under the heading, viz. "Estimated Costs and Benefits", as below.

Estimated Costs and Benefits

Establishment of an online BAN would involve incurrence of both fixed and variable costs in the form of one-time application development & installation costs and recurring maintenance & updation related expenses. Table 11 highlights the various types of costs along with underlying nature and assumptions, associated with setting up of an online Business Angel Network.

Table 11: Estimate of costs associated with setting up of an online BAN

Cost Type	Nature	Borne by Bank
Fixed	Web-based application development, installation and associated consultancy fees.	Estimated at around ₹ 3-4 Crore for development of online Business Angel Network model.
Recurring	Annual fee payable to IT vendor for operation & maintenance of the application.	Estimated at 20% of the application development cost – ₹ 80 Lakh.
	Administration costs associated with offline support (database updation / query resolution, etc.) to the angels and MSMEs.	Estimated at ₹ 50 Lakh.

It is observed from the best practices adopted in the case studies that the fees recovered by the BAN is only in nature of "registration fee" charged to the MSMEs in case of their request to share details of potential angel investors identified by BAN for their investment proposals. This registration fee is in the range of around ₹ 10,000 – 12,500 per reference provided.

On account of the nature of "fixed" costs associated with developing an online BAN, as detailed above, it is cost-effective only if a "threshold" scale of operations is achieved by the BAN in order to apportion the fixed costs appropriately. The indicative "threshold" scale of operations, considering a 10 year time horizon for the BAN, has been estimated to be 1,360 references per year, based on the details provided in Table 12.

Table 12: Cost-benefit analysis for setting up a BAN

Assuming fee per reference to be ₹ 12,500 and time horizon of 10 years for a BAN	
Annualized Costs	Fixed / One-time Component: ₹ 400 Lakh Variable Component: ₹ 130 Lakh per year (assuming the cost remaining same over a period of 10 years) Life time costs: ₹ {400 + (130*10)} Lakh = ₹ 1700 Lakh
Annual Fee Recovery	Assuming "X" no. of references per year, fee realization during the 10 year period would be ₹ (0.125 * X * 10) Lakh = ₹ 1.25 X Lakh.
Threshold number of references required for the model to be self-sustainable	X = 1360 references per year Going by standard norm of selection of 1 proposal for implementation from around 20 -25 proposals reviewed, this would translate to funding of around 55 proposals on an annual basis.

3.2. Best Practice RC-2: Development of public-private partnerships with incentives for participation of business angels in form of public guarantees & preferential returns

FINEP (Brazilian Innovation Agency), a public sector financial institution, launched the "INOVAR Semente" project in December 2005 with the objective of increasing access to finance for technology focused SMEs in pre-operating stage through investment in seed capital. The programme aimed at investing around R$ 300 mn (₹ 7,500 mn) in around 350 technology-based start-ups in respective technology clusters in Brazil during a 6 year time horizon with creation of 24 seed capital funds. Each seed capital fund was proposed to have a public-private partnership model with the following investment shares: i) minimum 20% by angel investors, ii) maximum 40% by FINEP and iii) balance by respective local development focused banks. The principal investment by angel investors was protected through a guarantee by FINEP, with preferential treatment in terms of distribution of profits / returns from investments made.

INOVAR Semente has received good response from respective angel investors and local development banks in Brazil. Based on the first call for establishing seed capital funds, FINEP had approved 3 funds with projected investments of around R$ 30 mn (₹ 750 mn) in around 40 companies. One of the first funds to be launched under this programme was Horizon, which committed to an investment of R$ 20 mn (₹ 1,000 mn) in 10 companies, with maximum single investment restricted to R$ 3 mn (₹ 75 mn). In 2008, INOVAR Semente was expected to announce 6 new investments in seed capital funds with projected investments of around R$ 120 mn (₹ 3,000 mn) encompassing 150 companies. Currently, based on fourth call for setting up seed capital funds in 2009, five of the seven proposals submitted have been pre-qualified

with proposed investments of around R$ 275 mn (₹ 6,875 mn) and an average of 13 companies per fund. The detailed due diligence for the same is yet to be completed[20].

The details of the identified case study along with the corresponding best practices adopted in Brazil have been presented in Table 13.

Table 13: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Brazil: FINEP (Financiadoras de Estudos e Projectos)[21]	1. Public call for setting up of seed capital funds, inviting professional fund managers to submit respective proposal for setting up a seed capital fund. 2. Proposal to be submitted by potential fund managers include the following: ● Proposed composition of shareholders in the fund in terms of share of angel investors. ● Investment strategy in terms of potential MSMEs in which investments would be made along with their geographic location. ● Legal structure of the proposed fund, with details of existing / past investments in MSME sector in terms of quantum, period, composition, etc. ● Proposed management fee and performance linked fees. ● Target returns. 3. Elaborate multi-stage evaluation process involving FINEP, its partners in form of Multilateral Investment Fund / Inter-American Development Bank (MIF / IDB) and consultants as may be deemed necessary by FINEP for purposes of evaluation. ● Includes presentation by potential fund managers on their proposed funds. 4. For approved seed capital funds, guarantee is provided by FINEP to cover the minimum principal investments to be made by angel investors, i.e. 20% of the assets of fund. 5. Preference is given to angel investors in distribution of profits on investments made by the fund, in terms of distribution to them prior to development banks and FINEP respectively.	1. Fund Managers submitting proposal for setting up seed capital fund need to be authorized / registered by CVM (Securities and Exchange Commission of Brazil) to offer portfolio management services. 2. Responsibility for identifying and bringing angel investors to the fund rests with the respective fund manager, with requirement for submission of letters of commitment for investment by proposed angel investors at time of submission of proposal. 3. Helps angel investors diversify their risk through investment of seed capital funds in multiple MSMEs. 4. Multi-stage evaluation with concerned stakeholders ensures continuous discussions with potential fund managers, in order to identify measures for improving management structure of proposed funds in a collaborative manner. 5. Detailed negotiations are conducted on the cost structure proposed by the fund manager, to align fees in line with the projected / expected returns and associated risks. 6. Guarantee offered by FINEP and preference in return are the key drivers for participation of angel investors in INOVAR Semente project. 7. Presence of professional fund manager along with an angel investor encourages active participation in the project by other local development banks.

[20]Source: website of FINEP (http://www.finep.gov.br/ and other sources
[21]http://www.infodev.org: InfoDev publication on Brazilian country study with focus on “Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities”

Implementation in the Indian context

Investment in seed capital of MSMEs at a pre-operating stage by business angels is very limited in India. This may be based on direct participation of business angels in equity of individual MSMEs, based on identification of opportunities through various informal channels. However, no formal mechanism exists in India to route funds from business angels in a “fund of funds”, which can invest in multiple companies with view of diversifying risk while leveraging the expertise of experienced fund managers.

One of the key “fund of funds” being operated in India with a focus on MSMEs is managed by SIDBI Foundation for Risk Capital (SFRC) with view of meeting risk capital requirement of MSMEs in different industry segments in form of equity instruments, mezzanine instruments and subordinate debt. In addition to direct risk capital assistance and start-up assistance scheme, SFRC is providing assistance to MSMEs through participation in state Venture Capital Funds focused on MSME sector. Under this “fund of funds” model, SIDBI contributes to the corpus of multiple MSME focused venture capital funds, with the mandatory stipulation that at-least twice of SIDBI’s contribution in the fund would be invested by the respective fund in the MSMEs. However, there is limited investment of business angels as part of this “fund of funds” model. Hence, there exists a scope for introduction of the model adopted in Brazil backed by public guarantee and preferential returns. In this context, an indicative roadmap for setting up this model in India has been proposed in Table 14.

Table 14: Indicative Implementation Roadmap

Action Points
Identifying sectors / industries requiring seed capital funding, this may be attractive to angel investors.
Establishing a pool of funds to be invested in seed capital of MSMEs in the identified sectors / industries.
Identifying mechanism for offering guarantees for capital protection of angel investors.
Identifying list of potential professional fund management houses with expertise in managing a “seed capital” fund focused on early stage funding.
Developing robust evaluation procedure for appointment of respective fund managers, including ability to commit investments from angel investors.
Information dissemination on the above model to MSMEs and potential partner banks / FIs / other financial intermediaries in order to secure their participation.

It is expected that implementation of this best practice would take around 1.5 - 3 years based on formulation of requisite policy enablers, establishment of pool of funds and identification of fund managers along with their performance monitoring mechanism. The associated costs and benefits with investment of angel investor in this public private partnership mode have been detailed under the heading, viz. “Estimated Costs and Benefits” in the next page.

Estimated Costs and Benefits

Implementation of a mechanism for raising & managing seed capital funds for investment in MSMEs at a pre-operating stage is likely to result in incurrence of the following key cost heads:

Table 15: Cost types associated with this model

Cost Type	Comments
Fund management fees	Dependent on size of fund being managed by respective fund manager. Usually around 2% of the fund asset pool.
Performance linked fees for the fund manager	Dependent on underlying risk associated with the asset portfolio. Usually around 20% of fund's profits.
Guarantee fee payable to entity offering credit guarantee	Usually up-front charge of around 1.5% of portfolio size with annual service fee of around 0.75% of portfolio size.

An illustrative example has been presented below (Table – 16), representing the respective costs and benefits accruing to financial institution / banks focused on MSME sector & other investors from implementation of this model. For purposes of this example, it has been assumed that a single fund has been raised with a corpus of ₹ 100, with contribution by angel investor, financial institution / bank focused on MSME sector and other investors in form of financial intermediaries like financial institution / bank being ₹ 20, ₹ 40 and ₹ 40, respectively. The annual return from seed capital fund has been assumed at 15%.

Table 16: Cost-benefit analysis

	Assumptions	Angel Investor	Financial institution / bank focused on MSME sector	Financial intermediary in form of financial institution / bank
Investment		20.0	40.0	40.0
Annual return	15 (@ 15% on portfolio size)	3.0	6.0	6.0
Management fee (payable to fund manager)	2 (@ 2% of corpus)	0.4	0.8	0.8
Performance fee (payable to fund manager)	3 (@ 20% of fund's net returns)	0.6	1.2	1.2
Guarantee fee payable for credit guarantee availed	0.45 (@ 2.25% on amount to be guaranteed)	–	0.45	–
Profit Distribution (considering net returns)		2.0	3.55	4.0
Returns*		10%	8.9%	10%

* Does not include capital gains on exit

With the above-specified assumptions, it is observed the a net return of around 10% for investors, other than financial institution / bank focused on MSME sector which bears a higher cost on account of payment of associated guarantee fees. Further, returns to angel investors could be increased through introduction of provisions for tax benefits on returns made from investments in seed capital of MSMEs.

3.3. Best Practice RC-3: Integrated lending comprising sub-ordinate debt and refinancing of senior debt portion of partner banks, with appropriate risk-reward sharing mechanism

The German Government development bank, viz. KfW Entwicklungsbank (KfW), launched a subordinated mezzanine financing product through the Entrepreneurial Capital Mezzanine Financing (ECMF) model aimed at providing long-term subordinated debt to meet the capital requirements at various stages in the life cycle of an SME, including the following:

- Start-up companies that had been in operation for less than 2 years.
- Relatively young companies which had been in operation for more than 2 years but less than 5 years.
- Mature companies which had been in operation for more than 5 years.

Innovative risk-reward mechanism was built into the ECMF model by KfW to ensure requisite incentives for participation of partner banks in order to leverage their access to SMEs through their physical branch network. These partner banks managed the operations of this ECMF model in terms of loan disbursement and collections both on their and KfW's behalf, with cost of senior debt being in the range of 3.8 – 6.8% and sub-ordinate debt being 5.15 – 8.8%. The uniqueness of ECMF model lay in the "indirect lending" model, wherein quantum of sub-ordinate debt advanced to SMEs by KfW was matched by respective partner banks in form of senior debt, which in turn was refinanced by KfW itself.

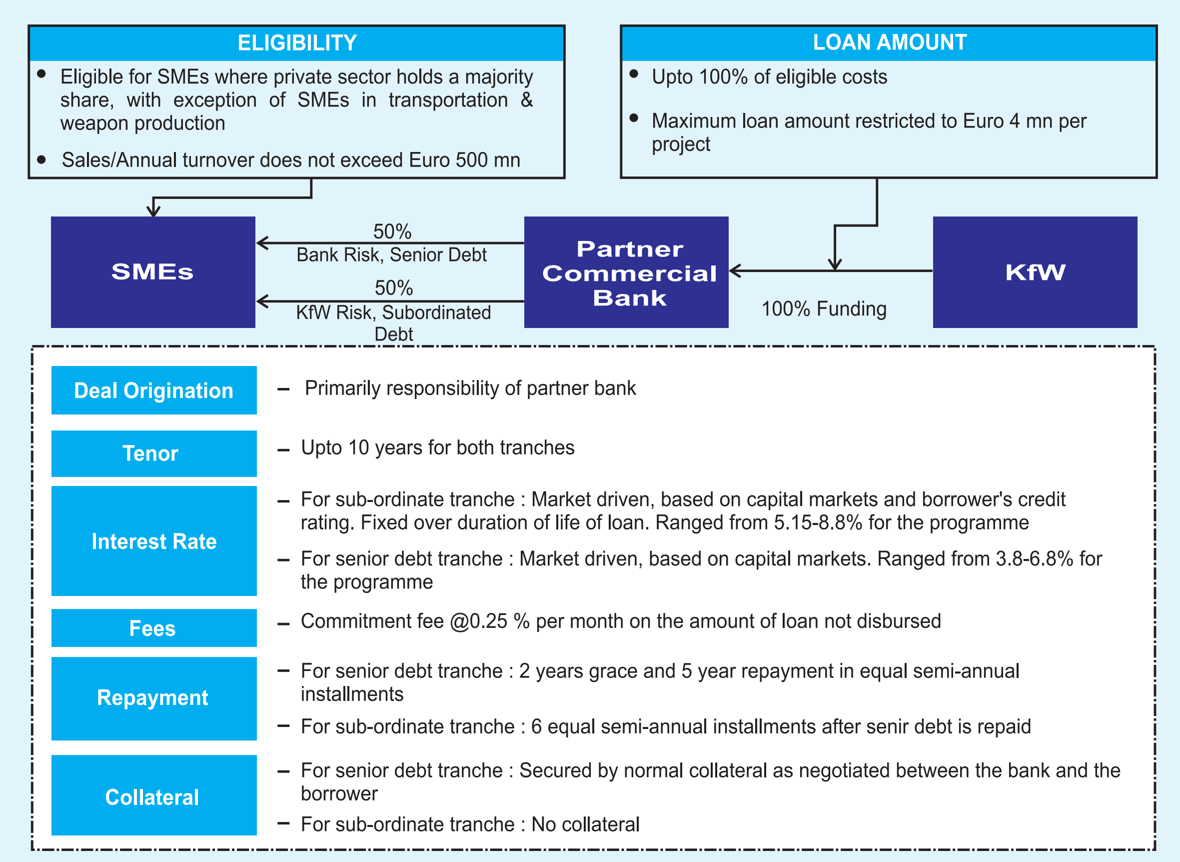


Figure 8: Highlights of ECMF model

The success of the program can be gauged from the fact that it had made loans of around Euro 2.7 bn (₹ 175 bn), including sub-ordinate debt of Euro 1.35 bn (₹ 85 bn) till 2005; with over 300 loans being advanced in 2005 itself. The key highlights of the ECMF model adopted by KfW are presented in Figure 8[22] (in the previous page).

This model has served as a benchmark for other countries like Croatia in developing mezzanine financing frameworks for MSMEs through the HBOR (Government owned Croatian Bank for reconstruction & development) Mezzanine Financing Program.

The details of the identified case study along with the corresponding best practices adopted by KfW in Germany have been presented in Table 17.

Table 17: Highlights of case studies with corresponding best practices

Country / Organization	Case Study	Best Practices / Critical Success Factors
Germany: KfW [23]	1. Deal origination role was awarded to the partner commercial banks, with responsibility for conducting requisite due diligence and underwriting to assess the credit worthiness and associated market-linked interest rate to be charged. 2. KfW also conducted a limited desk based due diligence based on documentation received, for purposes of validating the deal. 3. For these projects, 50% of the funding was in form of senior debt by the partner bank with the balance 50% being advanced as sub-ordinate debt from KfW. For purposes of administrative ease, partner bank served as the single source point of contact for SMEs, with entire 100% funding disbursal being undertaken by bank which included the sub-ordinate debt portion from KfW. 4. Bank's exposure to SMEs (50% of the entire funding) was also funded by KfW through a soft loan to the bank at concessionary interest rates. Hence, the bank's revenue stream comprised the spread between the interest rate payable to KfW for soft loan and the interest rate charged from SMEs. 5. Revenue streams for KfW & partner bank, other than interest payments, were generated through realization of fees from borrower relating to i) one-time management fee to be paid on signing of loan agreement, ii) recurring commitment fee based on amount of loan disbursed, iii) upfront structuring fee. 6. Repayment of sub-ordinate debt commences after repayment of senior debt, with maximum period for making repayments defined in the agreements. 7. Legal agreements were put in place with respective partner banks and borrowers to secure requisite safeguards & rights in events of default.	1. Involvement of potential partner commercial banks at the time of conceptualization of ECMF model by KfW to secure their participation during implementation phase. 2. Development of internal rating mechanism by KfW for selection of partner banks based on their due diligence & underwriting expertise. Periodic review of performance of portfolio of each partner bank was conducted to assess the adherence to mandatory norms for due diligence & underwriting and deciding way forward in terms of continuing / terminating agreement with respective partner bank. 3. Physical reach and SME client-base of partner banks helped KfW tap the segment without investing in augmenting its physical network. 4. In case of loan failure, the partner commercial bank had recourse to underlying collaterals furnished by the borrower on account of the senior debt position. However, partner banks were obligated to repay the soft-loan advanced by KfW for which they had to depend on liquidation of underlying collaterals. However, it should be noted that the subordinated portion of loan provided by KfW was totally exposed and not eligible for recovery via collateral liquidation. 5. In order to encourage and incentivize partner banks to identify "bankable" deals; a success fee was paid to the partner bank at the end of a successful financing, i.e. full repayment of all senior and sub-ordinate debt.

[22]Source: Publication titled "HBOR Mezzanine Financing Program" and presentation made in "the SME Guarantee Facility Conference 2005" on "SME Access to Finance: New Developments in SME Financing (Mezzanine Capital for SMEs)"
[23]Source: Publication titled "HBOR Mezzanine Financing Program" and presentation made in "the SME Guarantee Facility Conference 2005" on "SME Access to Finance: New Developments in SME Financing (Mezzanine Capital for SMEs)"

Implementation in the Indian context

Mezzanine financing in India for MSME sector is at a nascent stage with select established financial institutions / banks like ICICI Bank, SBI Capital Markets, etc. making an entry in the segment in mid 2000s. However, mezzanine financing in India has primarily focused on funding i) buyouts, mergers & acquisitions and ii) asset backed business, such as, real estate & infrastructure. SIDBI has also established the SIDBI Foundation for Risk Capital focused on offering equity / quasi equity mezzanine products directly or via intermediaries to MSMEs.

An indicative roadmap for implementing a mezzanine financing product similar to KfW's ECMF model in India is given in Table 18.

Table 18: Indicative Implementation Roadmap

Action Points
Development of mezzanine financing structure, including the following: ● Level of sub-ordinate debt vis-à-vis senior debt for respective projects: standardization in terms of exposure levels to Greenfield / Brownfield project, etc. ● Development of risk based pricing framework based on perceived credit risk of the borrower – standardization in terms of size, sales / turnover, industry characteristics, etc. ● Advancement of soft-loan to partner bank for senior debt amount, with determination of interest rate spread available to partner bank / financial institution.
Identification of mechanism to reduce risk burden associated with sub-ordinate debt portion.
Determining respective sectors to be focused on along with cut-off in terms of sales / turnover to ensure funding reaches MSMEs deprived of other risk capital sources. Further, eligibility criteria, loan quantum / maximum funding for each project would need to be determined.
Identifying & selecting partner banks / financial institutions along with segregation of respective rights & obligations through legal agreement, in terms of the following: ● Development of a performance monitoring framework / rating system in order to identify banks / financial institutions to be included / retained in the programme. ● Development of a legal agreement template for partner banks / financial institutions to ensure legal safeguards for concerned parties.
Ensuring viability of financing arrangement in terms of the following: ● Incentivizing partner banks to source bankable projects through payment of a success fee on successful repayment of loans by respective borrowers. ● One-time upfront management fees along with recurring commitment fee in addition to interest receipts.
Ensuring capacity building of partner banks / financial institutions, with specific focus on training programmes dealing with conducting due diligence / underwriting, etc.
Entering into legal agreements with borrowers along with associated enforcement rights, to be secured through appropriate legal & regulatory enablers.

It is expected that implementation of this best practice would take around 1.5 - 3 years based on formulation of requisite policy enablers, development of mezzanine financing structure, negotiation on respective legal structures & arrangements along with capacity building of partner banks / FIs. The associated costs and benefits with mezzanine lending through an integrated model (as detailed above) have been detailed under the heading, viz. "Estimated Costs and Benefits" in the next page.

Estimated Costs and Benefits

Implementation of the ECMF model adopted by KfW in the Indian context would include the following representative costs and benefits for the respective stakeholders:

Table 19: Cost-benefit analysis

Stakeholder	Costs	Benefits
MSME	Market-determined interest rate charged based on assessment of credit worthiness.	On account of quasi-equity nature of sub-ordinate debt, there exists a scope for MSMEs to raise further debt based on same asset base.
Financial Intermediaries (Partner Commercial Banks / Financial Institutions)	Interest rate to be charged by Financial Institutions / Banks focused on MSME sector on a recurring basis during the tenure of loan.	Interest rate spread an on annual basis, based on differential between cost of raising funds from Financial Institutions / Banks focused on MSME sector and interest rate charged to MSMEs for senior debt. Additional revenue streams in form of i) one-time management fee to be paid on signing of loan agreement based on portfolio size, ii) recurring commitment fee based on amount of loan disbursed, iii) one-time upfront structuring fee as a % of portfolio size. Further, a one-time “success fee” component is received from Financial Institutions / Banks focused on MSME sector on successful closure of loan.
Financial Institutions / Banks focused on MSME sector	Cost of raising funds to invest the same in the program. Guarantee fee payable to entity offering credit guarantee (CGTMSE) - Usually one-time up-front charge of around 1.5% of portfolio size with annual service fee of around 0.75% of portfolio size.	Interest rate spread on an annual basis, based on differential between cost of raising funds and interest rate charged to i) partner intermediaries for soft-loan and ii) MSMEs for sub-ordinate debt. Further revenue streams in form of i) one-time management fee to be paid on signing of loan agreement based on portfolio size, ii) recurring commitment fee based on amount of loan disbursed, iii) one-time upfront structuring fee as a % of portfolio size. Downside in case of loan default limited to sub-ordinate portion, with recovery from partner financial intermediary in form of a bank / FI secured through legal agreements for senior debt portion.

An illustrative example has been presented below, representing the respective costs and benefits accruing to partner financial intermediaries and financial institution / bank focused on MSME sector from implementation of this model. For purposes of this example, it has been assumed that a one-time ₹ 100 loan has been advanced to a MSME, with ₹ 50 as senior debt from partner financial intermediary (re-financed by the financial institution / bank focused on MSME sector) and ₹ 50 as sub-ordinate debt from financial institution / bank focused on MSME sector. Further, repayment of the entire loan amount has been factored in over a 10 year period.

Table 20: Illustrative example - Cost-benefit analysis

	Partner Financial Intermediary	**Financial Institution / Bank focused on MSME sector**
Annualized Benefit (net of cost, where applicable)	Fixed / One-time Component (to be apportioned over a 10 year period): Management Fee: 0.25 (@ 0.5% of investment) Structuring Fee: 0.25 (@ 0.5% of investment) Success Fee: 1 (@ 2% of investment) Variable Component : Commitment Fee: 1 (@ 2% of investment) Interest rate spread: 1 (@ 2% of investment)	Fixed / One-time Component (to be apportioned over a 10 year period) : Management Fee: 0.25 (@ 0.5% of investment) Structuring Fee: 0.25 (@ 0.5% of investment) Guarantee Charge: 0.75 (@ 1.5% of investment) Variable Component: Commitment Fee: 1 (@ 2% of investment) Interest rate spread: 2 (@ 4% of investment) Guarantee service fee: 0.375 (@ 0.75% of investment)
Annualized Return (net of costs)	**2.15 (4.3%)**	**2.60 (5.2%)**

Hence, it is observed that the returns, net of cost, are expected to be higher than the typical net interest margins of banks / FIs in India which are typically in the range of 2% - 3.5%.

3.4. Best Practice RC-4: Diversification of investor profile with greater participation from pension funds in risk capital of MSMEs through venture capital funds

Pension funds are the ideal investors to participate in the venture capital market because of their ability to diversify the portfolio across various asset types to hedge the overall portfolio risk along with the relative long-term investment horizon. In developed markets like the US, it is observed that over 50% of the capital raised by the venture capital funds comes from public and private pension funds. Further, the investments by these pension funds are primarily restricted to venture capital funds operated by various private and public sector venture capital firms with limited direct investment in risk capital.

It has been observed that pension funds have been incentivized in various countries like Brazil, Peru, etc. to participate in risk capital of MSMEs through various investment vehicles on account of implementation of requisite regulatory enablers. The investment vehicles in these countries have been primarily restricted to venture capital funds set-up through public private partnerships with active participation of local pension funds in addition to venture capitalists, local banks / FIs, multilateral donor agencies, etc. The participation of pension funds with a long-term investment horizon helps the venture capital fund managers balance the respective investment horizons of different investors to ensure long-term sustainability of the fund. It is estimated that local pension funds in Brazil had invested around USD 1 bn (₹ 50 bn), i.e. around 15% of the total venture capital / private equity market of Brazil.

The details of the identified case studies along with the corresponding best practices adopted in Brazil and Peru have been presented in Table 21.

Table 21: Highlights of case studies with corresponding best practices

Country/Organization	Case Study	Best Practice/Critical Success Factors
Brazil: FMIEE (Fundo Mútuo de Investimento em Empresas Emergentes)[24]	1. FMIEEs are venture capital investment vehicles with their investment portfolios focusing primarily on technology and information-technology companies at the seed capital, startup or expansion investment stages. 2. FMIEEs are closed-ended public-private partnerships, limited to 35 investors and to a ten-year term, which can be extended for any period decided by the majority of shareholders. 3. Investors include multilateral donor agencies, private sector investors, public sector FIs, banks and local pension funds. 4. FMIEE are managed by professional fund managers (individuals / legal entities), who are selected through a tendering mechanism. These fund managers have to be registered with CVM, which is the regulator for these FMIEEs. 5. Corpus of each FMIEE is between USD 5-10 mn (₹ 250 - 500 mn).	1. Primary focus on rapidly growing ICT/ ICTE sector, valued at around USD 22 bn (₹ 1,100 bn), with representation from MSMEs. 2. Participation of pension funds through applicable regulations (decree of 1994) authorizing them to invest 20% of their equities in VC funds. 3. Long-term investment horizon of pension funds helps stabilize the fund and attract investment from other investors like banks / FIs and private investors.
Peru: FTP (Fondo Transandino Peru)[25]	1. Managed by a venture capital firm, viz. SEAF Peru (a subsidiary of international SEAF network based in USA). 2. Investors include USAID, Swiss SECO, Belgian BIO and two local pension funds (Prima AFP and AFP Integra). 3. Corpus of USD 15 mn (₹ 750 mn) for investment in SMEs. 4. USD 5.6 mn (₹ 280 mn) already invested in four deals, including SMEs focused on exports.	1. Focused on meeting financing requirement of SMEs, primarily engaged in exports. 2. Participation of pension funds through applicable regulations authorizing them to invest in VC funds. 3. Long-term investment horizon of pension funds helps stabilize the fund and attract investment from other investors like banks / FIs and private investors.

[24]Source: http://www.infodev.org: InfoDev publication on Brazilian country study with focus on “Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities”

[25]Source: http://www.infodev.org: InfoDev publication on Peru country study with focus on “Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities”

Implementation in the Indian context

In absence of investment by Government-owned pension funds in India in the risk capital of MSMEs along with restrictions on non-Government pension funds in forms of restrictions on exposure to equities, requisite legal and regulatory enablers need to be formulated to ensure their participation in the various investment vehicles formed to invest in risk capital of MSMEs. This is expected to have a favorable impact in terms of participation of other banks / FIs in these investment vehicles, based on long-term commitment of pension funds.

In this context, an indicative roadmap for replicating this model in India has been proposed in Table 22.

Table 22: Indicative Implementation Road Map

Action Points
Identification & implementation of respective regulatory enablers for investment by pension funds in investment vehicles designed as unit-linked Mutual Funds

It is expected that implementation of this best practice would take around 6 months -1 year based on formulation of requisite policy enablers and implementation of the same.

3.5. Best Practice RC-5: Establishment of investment vehicles in form of Mutual Funds through public-private partnerships for channelizing venture capital funds into risk capital of MSMEs

The private equity / venture capital industry started in Brazil in 1974, through the National Social and Economic Development Bank (BNDES) program, with the establishment of a private equity firm, viz. BNDES Participations (BNDESPAR). However, the growth of formal sources in providing risk capital suffered through the 1980s and mid 1990s. Regulation 209 promulgated by the Brazil's Securities and Exchange Commission "Comissão de Valores Mobiliários" (CVM) in 1994 provided the much needed impetus for setting up and regulation of Venture Capital Funds in Brazil. The regulation 209, created *Fundos Mútuos de Investimento em Empresas Emergentes* (FMIEE- Brazilian acronym for "Mutual Investment Funds in Emerging Companies") the first national investment vehicle structured as a unit scheme to meet the risk capital needs of SMEs. Further, these units can be traded on the local stock exchange to facilitate greater participation of respective investors along with determination of market-ascertained value for the investments made by the fund.

FMIEEs were established with the aim of ensuring participation of venture capitalists / private equity firms in risk capital of SMEs vis-à-vis their primary focus on established operators and preference for late-stage deals. According to the laws regulating FMIEEs, they are mandated to invest in enterprises with an annual turnover of less than USD 50 mn (₹ 2,500 mn) and consolidated group net-worth of less than USD 150 mn (₹ 7,500 mn), with focus on SMEs in technology and information-technology sectors. The FMIEEs are established as public-private partnerships with joint sponsorship by i) international financial institutions like Multilateral Investment Fund (MIF), ii) private sector investors, iii) public financial institutions like SEBRAE/FINEP/BNDES and iv) other institutional investors like

pension funds. These FMIEEs are managed by private-sector fund-administering firms registered with CVM. The key role played by these FMIEEs can be gauged from the fact that there are around 28 active FMIEEs listed with the CVM, with total assets being managed by them valued at around USD 210 mn (₹ 10,500 mn).[26] Table 23 highlights the salient features and performances of select recently-launched FMIEE funds in Brazil (REIF, MVP Tech Fund and Fundotec).

Table 23: Salient features and performance of select FMIEE funds in Brazil

Fund	Managed by	Sponsored by	Average Deal size (USD)	Funding (USD)	Deals
REIF	Decisao Gestao de Fundas (DGF)	Inter-American Development Bank/Multilateral Investment Funds (MIF); Banco Sundameris and SEBRAE	1 mn (₹ 50 mn)	10 mn (₹ 500 mn)	11
MVP Tech Fund	Mercatto Venture Partners	MIF; BNDES, SEBRAE and private and institutional investors	2 mn (₹ 100 mn)	10 mn (₹ 500 mn)	5
Fundotec	FIR Capital Partners	SEBRAE and other public agencies	0.3 - 1 mn (₹ 15 – 50 mn)	13 mn (₹ 650 mn	13

The FMIEE funds have been successful in attracting private investors and are quickly becoming the predominant vehicle for investment in Brazil; with fresh call for proposals with the objective of creating 3-4 more such funds. The details of the identified case study along with the corresponding best practices have been presented in Table 24.

Table 24: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Brazil: FMIEE (Fundo Mútuo de Investimento em Empresas Emergentes)[27]	1. FMIEEs are venture capital investment vehicles with their investment portfolios focusing primarily on technology and information-technology companies at the seed capital, startup or expansion investment stages. Generally, the corpus of each FMIEE is between USD 5-10 mn (₹ 250 – 500 mn). 2. FMIEEs are closed-ended public-private partnerships, limited to 35 investors and to a ten-year term, which can be extended for any period decided by the majority of shareholders. Typically, at least 20% of the funds are provided by private investors.	1. Primary focus on rapidly growing ICT/ICTE sector, valued at around USD 22 bn (₹ 1,100 bn), with representation from MSMEs. 2. Pools deals with sizes of less than USD 1 mn (₹ 50 mn), in order to build scale for venture capitalists to be interested.

[26]Source: http://www.dlapiper.com/latinamerica/publications/detail.aspx?pub=4460

[27]Source: http://www.infodev.org: InfoDev publication on Brazilian country study with focus on “Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities”

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	3. FMIEE are managed by professional fund managers (individuals / legal entities), who are selected through a tendering mechanism. These fund managers have to be registered with CVM, which is the regulator for these FMIEEs. 4. Investment by the fund-managers is primarily restricted to CVM regulated corporations with pre-defined investment criterion detailed earlier. The general deal size is in the range of USD 0.7 – 1 mn (₹ 35 – 50 mn). 5. FMIEEs are obligated to keep at least 75% of their investments in stocks, convertible debentures, or stock subscription bonuses from SMEs at any point in time. 6. Units of FMIEEs can be traded in the Brazilian stock exchange (Bovespa), subject to CVM's approval. 7. Brazil's legislation provides significant regulatory and fiscal incentives for foreign investors who invest in FMIEEs. ● Capital gains tax is exempt for investors investing in FMIEE. ● For foreign investors, income tax exemption is granted provided they individually or jointly with related individuals/companies, hold less than 40 percent of the total shares issued by the fund.	3. Participation of institutional investors in form of pension funds through applicable regulations authorizing them to invest 20% of their equities in VC funds. 4. Appointment of fund managers through a tendering mechanism to optimize associated costs. Further, only those fund managers were eligible for participation in tendering process who were registered with CVM to offer portfolio management services. 5. Development of requisite safeguards / flexibilities for fund administration to attract investors: ● Permission to use derivatives for portfolio protection. ● Maintenance of minimum 75% of the investments in stocks /convertible debentures issued by SMEs, at any point in time. 6. Empowerment to shareholders in FMIEEs in taking decisions related to appointment & replacement of the fund manager / institution acting as the fund administrator vis-à-vis earlier norm of the same decision being taken only by CVM. 7. Development of the Brazilian stock exchange (Bovespa) for trading of units of respective funds, thereby i) allowing greater participation of retail / institutional investors and ii) facilitating investors to ascertain the current market value of their investments. 8. Fiscal incentives for investors in form of capital gain & income tax exemption.

Implementation in the Indian context

In India, a wholly owned subsidiary of SIDBI, viz. SIDBI Venture Capital Limited (SVCL) has a venture capital fund "SME Growth Fund" structured as a unit scheme with a mandate to invest in unlisted MSMEs in the manufacturing/services sector. It is registered as a venture capital fund with SEBI, focusing on providing not only financial assistance but also mentoring support, business development services, capacity development, etc. through acquisition of board representation and other rights as a venture capital investor. SIDBI's SME Growth Fund primarily focuses on investing in unlisted MSMEs on account of the absence of a well-developed exchange for MSMEs in India, unlike the case in Brazil where a well-developed & regulated capital market for SMEs facilitates investments in

regulator approved listed securities. With the initiatives underway for setting up a MSME dedicated exchange in India, there exists an opportunity to leverage the same in order to channelize venture capital funds through replication of the Brazilian FMIEE model in India. In this context, an indicative roadmap for replicating this model in India has been proposed in Table 25.

Table 25: Indicative Implementation Roadmap

Action Points
Identify & implement respective regulatory enablers for investment by pension funds in investment vehicles designed as unit-linked Mutual Funds.
Putting in place legal and regulatory enablers to facilitate greater participation of private sector players (venture capitalists) : ● Rationalization of capital gains tax. ● Rationalization of applicable income tax.
Prioritizing focus sectors for channelizing venture capital funds based on perceived interest of venture capitalists / private equity funds.
Developing unit-linked Mutual Fund based investment vehicle for channelizing venture capital funds into MSMEs, with drafting of requisite regulatory policies.
Limiting the participation of fund managers based on approved list of portfolio managers maintained by SEBI; ensuring monitoring of the same.
Developing exit option for fund shareholders through permission for trading of fund units in secondary markets.

It is expected that implementation of this best practice would take around 1.5 - 3 years based on formulation of requisite policy enablers, development of unit-linked mutual fund investment vehicle and permission for trading of fund units in the secondary market. The key costs for the implementing bank / FI would include i) time-costs associated with development of unit-linked mutual fund investment vehicle, ii) development of monitoring & evaluation systems for performance monitoring of fund managers (estimated to be around ₹ 30 - 50 Lakh, but would be based on amount of data to be maintained for the fund managers to be appointed under this model), iii) fee mechanism negotiated with professional fund managers and iv) promotional expenses for information dissemination on the same (estimated to be around ₹ 30 - 50 Lakh, but would be based on the target outreach levels). The break-even level would be based on the amount raised from venture capital funds through this model along with subscription to the units from the respective investors in the secondary market.

3.6. Best Practice RC-6: Strengthening the MSME sector by encouraging Foreign Direct Investments (FDI) and fostering linkages between foreign investors and local MSMEs

The role of MSMEs in the economic growth and development of developing economies is widely recognized in spite of the constraints in terms of limited access to finance, market opportunities, new technology and management know-how. This best practice considers strengthening of the MSME sector by encouraging foreign direct investment (FDI) which not only acts as an additional source of capital to the MSMEs but also represents a potential means for technology transfer for product improvement, market linkages with global network, etc.

By attracting FDI from foreign investors interested in forging strong linkages with local MSMEs, many countries like China, Malaysia, Singapore, etc. have fostered an environment conducive to MSME development. The linkages in these countries have been varied in nature, encompassing backward linkage with suppliers, forward linkage with customers, technology linkage, etc. Further, FDI inflow has been supported through active participation of all concerned stakeholders in form of Government Departments / Agencies, MSMEs and their associations, investor associations, etc. The various benefits that have accrued to MSMEs from induction of FDI include integration into international supply chains, development of specialized products, improvement in operating efficiency and fostering innovation through technology transfer. The details on the policy, regulatory & operational measures undertaken to facilitate inflow of FDI in MSME sector and forging of foreign investor-MSME linkages along with the corresponding best practices adopted in these countries have been presented in Table 26.

Table 26: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Various Countries (China, Malaysia, Singapore, etc.)	1. In order to facilitate the inflow of FDI in the MSME sector, various policies, regulatory and operational measures have been taken by the respective Governments. These include the following: **Policy & regulatory enablers** ● Development of effective legal & regulatory framework to attract foreign investors in terms of tax incentives / tax holidays, repatriation of profits, adherence to international trade norms, conventions & agreements, ban on formation of trade unions / exemptions under labour laws, etc. ● Streamlining of policies & processes to facilitate “single window clearance” for potential investors to reduce processing time. ● Developing policies for adoption of various promotional activities to attract FDI in MSME sector in form of meets to facilitate interaction among domestic MSMEs and potential investors. **Access to information** ● Developing adequate facility for ensuring access to information about various domestic laws and regulations applicable to the foreign investors for setting up business along with requisite details of MSMEs by respective sector, geography, industry, etc. **Automation of the government systems** ● Simplification and harmonization of domestic processes, regulations and standards with international practices to minimize time required to process investment applications by respective investors. **Establishing clusters** ● Establishing geographic and industry oriented clusters to realize economies of scale and develop competitive advantages with proximity to sources of raw material; availability of suitably customized business development services; abundance of clients; and presence of skilled labour force. The presence of clusters reduces search cost for foreign investors in terms of investments in MSMEs. **Infrastructure Development** ● Develop incentives for creation of requisite infrastructure in form of telecom, power, road & rail network, etc. to attract potential foreign investors.	1. Government commitment & willingness to provide necessary infrastructure, invest in skills and technology and create an appropriate regulatory environment for promoting FDI into the MSME sector. 2. Development of robust database of MSME to ensure informed decision making by foreign investors. 3. Simplification and harmonization of policies and procedures related to induction of FDI in the desired sector, especially in terms of single window clearance, ensured that the processing time is considerably reduced. 4. Development of information database about applicable domestic laws & regulations related to channelizing of FDI in the country. 5. Development of policies and fiscal/monetary incentives for promoting establishment of MSME oriented clusters.

Implementation in the Indian context

Historically in India, there have been limited options for MSMEs to obtain FDI. Some of the key issues impacting the flow of FDI in the Indian MSME sector include the following:

- Multiple agencies handling the policy related issues for induction of FDI and its implementation for the MSMEs. With respect to specific case of induction of investments by non-resident Indians, it is observed that the following Government agencies / departments are involved in processing investment proposals:
  - Policy with respect to FDI, including investments by NRI/PIO is notified by the Department of Industrial Policy and Promotion (DIPP)
  - Ministry of Overseas Indian Affairs is responsible for the promotion of investment by NRIs
  - Foreign Investment Promotion Board (FIPB) considers the investment proposals of NRIs
  - Ministry of Micro, Small and Medium Enterprises administers the MSMED Act thereby impacting the induction of FDI into MSME sector
  - Reserve Bank of India monitors the investment inflows received through NRI
- Absence of specific provision regarding FDI into MSMEs in the MSMED Act 2006

With the MSME sector emerging as the vibrant sector of the Indian economy, accounting for 40% of the exports, 45% of the industrial production and contributing 8% to the GDP, recently Government has relaxed the FDI norms by way of Press Note 6 of 2009, which permits MSMEs to obtain up to 100% FDI subject to the normal sectoral equity caps, entry routes and other relevant sectoral regulations. With this policy reform being the first step by the government towards broadening the options available for cash-strapped MSMEs to raise capital, further policy, regulatory and institutional reforms need to be undertaken for encouraging FDI participation in the MSME sector. An indicative roadmap for encouraging flow of FDI in the MSME sector in India has been detailed in Table 27.

Table 27: Indicative Implementation Roadmap

Action Points
Identifying potential sectors in which FDI is required for promotion of MSME sector, based on level of involvement of MSMEs, relative maturity & competitiveness of MSMEs, etc.
Developing requisite legal & regulatory enablers to facilitate FDI inflow into MSME sector in terms of i) tax incentives for foreign investors in MSME sector, ii) adoption & adherence to international trade norms, conventions & agreements, ii) relaxations in labour laws, etc.
Establishing a single window for FDI investment proposal evaluation in MSME sector to reduce proposal processing time.
Developing a national-level database with details of MSMEs in terms of sectors / industries / geographies / presence in cluster or not to facilitate identification of potential investment opportunities by foreign investors. This can be supplemented with details of past FDI investments in respective MSME sectors for potential investors to get feedback from existing investors.
Conducting promotional tours / road-trips highlighting the successful case studies of FDI in MSME sector along with facilitating interaction between MSMEs and foreign investors.
It is expected that implementation of this best practice would take around 6 months – 2 year based on formulation of requisite regulatory enablers and development of appropriate databases.

It is expected that implementation of this best practice would take around 6 months – 2 year based on formulation of requisite regulatory enablers and development of appropriate databases.

CHAPTER 4

CREDIT DELIVERY

Highlights

- Lending models are either transaction or relationship based, depending on the data, collateral availability and legal environment. Primary reliance on physical collateral based lending models for MSMEs on account of concerns over credit worthiness.
- Emergence of non-physical collateral based lending models involving factoring, purchase order financing, warehouse receipts, etc. and non-traditional channels leveraging technology interventions.
- Risks associated with credit delivery to MSMEs for banks / FIs include i) borrower credit risk and ii) MSME portfolio credit risk.
- Reliance on qualitative and quantitative risk management tools & methodologies to assess, measure and mitigate associated credit and portfolio risks, thereby helping improve quality of assets for banks / FIs.

Theme Description & Benefits to MSMEs

Credit delivery to MSMEs can be extended from either the informal or the formal sector. Credit delivery through informal sector in form of moneylenders, credit & savings co-operative, etc. is highly localized, unregulated and associated with higher costs for MSMEs. Formal sector intervention in credit delivery has been channeled traditionally through physical bank branches; on-field sales staffs, intermediaries like partner financial institutions in form of MFIs / NBFCs. The effectiveness of a credit delivery channel depends on the transaction cost, ease of access for borrower, turnaround time (TAT) for delivery, ease of monitoring & managing risk for the bank. On account of reduced servicing costs & time, new channels of credit delivery through technology interventions in form of internet, mobile phones, smart cards, etc. are gaining popularity. These new channels have a limited downside in terms of level of investments required in underlying infrastructure. One of the key advantages of leveraging technology interventions is access to real-time information on transactions which can help banks / FIs make informed decisions on credit appraisal and delivery for effective risk management. Access to relevant and updated information is one of the key concerns impacting the strengthening of risk management framework for SMEs in terms of robustness of associated qualitative & quantitative tools and methodologies.

Leveraging technology interventions for deployment of innovative credit delivery models, banks / FIs reduce the processing time and cost associated with loan disbursement along with improvement in quality

of asset portfolio. This can lead to potential benefit to MSMEs in terms of access to funds from banks / FIs at a relatively reduced cost.

The key best practices associated with i) credit delivery for SMEs in China through deployment of online channel for loan origination supported with application-driven dynamic risk management, ii) online auction based loan disbursement to ensure most competitive rates for MSME borrowers, iii) leveraging web-based warehouse receipt system with underlying physical inventory to increase credit delivery to MSMEs, iv) appointment of dedicated SME account managers and v) deployment of automated credit scoring / rating tools customized for MSMEs are described below.

4.1. Best Practice CD-1: Deployment of web-based application for loan processing and risk management through analysis of financial parameters updated in real-time

On account of reduced processing costs and time associated with delivery of credit through deployment of internet based applications, SME loan, Hong Kong developed an online application to facilitate online loan processing through collaboration with a technology implementation firm, viz. Maveo Systems Ltd. As part of this process, online credit appraisal was conducted based on information collected from SMEs. Further, SME loan had a system of updating the information periodically, based on information sourced from SMEs either physically or through online submission. This facilitated development of a dynamic risk management tool with credit decision based on underlying performance, without recourse to information / rating access from credit bureau or rating agencies, etc. The differences in the model adopted by SMEloan vis-à-vis traditional methods of lending have been presented in the Figure 9.

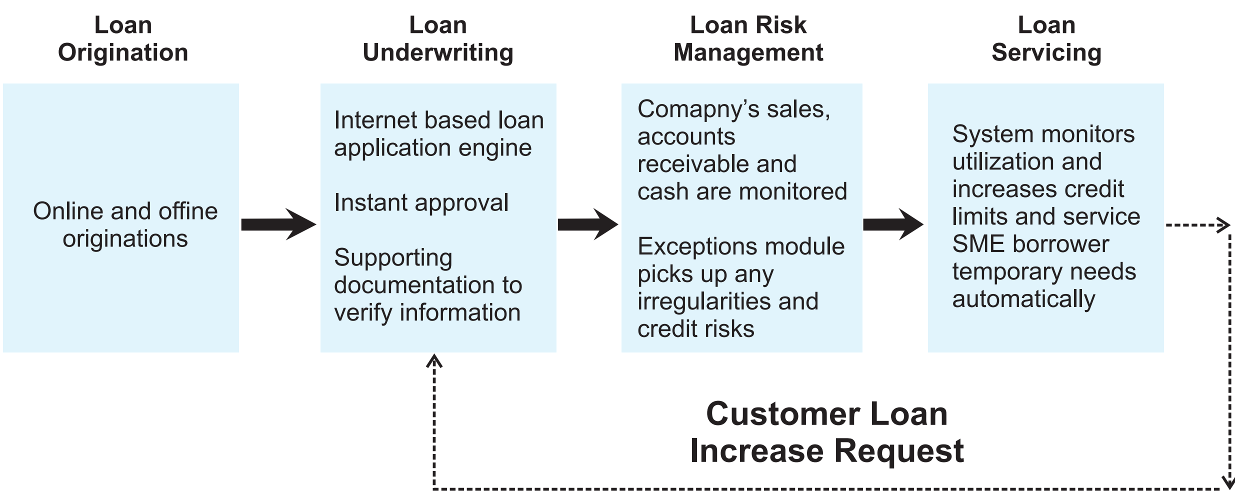


Figure 9: Traditional credit disbursement vis-à-vis disbursement leveraging SMEloan model

The impact of this credit delivery model developed by SMEloan is given below:

- Approval of "Express Loan" up to USD 1,28,000 (₹ 6.4 mn) within one minute of submitting online application[28].
- In October 2000, SME loan Hong Kong Limited obtained a USD 75 mn (₹ 3,750 mn) financing facility for SMEs with funding from a group of banks, lead arranged by Standard Chartered Bank. The same was also backed by a surety bond from Centre Solutions (Asia) Ltd. The facility enabled SME loan to expand its customer base from 200 SMEs to well over 1,000 by mid-2002.

While focusing on loan disbursement to SMEs in China (mainly Hong Kong) on its own, SME loan has decided to leverage its web-based applications to increase outreach of finance to SMEs through partnerships with banks / FIs in other countries. Under this partnership model, SME loan installs and customizes their application as per requirement of the partner bank / FI along with training / capacity development of the concerned staff for effective administration of the application. As part of these efforts, SME loan's product was adopted by OCBC Bank of Singapore[29].

The details of the identified case study along with the corresponding best practices adopted by SME loan have been presented in Table 28.

Table 28: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
China: SME loan	1. Development of an online application to facilitate loan processing, including origination and underwriting. 2. Provision for submitting requisite details for securing credit through the online application. For these purposes, each SME can create password-protected individual login. For SMEs not conversant with internet, provision exists for any authorized person to fill the information on their behalf. 3. Information to be provided at pre-approval stage includes background of management team, industry operated in, details of financial obligations, banking transaction history, existing bank credit support, commitment of owners, debtor profile of borrowers, recent financial performance, etc. 4. Profiles of SMEs acceptable as clients to SME loan are built into the web-based risk management tool for purposes of approving respective credit applications. 5. Based on information submitted & risk-based scoring, risk management tool identifies profiles of borrowers which match the "acceptable" profiles for purposes of further loan processing. 6. Mandatory information to be submitted by SMEs, post approval, include details of sales, cash flows, debtor position (balance, outstanding period, etc.), with provision of uploading files directly from respective accounting packages of SMEs in addition to offline mode of submission. 7. Post disbursement, risk management tool continuously monitors cash flows, turnover and debtor performance of respective borrower on a real-time basis, based on periodic updation of the same by the SME through the online application. 8. Exception based risk management model is adopted, with allocation of staff for follow-up / counseling of identified borrowers with potential "exceptions".	1. Provision for online submission of credit request along with supporting information / documents helps reduce processing time, associated overhead costs in terms of hiring / training staff on credit appraisal assessment & monitoring. 2. Web application maintains an audit trail of the approval given to serve as a reference for subsequent decisions. 3. Adoption of exception based monitoring ensures optimum utilization of resources, reduction in overhead costs and minimizes chances of credit default through early identification followed by requisite counseling. 4. On account of dynamic real-time updation of borrower's financial performance parameters, potential increase in loans to be advanced to borrowers, who demonstrate growth, is also identified through the online application & approved automatically on receipt of requests.

[28]http://www.tradeforum.org/news/fullstory.php/aid/414/Innovation,_Specialization_and_E-finance_for_SMEs.html
[29]http://www.unctad.org/en/docs/sdteedc20051_en.pdf

Implementation in the Indian context

Currently, most of the banks / FIs in India use primarily manual mechanisms backed with spread sheet-based financial packages or automated credit risk assessment models for credit appraisal of MSMEs. However, the loan origination continues to be primarily offline for MSMEs on account of their limited exposure to internet based technologies. Further, these manual / automated credit appraisal packages are static in nature with absence of periodic / continuous updation of real-time data to facilitate dynamic credit appraisal based decision making process. Given the same, an indicative roadmap for implementing the credit delivery model in terms of deployment of online application for loan processing and real-time risk management, has been detailed in Table 29.

Table 29: Indicative Implementation Roadmap

Action Points
Developing a partnership with SME loan for deployment of their application, post requisite customization.
Ensuring training / capacity building of resources for operation of application developed by SME loan.
Increasing awareness among Indian MSMEs for adoption of online web-based tool for loan application and processing.

It is expected that implementation of this best practice would take around 6 months – 1 year based on ability to secure tie-up with MSME loan for deployment of their web based application. The key costs for the implementing bank / FI would include i) license fee payable to MSME loan on a recurring basis, ii) one-time investment in training of end-users on the application through tie-up with MSME loan and iii) promotional expenses for information dissemination on the same (estimated to be around ₹ 30-50 Lakh, but would depend on the target outreach level). The break-even level would be based on the level of subscription to this web based model along with volume of business transacted using the same.

4.2. Best Practice CD-2: Deployment of a web-based auction-based mechanism for identification of lenders offering the most competitive rates

Peer-to-peer lending generally refers to specific financial transactions, primarily related to lending and borrowing, which occurs directly between lenders & borrowers without the intermediation/participation of a traditional financial institution. This model leverages the availability of technology in form of internet based applications to provide an online platform for peers to transact. This model has been specifically leveraged by SMEs in the US and Europe to raise funds directly from individual / private investors with the selection of respective lender based on an auction-based mechanism to ensure most competitive rates for respective SME borrower. The additional advantage of raising funds through this mechanism is the associated lower cost on account of removal of the intermediary with a higher overhead cost. Further, these transactions do not involve any need to furnish physical collaterals with the underlying credit rating serving as the pointer to potential lenders in terms of the respective credit worthiness of the SMEs. However, such peer-to-peer lending is typically more suitable for standardized small ticket / micro loan products. The P2P lending models adopted in the US and UK by Prosper and Zopa respectively has been detailed.

Prosper/USA: Prosper is an online platform for borrowing and lending in the US, leveraging the concept of P2P lending. Prosper operates on the principle of online auction where i) SMEs list and ii) retail & institutional investors bid for loans using an online auction platform. Investor participation through this online platform usually involves scanning of potential investment opportunities and evaluation of respective borrower on a case-to-case basis. However, provision exists for defining a model portfolio with target risk profile and expected returns, based on which the online platform recommends potential lending opportunities to respective lenders. Further, trading of respective loan portfolio of investors is facilitated through an online interface provided by Proposer to interested investors. The relative success of the Prosper model can be assessed from the following :

- Since its inception in 2006, it has enrolled over 9 lakh members.
- Till August, 2008; loans transacted through Prosper have been estimated at USD 164 mn[30] (₹ 8,200 mn).

Zopa/UK: Zopa is an online P2P platform launched in the UK in March 2005 which operates on the principle of online auctioning of the loan like Prosper. Zopa has got its license from office of Office of Fair Trading and it is not regulated by Financial Services Authority (FSA), the regulator of UK. Lenders include both retail as well as institutional investors with maintenance of an account with Zopa with a minimum lending balance of USD 10, before any bid by the respective lender can be considered in the online system. Further, each borrower is mandated to have complete details of identity, verifiable credit history and proof of requisite levels of income to meet the debt obligation, before putting in requests for loans in the online system. One of the unique features of Zopa is that a borrower in Zopa market can also be a lender to other borrowers. The relative success of this model can be gauged from the following:

- Nearly USD 45 mn (₹ 2,250 mn) loans arranged till July 2008.
- It has received different awards. Among others “Best Financial Services Website-2008” and “Retail Banker International Global Award” are a few of them.

The details of the identified case studies relating to the US and UK along with the corresponding best practices adopted by Prosper and Zopa in these cases have been presented in Table 30.

Table 30: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
USA/ Prosper[31]	1. Any loan requisition by a borrower has to include the details relating to i) loan amount & tenure, ii) maximum interest rate, iii) family & friend references, iv) loan purpose, v) credit scores, etc. to be submitted through the online application.	1. Direct access without the help of any intermediation helps reduce cost of funds on account of minimal overhead costs associated with internet-based intermediation.

[30]The Revolution of Peer to Peer Lending in Microfinance: www.european-microfinance.org/data/file/Babyloan%20-%20P2P.pdf
[31]http://www.prosper.com

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	2. Credit score ascertained by the respective credit bureaus along with monitoring of Prosper score through evaluation of above information & past performance history of the borrower forms the basis for qualifying respective loan applications to list on Prosper. 3. Borrowers can request for loans ranging from USD 1000 to 25000 (₹ 50,000 to 1,250,000) through Prosper's online application. Further, lenders can seek clarifications from the borrowers for the respective loans. 4. Selection criteria used by a Prosper lender includes credit scores, past repayment history, other credit lines enjoyed along with endorsements by personal friends and group affiliates. 5. Based on listing of loan requirement, the online auction system starts functioning. Individual and institutional investors listed as lenders quote their minimum interest rate and bid in multiples of USD 25 up to USD 25000 (₹ 1250 to 1,250,000). The interest rate offered by lender forms the basis for bidding, with any loan listing remaining active for 7 days after posting. 6. Prosper's online system matches each loan request with lowest interest rate quotes from single / multiple lenders, based on amount bid by respective lenders. System generates & automatically sends a note to the winning bidder(s). 7. Further, provision exists for individuals lenders to define their target portfolios in terms of target returns and risk profiles, based on which the system recommends potential investment opportunities to the respective lender to save investment identification cost. 8. Also, provision exists for investors to trade their loan portfolio with other Prosper members through an online interface. 9. Prosper handles the ongoing loan administration and collection function on behalf of the lender. The monthly loan repayment amount is deducted from the bank account of the borrower and deposited in the account of the lender. 10. A transaction fee, varying from 0.5% - 3% is levied on the borrower, depending on the rating of the borrower, with a minimum charge of USD 50 (₹ 2,500). Further, lenders are charged an annual 1% loan servicing fee. 11. Lenders are not protected by Federal Deposit Insurance Corporation (FDIC) and have to bear the default risk.	2. Risk mitigation mechanism in form of freedom to lenders to lend as per their risk profile, with minimum investment permitted being USD 25 (backed by rating of borrower from credit rating agencies as well Prosper score). 3. Minimum borrowing cost through discovery of most competitive lending terms through online auction system. 4. Potential for diversifying risk for investors through investment in multiple MSMEs. 5. Reduction in search cost through automation of investment identification leveraging risk-return profile submitted by respective lender. 6. Greater liquidity to the investor due to the provision of tradability of loan portfolios through the online interface.
UK/Zopa[32]	1. Zopa uses the service of Equifax for i) assigning credit score to potential borrowers and ii) reference & identity check for the new borrowers and lenders.	1. Minimum risk rating specified by the Zopa system screens the bad quality borrower.

[32]http://uk.zopa.com

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	2. Any loan requisition by a borrower has to include the relevant details for computation of credit score & rating. The key information supplied includes i) loan amount & tenure, ii) maximum interest rate, iii) family & friend references, iv) loan purpose, etc. to be submitted through the online application. Credit score is sourced from Equifax based on the information submitted. 3. Loan proposals are qualified based on a bare minimum credit score set by Zopa. Qualified proposals can request for loans in the range of GBP 1000 to 15000 (₹ 75,000 to 1,125,000) along with expected interest rate over the Zopa's online platform. 4. Post listing of a loan requirement, online bidding starts for the loan with participation from interested lenders. 5. Lenders list their offer on Zopa specifying the amount, interest rate and the risk rating in which they want to invest. Each lender can lend anything between GBP 10-25000 (₹ 750 to 1,875,000). 6. Any loan proposal remains active for a specified number of days along with an associated acceptance time-frame for the borrower to respond to rates offered. Based on acceptance of any offer, lenders enter into a legal agreement with the borrower directly. 7. Lenders put in their money in Zopa account to make it available to the respective borrower. Similarly, the monthly loan repayment from borrower is directly debited from their respective bank accounts. 8. For purposes of risk diversification, lenders are prohibited from over-exposure to select borrowers. Norms followed include limiting the maximum exposure to a single borrower to higher of i) 1/50th of total amount lent by a particular lender and ii) GBP 10 (₹ 750). 9. Further, provision exists for individual lenders to set standard instructions for periodic investments of the idle amount in their Zopa accounts along with underlying expectation on risk-return. The system recommends potential investment opportunities through analysis of past loan offers made and the risk-return profile recommended. 10. Zopa charges a transaction fee of GBP 118.50 (₹ 9,000) to the borrower and recovers 1% loan servicing fee per annum from the lender. 11. If there is a default, Zopa has tie-ups with a collection agent for loan recovery. In case of discontinuation of operations by Zopa on account of any reason, the loan agreement between borrower and lender transacted using Zopa's online platform will remain valid. The collection agent will continue to collect the amount due from the borrowers at the same fee.	2. Minimum borrowing cost in terms of discovery of most competitive lending terms through online auction system. 3. Mandatory diversification of risk by putting a cap on upper investment limit for exposure to any particular borrower, leading to diversification of risk for investors through investment in multiple MSMEs. 4. Reduction in search cost through automation of investment identification leveraging risk-return profile submitted by respective lender along with analysis of past loan offers made. 5. Loan recovery through a separate collection agent independent of Zopa, mitigates the risk for lenders associated with default.

Implementation in the Indian context

Currently, there is no concept of peer to peer (P2P) lending through on online auction system for extending credit to MSMEs in India. There are some online lending platforms (viz. DhanaX and RangDe) which facilitate lending to micro enterprises or SHGs by socially minded investors for subsequent on-lending to MSMEs. However, the intermediation fees charged are significant which impacts the efficiency of this model. e.g. DhanaX charges interest at the rate of 24% from the borrower while paying interest at the rate of around 14% to the investors providing the fund. In addition to the higher intermediation costs, some of the other challenges impacting the growth of P2P lending for MSMEs in India include i) regulatory constraints, ii) unavailability of credit scores of MSMEs with support to Credit Information Bureau (India) Ltd (CIBIL) under MSME Financing and Development Project being implemented by SIDBI for ensuring the development of repository of credit-related information specific to MSMEs expected to address this issue in the near future, iii) high default rate in unsecured loan, iv) risk averseness of the investors and v) lack of awareness among MSMEs about P2P lending platform. In order to address the same, an indicative roadmap for implementing P2P lending model in India along with the roles of key stakeholders has been detailed in Table 31.

Table 31: Indicative Implementation Roadmap

Action Points
Developing approach and guidelines for P2P lending in India.
Developing requisite regulatory & policy enablers to facilitate access to finance for MFIs and MSMEs through the online P2P lending model • KYC norms to maintain identity of lender. • Prevention of Money Laundering Act (PMLA) 2002 to counter suspicious transactions and terrorism financing.
Increasing awareness of the P2P model among the MFI and MSMEs for securing access to finance from retail as well as institutional investors.
Increasing awareness of the P2P model among the potential retail & institutional investors to secure their participation in the model.
Facilitating development of an online P2P lending platform to ensure access to finance for MFIs and MSMEs.
Facilitating scoring/rating of the micro-enterprises and MFIs for accessing funds in the online P2P model.
Arranging for tie up with credit bureaus / rating agencies for information sourcing with view of conducting reference check.
Securing partnerships with collection agencies agents to ensure timely collection and serve as additional comfort to lenders.

It is expected that implementation of this best practice would take around 1 – 2 years based on formulation of requisite regulatory enablers, development of online auction based lending system and securing tie-ups with credit bureaus / rating agencies. The key costs for the implementing bank / FI would include i) development of online auction based system (one-time cost expected to be around ₹ 2-3 Crore with recurring cost of around ₹ 0.4 - 0.6 Crore on an annual basis, with actual costs to be dependent on number of participants in this online platform), and ii) fee-based mechanism negotiated with credit bureaus / rating agencies and collection agencies. The break-even level would be based on the level of subscription to this web based model along with volume of business transacted using the same.

4.3. Best Practice CD-3: Leveraging the deployment of web-based warehouse receipt system with underlying physical inventory to increase on-lending to MSMEs

One of the key challenges impacting rural financial intermediation is availability of low-cost, convenient & effective modes of credit delivery to meet the requirements of MSMEs. According to the World Bank estimates, 90% of the population in developing countries has no access to formal financial services and the emerging microfinance industry is currently reaching only 2-5 % of the potential MSMEs[33] seeking finance due to delivery constraints. One of the credit delivery models adopted worldwide includes issue of web-based warehouse receipts to facilitate inventory pledging based financing. This model was pioneered by the UAE in Middle-East. This best practice highlights the case of introduction of a web-based warehouse receipt system in the UAE as an effective credit delivery and risk mitigation tool, eliminating the possibility of multiple financing against the same goods and ensuring efficiency, speed and security in credit delivery. Based on the success of the web-based warehouse receipt system in the UAE, the same was rollout out in the first phase in 2007 by Singapore, Malaysia and South Korea. Subsequently, it is proposed to extend this web-based system to other countries in Europe and North America in due course.

The details of the identified case study along with the corresponding best practices adopted in UAE- Dubai have been presented in Table 32.

Table 32: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practice/Critical Success Factors
Dubai/ Dubai Metal and Commodity Centre (DMCC)	1. To expand outreach and ensure efficient, speedier and secure credit delivery to SMEs in UAE, Dubai Metal and Commodity Centre (DMCC) launched first on-line warehouse receipt Global Multi-commodity Receipt (GMR) in the Middle East. 2. The participants in the GMR based warehousing receipt system operated by DMCC include the following: ● Originators which may include SMEs (traders / processors of commodities) depositing the physical commodity. ● Issuers who are operators of DMCC approved warehouses. ● Collateral Managers/Inspectors who certify the accuracy of the description of goods in the GMRs, issued by DMCC. ● Financers who are the banks that accept GMR as collateral. ● DMCC is the regulator and the administrator.	1. Ensuring standardized and secure trade by allowing only DMCC approved members to transact. 2. Ensuring credibility of the system by offering credit risk mitigation measures: ● Appointment of DMCC as the only agent to hold the GMRs and maintain audit trail, data backup of the transactions, etc. ● Audit trail kept by DMCC ensures that the warehouse receipts are transferred between successive holders free of any outstanding claims. ● Creation of pledge in favour of the Financer, which is released only on loan re-payment. ● Provision for holding the Collateral Manager or the Issuer liable for damages in case of material discrepancy.

[33]Source: Study titled “Creating an Enabling Environment for Microenterprises Development”

Country/ Organization	Case Study	Best Practice/Critical Success Factors
	3. Membership to GMR system is extended to the individuals and firms on the basis of their financial standing and past history. 4. Highlights of the functioning of GMR based warehouse receipt system includes the following: ● Originator deposits goods with the Issuer, requesting for GMR issuance. ● Issue of web-based GMRs against goods deposited based on inspection by Issuer. ● Issued GMR is presented to the Financer by the Originator to avail the finance. ● Inventory is pledged in favour of the Financer in form of the GMRs and a pledge notification is made to DMCC. ● Financer accepts the pledge and releases the loan to the Originator. ● On loan repayment, pledge is released by the Financer and the GMR is cancelled. ● In case of default by Originator, the first right on the pledged inventory rests with the holder of GMR. It could be the Financer or could be transferred by the Financer to another "Security Beneficiary". ● In case of any material discrepancy between the quantity / description of goods as indicated in the GMR vis-à-vis the actual quantity of goods, the Issuer or the Collateral manager is held liable for damages. 5. The web-based GMR system enables the transfer of these negotiable receipts among members of the system. However, transfer endorsement certificate needs to be obtained from DMCC. The "Transferee" by virtue of transfer endorsement acquires such title to the goods as the "Transferor". 6. Each Originator, Transferee and Financer irrevocably & unconditionally appoints DMCC as its agent to hold all GMRs issued by the Issuer in respect of goods stored on behalf of the originator. ● DMCC also records all the future transfers and pledges to ascertain if there is any competing claim on the underlying pledged inventory.	3. Periodic inventory reports by the Collateral Manager offers easy monitoring of the inventory by the Originator/Borrower. 4. Provision for quick title transfer through negotiability and fraud prevention leveraging web-based tracking of endorsement to assess competing claims on pledged inventory. 5. Release of Transfer Endorsement by DMCC after all checks ensures that the Transferee shall not be liable for any failure on the part of the Issuer or the previous legal owner to fulfill their respective obligation. 6. Reduced monitoring cost for Financers on account of assurance of Issuer on quality / quantity of the pledged inventory; no need to monitor each SME's pledged inventory separately. 7. Partial cancellation of the GMR and fresh issuance is permitted facilitating the originator/borrower to use the commodity for processing as & when the orders are received from buyers / self consumption, etc. 8. Established institutional framework and regulations which enable physical delivery of the collateral through Dubai Gold & Commodities Exchange (DGCX) contracts.

Implementation in the Indian context

Access to finance for MSMEs like processors / traders engaged in agri-business in India is very limited on account of lack of significant presence of the formal financing sector in the rural areas. Though financing based on warehouse receipts has been in operation in India for a long time, it suffers on account of unorganized nature of operations, lack of integration with private sector supply chains, lack of confidence in storage & quality practices followed by warehouses, etc.

Leveraging the inventory of agri-commodities stored by these MSMEs, acting as intermediaries in agri-business value chains, a web-based warehouse receipt system can be developed in line with the one adopted by DMCC. This could extend to other MSMEs involved in processing, packaging & adding value to the respective non-agri commodity, but requiring storage space. Further, with the credit delivery model and the concept of closed user group (CUG) being seconded by the Working Group on Warehouse Receipts constituted by RBI in 2005, there is an opportunity with the banks/FIs to leverage the electronic warehouse receipt system for delivering credit to MSMEs in a secured, flexible and quick manner. According to the report of Press Trust of India released in April 2009, only ₹ 20,000 Crore of loans are disbursed annually against the warehouse receipt in India but with the banking sector showing interest, this can grow to ₹ 1, 00,000 Crore by 2015.[34] An indicative roadmap for implementing the model in India along with the roles of key stakeholders has been detailed in Table 33.

Table 33: Indicative Implementation Roadmap

Action Points
Developing adequate rules & regulations governing negotiability & transferability of Warehouse receipts to facilitate lending based on warehouse receipts as the underlying collateral.
Developing national grading system for independent determination & verification of the quantity / quality of stored commodities.
Permitting banks to deal in agri-commodity based derivative products to hedge price risk.
Developing a pan-India based spot market along with associated clearing & settlement facility, for trading of warehouse receipts (Currently, the National Spot Exchange is operational in 7 states encompassing 17 commodities[35]).
Developing requisite legal & regulatory enablers to reduce risk weightage for loans advanced by banks/FIs against warehouse receipts.
Developing a roadmap for formation of closed user group (in line with recommendation of Working Group on Warehouse Receipts constituted by RBI in 2005) and electronic warehouse receipt system as adopted by DMCC.
Information dissemination among the key stakeholders about the electronic warehouse receipt system as an effective mechanism for credit delivery.
Identifying key agricultural and industrial products where electronic web enabled warehouse receipt system can be piloted.
Identifying the members or user-groups of the warehouse receipt system (issuers, originators, financers, collateral mangers, and regulators) and developing mechanism for their selection.
Facilitating development of an electronic web enabled warehouse receipt system with central registry to ensure system efficiency and integrity.
Monitoring and evaluating performance of web-enabled warehouse receipt system to serve as input to future roll-out/ scaling up.

It is expected that implementation of this best practice would take around 1.5 – 2 years based on formulation of requisite regulatory enablers and development of web-based warehouse receipt system, post identification of appropriate vendor. The key costs for the implementing bank / FI would include development of web based warehouse receipt system (one-time cost expected to be around ₹ 2 - 4 Crore with recurring cost of around ₹ 0.4 – 0.8 Crore on an annual basis, with actual costs to be dependent on the volume of transactions to be supported through this model). The break-even level would be based on the level of subscription to this web based model along with volume of business transacted using the same.

[34]http://www.business-standard.com/india/news/warehouse-receipts-mkt-may-rise-to-rs-1-trn/54911/on
[35]Source: http://www.nationalspotexchange.com/

4.4. Best Practice CD-4: Appointment of trained "SME Account Managers" to facilitate credit delivery to MSMEs

Considering the fact that lending to MSMEs has emerged as a focus area for banks worldwide while managing the associated risks in terms of insufficient assets, low capitalization, etc.; it is imperative to manage the credit risk associated with MSMEs in an effective manner. In addition to the development of credit scoring mechanisms, risk classification instruments and in-depth financial analysis, the banks worldwide acknowledge the importance of having well-trained resources who can manage the client relationships with MSMEs profitably. This typically requires the following high-level steps:

- Selection of appropriate candidate for the account manager's role based on criteria in terms of adequate knowledge and information about key issues and constraints faced by MSMEs.
- Investment in capacity development and training of these SME Account Managers in areas related to credit appraisal, risk management, portfolio management, collections, etc.
- Design of lucrative incentive schemes for retaining Account Managers in their role for a substantial duration in order to develop a close relationship with the clients and build up knowledge in this sector.

On account of need to grow its market share in the growing SME space, Swedbank (a leading bank in Sweden and the Baltic region) embarked on its programme for developing "SME Account Managers" who can be assigned to each SME client from day one to address all financial issues – from preparation of loan documents to actual credit disbursement and collections. The programme had two clear objectives, viz. i) to improve bank's competency for servicing the needs of SME, and ii) to create a sales organization proactive in approach and sensitive to customer need. This comprehensive initiative undertaken in 1996 has helped Swedbank secure a 40%[36] market share with respect to MSMEs in its target geographies with 75% of group profits attributed to this sector.

This approach has been adopted by a host of other banks focused on MSME sector, including NatWest and Bank of Ireland. The details of the identified case studies along with the corresponding best practices adopted have been presented in Table 34.

Table 34: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Sweden: Swedbank (SME Account Manager)[37]	1. Each participant for the training programme is selected carefully based on underlying credentials. Further, each of them is assigned a mentor in form of a senior colleague. 2. The training program covers 7 different subjects, including accounting, law, policies and entrepreneurial skills. The methodology involves assignments on individual and group basis, with class room based training.	1. Careful planning and development of course content through effective liaison with academicians. 2. Mentoring by senior colleagues.

[36]Source: UNCTAD Publication titled "Improving the competitiveness of SMEs in developing countries" (2001)
[37]http://ec.europa.eu/enterprise/policies/finance/files/rt2_en.pdf : The Second Round Table of Bankers and SMEs, Final Report

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	3. Exposure is provided to all steps required in setting up a company in terms of getting necessary approvals for starting a business, drawing a business plan, preparing budgets, liaising with the necessary authorities for fulfilling the statutory requirements. 4. Participants are also given exposure to associated financing related processes for setting up business, in terms of setting up accounts and requesting credit, etc. 5. Award of diplomas only when participants have passed all examinations and on demonstration of requisite standards.	3. Feedback from participants clearing the programme is incorporated for purposes of improvement of future training initiatives. 4. Networking with classmates and teachers facilitates access to their experience in solving issues in future. 5. Strengthening of back-office operations and processes to enable SME Account Managers to devote more for client acquisition and for resolution of their problems. 6. Single point of contact for MSME client for all their financing requirements.
India: ICICI Bank and UK: NatWest & Ireland: Bank of Ireland	1. Segmentation of SME customers into respective categories: ● ICICI Bank segregated its MSME clients into i) corporate linked businesses, ii) cluster based groups and ii) others. ● NatWest segregated SME clients into i) small businesses, ii) mid-corporate businesses. ● Bank of Ireland segregated SME clients into i) existing and new small entrepreneurs and ii) larger SMEs. 2. Appointment of dedicated / shared Account Managers, based on perceived level of business with associated categorization of SME clients.	1. Effective segmentation which forms the basis for customization of service approach. 2. Appointment of relationship managers / account managers, supported with systems & processes to facilitate ease of transaction processing. Role of relationship / account manager is then restricted to development of client relation for cross-selling, handling exceptions, etc.

Implementation in the Indian context

In India, all State-owned banks and most of the private sector banks provide in-house training to their staffs through the Staff Training Colleges or hire external trainer for this purpose, including Bankers Training College (BTC) of Reserve Bank of India (“RBI” – India’s Central Bank), National Institute of Bank Management (NIBM), Indian Institute of Banking and Finance (IIBF) for offering customized training for officers and staff associated with MSME sector. Under GIZ TA , MSMEFDP had provided sectoral training to different bankers. However, there is no course devoted exclusively for developing potential account / relationship managers for MSME clients. On account of the same Banks / FIs looking at effectively growing their business with the MSME sector need to develop appropriate course content. This could be achieved by leveraging their respective past experience or through external faculty in form of apex training institutions. Further, for purposes of standardization of course content across all banks/ FIs in India, Reserve Bank of India (“RBI”) could play a key role in content development. In this context, an indicative roadmap for strengthening this model in has been presented in Table 35 in the next page.

Table 35: Indicative Implementation Roadmap

Action Points
Should design eligibility criteria for selection of "MSME Account Managers".
Should develop the courseware and training module.
Should appoint mentors for course participants.

It is expected that implementation of this best practice would take around 0.5 – 1 years based on forging of partnerships with identified training institutes along with development of course content. The key costs for the implementing bank / FI would include i) fees payable to training institutes (expected to be around ₹ 10 Lakh for each training session with around 50 participants for a fortnight), ii) time-cost associated with monitoring of pilot project to identify areas of improvement.

4.5. Best Practice CD-5: Introduction of credit scoring / rating tool to reduce turnaround time associated with MSME lending

On account of the high risk associated with lending to MSMEs along with the lack of proper appraisal mechanism and absence of MSME focused rating tools, it has been observed globally that the credit flow to the MSME sector is impacted in terms of high turnaround time along with associated higher transaction costs.

India:

Small Industries Development Bank of India (SIDBI) has developed an in-house Credit Assessment and Rating Tool ("CART") for purposes of conducting appraisal and rating of small loans up to ₹ 50 Lakh. This has helped in reducing the turnaround time associated with loan processing along with providing transparency in determination of borrowing interest rate which is linked to credit rating of the respective borrower. This tool has been acknowledged by Reserve Bank of India ("RBI" – India's Central Bank) with request to SIDBI to share this tool with other banks/FIs in order to facilitate the credit flow to MSMEs with potential reduction in transaction costs associated with lending to MSMEs. Since its launch, SIDBI has upgraded the "CART" in terms of strengthening the appraisal and rating models which can now process loan proposals up to ₹ 200 Lakh. This tool has also been upgraded to an open system architecture platform with SIDBI sharing the same with 20 public sector banks and 18 State Financial Corporations based on MoUs signed with respective banks/FIs. A snapshot of the performance achieved leveraging this tool as on September 30, 2010[38] has been given in Table 36.

Table 36: Highlights of performance achieved leveraging CART

	Number of Proposals sanctioned	Amount Sanctioned (₹ Lakh)	Average Loan Size (₹ Lakh)	Average No. of Proposals Sanctioned /Month
CART (Old Version) for upto ₹ 50 Lakh (Since Dec 2003)	4337	106630	24.58	51

[38]Source: SIDBI

	Number of Proposals sanctioned	Amount Sanctioned (₹ Lakh)	Average Loan Size (₹ Lakh)	Average No. of Proposals Sanctioned /Month
CART (Java Version) for upto ₹ 200 Lakh (Since Jan 2007)	999	80554	80.63	22
Total	**5336**	**187184**	**35.07**	**37**
Average Turn Around Time (TAT) in CART	2.3 days (In case all relevant information is made available at once, then a proposal can be processed within 4 hours in "CART". However, considering the delay in receiving all the requisite information, the turnaround time is usually longer and has been estimated at around 2.3 days)			

Bulgaria:

In addition to the limited knowledge of the Bulgarian banks about the appropriate products and services required by SMEs, the excessive documentation required for purposes of availing loans and inclusion of restrictive covenants in form of higher borrowing rate & collateral requirement has severely impacted the credit flow to SMEs. In order to address the same and re-engineer the SME lending process, EU-EBRD SME financing project extended a loan and a Technical Assistance (TA) program to interested Bulgarian banks. This TA program was leveraged by the United Bulgarian Bank (UBB) since November 2002 for purposes of streamlining the loan application and approval process associated with SMEs. This re-engineering included design and implementation of an integrated application processing system (APS) along with a credit scoring model. APS integrates all forms used in loan processing and approval process starting from registration till loan repayment and feeds the same into "internal credit bureau". APS takes the inputs in form of relevant client data including financial information along with details of loan required and develops cash flow forecasts along with a credit score. Based on the score ascertained by APS, the loan file is i) rejected if the score is below 175, ii) approved if the score is above 350 or iii) identified for further review if the score ranges between 175 and 350. In case of further review, UBB may ask for additional information from the client to assess the credit worthiness of the respective borrower.

An assessment of scoring results from Oct 2003 to June 2006[39] reflects that i) all applications below 175 were rejected, ii) 91% of applications with score of 175 – 300 were accepted and iii) 99% acceptance levels for applications scoring above 350. The impact of this UBB initiative can be assessed from the following:

- For loans with arrears of 60 days or more, it was observed that the delinquency rate was 0% for loans which secured a credit score of 400 & above, 0.24% for loans which secured a credit score in the range of 350-400.
- Loan processing time reduced by 50% and productivity of loan officers improved by a factor of 5.
- Application process was streamlined with reduction from need to fill in 3 forms to a single form.
- Increase in SME loan portfolio by around 130%.
- Reduction in collateral requirement.

[39]Source:http://www.msmefdp.net/Events/frmViewEvents.aspx?Id=103

The screenshots related to the inputs and outputs of APS have been presented below.

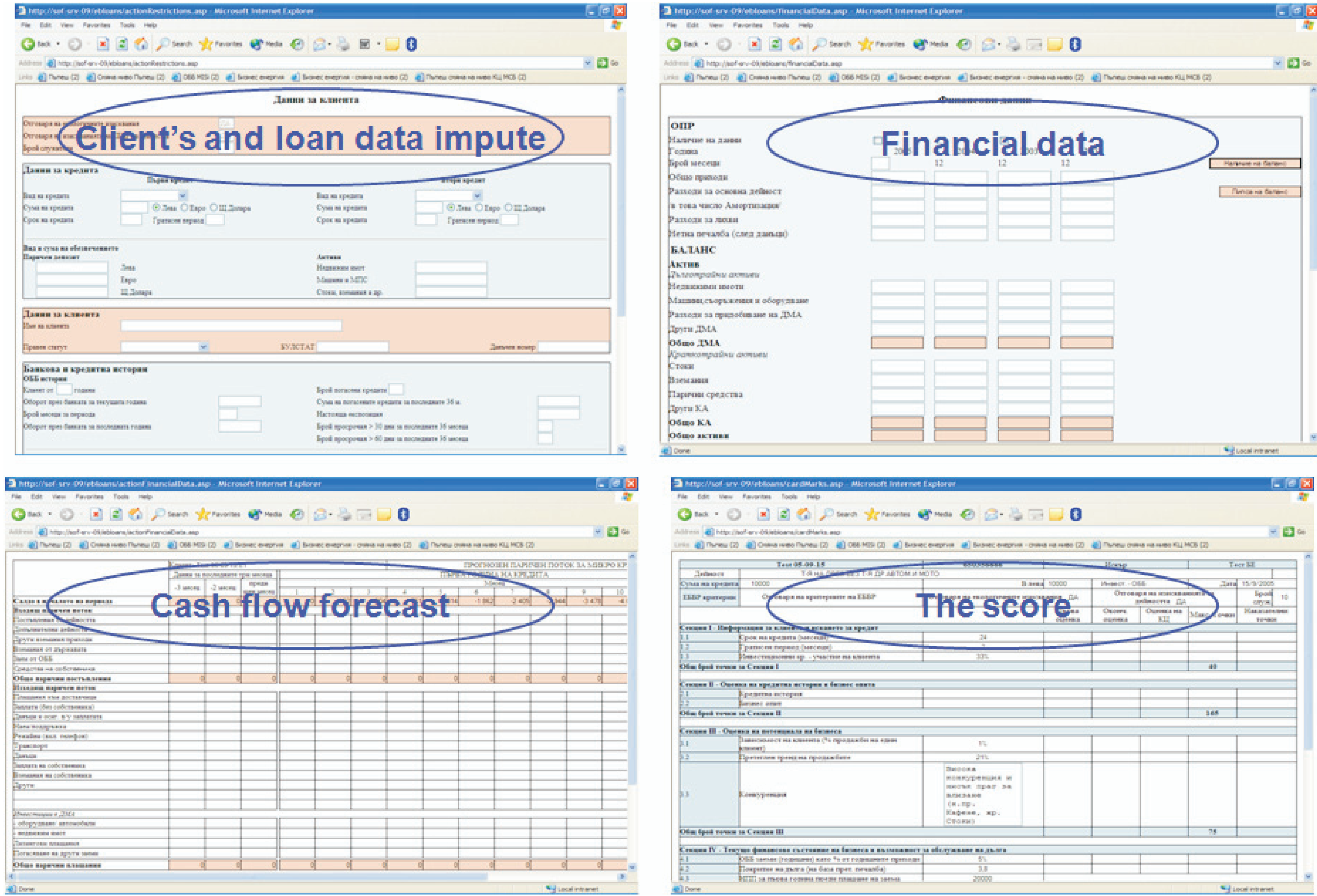


Figure 10: Screenshots of inputs & outputs from APS

The details of this identified case study along with the corresponding best practices adopted have been presented in Table 37.

Table 37: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practice / Critical Success Factors
India: SIDBI (CART)[40]	1. CART is a user friendly software developed in open system architecture, allowing the users (other banks / FIs) to integrate it with their IT platforms. 2. Loan proposals in CART are appraised in two separate platforms, one for loans below ₹ 50 Lakh and another for loans between ₹ 50-200 Lakh. Each platform uses different parameters for scoring/rating depending on the size of the loan proposals.	1. System driven process ensures standardization, thereby enabling field functionaries and competent authorities to take a quick decision on loan approval. 2. Automated workflow reduces the loan processing turnaround time and facilitates paperless transaction, thereby reducing associated transaction costs.

[40]Source: www.sidbi.in

Country/ Organization	Case Study	Best Practice / Critical Success Factors
	3. Applicable for various loan requirements, including term loan / working capital requirement / composite loan for both existing / greenfield projects. 4. CART has two main modules, viz. i) credit appraisal, ii) scoring/rating, with an automated document flow system integrating the loan approval process from the time it is received by the credit officer till the sanctioning by the respective authority. 5. Credit rating is based on the following key parameters: Management, Financials, Industry, Market outlook, etc. 6. It can generate two dimensional rating (obligor and facility rating) in line with requirements of BASEL-II, which improves the transparency in pricing and helps in determination of the interest rate. 7. The CART application also takes care of KYC and AML norms unlike other rating tool used by commercial banks, where this aspect is usually taken in care by the transaction banking system. 8. It has an additional facility of generating MIS reports to track the performance of loan portfolio. *With support of MSMEFDP funded by international partners, SIDBI is engaged in developing variants of the tool to enhance its outreach.*	3. Potentially lower interest rate for MSME clients with good track record. 4. Creates a repository of business data/information which can be used for various purpose like i) determining exposure to respective obligor, group, industry and ii) validation of credit risk parameters like Probability of Default.
Bulgaria: United Bulgarian Bank (Scoring Tool based on 5 Cs of credit)[41]	1. Integrated loan application processing and scoring system in form of APS. 2. APS has a credit scoring model which is based on 17 factors related to 5 Cs of credit, detailed as below with associated weightages. • Capital (8%): client contribution, account turnover. • Character (33%): repayment history of business/owner's personal, business experience (sales weighted). • Condition (15%): assessment of outlook for business loan term/grace period. • Capacity (24%): analysis of current and projected financial data including debt coverage and cash flow. • Collateral (20%): Type and amount of collateral offered.	1. Integrated loan application processing and scoring improves the turnaround time of loan approval leading to customer satisfaction and retention. 2. Automated process for loan origination and processing lowers the transaction cost as it reduces the overheads associated with human intervention. 3. Frees up time for bank staff to focus on key areas like client relationship management. 4. Improves the risk management capability as the loan proposals are segregated based on the automated scoring application system.

[41]Source:http://www.msmefdp.net/events/frmViewEvents.aspx?Id=103

Country/ Organization	Case Study	Best Practice / Critical Success Factors
	3. After the score is obtained by applying above scoring factors, the loan proposals are either i) approved or ii) considered for further review or iii) automatically rejected. 4. Interest rate to be charged along with the tenor of repayment for the borrower is also linked to the credit score. 5. APS takes care of monitoring process and management of watched and problem loans through monitoring of associated MIS, at the branch and central level.	5. Risk based pricing rewards the MSME client with a good track record in the form of lower interest rate. 6. Performance based incentive scheme backed by performance tracking in APS imposes accountability on the sanctioning / recommending authority resulting in better quality of loan portfolio. 7. Data repository helps in credit risk modeling and portfolio risk modeling to enhance the bank's risk management capability for MSME sector.

Though this best practice has already been implemented in the Indian context through the CART model adopted by SIDBI, the best practice may be customized in line with global best practices. Based on the tie-ups secured by respective banks/ FIs with SIDBI to use this model for loan processing for MSMEs, a performance-based incentive structure may be built in by monitoring the performance of loan portfolio of respective bank employee in order to ensure greater accountability and identification of capacity development requirements.

CLUSTER FINANCING

Highlights

- Hard externalities such as a larger company pool to provide requisite scale, specialized and customized input providers, lower costs of supplies in form of raw materials / components, skilled labour with sector-specific skills and potential partners.
- Soft externalities that produce access to tacit knowledge of technologies, markets, opportunities to network, and to aggregate interests & needs.

Theme Description & Benefits to MSMEs

Clusters are agglomerations of interconnected companies and associated institutions in a particular field / sector located in geographic proximity, linked by commonalities and complementarities. Firms in a cluster produce similar or related goods or services and are supported by a range of dedicated institutions located in spatial proximity, such as business associations or training and technical assistance providers. The key principles underlining the formation of a cluster are *proximity, networking and specialization.*

One of the key drivers for increased access to finance for cluster participants includes financing leveraging underlying purchase order / contract among cluster participants as collateral for the loan. The identification and selection of these key stakeholders in the value chain is the most critical element for the success of these partnerships with banks / financial institutions, as it helps them facilitate the following:

- Securing access to potential customers leveraging value chain linkages among the respective cluster participants.
- Accessing information in terms of credit history, based on existing relationships between cluster participants, for credit appraisal assessment of respective MSME cluster participant.
- Leveraging underlying purchase commitment / contract / purchase order as the collateral for loan disbursement.
- Reduced investment in monitoring / implementing loan collection related activities with recovery of loan repayment due to lender from amount to be paid by buyer to the respective seller for their supply, based on underlying contract / agreement between the cluster participants.

The best practice associated with purchase order based financing to improve access to finance for MSME clusters has been detailed below through the case studies on partnering with key stakeholders for credit appraisal, loan disbursement & collection to cluster participants in Paraguay, Costa Rica and Bolivia.

Benefits to MSMEs

- Enhanced access to finance, without recourse to physical collateral
- Better credit terms through up-scaling on the demand side
- Sustained competitiveness and co-operation among MSMEs in cluster
- Faster credit delivery by lending bodies, giving due weightage of
  - Filter criterion for the units
  - Project intricacies

Harmonisation with other programmes / schemes of other agencies is turned simple.

5.1. Best Practice CF-1: Leveraging value-chain linkages among cluster participants for credit appraisal, loan disbursement and collections

The typical model adopted for purchase order / contract based financing, has been presented in the Figure 11.

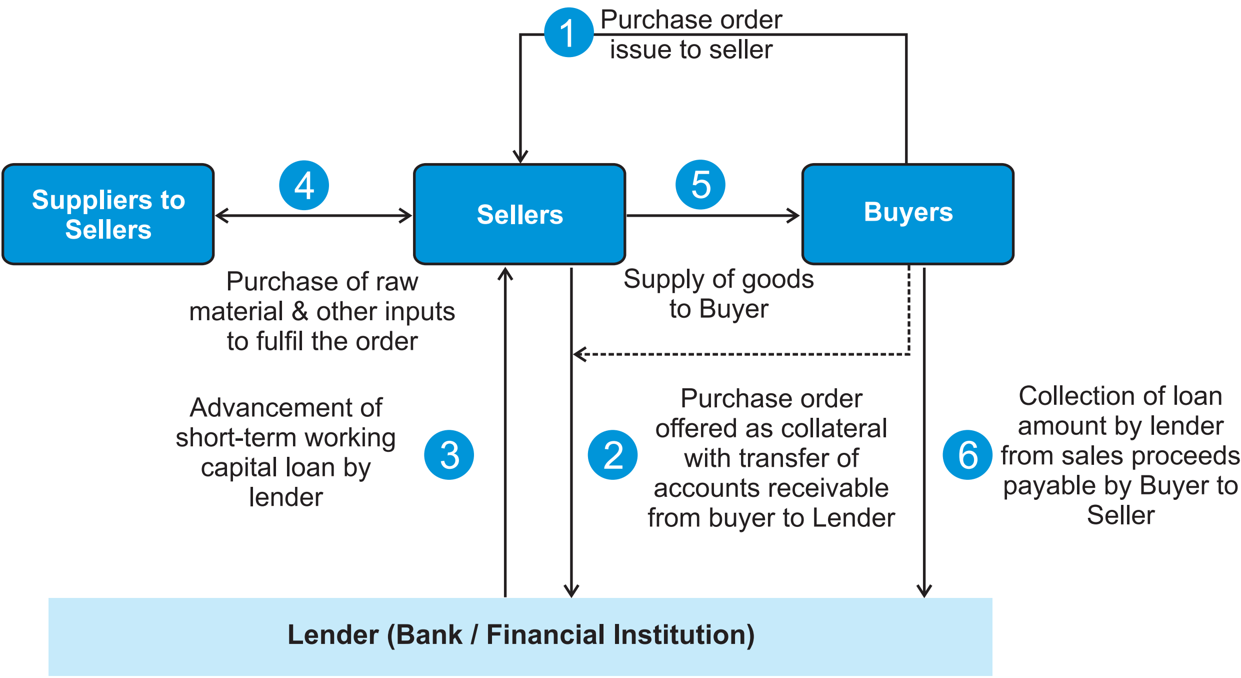


Figure 11: Model followed for purchase order financing

Under this model of financing, the lender uses the purchase order as collateral to extend credit to a cluster intermediary (seller) to process an order for a cluster-based buyer, including activities associated with purchase of raw materials or buying trade goods for resale to fill an order. In this regard, identification of the

key stakeholders (typically buyers) in the respective cluster / value-chain and development of partnerships with them helps banks / financial institutions increase their outreach to previously untapped customers in form MSME cluster participants, which may have limited exposure to formal finance sector.

This model has been leveraged by banks / financial institutions for advancing credit to cluster participants, primarily MSMEs, in various countries. The highlights of select case studies in Paraguay, Costa Roca and Bolivia have been presented.

Paraguay :

- Financiera El Comercio is a microfinance institution regulated by the Central Bank of Paraguay, focusing on extending credit to rural entrepreneurs engaged in agriculture related activities. Agriculture contributes to around 30% of Paraguay's GDP, with soybean being the main agricultural product. Hence, El Comercio decided to focus on soybean clusters to identify potential value chain participants with which it could partner to meet fund requirements of respective soybean cluster participants in a cost-effective manner. Based on their study, they identified "silos" which provide i) inputs in form of equipments / seeds / fertilizers in-kind to producers and / or their associations & cooperatives along with ii) optimally located storage infrastructure for the produce. Silos played a key role in imparting training to producers and / or their associations & cooperatives along with procurement of their produce based on contracts entered on account of provision of in-kind credit. However, their ability to offer cash credit was constrained on account of limited availability of funds.

  With an increase in the number of alliances with silos from 2 to 12 during the 2003-05 period, it has been observed that the loan portfolio of El Comercio for soybean related value-chain participants increased from USD 2 mn to around USD 2.4 mn (₹ 100 to 120 mn), in spite of depressed demand in 2005 on account of unfavorable weather conditions.[42] Further, El Comercio has also managed to grow their businesses with these silos to meet their financing requirements for inputs, fertilizers, equipments, etc.

Bolivia :

- This model was tested on the organic coffee value chain in the Yungas region of Bolivia, wherein loans from FIE (a MFI) financed a transaction between i) Cooperativa Agropecuaria Integral Noreste (CAIN), a 260 member association of small coffee producers and ii) A. Van Weelly, a well known Dutch trading company specializing in organic goods. The loan, secured leveraging the purchase order from A. Van Weelly, allowed CAIN to pay its suppliers upon delivery of coffee, vis-à-vis a typical wait period of 3-5 months for payment without recourse to purchase order financing. This also incentivized suppliers to supply higher-quality coffee to the cooperative, which was leveraged to bargain for higher price from buyer on account of better quality of supply.

  Starting with 4 branches in these regions, FIE managed to replicate this model through 38 transactions in the coffee value chain totaling over USD 1 mn in Yungas region over a 1.5 year period. Subsequently, this model was extended to around 262 loans totaling USD 2.1 mn (₹ 105 mn) over 2 years, with extension to other agri-business commodities like dairy products & organic vegetables and various

[42]Source: Accion publication titled "Providing cost-effective credit to small-scale single-crop farmers: The case of Financiera El Comercio"

regions of Bolivia. The success of the model in Bolivia has resulted in its replication in other countries like Moldova, Armenia, Kosovo, Macedonia, Azerbaijan and Peru.[43]

Brazil:

- Banco Triangulo S/A (Tribanco) was formed in 1990 to finance the entire value chain of Martins group, which is the largest wholesale distribution company in Brazil involved in distribution of foodstuff, electronic appliances, building materials, pet food, pharmaceuticals, etc. The group distributes retail merchandise to over 0.2 mn retail outlets and small shops all over Brazil, using its own fleet of trucks with GPS monitoring devices. These small shops are usually owned by MSMEs, whose financing requirements are met by Tribanco leveraging their association with Martin group. Tribanco has managed to leverage this value chain linkage to extend credit to not only around 23,000 retail shop owners but also extended credit to over 2.5 mn consumers[44]. On account of this focus on MSMEs, Tribanco has extended 80% of its entire lending to the MSME sector with outreach to areas where formal banking sector was not present.

  The salient features of this best practice & associated critical success factors have been detailed in Table 38.

Table 38: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Paraguay: Financiera El Comercio[45]	1. On account of in-kind credit extended by silos being insufficient for rural entrepreneurs in growing season, they are referred by partner silos to El Comercio for credit disbursement. 2. El Comercio conducts a credit appraisal of respective entrepreneur based on information supplied by silo in terms of past financial history. 3. Disbursement of loan by El Comercio in cash – either from one of its 12 rural branches or in the field, backed with the collateral in form of contract with silo committing to buy the production from respective entrepreneur. 4. Post harvest, production by respective entrepreneur is bought by partner silo in line with contract. Loan repayment due to El Comercio is netted off from amount payable by silo to respective producer and the same is passed on to El Comercio by the silo.	1. Ready access to potential rural entrepreneurs engaged in soybean value-chain through reference from partner silos, thereby reducing associated cost & time in acquiring new customers along with providing access to new segment of customers. 2. On account of in-kind credit extended by silos, they continuously monitor crop production to ensure realization post harvesting. This reduces i) need for El Comercio to contract agriculture technicians as staff or loan officers and ii) time required to be spent by El Comercio's loan officers in monitoring the loan. 3. Since the repayment of loan to El Comercio is directly recovered from the sale of crop by entrepreneur to silo, it reduces cost of collection for El Comercio in terms of monitoring repayment and implementing recovery strategies.

[43]Source: USAID publication titled "Purchase Order Finance in Bolivia" and USAID presentation titled "Value Chain Financing in Rural Bolivia: Introducing Purchase Order Financing"
[44]Source: Publication titled "Business Linkages: Lessons, Opportunities and Challenge" for IFC, Harvard University & International Business Leaders Forum (2007)
[45]Accion publication titled "Providing cost-effective credit to small-scale single-crop farmers: The case of Financiera El Comercio"

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Bolivia: FIE (MFI)[46]	1. Implemented as a project funded by USAID for Rural Competitiveness Assessment (RCA). The project designed with “subsidies” from RCA for participating lending institution in form of i) bearing of portion of start-ups costs to establish rural branches, ii) performance-based incentives on achievement of minimum level of purchase order financing based loan portfolio size and iii) technical assistance to staff in marketing purchase order based loans. 2. Participating financial institutions were selected through a competitive tendering mechanism by RCA, based on local presence. 3. CAIN had received a purchase order from A. Van Weelly for a full container (nearly 20000 kgs) of washed Arabica organic Bolivian coffee. At a price of USD 2.84 per kilo (₹ 140 per kilo), the total value of the order stood at around USD 55,664 (₹ 2,783,200). 4. On account of limited financial ability to execute the order, CAIN availed a purchase order based loan of USD 30,000 (₹ 1,500,000) for 90 days at a 12% annual rate for post-harvest processing, packaging and payments to coffee growers. 5. CAIN transferred its accounts receivables to FIE along with a deposit of USD 10,000 (₹ 500,000) in an account maintained with the lender as collateral. 6. FIE recovered the loan and interest from the payments received from A. Van Weelly.	1. Design of subsidies to lower cost of entering the market and encourage long-term sustainable interventions by financial institutions. 2. Deployment of a competitive mechanism to select the implementing lending partner, with need to deploy own funds, ensured commitment and focus on achieving targets to get the requisite incentives to cover initial fixed costs. 3. Training to FIE’s marketing staff by RCA to educate rural MSMEs on the impact of availing purchase order based loans; helped increase the outreach of the product. 4. Reduced transaction costs for FIE on account of dealing with a co-operative vis-à-vis individual producers. 5. Reduced risk for FIE in form of creation of accounts receivable of a co-operative vis-à-vis receivables of individual producers based on buyer demand. 6. Upfront payment to suppliers of co-operative in purchase order based financing mechanism on supply of inputs / raw materials ensures they don’t have to bear financing costs and gives them incentive to supply better-quality product, which in turn fetches better returns for all concerned stakeholders.
Brazil: Tribanco and Martins Group with support from IFC[47]	1. Martins Group focuses on serving the small retailers in order to distinguish itself from competitors. 2. Martins Group offers integrated solutions to its clients (retailers) in form of dissemination on best practices related to retail business along with associated financing. This has been facilitated through establishment of a dedicated Martins Retail University. 3. Tribanco acts as financial solution integrator for participants linked with value chain of Martins group, offering an integrated solution covering inter-alia, working capital and re-modeling loans. These participants include suppliers, customers (retailers) and final consumers. 4. Tribanco got its credit officers trained leveraging technical assistance support from IFC in order to strengthen the financial intermediation role of retailers in the value chain of Martins group. “Train the trainer” concept was adopted with credit officers of Tribanco offering training support to retailers in developing innovative financial products.	1. Ready access to potential MSME clients engaged in retailing through reference from Martins group, thereby reducing associated cost & time in acquiring new customers along with providing access to new segment of customers. 2. With Tribanco addressing financing requirements of participants in value chain of Martins group, the group can focus on developing the business & operating aspects associated with retail business for MSMEs. 3. Training and capacity building of the retailers increases the outreach of Tribanco and makes the financial intermediation successful.

[46]Source: USAID publication titled “Purchase Order Finance in Bolivia” and USAID presentation titled “Value Chain Financing in Rural Bolivia: Introducing Purchase Order Financing”
[47]Source: Publication titled “Business Linkages: Lessons, Opportunities and Challenge” for IFC, Harvard University & International Business Leaders Forum (2007)

Implementation in the Indian context

The presence of formal sector in MSME financing, leveraging relationships between respective cluster participants, has been limited due to lack of economies of scale on account of i) widely dispersed population of rural MSMEs and ii) underdeveloped infrastructure, which lead to higher transaction costs. However, with the organization of MSMEs in respective clusters, there have been specific examples of intervention by leading commercial banks like ICICI, IDBI, SBI, UTI in providing purchase order financing to cluster participants subject to their association with a relatively large recognized buyer. These associations have been in the form of contract farming in agri-business by private sector companies like Cadbury in cocoa, Pepsico in potato, Unilever in tomato, ITC in tobacco, etc. along with non-agri clusters developed by other organizations like UNIDO. SIDBI has also taken concerted steps by opening cluster centric offices and bringing out customized products including involving/integrating Businesss Member Organisations to facilitate MSMES access to credit. However, further steps need to be considered for increasing credit flow to rural MSMEs and micro-enterprises in cluster-based value chains involving agriculture and other industries. An indicative roadmap for facilitating the same has been presented in Table 39.

Table 39: Indicative Implementation Roadmap

Action Points
Identifying Key clusters of agri-business & industrial value chains, based on involvement of MSMEs and potential for tie-ups with buyers from organized private sector / government.
Identifying value-chain intermediaries for forging potential partnerships, based on their contracts / agreements with MSMEs. For industrial clusters, these could include cluster development agents while for agri-business value-chains; these could include private sector corporate / Government purchasers, etc.
Development of partnership terms and conditions with identified intermediaries, through mutual agreements with focus on i) inputs on credit appraisal, ii) disbursement and iii) collections.
Advancing loans to value-chain participants on a pilot-basis, based on underlying agreement between cluster participants.
Monitoring & evaluating the performance of loan portfolio advanced leveraging this model to serve as input to future roll-out / scaling up.
Providing technical assistance to Seller to ensure timely delivery of goods / services as per the requisite quality norms.
Developing Legal and Regulatory enablers relating to i) recourse in event of default in terms of non-delivery of products & services / rejection of delivery, ii) development of incentives for lenders in terms of lower risk weightage to loans advanced to cluster participants based on underlying purchase order.

It is expected that implementation of this best practice would take around 0.5 – 1.25 years based on identification of potential value-chain participants along with negotiation on partnership terms & conditions with the same. The key costs for the implementing bank / FI would include time-costs associated with identification of i) value chains in agriculture and non-agriculture areas along with potential partners and ii) negotiation on partnership terms & conditions with identified partners. Further, costs would be incurred to monitor performance of loan portfolio under this model and promotional expenses for information dissemination on the same. The break-even level for the success of this project would be based on number of value chain participants securing financing leveraging value-chain linkages along with the performance of the loan portfolio under this pilot project.

CREDIT GUARANTEE

Highlights

- Risk sharing mechanism that reduces the capital adequacy requirement and improves the Return on Equity of the lender.
- Encourages Banks/FIs to lend to sectors where risk perception is higher.
- Encourages banks to have proper monitoring and evaluation mechanism in place.
- Mobilizes local resource without relying on donor funding.
- Reduces market imperfection by reducing collateral requirement.

Theme Description & Benefits to MSMEs

A credit guarantee is a promise by a government, public or private sector to assume a private debt obligation if the borrower defaults. Most credit guarantee programs are established to correct perceived market failures by which small borrowers, regardless of creditworthiness, lack access to the credit resources available to large borrowers. Some of the key drivers for growth of credit guarantee schemes are as follows:

- Differential information in terms of better knowledge of borrower's creditworthiness to a guarantor vis-à-vis the lender.
- Means of spreading and diversifying risk in cases where the lender's portfolio is geographically concentrated whereas the guarantor has a diversified portfolio.

Benefits from the viewpoint of MSME access to finance

- Reduces lender's perceived level of risk associated with a particular MSME on account of reduced chances of default.
- Potentially lower collateral security requirement which enables the MSMEs lacking adequate collateral to borrow.
- Potentially longer repayment period enabling the MSMEs to invest in costly equipment, machinery and technology.
- Potential relief from capital charges through reduction in risk weights if the guarantee is from a guarantor with a high credit rating.

Variants

Credit Guarantee products are primarily classified into the following four categories[48] , with the respective features for each of these products having been presented in Table 40.

Table 40: Variants of Credit Guarantee

Product Name	Features
Loan Guarantee	• It covers the risk on an individual loan from a lender to a predefined borrower. • The purpose of the loan and the use of proceeds are set forth in both the credit guarantee agreement (between guarantor and lender) and loan guarantee agreement (between guarantor and borrower).
Bond Guarantee	• It ensures investors in corporate and/or sub-sovereign bonds of both recovery and repayment. • The guarantee often enables the issuer to obtain a higher credit rating, and thus, access less expensive and longer term financing. • The guarantor enters into an agreement with the bond issuer specifying the permitted use fund mobilized out of the bond.
Loan Portfolio Guarantee	• It ensures risk coverage to a lender from a portfolio of loans that it plans to make to eligible borrowers which satisfy some pre determined criteria. • The evaluation parameters, identified sectors, etc. are identified in the guarantee agreement. • The purpose of a loan portfolio guarantee is to encourage a lender to extend credit to areas that are underserved by financial institutions.
Portable Commitment Guarantee	• A Portable Guarantee (PG) is similar to a loan guarantee except that the lender is not identified. • Guarantor provides a commitment letter to the prospective borrower which allows the borrower to negotiate the best deal from the potential lenders. • Once the lender is identified and agrees to the terms of the guarantee, the commitment letter becomes a loan guarantee.

Other than the classification based on various product categories, the credit guarantee schemes are also classified on basis of respective organizational frameworks adopted. Features of these organizational frameworks are detailed in Table 41.

Table 41: Classification of credit guarantee schemes based on organizational frameworks

Organization Framework	Features
Guarantee Program	• Does not exist as an independent legal entity. • Usually part of a Government or donor program and funded by public or donor resources which can be suspended as a result of political decisions. • Usually deploy an automatic or portfolio guarantee, where they share risk with the financial intermediary.
Guarantee Fund	• Established as separate legal entities. • Have mixed capital, supported by both the public and private sector. • Always apply the principle of risk sharing with financial intermediaries. • Can offer individual and automatic guarantees. • Delegate the administration of risk and loan collection to the financial intermediary.

[48]USAID: Designing Loan Guarantees to spur growth in developing countries by Paul L. Freedman

Organization Framework	Features
Mutual Guarantee Society	● Established as private entities with members. ● Offer individual guarantees to their members, between 70 and 100 percent of the loan, substituting the bank's role of assuming and managing client credit risk. ● Evaluates each individual client application, charging them fees and commissions for the evaluation and providing the guarantee. ● Usually do not share risk with the financial intermediary, but substitute risk. ● Portfolio administration along with collection in case of default is the responsibility of the society.

The best practice associated with offering credit guarantee has been detailed below through the case studies on i) multi-level partial guarantee involving mutual guarantee societies and credit guarantee funds and ii) partial guarantee to mutual guarantee societies and banks / FIs to increase on-lending to MSMEs either directly or through MFIs.

6.1. Best Practice CG-1: Extension of multi-level partial guarantees to increase on-lending to MSMEs

The concept of providing multi-level guarantees can be implemented through various avenues, including formation of mutual guarantee societies or through formation of a guarantee fund. The first case i.e. the formation of mutual guarantee societies to provide collective guarantee to the respective members has its genesis in Italy as early as in 1957, through formation of CONFIDIs. CONFIDIs are associations of MSMEs, with their activities based on co-operation and mutuality with the view of facilitating access to finance for its members. It aimed at bridging the need for an intermediary between the MSMEs and banks / FIs. Under the Italian legislation, CONFIDIs are registered as financial companies, usually focusing on meeting financing requirements of MSMEs in a particular sector / region along with other technical / business development support. The access to finance for member MSMEs is facilitated through extension of partial guarantees to lenders to its members. Further, these local CONFIDIs have organized themselves into multiple national level federations, viz. Fedartfidi, Federconfidi, Federasconfidi, Fincredit, Federfidi and Coldiretti. These federations are referred to as "Mutual Guarantee Consortia" (MGCs), which maintain a "guarantee fund" that is funded by the members through fixed membership fees and commissions proportional to the loans granted. The "guarantee fund" is maintained as a deposit with the bank, serving as the collateral for loans advanced by the bank to member CONFIDIs.[49]

This two-tiered model is associated with a primary guarantee by the respective CONFIDI to the banks / FIs financing the respective MSME based on requisite due diligence, which in turn is counter-guaranteed by the MGCs based on past track record of respective CONFIDI and its members. On account of the two-tier guarantee and lower risk weightage associated with lending to SME sector, banks have increased their exposure through increased level of financing to SMEs through CONFIDIs. The success of the same can be gauged from the fact that the CONFIDIs in Italy have around Euro 13,200 mn (₹ 858,000 mn) of outstanding guarantees with a rate of default of around 1.5%, which is significantly lower than those of other loans advanced by banks.[50] Further, it is estimated that in Italy, the ratio between the credit extended

[49]Source: mpra.ub.uni-muenchen.de/17052/1/MPRA_paper_17052.pdf: Study titled "The effects of mutual guarantee consortia on the quality of bank lending"
[50]Source: www.aecm.be/PDF/Fiches_organismes/fiche13_uk.pdf - Study titled "The Italian Confidi Networks"

to the guarantees given can be as high as 10-20, based on comfort of lending institutions with respective CONFIDI and historical low default rates.[51]

The second model of extending multi-level guarantee has been adopted in Colombia with the establishment of a guarantee fund, viz. Fondo Nacional de Garantías S.A. (FNG) in 1982, with the mandate of providing guarantee to cover all loans made by respective SME focused lenders in Colombia, in order to promote access to finance for Colombian SMEs. Operations of FNG are supervised by the Superintendencia Bancaria de Colombia, the nation's bank regulatory agency.

FNG operates partial guarantee scheme for a portfolio of SME loans through a two-layered guarantee mechanism. This two-layered mechanism consisted of primary guarantee from Regional Guarantee Funds operating at a regional level, which were counter-guaranteed by FNG. On account of the first-tier guarantee extended by Regional Guarantee Funds, FNG was able to increase its portfolio size and outreach of its operations with limited capital addition in form of investments in the capital of 12 Regional Guarantee Funds. The impact of this model adopted by FNG is evident from the following:

- First-level guarantee by Regional Guarantee fund, supplemented with FNG's counter guarantee on the same has helped the regional funds extend guarantees up to 21 times the value of their underlying fund. Further, fee rates for guarantees offered is very competitive, i.e. around 1.2 – 2.8% depending on the guarantee coverage, considering high borrowing cost in order of 15-20% for SMEs in Colombia[52].
- By charging higher fee for higher coverage, FNG controls the risk associated with indiscriminate adoption of partial guarantee by respective regional funds.
- Backed by the guarantee scheme, it has been estimated that the annual lending to SMEs in Colombia has achieved a level of around USD 0.8 bn[53] (₹ 40 bn).

  The details of the identified case studies relating to multiple level guarantees through mutual guarantee societies and guarantee funds along with the corresponding best practices adopted in Italy and Colombia are presented in Table 42.

Table 42: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practice/Critical Success Factors
Italy: CONFIDI (Association of Small Entrepreneurs) as intermediaries between Banks and SMEs	1. Organization of SMEs in a two-tier structure, with local / regional level organization into CONFIDIs. Further, multiple CONFIDIs organize themselves into MGCs. The multi-level association lends additional credibility to the member MSMEs at the regional level. 2. CONFIDIs provide first-level guarantees to banks for loans sanctioned to member enterprises based on an internal due diligence process. Technology is being leveraged to better assess the credit worthiness of member MSMEs.	1. Integrated national / regional / local level structure enables the requisite aggregation of financing requirements of multiple MSMEs, based on a sectoral / geographic focus, thereby de-risking the SME portfolio through mutualization.

[51]Source:mpra.ub.uni-muenchen.de/17052/1/MPRA_paper_17052.pdf: Study titled "The effects of mutual guarantee consortia on the quality of bank lending"
[52]Source: Document titled "Credit guarantee schemes for SMEs an international review" sourced from World Bank website, viz http://siteresources.worldbank.org/INTEXPCOMNET/Resources/Levitsky_1997.pdf and UNIDO: Credit Guarantee Scheme for Small Enterprises-An Effective Instrument to Promote Private Sector-Led Growth?
[53]Source: http://www.bnamericas.com/news/banking/Dep_minister:_FNG_is_key_to_boosting_SME_lending

Country/ Organization	Case Study	Best Practice/Critical Success Factors
	3. CONFIDI guarantees are counter-guaranteed by MGCs, leveraging creation of dedicated "guarantee fund" funded by members. The peer monitoring at the MGCs provides the incentive for banks to lend in "multiples" of guarantees offered. 4. Only partial guarantee is extended, ranging from 50 – 80 % of the loan portfolio, with the balance being borne by the lender. Maximum guarantee extended by MGCs is usually restricted to 50% of the loan portfolio size. 5. In case of default, lender informs MGCs / respective CONFIDI of the same and takes recovery action. Depending on the lenders' success, the lender may invoke the guarantee offered by MGC / CONFIDI. 6. Regulatory provisions relating to CONFIDI were formulated under Italy's General Policy Law 326/2003 and allow CONFIDIs to be registered under Article 106 of the Italian Banking Law. Registered CONFIDI are regulated and supervised by the Italian Central Bank and are permitted to: i) offer guarantees in favour of member SMEs; ii) sign contracts with banks managing guarantee funds in order to facilitate the access to these funds for member SMEs.	2. Multiple-level guarantees provide the mechanism to guarantee higher proportion of loans sanctioned by banks to members of CONFIDIs, with creation of dedicated "guarantee funds" funded by members. 3. Regulatory enablers according special status to the CONFIDIs to act as recognized guarantee institutions, thereby reducing risk weights for loans advanced by banks leveraging their guarantees. 4. Standardized objective processes for carrying out due diligence exercises in respect of individual applicants by CONFIDIs, eliminating the onus of carrying out credit assessment of individual applicants from the banks.
Colombia: FNG (Fondo Nacional de Garantías)[54]	1. Decentralization of services through setting up of 12 regional guarantee funds (Fondos Regionales de Granatias – "FRGs"), funded from FNG, local private investors and other entities like municipalities & regional governments. 2. FRGs were entrusted with advancing guarantee to credit extended in their respective regions to SMEs, based on their credit appraisal. 3. FNG tied up with major state owned and private banks for promotion of credit guarantee scheme. Agreement was signed with 4 major banks including 3 state-owned and another private sector bank to provide guarantees to loans offered by them to SMEs. These agreements allowed guarantee up to 50% of the credit amount disbursed. 4. Guarantee is either provided i) directly based on assessment of MSME by lender and sharing of relevant documentation with FNG / FRG, subject to a maximum ceiling or ii) beyond the threshold ceiling, all documentation is shared with FNG/ FRGs by the lender along with subsequent interaction with MSME prior to approval of guarantee by FNG.	1. Scheme of partial guarantee avoids indiscriminate loan disbursal by participating banks / FIs through better risk assessment, book keeping & monitoring of loan performance. 2. Restriction was imposed in terms of minimum tenor of the loan set at 90 days, which can be guaranteed by FNG, to restrict risks associated with short-term lending. 3. Additional lending to MSME due to freeing of regulatory risk capital on account of improved risk rating. 4. Decentralization of operations through setting up of Regional Guarantee Funds, which operate as "commercial agents" helps increase the outreach of the programme. Achievement of minimum portfolio size is critical for the viability of the fund operations. 5. Incentive to lenders to share more risk by charging higher fees for higher coverage.

[54]Source: Document titled "Credit guarantee schemes for SMEs an international review" sourced from World Bank website, viz. http://siteresources.worldbank.org/INTEXPCOMNET/Resources/Levitsky_1997.pdf

Implementation in the Indian context

The concept of formation of mutual guarantee societies through the Mutual Credit Guarantee Fund Schemes (MCGFS) has been rolled out in India by banks and financial institutions in collaboration with UNIDO as far back as in 2000, with an initial project in the Jaipur Hand Block Printed Textiles cluster, and subsequent replication at the leather cluster of Ambur[55]. However, based on benchmarking with the international experience, these initiatives need to be further strengthened through a multi-layered central/ /state /regional level hierarchical structure for advancement of guarantees to banks / FIs for lending to member MSMEs of MGSs. In order to improve access to finance for MSMEs through greater incentives for lenders like banks / FIs, it is recommended that the best practice with respect to advancement of guarantee to a portfolio of MSME loans through a multi-layered hierarchical structure should be adopted. An indicative roadmap for addressing these specifics has been detailed in Table 43.

Table 43: Indicative Implementation Roadmap

Action Points
Formation of local / regional mutual guarantee societies based on sectoral / geographic focus on a pilot basis in a particular state.
Creation of a "guarantee fund" through association of multiple local / regional guarantee societies aggregating at a central / state level to counter-guarantee primary guarantees by MGSs, with contributions from member guarantee societies based on loan off take and credit worthiness along with investment from other private / public investors.
Ensuring adequate capitalization of the Guarantee Funds by participation from private investors through development of requisite legal and regulatory policy enablers like exemption from income tax & other applicable taxes. In the absence of the same, avenues may be explored to leverage CGTMSE funds for capitalization of these funds.
Development of standard credit assessment methodologies to assess credit worthiness of individual member MSME.
Rolling-out of the pilot on a national basis, based on the success of the pilot.
Developing requisite legal and regulatory enablers to ensure special treatment (e.g. reduced risk weighting for regulatory charge) for loans guaranteed by MGSs and the proposed Guarantee Fund.
Information dissemination on the above model among the respective MSMEs, with a focus on first targeting the established clusters.

It is expected that implementation of this best practice would take around 1.5 – 2.5 years based on formation of MGS and creation of guarantee fund for MGSs at local / regional and state / national level. The associated costs and benefits with a credit guarantee transaction have been detailed under the heading, viz. "Estimated Costs and Benefits of any loan disbursement involving credit guarantee", later in this section.

Risk Sharing Facility (RSF)

The RSF supported by World Bank under MSMEFDP being implemented by SIDBI is designed to help mitigate commercial banks' risks related to MSME financing. By sharing the MSME credit risk with commercial banks, while at the same time making participation contingent on better credit assessment and risk management by the commercial banks, the RSF will help upscale commercial bank lending to MSMEs and help banks build up a track record of good MSME lending.

[55]http://web5.laghu-udyog.com/clusters/publications/news/eclnw0903.htm#cs

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has been instrumental in implementing the pilot Project. Under the scheme it had signed MOUs with eight Member Lending Institutions (SIDBI, UBI, BOB, BOI, PNB, Canara Bank, United Bank, SBI). In view of satisfactory progress of the pilot scheme (64 cases spread over 14 states /UT covering an amt of ₹ 47 Crore). CGTMSE has since institutionalized the scheme by enhancing guarantee coverage from ₹ 5 Million to ₹ 10 Million. Quantum of loans guaranteed under segment (₹ 5 Millon to ₹ 10 Million) earlier attended to under risk sharing facility (and now though normal product has been enhanced to ₹ 10 Million but guarantee for this segment is limited to 50% as akin to risk sharing facility). Till August 2010, 2260 guarantees worth ₹ 1733.77 Cr. have been sanctioned in this range indicating leveraging. In discussion with stakeholders, MSMEFDP is examining the aspect of scaling this up with options such as product focusing on the underserved regions, underserved section, environment friendly projects and portfolio risk based products.

6.2. Best Practice CG-2: Partial guarantees to mutual guarantee societies and banks / FIs to facilitate direct on-lending to MSMEs or through MFIs

Provision of counter-guarantees to mutual guarantee societies and banks / FIs helps increase the attractiveness of lending to the member MSMEs for the respective banks / FIs focused on lending to MSMEs along with reduced collateral requirements and better rates for concerned MSMEs. However, availability of sources / funds for offering counter guarantees is a key concern and is typically addressed through either i) public sector intervention by leveraging funds marked for MSME development by the local / central government or ii) participation of private investors. This model has been successfully implemented in a number of European countries like Portugal, Spain, Italy along with a host of Latin American countries.

In case of Portugal, the genesis of mutual guarantee societies (MGSs) can be traced to formation of SPGM in 1994 as a pilot MGS in a public-private partnership with participation from national SME development agencies, private sector commercial banks and MSMEs. With the success of the pilot, it has been split since end 2002 to carve out 3 “regional” MGSs and 1 agro-industry focused “national” MGS. Currently, SPGM operates as the manager of the counter guarantee fund, viz. MCGF, and also acts as a shared services centre to all the MGSs. It also has minor participation in share capital of the respective MGSs. The operating model has been summarized in the Figure 12.

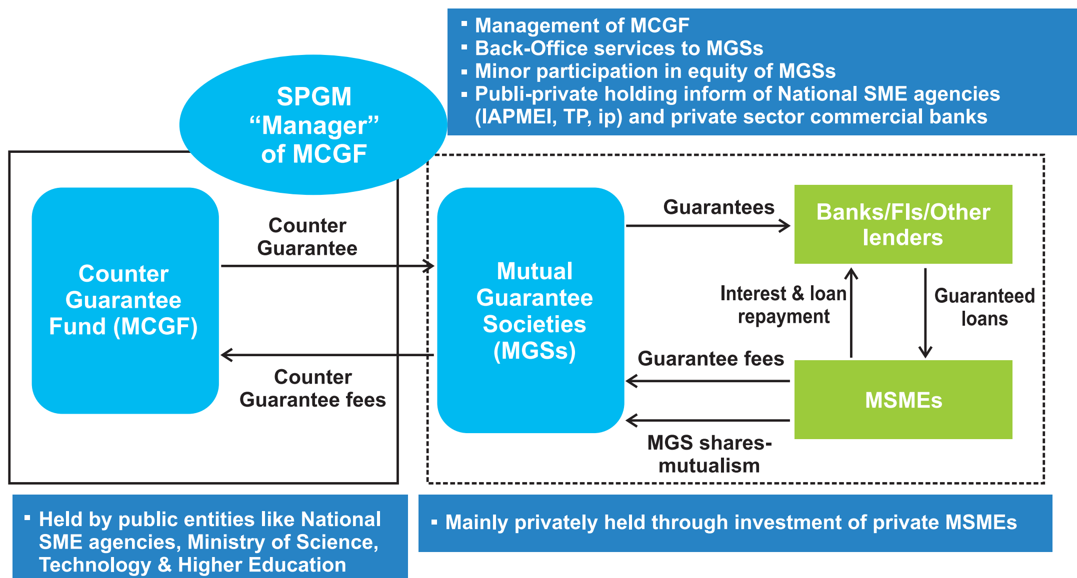
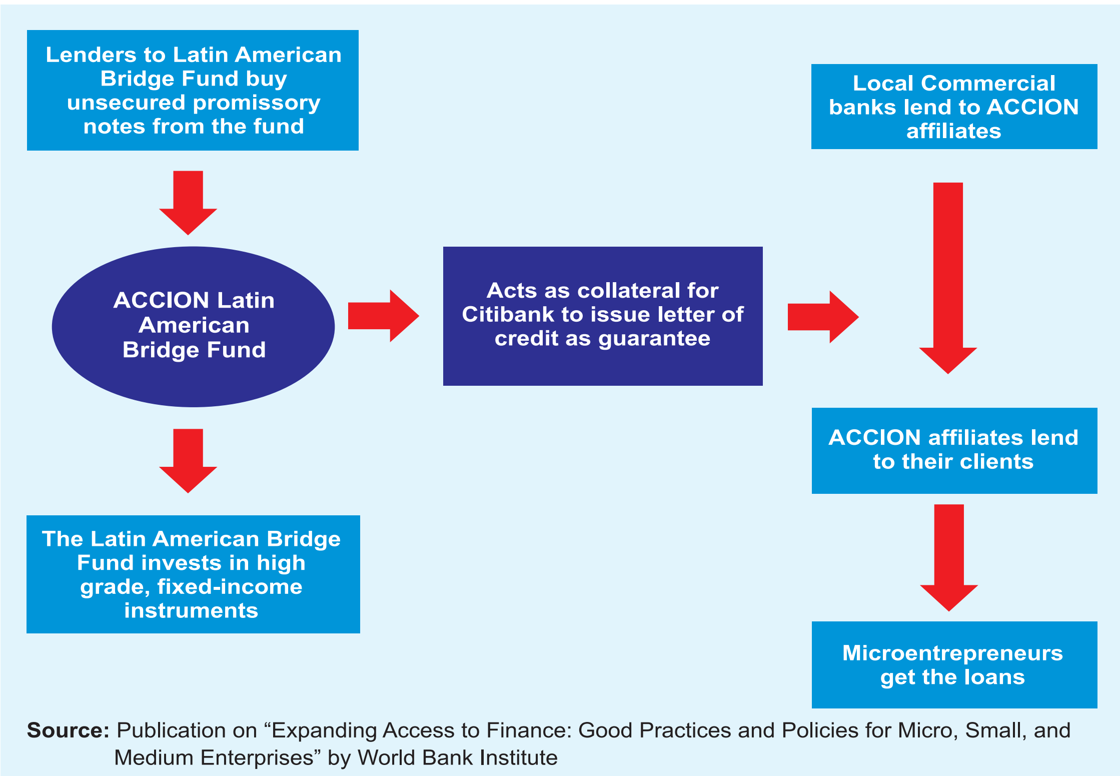


Figure 12: Operating model for partial guarantee to mutual guarantee societies

The impact of mutual guarantee societies along with counter-guarantee program in Portugal can be assessed from the fact that guarantees issued to MSMEs registered a 50% CAGR post formation of MGSs in 2003 till 2007. It is estimated that the guarantees issued in 2007 through MGSs in 2007 was around Euro 1044 mn (₹ 67,860 mn).[56] The same model has been replicated in Brazil through the GarantiSerra scheme, which is expected to provide guarantees to some 4,600 MSMEs (with turnover below USD 7 mn (₹ 350 mn)) for a total amount of around USD 50 mn (₹ 2,500 mn) over the first 5 years.

ACCION

ACCION International is a leading private sector microfinance institution with a global presence. It created Latin America Bridge Fund in 1984 with a view of extending guarantee to commercial banks / financial institutions for financing of ACCION affiliated microfinance institutions ("MFIs"). Since its inception, the fund has collateralized more than USD 70 mn (₹ 3,500 mn) of letters of credit for 23 ACCION affiliated MFIs in 12 Latin American countries, viz. Brazil, Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Paraguay, and Peru. Leveraging guarantees extended by the fund to around 45 partner local commercial banks, ACCION affiliated MFIs have advanced around USD 140 mn (₹ 7,000 mn) in microloans to an estimated 3 lakh MSMEs. Since its creation 20 years ago, the fund has suffered losses on only three letters of credit totaling USD 0.63 mn (₹ 30 mn), and in each case the fund's loan loss reserve fully covered the loss. No investor in the fund has experienced a loss of principal or interest till date. The working model of the Latin American Bridge Fund has been depicted in Figure 13.



Source: Publication on "Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises" by World Bank Institute

Figure 13: Operating model of Latin American Bridge Fund (LABF)

[56]Source: www.eastagri.org/meetings/docs/.../08_Jose%20Figueiredo.ppt: Presentation on "Portugese Mutual Guarantee Scheme"; www.mctes.pt/archive/doc/Jose_Barros.pdf: Presentation on "Mutual Guarantee schemes and other financial instrument"

The details of the identified case study along with the corresponding best practices adopted in Portugal, Brazil & Latin American countries have been presented in Table 44.

Table 44: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Portugal: Mutual Guarantee Societies along with SPGM and FCGM	1. Mandated minimum share capital for MGSs is Euro 2.5 mn (₹ 162 mn), with minimum initial contribution from member MSMEs of 25% of total equity, which is to be increased to 50% after first 3 years of activity. 2. MGSs are responsible for originating deal flows, based on risk assessment and due diligence. Further, they are responsible for monitoring timely repayment of guaranteed loans and coordinating efforts for recovery in case of default. 3. MGSs charge guarantee fees from respective MSMEs. Further, loan availing MSMEs have to make a minimum investment in the equity of respective MGS corresponding to 3% of the respective guarantee value. 4. SPGM manages the counter-guarantee fund and based on deals identified by MGSs, decide to advance counter-guarantees to MGSs. Monitor recovery of counter-guarantee fees from respective MGSs. 5. SPGM also provides shared service support to the MGSs to co-ordinate loan disbursement, collections, payment of respective guarantee fees, etc. 6. Subscribed capital based of Euro 144 mn (₹ 9,360 mn) of MCGF. Usual counter guarantees cover around 50-75% of MGS guarantee amount. 7. Regulatory enablers according special status to MGSs, which requires banks to assign lower weightage of 20% to guaranteed loan portfolio.	1. All MGSs apply a homogeneous credit assessment, according to principles and rules discussed and approved by all entities of the respective scheme. 2. Assignment of deal origination and guarantee approval role to MGSs ensures peer-to-peer monitoring and evaluation on a continuous basis, thereby decreasing overheads for the lender. 3. Optimum risk-reward mechanism for availing guaranteed loans in terms of requirement to invest a minimum of 3% of guaranteed loan as equity in MGS for respective interested MSME. 4. Increased lending on account of release of regulatory capital on account of lower risk weightage assigned to MGS guaranteed loan portfolio. 5. Administrative support to member MSMEs from SPGM for loan administration and monitoring.

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Brazil Credit Guarantee Societies. AGC Scheme (Brand Name GarantiSerra) of Caxias do Sul region. [57]	1. Created in 2003, as a joint project of SEBRAE[58], the Government of Rio Grande do Sul, the regional Chamber of Commerce, and several municipalities. 2. Supported by Technical Assistance from Italian Partners. 3. Financial Assistance provided by the Inter American Development Bank. 4. Pioneering initiative prompted by the inability of existing credit guarantee schemes to enhance SME lending significantly.	1. Financial support from IADB for provision of counter-guarantee. 2. Elimination of risk associated with deployment of "public funds" for existing credit guarantee schemes and associated monitoring mechanism.
Latin American Countries: ACCION International [59]	1. Funds raised by ACCION International for the Latin American Bridge Fund from multiple sources like Government grants, private investors, trusts, foundations, etc. 2. ACCION deposits this fund in mainstream US bank (for bridge fund it has used Citibank account to pool the fund) to create a guarantee fund. 3. MFI approaches ACCION for Bridge Fund guarantee to avail a line of credit from bank. 4. After assessing the eligibility of the MFI in terms of adherence to Bridge Fund's financial & non-financial criteria, the Bridge Fund instructs the bank to issue standby letters of credit to MFIs using the Fund guarantee as collateral. 5. The Bridge Fund acts as collateral for irrevocable standby letters of credit issued by Citibank in US dollar and usually guarantees 10 to 90 percent of the credit provided by local commercial banks to ACCION affiliated MFIs.	1. Ensures access to finance for MFIs lacking the requisite capital, on account of guarantee from the Bridge Fund. 2. On account of underlying guarantee, collaterals required to be provided by MSME borrowers is limited vis-à-vis guarantee-less funding. 3. By funding the MFIs, banks do not need to invest in physical infrastructure & resources to reach the MSME sector clients on their own. 4. Forex risk is mitigated through local currency lending by banks to MFIs, using the dollar backed funds of the Bridge Fund as the collateral. Applicability only in case of loan defaults.

[57]FINANCING TECHNOLOGY ENTREPRENEURS & SMES IN DEVELOPING COUNTRIES: CHALLENGES AND OPPORTUNITIES. BRAZIL COUNTRY STUDY. (infoDev. June, 2008). www.infodev.org

[58]Established in 1972, SEBRAE (Brazilian Service for the Support of Micro and Small Enterprises) is a not-for-profit intermediate organization gathering around 350 national public and private institutions, including central and local Governments, business associations, educational and research institutions and other stakeholders.

[59]Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises-World Bank Institute

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	6. On account of the collateral offered by the Bridge Fund for the respective portion of the credit to be extended, local bank lends to MFI in local currency which is used for on-lending to MSMEs. 7. In case of a default by MFI in payment to participating bank, the bank sends the claim to Bridge Fund which is confirmed with the respective MFI by the Bridge Fund managers. Accordingly, payment is released by the Fund to the bank in case of default, as per risk sharing agreement. 8. Default payments are made from loss reserve funds, maintained at around 5% of all outstanding obligations at any point in time. Loss reserve funds are typically funded by donor agencies / socially responsible individuals / trusts, etc. The loss reserve fund serves as the first loss bearer in case of default on guaranteed loan exceeding the reserves of the MFI, as the loan advanced by bank to MFI is senior to equity / quasi-equity / reserves of the MFI. In case of a loss above the provision created through the loss reserve fund, the loss is borne by investors in the Bridge Fund on a pro-rated basis.	5. Prior to approval of guarantees for a particular MFI, annual audited accounts are assessed along with due diligence of loans and liabilities, loan losses in the past, due loans, etc. Periodic review of the credit of affiliate MFIs availing credit is also undertaken at least once a year through review of financial statements and field visits. 6. Effective monitoring of credit risk by Bridge Fund on account of association with ACCION, which is one the large global microfinance institutions and its access to information on affiliate members. 7. Ensures linkage of MFIs with formal financial sector, thereby helping formal financial sector identify the potential of lending to MSMEs. 8. Investment of funds received for "loss reserve fund" are invested in safe Government securities, commercial paper or corporate debt securities. 9. Sustainable operations through charging of a 3% annual guarantee fee by the Bridge Fund.

Implementation in the Indian context

The concept of formation of mutual guarantee societies (MGS) through the Mutual Credit Guarantee Fund Schemes (MCGFS) has been rolled out in India by banks and financial institutions in collaboration with UNIDO as far back as in 2000, with an initial project in the Jaipur Hand Block Printed Textiles cluster, and subsequent replication at the leather cluster of Ambur[60]. However, the concept of leveraging public and private sector intervention in form of counter-guarantees has been limited for these MGSs, with Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) being the only credit guarantee scheme operated through public sector intervention not being applicable to these MGSs. The exposure leveraging CGTMSE scheme was ₹ 2,767 Crore (as on March 31, 2008) which was estimated by Reserve Bank

[60]http://web5.laghu-udyog.com/clusters/publications/news/eclnw0903.htm#cs

of India to be around 14% of collateral free advances by banks / FIs to MSMEs. However, there has been a significant increase in the number of proposals approved for guarantee under CGTMSE scheme during FY 09-10, with around 53,708 & 1,13,029 proposals amounting to ₹ 2,199 Crore and ₹ 5,110 Crore respectively being approved during FY 2009 and FY 2010. Considering the lack of investments by other retail / institutional investors in the Guarantee Funds, it may be useful to implement a MSME credit guarantee program in India in line with the best practices detailed above, detailed in Table 45.

Table 45: Indicative Implementation Roadmap

Action Points
Creating a Credit Guarantee Fund with objective of providing counter-guarantees to facilitate on-lending to MSMEs. Considering the envisioned higher level of guarantees to be extended, either the corpus of existing CGTMSE scheme could be enhanced with extension of scope of this scheme to MGS or marketing of the proposed Credit Guarantee Fund to raise funds from various public and private sector investors.
Marketing the Credit Guarantee Fund to potential investors / marketing to increase the credit guarantee corpus along with increase in scope to encompass MGSs.
Identifying administrator of the "guarantee fund".
Development of requisite legal and regulatory enablers to ensure i) special treatment (e.g. reduced risk weighting for regulatory charge) for loans guaranteed under this model, ii) tax incentives for potential investors in Credit Guarantee Fund.
Identifying potential intermediaries (MGSs/ banks / FIs) which may leverage the guarantee to increase on-lending to MFIs/MSMEs and marketing of Credit Guarantee Fund to the same.
Information dissemination on the above model among the respective MSMEs / MFIs, with a focus on first targeting the established clusters, in collaboration with MGSs and banks / FIs identified in the previous step.
Developing standard credit assessment methodologies to assess credit worthiness of individual member MSME.
Advancing guarantee through the Guarantee Fund to i) the MGS for facilitating on-lending to MSMEs, ii) bank/FIs for facilitating fund disbursement to MFIs for on-lending to MSMEs.
Advancing credit to the member MSMEs of MGSs / MFIs for on-lending to MSME backed by guarantee.

It is expected that implementation of this best practice would take around 2 – 2.5 years based on creation of guarantee fund, marketing of the same to investors and securing tie-ups with potential partner MGS and banks / FIs who will leverage the guarantee fund. The associated costs and benefits with a credit guarantee transaction have been detailed under the heading, viz. "Estimated Costs and Benefit of any loan disbursement involving credit guarantee" as below.

Estimated Costs and Benefits of any loan disbursement involving credit guarantee

Any loan disbursement backed with a credit guarantee involves costs to be incurred by both the Credit Guarantee Fund and the lender. Costs can be categorized as fixed and variable costs in the form of one-time upfront or recurring expenses.

Table 46 highlights the various types of costs along with underlying nature, associated with a typical guarantee-based loan disbursement.

Table 46: Costs associated with guarantee-based loan disbursement transaction

Cost Type	Nature	Borne by Credit Guarantor	Borne by Lender
Fixed	Guarantee fee payable to entity providing credit guarantee.	Not Applicable	Estimated at 1.5% of the loan amount disbursed.
	Underwriting cost.	Estimated at ₹ 2 Lakh per transaction.	Estimated at ₹ 2 Lakh per transaction.
	Provision for loss, leading to additional provision of regulatory capital (assumption of Credit Guarantor bearing 75% of the risks).	Estimated at guarantee fee rates charged (1.5%) on 75% of the loan amount disbursed.	Estimated at interest rate spread @ 2% on 25% of the loan amount disbursed.
Recurring	Annual service fee payable to entity providing credit guarantee.	Not Applicable.	Estimated at 0.75% of loan amount disbursed
	Administration & transaction monitoring charges.	Estimated at ₹ 2 Lakh per annum per transaction.	Estimated at ₹ 2 Lakh per annum per transaction.

On the other hand, the underlying benefit from a guarantee-based loan disbursement for the credit guarantor and the lender has been projected as follows:

Table 47: Benefits associated with Securitization transaction

Benefit	Credit Guarantor	Lender
Guarantee fee	One-time upfront receipt @ 1.5% of loan amount disbursed in addition to recurring fee @ 0.75% of the loan amount disbursed.	Not Applicable.
Transaction structuring fee	Not Applicable.	One-time upfront receipt @ 1.5% of loan amount disbursed.
Interest Income	Not Applicable.	Interest rate spread @ 4% on the loan amount disbursed (to cover costs of guarantee). On account of reduced risk weightage of guarantee-backed loan disbursed, potential for on-lending additional funds (assumed at 50% of the loan amount disbursed) at an interest rate spread @ 2%. Underlying assumption that the on-lending is restricted to MSME sector in order to maintain regulatory capital requirements.

However, it should be noted that on account of the nature of “fixed” costs associated with the guarantee-backed loan disbursement, as detailed above, it is cost-effective only if a “threshold” loan disbursement amount is achieved to apportion the fixed costs appropriately. The indicative “threshold” loan disbursement amount for both the Credit Guarantor and Lender, considering a 5 year time horizon for the loan repayment has been estimated to be around ₹ 55 Lakh based on the details provided below:

Table 48: Illustrative Example - Cost-benefit analysis

Assuming loan disbursement of ₹ X Lakh	Credit Guarantor	Lender
Annualized Costs	Fixed / One-time Component: (2 + 0.01125 X) / 5 Variable Component: 2 (Refer Table 46)	Fixed / One-time Component: (0.015 X + 2 + 0.005 X) / 5 Variable Component: (0.0075 X + 2) (Refer Table 46)
Annualized Benefits	Fixed / One-time Component: (0.015 X) / 5 Variable Component: 0.0075 X (Refer Table 47)	Fixed / One-time Component: (0.015 X) / 5 Variable Component: 0.05 X (Refer Table 47)
Threshold portfolio size required to achieve a positive return from securitization	X = ₹ 290.9 Lakh*	X = ₹ 57.8 Lakh

*Considering the high levels of minimum loan disbursement amount for it to be feasible for MSME loans for Credit Guarantee funds, Government subsidizes the operations of the Fund to ensure that they can guarantee MSME loans.

NPA MANAGEMENT

Highlights

- NPA as % of total asset is an important financial indicator of any bank and reduction of NPA improves risk rating of a bank.
- NPAs are divided into sub-standard, doubtful and loss assets depending on the period of default, progress of project implementation and availability of security.
- NPA management involves rehabilitation of the loan account indentified as non performing by way of rescheduling, restructuring and / or asset sales. This can be done by a bank either in-house or through an Asset Reconstruction Company (ARC).

Theme Description & Benefits to MSMEs

Non Performing Asset (NPA) is an asset (the loan account of a borrower), which does not provide any return by way of interest and a part or whole of the principal which is unlikely to be paid back by the borrower. An NPA is classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the norms relating to income recognition and asset classification issued by the respective regulator.

The level of NPA as a percentage of total credit is a key performance indicator for any lender, and it is essential to contain this in order to sustain its financial health. Typically MSME lending is considered to be a high risk segment and this has led to security based lending rather than cash flow based lending. The most common approach to address this is to secure MSME loans with collaterals, thus creating a bottleneck for access to finance for this sector, given the lack of availability of collaterals with such enterprises.

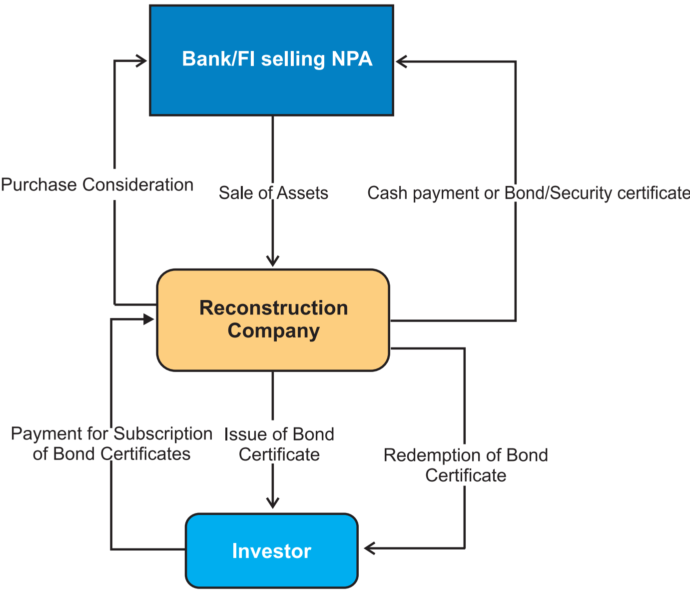


Figure 14: NPA Management Process

NPA management is of particular importance in the context of MSME financing since this sector has a marked proclivity for registering a high proportion of NPAs.

NPA management is usually done through one or more of the following mechanisms, executed by specialized institutions sponsored by state and financial institutions to address the issue of NPA across banks and financial institutions:

- Rehabilitation of the account through restructuring or rescheduling of the loan.
- Compromise Settlement.
- Selling off the NPA (Financial Asset) to Asset Reconstruction Companies or other banks / agencies as per applicable central bank guidelines.

Overview of NPA Sale Process

Process of transferring NPA from bank to an asset reconstruction company (ARC) involves the following steps:

- Identification of NPA by the bank for the purpose of sale.
- Details of the NPA portfolio are shared with the probable buyers (reconstruction companies). Further, following information is also shared:
  - Collateral security details.
  - In case of consortium lending, share of each member of the consortium.
  - Legal status of suit filed, if any.
- Due diligence exercise is conducted by the prospective buyers themselves or through appointment of a consultant.
- Short-listing of potential buyers by the bank themselves or with the assistance of a consultant.
- Price of the asset is negotiated between the bank and the ARC buying the asset.
- Post price negotiation and settlement, NPA is transferred to the ARC with all underlying security documents. Banks receive cash or bonds/security receipts issued by ARC. Further, banks benefit through improvement in rating through disposal of NPAs from their books and also reduce overhead costs associated with maintenance of staff for recovery of loans.

Sometimes the banks can also sell the NPAs to the ARCs on bilateral basis on mutually agreed terms & conditions. In such cases, the banks will arrive at a benchmark price based on the valuation of the underlying security and will take a holistic view of continuance of the NPA in its books vis-à-vis the advantage of getting it rid of its balance in terms of provision requirements and recurring costs to be incurred for maintenance of the asset. Another avenue for the banks to tackle NPAs is to outsource the recovery work to ARCs (which are specialized institutions) for certain fees and incentives based on the recovery achieved. In such cases, there is a possibility of turning around an NPA to a standard account which will be desirable for a bank as it keeps its asset base intact and at the same time deploys its own staff for productive purposes or core activities. This incidentally also meets with the objective of formation of ARCs for reduction of NPAs in the financial sector.

7.1. Best Practice NPA-1: NPA management though formation of government supported Asset Management Company (AMC)

One of the major problems plaguing many of the Asian banking systems have been high level of NPAs, which causes a strain on the capital of banks if it exceeds 5% of the loan portfolio[61]. In case of China, the banking system is characterized by large but weak banking sector with NPA estimated to be at 40% of the loan outstanding. The Chinese government started banking reforms by establishing four state owned AMC in 1999 with each one being attached to one of the four state owned banks dominating the banking system of China (owning 70% of total assets of Chinese banking system). In spite of the different hurdles like weak legal system, absence of loan data, high volume of NPA and lack of well formed capital market Chinese AMCs had total recovery of 33% of the book value of asset disposed, out of which 22% was recovered in cash.

In Malaysia, the NPAs level started to increase from the year 1998 and remained at 16-18% level till 2002. An asset management company, viz. Danaharta, was established in 1998, which had assets under management of around RM 47.76 bn (₹ 645 bn) by end of 2002. As of December 2002, Danaharta made successful resolution of RM 30.19 bn (₹ 408 bn) with RM 12.31 bn (₹ 166 bn) recovered in cash, accounting for around 25% of total NPA portfolio being managed.

The details of the identified case studies relating to China, and Malaysia along with the corresponding best practices adopted in these cases have been presented in Table 49.

Table 49: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices/Critical Success Factors
Chinese Asset Management Corporations /4 State Owned AMCs of China (Initial equity from Ministry of Finance, China)[62]	1. Total assets of USD 170 bn (₹ 8,500 bn) were transferred to the four state-owned AMCs (around 20% of the loan outstanding of the four banks) with objective of maximizing the asset recovery through the disposal of NPAs. 2. Different funding options utilized for purchasing NPA from the banks included: ● Loan from Central Bank i.e. PBoC (40%). ● AMC Bonds (60%). 3. Different resolution methods used, included the following: ● Restructuring/Rescheduling: Recovering the loan by way of restructuring or rescheduling it. ● Portfolio sale: Sale of loan portfolio through securitization. ● Auction: Selling the collateral security attached to the loan for recovering the loan outstanding.	1. In China, AMCs enjoy explicit financial support from the government. 2. Chinese AMC enjoys certain tax advantage in their disposition operations. They are exempted from: ● Value Added Tax ● Real Estate Tax 3. Chinese government is also offering the cash bonus to the AMC for their cash recovery from the acquired NPA.

[61]BIS: Public Asset Management companies in East Asia-Occasional paper by Ben Fung, Jason George, Stefan Hohl and Guonan Ma http://www.bis.org/fsi/fsipapers03.pdf

[62]BIS: Public Asset Management companies in East Asia-Case Studies by Ben Fung, Jason George, Stefan Hohl and Guonan Ma http://www.bis.org/fsi/fsipapers03cs.pdf

Country/ Organization	Case Study	Best Practices/Critical Success Factors
	• Joint Venture: This is a type of corporate restructuring where the management of the borrower is changed by induction of a strategic partner to make the business viable. • Debt for equity swap: Under this a company's creditor agrees to cancel some or all of its debt in exchange for equity in the company. This is because both the debt and the remaining assets in these companies are so large that there is no advantage for the creditors to drive the company into bankruptcy. Instead they prefer to take the control as going concern. • Leasing of underlying asset: This involves taking over the underlying asset attached to the loan and managing it for recovering the loan.	4. In China, AMCs enjoy supportive legal infrastructure including bankruptcy and foreclosure laws which allows the AMC to resolve quickly and recover more amount from the borrower. 5. Presence of a well functioning capital market to facilitate trading of the bonds issued by the AMC. 6. Availability of records of the borrower, primary and collateral security valuation and other details of Non Performing Loans in the banking system.
Malaysia Asset Management Corporation (DANAHARTA) / Wholly Owned Subsidiary of Ministry of Finance, Malaysia	1. Danaharta was formed primarily to take over NPAs from the banking system and manage them with the objective to maximize the recovery proceeds. 2. Sources of funds for Danaharta to purchase the NPAs included the following: • Government equity RM 3 bn (₹ 40 bn). • Loan from Employees Provident Fund and an Investment arm of Ministry of Finance maximum up to RM 2 bn (₹ 27 bn). • Public borrowing of AMC bonds (maximum up to RM 15 bn (₹ 202 bn)). 3. Asset Acquisition: For acquisition, Danaharta offers a valuation to the selling bank using "net tangible asset" or "discounted cash flow" method. Transaction is funded by issue of zero coupon bonds by Danaharta that are government guaranteed. 4. Assessment of valuation of NPA involves the following key principles: • For secured loans, value of underlying collateral is ascertained based on independent appraisal by a valuer. • For unsecured loans, 10% of the outstanding principal is considered as underlying value. In both the cases above, there is a profit sharing approach followed wherein Danaharta provides 80% of the recovery to the bank after adjusting its recovery and purchase cost.	1. Disincentive for bank to retain the NPA in their books as they are bound to write down the NPA to 80% of value offered by Danaharta, in case of refusal to sell the NPA. 2. Bonds issued by the Danaharta are government guaranteed therefore a zero risk weight is assigned to these bonds.

Country/ Organization	Case Study	Best Practices/Critical Success Factors
	● For certain large loans (around 10% of the portfolio of Danaharta) where it is difficult to carry out the valuation, Danaharta pays a percentage of the principal or a negotiated price. In this case, Danaharta has full recourse upto the purchase price, if the subsequent recoveries are less than the purchase price. 5. Danaharta uses two main approaches for managing and disposing NPA, viz. loan management and asset management ● Loan management involves recovery through loan restructuring, foreclosure or disposal of the loan. ● Asset management approach is applicable in case of assets like real estate collateral, equity in borrowing company are obtained in resolution process where ongoing management is needed to maximize the value of asset. 6. Loan management approach is segregated for loans classified as i) viable and ii) non viable ● Resolution of viable loans is done primarily by restructuring, which could include rescheduling of loans in terms of tenor, partial cash settlement or asset disposal. ● Non viable loans are put under asset restructuring where the primary focus lies on recovering debt by selling either the business or the collateral. In case of foreclosure, the AMC is given special power to sell the physical collateral or equity shares pledged as collateral.	3. Incentive for the banks to sell assets to Danaharta on account of higher recovery rate achieved by Danaharta and profit sharing in case of recovery over & above the purchase price.

Implementation in the Indian context

As per estimates of Reserve Bank of India (RBI), the total NPAs in India comprises around 2.39% of the net bank credit advanced during the 2009-10 period. However, it is observed that the NPAs corresponding to MSMEs have been relatively higher than the overall NPA levels with estimates by RBI based on information available for 2006-07 estimating NPAs for MSMEs at 5.58 % which was almost double of overall NPA levels of 2.93% in that year. On account of the relatively higher levels of NPAs for MSMEs in the Indian banking system, there is a need to constitute an MSME focused Asset Reconstruction Companies (ARCs). In this regard, an MSME focused ARC, viz. India SME Asset Reconstruction Company Limited (ISARC), has been established with the support of SIDBI and other leading public sector banks. MSMEFDP has also supported ISARC to document national/ international practices in MSME sector in NPA management / asset reconstruction, suggest on resolution measures, devise suitable NPA management model.

In line with the best practice detailed above, it is recommended that the following steps need to be taken for implementing an NPA management program for MSMEs in India, leveraging the establishment of ISARC. The action points have been detailed in Table 50 in the next page.

Table 50: Indicative Implementation Roadmap

Action Points
Ensuring formation of an Asset Reconstruction Company (ARC) to deal exclusively with NPAs related to the MSME sector.
Funding acquisition of MSME NPAs by MSME - Focused ARC through issue of Government guaranteed bonds. Incentive for potential investors in form of banks / FIs in terms of acquisition of an asset with a zero risk weightage.
Streamlining the transfer pricing and transfer process to reduce the transaction cost / time so that the ARC can focus on resolution.
Ensuring secondary market for trading of ARC bonds.
Providing incentives to the bank for selling MSME NPA to the ARC in the form of profit sharing in line with the Malaysian ARC, Danaharta.
Information dissemination on the proposed NPA management model.

It is expected that implementation of this best practice would take around 1 – 2 year based on formulation of requisite regulatory enablers, facilitating acquisition of MSME specific NPAs through issue of bonds backed with Government guarantee along with development of secondary market for trading of these bonds. The key costs for the implementing bank / FI would be in the form of initial capital infusion for formation of the Asset Reconstruction Company focused on MSME sector and promotional expenses for information dissemination on the same. However, the success of this best practice would be greatly dependent on development of a secondary market through effective liasoning with capital market development agencies.

CHAPTER 8

MARKETING PRODUCTS & INFORMATION DISSEMINATION

Highlights

- Supply-side marketing of product offerings from banks / FIs, including information dissemination among target MSME segments

Theme Description & Benefits to MSMEs

Marketing of products from the perspective of MSME financing primarily relates to supply-side interventions which involve adoption of innovative channels / models to disseminate information on various products offered by banks / FIs for MSMEs along with development of market for the same through education / training of concerned MSMEs leveraging on-field partners.

It is described that the key best practices related to role played by i) cluster intermediaries in Indonesia and ii) business member organizations in Europe in facilitating marketing of products along with information dissemination on the same to the cluster MSMEs on behalf of participating banks / FIs.

8.1. Best Practice MP&ID-1: Appointment and capacity building of intermediaries for marketing of products & information dissemination

Based on an assessment of the constraints faced by MSMEs in securing finance from banks/FIs in Indonesia including their limited reach, IFC & Swisscontact conducted a pilot project (viz. Promoting Enterprises Access to Credit (PEAC)) in association with Bank of Indonesia along with other local banks. The key aspect of the project included the following:

- Identification of the MSME hubs (clusters) requiring financing.
- Appointment of cluster intermediaries to offer marketing, credit advisory, loan disbursement and collection services with a fee based payment structure.
- On account of identified capacity building requirements for these intermediaries, specific agents were appointed through the PEAC project to facilitate their training and capacity building.

These PEAC projects were extended to key MSME clusters in Indonesia from 2005 onwards. Since the launch of PEAC project till the mid of 2008, 79 intermediary organizations reported successful credit facilitation to 15,329 MSMEs of Indonesia, the total volume of which is IDR 552 bn[63] (₹ 2.8 bn). The project has proved that credit facilitation does improve bankability and access to finance for MSMEs. PEAC Project has over achieved its target in terms of number of MSMEs covered along with the target loan disbursement apart from improving loan recovery.

A similar model has been adopted in India by SIDBI through the Rural Industries Programme (RIP) wherein economically underdeveloped districts are identified with the view of encouraging rural industrialization through support to potential entrepreneurs. RIP, the flagship programme of the Bank, is a comprehensive enterprise support service programme for the benefit of rural entrepreneurs. It aims at promoting viable rural enterprises leading to employment generation in rural areas and use of local resources. The package of Business Development Services offered under the programme includes identifying and motivating rural entrepreneurs, identification of viable ventures based on local skills and resources, training, appropriate technology, and establishing linkages with the formal banking sector. Thus, RIP addresses problems of rural unemployment, urban migration, under-utilisation of know-how, latent rural resources and marketing of rural products. The incentive for RIP implementing agencies is dependent on their linking of financing of the units from Banks/SFCs. Cumulatively, upto September 30, 2010, the Rural Industries Programme has been implemented in more than 120 districts in 24 States. Under the programme more than 35,000 enterprises have been promoted, including about 2214 units during the year. These enterprises have generated employment opportunities for over one Lakh persons.

SIDBI as a pilot under MSMEFDP has suitably modified RIP to include the business related aspects of livelihood and re-christened it as Modified Rural Industrialization Project [MRIP]. The MRIP aims at promoting viable rural enterprises leading to employment generation in rural India by facilitating availability of business services. It would create a mechanism to provide help in identifying, motivating and guiding rural entrepreneurs in setting up industrial ventures. It also aims at gainful utilization of local resources. The target group of the programme is potential as well as existing entrepreneurs in the rural /underserved areas/artisanal clusters.

The details of the identified case study along with the corresponding best practices adopted in Indonesia have been presented in Table 51.

Table 51: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices /Critical Success Factors
Indonesia: Bank Perkreditan Rakyat & other Commercial Banks of Indonesia[64]	1. IFC-PENSA and Swisscontact signed a Memorandum of Understanding (MoU) for increasing access to finance for MSMEs in Indonesia in association with Bank of Indonesia.	1. Strong partnership between international donor agency, large banks/FIs in Indonesia and private sector entities with overall supervision and implementation support of the Bank of Indonesia (the Central Bank) and the local government.

[63]http://pdf.usaid.gov/pdf_docs/PNADP081.pdf
Models of financial business services case studies and lessons from financial intermediaries
[64]http://www.bdsknowledge.org/dyn/bds/docs/347/Bissegger.pdf
PEAC: Promoting Enterprises Access to Credit or How to develop the market for credit- related business services-Swisscontact

<table>
<tr><th>Country/ Organization</th><th>Case Study</th><th>Best Practices /Critical Success Factors</th></tr>
<tr><td></td><td>2. Promoting Enterprise Access to Credit (PEAC) was conceptualized with signing of this MoU. Facilitation by the PEAC includes services to the bank as well as to the cluster intermediaries.

3. PEAC project supports intermediaries like business development service providers (BDSP) in five provinces of Indonesia. The support offered include training these BDSPs in understanding the finance and banking products for effective marketing of the same, origination and monitoring of credit to MSME by providing pre and post credit related services to banks, etc.

4. While facilitation for BDSP ranges from information on financial services, training on credit appraisal, establishing business linkages and networking with other intermediaries; in case of banks, PEAC helps in identification of suitable intermediaries, information on services to MSME, training for MSME relationship officers and certifications for the BDSPs.

5. Based on the training imparted to these BDSPs through the PEAC project, partner banks / FIs leveraged the presence of these BDSPs to market various financial products to MSMEs in the respective hubs / clusters.

6. PEAC tracked the growth and successes of the BDSPs with which its units worked, by recording the increases in the following:
● Number of BDSPs accredited,
● Number of BDSPs with contracts with SME,
● Number of BDSPs successfully facilitating credit for MSMEs, and
● Total credit facilitated through BDSPs, and micro and small enterprises accessing credit through them.</td><td>2. Trained intermediaries acted as key linkages between the bank and the MSMEs. They provided i) marketing of various financial products of banks / FIs, ii) pre-credit services like feasibility studies, collection of financial data, business plans and iii) post-credit services like loan documentation, monitoring of the credit portfolio, collection of receivable, etc.

3. Commitment of the PEACs to the ultimate goal of developing market for credit-related services in the MSME clusters. They helped to develop an overall understanding of the MSME financing trends in terms of:
a. How MSMEs access credit and finance for business.
b. How the MSME interacts with the intermediaries.
c. Difficulties for the intermediaries/ BDSPs in identification of the clients and how to overcome that.
d. Motivation for MSMEs to work in such a set up.</td></tr>
</table>

Country/ Organization	Case Study	Best Practices /Critical Success Factors
India: SIDBI[65]	1. SIDBI identifies the economically underdeveloped districts where there is a significant potential for industrialization. 2. Appointment of Implementing Agency (IA) Development professionals, in form of a technical consultancy organization / NGO. 3. Adequate training / capacity building / input support to the appointed IA so that they can offer requisite support to the MSMEs in the selected district for a period of 5 years. This includes training on respective products / services offered by formal financial sector, which can be leveraged by the MSMEs. 4. The training is leveraged by IAs to increase awareness among MSMEs about the benefits of associating with formal financial sector for financing requirements. This includes sharing information on various products / services offered at various stages of evolution of an enterprise along with the means for availing the same. 5. In addition to establishing financial linkages, IAs also offer a comprehensive and integrated package of inputs & business development services to the MSMEs in terms of identification of viable ventures based on local skills and resources, training, appropriate technology linkages, etc.	1. IAs act as key linkages between the formal financial sector and the MSMEs. They offer support related to marketing of various financial products of banks / FIs. 2. Post implementation support to ensure sustainability of MSMEs is also offered by IAs.

Implementation in the Indian context

The model described above in terms of appointment of specific intermediaries to offer complete range of services associated with marketing of financial products and credit delivery in terms of appraisal, disbursement and collection is being piloted in India through various initiatives like the one taken by SIDBI (viz. Rural Industries Programme (RIP)) which is being implemented in economically under-developed districts through implementation agencies (IA). These IAs help in developing rural MSMEs by providing business development services which includes, inter-alia, financing tie-up with formal banking sector through marketing of products / services offered by formal financing sector. In its advanced version as Modified RIP (MRIP), it not only covers the financial services but also to cater the needs of the micro and small enterprises for non-financial services. In this model a developmental / implementing agency (IA) with regional / national presence is appointed to carry out developmental activities for the promotion and

[65]Source: http://www.sidbi.in/rip.asp

development of MSEs as also to strengthen the MSE stakeholders groups. The IAs provides / facilitates qualitative consultancy / net-working services which encourages and attracts self and institutional finance to rural sector. MRIP focuses on value-addition in terms of marketing and technology linkages and sub-sectoral approach is being encouraged. However, there exists a potential for taking a formal organized approach for cluster financing leveraging this model with support of MSME-focused associated institutes like SMERA for imparting training to identified cluster intermediaries to ensure that they can carry out all activities associated with credit delivery, including pre-credit disbursement assessment and post-credit monitoring. Given the above, an indicative roadmap for addressing these specifics has been detailed in Table 52.

Table 52: Indicative Implementation Roadmap

Action Points
Identifying the clusters, where PEAC like pilot project can be implemented.
Identifying cluster intermediaries (like cluster development agents / BDS providers) in these identified pilot clusters, who will offer marketing and credit delivery services.
Developing policy and regulatory enablers for allowing BDSPs and other such intermediaries to act as credit related service provider.
Financing entities piloting this project should enter into a MoU with MSME-focused agencies like SMERA /other training institutes, etc. for training these intermediaries in all aspects of credit delivery including pre and post credit related services, knowledge of financial products offered by respective lender, etc. These external MSME focused agencies / training institutes would be further required to certify the cluster intermediaries as accredited service providers based on level of performance achieved.
Developing incentives for the identified cluster intermediaries in form of performance linked fee structure.
Monitoring the performance of these intermediaries in terms on volume of credit facility advanced and performance of respective loan portfolio
Evaluating the performance of the pilot project in terms of the parameters like, 1. Number of the service providers certified, 2. Number of participating banks / FIs, 3. Total credit facility generated and, 4. Number of MSMEs receiving credit, etc. Deciding about rolling out on national level if pilot is successful

It is expected that implementation of this best practice would take around 1 – 2 year based on formulation of requisite regulatory enablers, facilitating acquisition of MSME specific NPAs through issue of bonds backed with Government guarantee along with development of secondary market for trading of these bonds. The key costs for the implementing bank / FI would be in the form of initial capital infusion for formation of the Asset Reconstruction Company focused on MSME sector and promotional expenses for information dissemination on the same. However, the success of this best practice would be greatly dependent on development of a secondary market through effective liasoning with capital market development agencies.

8.2. Best Practice MP&ID-2: Monitoring & evaluation of performance of Business Member Organizations (BMOs) with respect to services offered

BMOs are intermediaries providing the business development service (BDS) with view of improving its relevance, effectiveness, efficiency, impact and sustainability. As part of IFC funded SEED project, BMOs were appointed in the Southeast European countries like Albania, Bosnia & Herzegovina, FYR Macedonia, Serbia & Montenegro with a view of providing BDS support. This was part of a larger SEED project which also included establishing value chain linkages, ensuring access to markets and leasing support. Through IFC sponsored support to BMOs, the scope and reach of BMO activity was extended with the SEED project having access to over 2,600 SMEs[66] through BMOs in various industry sectors, regions, geographic areas and constituent bases. A key element of this project related to BMOs was the process of continuous evaluation of performance of BMOs with respect to the stated mandate. For this purpose, a framework was developed with a focus on the following parameters: leadership, membership base, financial sustainability, provision of business development services and success of advocacy issues.

The details of the identified case study along with the corresponding best practices adopted in the respective Southeast European countries have been presented in Table 53.

Table 53: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices/Critical Success Factors
Southeast European countries: IFC - SEED[67]	1. Development of a framework for rating of BMOs based on objective assessment of performance levels. 2. Parameters considered included the following ● Capacity, ● Financial Sustainability, ● Market development, ● Business development services, and ● Advocacy. 3. Capacity was specified in terms of i) growth of membership with respect to baseline levels, ii) % of members paying their dues. 4. Financial Sustainability was ascertained through assessment of i) % recovery of costs vis-à-vis revenues, ii) break-up of revenues in terms of a) membership fees, b) service fees, c) donor / Government funding, d) other sources. The existing levels were benchmarked with the baseline levels.	1. IFC – SEED selected only those BMO partners which qualified as per World Bank criteria in terms of being i) free from state influence, ii) unaffected by secretarial divisions, iii) free from exercise of influence through formal and transparent channels. 2. Capacity development support from SEED to respective BMOs in order to deliver business development services along with discharge of advocacy role. 3. Mobilization of additional resources for BMOs through cooperation & partnership with other donor agencies. 4. Empowerment of BMOs leveraging SEED's reputation to successfully engage with Government in dialogue on advocacy role.

[66]Source: Draft Report on "SEED Impact Evaluation: Linkages, BMOs, Access to Markets and Leasing" sourced from http://www.ifc.org (February 2006)
[67]Source: Draft Report on "SEED Impact Evaluation: Linkages, BMOs, Access to Markets and Leasing" sourced from http://www.ifc.org (February 2006)

Country/ Organization	Case Study	Best Practices/Critical Success Factors
	5. Market Development with formal process in terms of preparation of written annual plans & reports on activities undertaken. The same was measured through review of information dissemination channel deployed in terms of newsletters, web-site development, publications, events along with the number of participants. 6. Assessment of business development services in terms of i) inputs received from donor agency / other specialized MSME focused agencies and ii) inputs provided to member MSMEs in terms of number of trainings and number of participants. 7. Efficiency of advocacy role was ascertained through monitoring of issues advocated, position papers developed, research conducted, public-private dialogues / roundtables facilitated.	5. Continuous updation of monitoring & evaluation framework for tracking performance of BMOs. 6. Sample impact assessment forms for each of the evaluation parameter along with overall BMO rating has been presented as below[68].

Snapshot of parameters deployed to assess capacity of BMOs

BMO Membership Growth and Fee Paying Members

S. No.	BMO	Status	Date	No. of Members	% Paying Members
1	ACA, Albania		30-Dec-04	242	90%
	Growth in membership: 55%	Baseline	30-Dec-02	156	80%
2	Herbal Zlatinica, BiH		22-Mar-05	68	19%
	Association Established Dec '03	Baseline	01-Jul-03	0	0%
3	Consulting Engineers (ACE) BiH		31-Mar-05	13	100%
	Association Established Dec '04	Baseline	01-Oct-04	0	0%
4	Employers Assoc RS		22-Mar-05	140	100%
	Growth in membership: 92%	Baseline	30-Sep-03	73	89%
5	BAIT, BiH		22-Mar-05	49	88%
	Association Established Dec '03	Baseline	05-Jan-04	0	0%
6	Shoe Assoc, FYRM		30-Mar-05	100	52%
	Growth in membership: 0%	Baseline	01-Jan-04	100	50%
7	Beekeepers, FYRM		25-Mar-05	430	100%
	Growth in membership: 54%	Baseline	01-Mar-04	280	0%

[68]Source: Draft Report on “SEED Impact Evaluation: Linkages, BMOs, Access to Markets and Leasing” sourced from http://www.ifc.org (February 2006)

S. No.	BMO	Status	Date	No. of Members	% Paying Members
8	Herbal Dr. Jovan Tukanov, S&M		22-Mar-05	200	55%
	Growth in membership: 700%	Baseline	01-Nov-03	25	100%
9	BA Vrsac, S&M		22-Mar-05	287	56%
	Growth in membership: 72%	Baseline	16-Jan-03	167	0%
10	BA Sloga, S&M		03-Mar-05	533	100%
	Growth in membership: 242%	Baseline	01-Apr-04	156	33%

Snapshot of parameters deployed to assess financial sustainability of BMOs

Financial Sustainability assessment framework for BMOs

S. No.	BMO	Status	Date	% Revs cover costs	From Fees Membership ip	From Fees Services	Donor / Govt Funding	Others (Specify)
1	ACA	Recent	30-Dec-04	100%	70%	0%	7%	23%
	Albania	Baseline	No Data					licensing fees
2	Zlatnica	Recent	22-Mar-05	100%	10%	5%	85%	0%
	Herbal BiH	Baseline	01-Jul-03	0%	0%	0%	0%	0%
3	ACE BiH	Recent	31-Mar-05	100%	100%	0%	0%	0%
	Construction	Baseline	01-Oct-04	0%	0%	0%	0%	0%
4	ECRS, BiH	Recent	22-Mar-05	100%	12%	4%	23%	61%
	Employers	Baseline	30-Sep-03	100%	37%	0%	0%	73%
5	BAIT	Recent	22-Mar-05	100%	90%	0%	10%	0%
	IT, BiH	Baseline	05-Jan-04	0%	0%	0%	0%	0%
6	Shoe Assoc	Recent	30-Mar-05	80%	40%	20%	20%	0%
	FYRM	Baseline	01-Jan-04	80%	40%	25%	15%	0%
7	Beekeepers	Recent	25-Mar-05	85%	50%	5%	30%	0%
	FYRM	Baseline	01-Mar-04	100%	10%	0%	90%	0%
8	Dr. Jovan Tukanov	Recent	22-Mar-05	90%	10%	0%	80%	0%
	Herbal, S&M	Baseline	01-Nov-03	95%	10%	0%	25%	60%
9	BA Vrsac	Recent	22-Mar-05	100%	45%	10%	45%	0%
	SMEs, S&M	Baseline	16-Jan-03	0%	0%	0%	0%	0%
10	BA Sloga	Recent	03-Mar-05	100%	55%	10%	20%	15 (rent)%
	SMEs, S&M	Baseline	01-Apr-04	70%	0%	0%	15%	55 (rent)%

Snapshot of parameters deployed to assess effectiveness of market development initiatives of BMOs

Assessment framework for Market Development Initiatives offered by BMOs

S. No.	BMO	Status	Newsletters	Web-site	Publications	Events	Number of participants
1	ACA	Current Status	0	Yes	1	14	336
2	Herbal Zlatnica	Current Status	10	Yes	11	12	500
3	ACE (FIDIC)	Current Status	0	No	0	1	73
4	ECRS	Current Status	31	Yes	3	10	164
5	BAIT	Current Status	0	Yes	1	1	15
6	Shoe Assoc	Current Status	1	Yes	62	8	160
7	Beekeepers	Current Status	3	No	15	25	309
8	Dr. Jovan Tukanov	Current Status	18	Yes	7	23	380
9	BA Vrsac	Current Status	16	Yes	9	25	309
10	BA Sloga	Current Status	11	Yes	2	10	196

Snapshot of parameters deployed to assess effectiveness of business development services offered by BMOs

Assessment framework for business development services offered by BMOs

A. Services by SEED to BMOs (I-II) – BMO's consumption of SEED's Services

B. Services by BMOs to SMEs (III-V) – BMO provision of services to its members

S. No.	BMO	Consultancy to BMO	Trainings to BMO		Trainings to SMEs	Number of Partici-pants	Legal Advising to SMEs
		I	II		III	IV	V
1	ACA	No	Current		Data		Yes
2	Herbal Zlatnica	0	7		7	350	Yes
3	ACE (FIDIC)	0	3		3	72	No
4	ECRS	5	10		10	138	Yes
5	BAIT	2	0		1	15	Yes
6	Shoe Assoc	3	8		3	45	No
7	Beekeepers	1	7		8	65	Yes
8	Dr. Jovan Tukanov	0	5		5	200	Yes
9	BA Vrsac	5	17		20	235	Yes
10	BA Sloga	3	6		6	101	Yes

Snapshot of parameters deployed to assess effectiveness of advocacy role of BMOs

Assessment framework for advocacy role of BMOs

S. No.	BMO	Date	Issues Advocated	Position Papers Developed	Research	Public / Private Dialogue Roundtables
1	ACA	Dec-04	5	30	0	25
2	Herbal Zlatnica	Mar-05	2	1	0	3
3	ACE (FIDIC)	Jun-05	1	1	1	1
4	ECRS	Mar-05	18	10	7	4
5	BAIT	Mar-05	0	0	2	6
6	Shoe Assoc	Mar-05	3	1	3	6
7	Beekeepers	Mar-05	0	0	0	0
8	Dr. Jovan Tukanov	Mar-05	5	2	0	4
9	BA Vrsac	Mar-05	22	11	16	15
10	BA Sloga	Mar-05	3	2	1	7
	Total		**59**	**58**	**30**	**71**

Overall Rating of respective BMOs

Country	BMO	Rating out of 5	Reason for Rating
Albania	Albanian Builders Association	5.0	Strong organization, clear goals, important sector with much investment, rapid member growth, government recognizes as partner, success with advocacy issues, financial sustainability with $$ from licensing school.
BiH	Bosnian Association IT (BAIT)	3.75	Recently founded BMO, sector of potential strategic importance, SME members lack of transparency in reporting results, low cooperation. Strong motivation of founders.
	Association of Consulting Engineers BiH ACE	4.25	Recently founded association, Strong leader, received FIDIC certification, too soon to predict sustainability, important sector with strong FDI potential.

Country	BMO	Rating out of 5	Reason for Rating
	Employers' Confederation RS	5.0	Strong leadership, excellent advocacy issues, broad membership base, development of core products.
	Medical Herbs "Zlatnica" HDI	4.0	Economic, social, environmental impact, involves other donors, needs capital and legislative reforms, Rec'd organic certf'cn.
FYR Macedonia	Association of Secondary Raw Materials	4.5	Strong industry, facilitated passage of conservation law, leadership problems, member Bureau International Recyclers.
	Union of Chamber of Commerce	4.5	Members are industry keyholders. BMO recently founded, needs more organizational support. Pursues important BEE issues.
	Beekeepers Association	4.5	Received export license, strong cooperation among regional associations and $$ support from donor agencies.
	Shoe Producers Association	3.0	Weak leadership, lack cohesive vision, former state-owned enterprise, industry which faces many structural obstacles.
Serbia & Montenegro	Association of SMEs Vrsac	4.0	Strong initiative provides trainings to SMEs. Hurt by local election outcome for one-stop-shop, VAT.
	Association on Entrepreneurs Sloga	4.5	Fortunate timing with local elections, helps many sectors, built up in a short time.
	Herbal "Dr. Jovan Tucakov" - HDI II	4.0	Advances in organization, organic certification, other donors present. Needs help promoting exports.

BMOs Average Impact Score 4 out of 5

Implementation in the Indian context

With the focus on organization of MSMEs into clusters along with identification of need for strengthening of BDS providers through training / capacity development in these clusters, it becomes very critical to have adequate monitoring & evaluation frameworks in place to assess the performance level of BDS providers. This would serve a two-fold purpose, viz. i) assess the efficiency of policies and procedures adopted for training / capacity building of these BDS providers and ii) impact of the BDS providers on MSMEs in terms of increased outreach to finance, markets, etc. This is especially critical for public sector financial institutions / banks focused on MSME sector which pro-actively invest in undertaking training / capacity

building initiatives of BDS providers. For example, this could be extended to assess the effectiveness of implementation agencies (IA), through which SIDBI is implementing its Rural Industries Programme (RIP) in economically under-developed districts. Given the above, an indicative roadmap for addressing these specifics, together with the roles of relevant key stakeholders has been detailed in Table 54.

Table 54: Indicative Implementation Roadmap

Action Points
Identifying the clusters where BDS providers would be deployed on a pilot basis
Identifying cluster intermediaries (like cluster development agents / BDSPs) in these identified pilot clusters who will be offered training / capacity building support.
Develop framework to assess the performance level of these trained cluster intermediaries in form of BDS providers.
Monitoring the performance of these intermediaries in terms of existing level of performance vis-à-vis baseline levels (The same would have to determined through a baseline survey prior to roll-out of the pilot). Deciding about rolling out on national level, based on perceived success of the pilot.

It is expected that implementation of this best practice would take around 1 – 2 years. The key costs for the implementing bank / FI would include i) fees to be paid to training institutes (expected to be around ₹ 10 Lakh for each training session with around 50 participants for a fortnight), ii) time costs associated with development of framework to assess performance of BDS providers, iii) promotional expenses for information dissemination on the same (estimated to be around ₹ 50 Lakh, but would depend on target outreach levels) and iv) development of internal monitoring and evaluation systems & databases (estimated to be around ₹ 50 Lakh with actual expenses dependent on the number of intermediaries involved) along with time-costs associated with monitoring of the same.

CHAPTER 9

MICRO ENTERPRISE / RURAL MSME DEVELOPMENT

Highlights

- Refers to development initiatives in terms of i) access to finance, ii) access to markets, iii) training & capacity development, etc. primarily for relatively small entrepreneurs.
- Targets specific segments of the population in terms of low income groups / agriculture dependent entrepreneurs based in villages etc. through focus on community economic development, poverty alleviation and economic self sufficiency.

Theme Description & Benefits to MSMEs

Micro enterprise development, through various financial and non-financial mechanisms, aims at encouraging relatively small enterprises and their entrepreneurs in establishing sustainable and viable operations. This is expected to contribute to improvement in productivity of these enterprises thereby resulting in increased production, higher levels of income, employment generation, asset development, etc. which contribute to development of respective local economies. Some of the key mechanisms deployed for micro enterprise development along with benefits accruing to MSMEs have been highlighted below:

- Access to finance services for entrepreneurs lacking access to formal financing systems in terms of availability of requisite capital through convenient delivery channels, reasonability of financing terms & repayment conditions, involvement of collaterals, etc. This is generally ensured through Micro Finance Institutions (MFIs) in collaboration with i) commercial banks / financial institutions for raising credit and ii) Self Help Groups / NGOs for credit delivery.
- Access to market services that assist entrepreneurs in establishing direct contact with potential buyers for better price realization, especially applicable for MSMEs in rural areas, where knowledge, availability of resources, etc. restricts ability of MSMEs to identify and tap new markets for their products.
- Training and technical assistance that assists micro entrepreneurs in augmenting their skills and competencies in terms of adoption of updated technology & associated processes, identifying product diversification opportunities, accessing information for business expansion, etc.

The key best practices associated with micro enterprise development through increasing access to finance & markets, is given below, along with associated critical success factors.

Access to Finance: Deployment of innovative credit delivery mechanisms

Globally, loan disbursement for micro-enterprises / rural MSMEs has been primarily associated with traditional cheque-based disbursals. However, with the adoption of latest innovations in technology in the financial sector, it is now possible to shift to faster, more efficient and cost-effective mechanism for loan disbursement which also ensures customer comfort in terms of reduction of processing time & associated costs. Some of these innovations involve introduction of mobile phone based banking, mobile branch based banking and deployment of "prepaid cards" with pre-approved disbursement amount for distribution to respective MSMEs. However, cost associated with adoption of this technology-intensive innovation restricts its deployment on a large-scale by MFIs. In order to address this constraint, MFIs are increasingly collaborating with commercial banks / financial institutions for effectively delivering these services to the micro enterprises by leveraging the investments in infrastructure and technology already made by established banks / financial institutions. While it enables the MFIs in offering convenience of services to MSMEs without need to make substantial investments, it helps the partner banks / financial institutions in expanding their services to a new investor class without investing in physical branch expansion.

The best practices detailed later highlight the impact of i) mutually-beneficial partnership between a MFI and a commercial bank in deployment of innovative mechanism, i.e. prepaid cards, for loan disbursement to MSMEs in Mexico, ii) introduction of branchless banking in form of "mobile" branches, iii) introduction of branchless banking in form of "mobile phone" based banking and iv) derivative based products as collaterals with cash based settlement for working capital funding.

Access to Markets supplemented with capacity building support

Establishing linkages for MSMEs with large enterprises through supplier and sub-contracting relationships represents an important mechanism for deriving benefits associated with superior access to markets. MSMEs generally fit into the value chains[69] of large enterprises as peripheral suppliers to one or more links in the chain, usually as the second or third tier suppliers. In addition to establishment of dedicated linkages with large enterprises, these arrangements also ensure adoption of latest technology and processes by MSMEs in close collaboration with larger enterprises, which contributes to improved productivity and associated bottom-line impact.

The best practice details increase in access to markets leveraging access to information on markets to develop partnership between buyers and sellers, along with development of partnerships for underlying working capital finance.

[69]A value chain refers to the integration of various organizations, resources, and knowledge streams involved in the creation and delivery of value to end customers. For any given industry, the value chain represents the different stages of processing of inputs to generate either intermediate or final output for sale to customers. Each stage involves the addition of value in the form of goods and / or services.

9.1. Best Practice ME/RMSMED-1: Introduction of branchless banking through deployment of "prepaid cards" for purposes of loan disbursement

Foundation for International Community Assistance International (FINCA International) aimed at providing financial services to the world's lowest-income entrepreneurs with view of generating employment, asset development and improvement in standard of living. FINCA began operations in Mexico in 1989 and was serving around 116,738 active clients with around 63 offices in four regions and 20 states of Mexico. In line with its strategic plan of expanding into new markets while consolidating its position in existing markets, it was felt that FINCA had to focus on reducing operational costs and offer increased convenience & innovative products to clients. For purposes of implementation of this strategic plan, FINCA decided to adopt the card based loan disbursement mechanism vis-à-vis the existing cheque-based system with view of reducing operational costs and addressing client demand for reduction in disbursement time, processing costs, etc. Other key drivers for implementation of the "prepaid card" system have been highlighted in the adjoining box.

FINCA Mexico's Five Goals for Electronic Banking Cards

- Reduce operational costs avoiding the higher cost per disbursement of using cheques.
- Offer increased convenience to clients by enabling them to make transactions without a bank teller, thus avoiding delays and poor service. This was possible since ATMs in Mexico are numerous and readily accessible, even in remote areas.
- Provide increased flexibility and security to clients by enabling them to withdraw loan disbursements in multiple tranches, rather than in one lump sum, based on as-needed basis.
- Acquire a technological platform (the prepaid card) that could be applied to other new products, such as remittances and savings.
- Bring clients into the formal financial sector by introducing them to banking cards and regular use of banks.

Considering the associated investment in shifting from cheque-based system to card-based system, FINCA entered into a partnership with HSBC Mexico to offer "prepaid bank cards" for purposes of loan disbursement through its pilot project, viz. "Cheque Inteligente" prepaid card, in May 2009 in branches throughout 5 Mexican states.

The impact of the prepaid card can be gauged from the findings of a survey conducted within a week of its distribution, which revealed that 93% of the 205 clients who received cards planned to continue using the card as they not only saved valuable time by not having to travel to far-off bank branches and wait in bank queues, they also gained unlimited access to their loans 24 hours a day, seven days a week through a country-wide distribution network. It was also revealed from the survey that by using a prepaid card, the total cost in time & money for a rural client to access the fund reduces from USD 23.70 (₹ 1185) and 8 hours to just USD 1.05 (₹ 52) and 30 minutes; and the urban clients save about USD 1.15 (₹ 58) per loan.[70]

[70]Source:http://www.villagebanking.org/site/c.erKPI2PCIoE/b.5572107/k.7B7F/Case_Studies.htm

Further, the recent cost benefit analysis estimate of FINCA showed that the Mexican unit has experienced cost savings with prepaid card clients in either the fifth loan cycle (with the cost of training included) or the third loan cycle (without training costs). Based on the success of pilot testing, FINCA decided to offer the prepaid card to its entire customer base in Mexico.

The salient features of this best practice & associated critical success factors have been detailed in Table 55.

Table 55: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practice/Critical Success Factors
MEXICO: FINCA International[71]	1. FINCA, Mexico initiated a partnership with HSBC Mexico, to offer to its clients a customized prepaid card ***"Cheque Inteligente"*** that allows disbursement of loan at ATMs, merchant point of sale (POS) terminals and outlets that offers money transfer services. 2. Each prepaid card features FINCA Mexico's logo and colors and is personalized with the cardholder's name. The card has a memory chip on its surface that contains all information pertinent to the client's loan. 3. The prepaid card is electronically loaded with cash derived from a single pooled account managed by FINCA. 4. HSBC provides monthly card transaction reports to FINCA. FINCA holds a line of credit with HSBC and based on these reports, settles net transfers to and from its line of credit. 5. No commission is charged from the clients in case the fund is accessed from HSBC ATMs. However, if the fund is accessed from other ATMs or money transfer outlets, commission is charged.	1. Segmentation of potential customer base through market surveys to identify potential early adopters (those who lived far from bank branches, experienced long waiting queues, etc.), which served as base for pilot testing. Interventions were designed for pockets of resistance in form of training. 2. Design of product features in line with regulatory norms • Designed as a "prepaid" card vis-à-vis "debit" card" on account of prohibition of saving intermediation for non-banking MFI. • Ensured that client data need not be shared with partner bank; with certain exceptions on account of anti-money laundering & terrorist financing monitoring requirements, subject to restrictions on marketing usage by partner banks. 3. Design of product features in line with customer requirements • Personalization of cards in line with market study, reflecting client's association with the card as a "status symbol". • Extension of card's validity from 24 to 30 months, thereby reducing re-issuance fees for FINCA and increasing the chance of increased number of loan cycles per card, thereby recouping associated fixed costs. 4. Assessment of service providers in terms of i) their geographic footprint in same areas as FINCA clients, ii) reputation for service, iii) access to large electronic card networks in Mexico like Visa, to determine the potential partners.

[71]Source: USAID publication titled "Bank-Microfinance Alliances: FINCA's Pilot Program for Prepaid Cards in Mexico"

Country/ Organization	Case Study	Best Practice/Critical Success Factors
	6. FINCA operates a call centre Centro de Attention FINCA (CAF), which conducts surveys of clients with cards, and records incidents reported by clients and staff. 7. FINCA also developed a comprehensive set of training materials to teach clients how to use the cards. These included a model ATM for simulating transactions and printed wallet-sized guides with step-by-step instructions on how and where to use the cards. 8. FINCA used funds from a Visa Foundation grant to implement the new cards.	5. Development of business case in terms of benefits for partner banks like i) increased outreach with limited investment, ii) meeting sector-specific compliance requirements, iii) revenue source in terms of card activation fees, interest on loans disbursed, etc. • Proposed scale of operations were leveraged to reduce issuance cost per card from 20 to 16 pesos (from ₹ 72 to around ₹ 58) along with lower cost per transaction of 4 pesos vis-à-vis standard rate of 5 pesos. • FINCA offered to purchase the first 20,000 cards out of the estimated 60,000 cards to be issued in the pilot phase, in exchange for securing personalization of cards. 6. Implementation of requisite training schemes for own resources / potential clients to ensure i) internal staff are trained to facilitate implementation of prepaid cards on a pilot basis and ii) necessary knowledge / information is given to clients through brochures / guides / practical training on ATM simulators. 7. Regular monitoring and evaluation through a dedicated call centre in order to collect data related to the card. Data gathered from call centres along with transaction data from HSBC facilitated monitoring of efficiency of implementation and identification of intervention measures.

Implementation in the Indian context

Access to finance for micro enterprises / rural MSMEs is mainly restricted to micro credit delivered as small loans from the informal sector and select formal sector institutions like banks / financial institutions, etc. However, the presence of formal sector is limited due to lack of economies of scale on account of i) widely dispersed population of rural MSMEs and ii) underdeveloped infrastructure, which lead to higher transaction costs. This is corroborated from the fact that major around 75% all micro finance activity in the country is concentrated in only four southern states of Andhra Pradesh, Karnataka, Kerala and Tamil Nadu.

On account of the growing thrust of banks / financial institutions at "down scaling" in order to expand their service / product portfolio for MSMEs on account of underlying potential and regulatory norms, it is expected that there would be mutually beneficial partnerships between them and MFIs / NGOs / SHGs etc. in serving the MSMEs going forward. One of the key drivers for this partnership could involve adoption of technology available with these banks by MFIs in return for access to increased customer-base for these banks / financial institutions. This could involve introduction of "prepaid cards" for loan disbursement, based on the model adopted by FINCA and HSBC Mexico. However, this would depend on strengthening

of the ATM network in semi-urban and rural areas to facilitate easy access for MSMEs. It has been estimated that the number of ATMs in India would register a three-fold increase from existing levels to reach a figure of around 1.8 lakh ATMs by 2012[72]; with adoption of innovative models like "biometric based ATMs" to popularize its usage in rural areas. This could be supplemented with use of these cards at point of sales outlets of leading national telecom player, viz. BSNL, based on underlying agreement between the telecom player and the partner bank / FI in terms of cash to be maintained at such outlets for disbursement to MSMEs. Further, the reach of post offices could also be leveraged for implementing this "prepaid card" based loan disbursement model. With these key facilitators expected to be in place, an indicative roadmap for piloting prepaid cards in India to improve rural clients' access to financial services along with the respective roles of key stakeholders has been detailed in Table 56.

Table 56: Indicative Implementation Roadmap

Action Points
Conducting market study to quantify market demand for the "prepaid card" product for purposes of loan disbursement along with associated challenges, constraints and opportunities.
Developing appropriate product features to ensure consistency with i) feedback from market study and ii) regulatory requirements governing the functioning of MFIs.
Conducting a cost- benefit analysis in order to ascertain the viability of the introduction of card-based system.
Assessing potential partners in form of banks / financial institutions with requisite i) geographical reach, ii) technology, iii) service orientation for purposes of establishing tie-ups, if required, and conduct negotiations for launching "prepaid" card for loan disbursement.
Designing and implementing a pilot in select districts in a state; make adjustments based on evaluation of findings from pilot implementation and incorporate the same for state-wide and national roll-out. The state and national level roll-outs should not only leverage the existing channels for these "prepaid card" usage but also target deploying other innovative channels to increase the outreach. Card issuers like Visa / Mastercard, etc. could be tapped for sponsoring the card rollout as in case of FINCA Mexico.

It is expected that implementation of this best practice would take around 1.5 – 2.5 years, based on conducting feasibility study to assess the viability of introducing "prepaid cards" along with negotiation between respective banks / FIs and MFIs / NGOs/ SHGs. The key costs for the implementing bank / FI would include i) one-time cost associated with the feasibility study (expected to be around ₹ 30 – 50 Lakh) to assess market demand, ii) time costs associated with conducting detailed cost-benefit analysis followed by negotiations & formation of strategic alliances with respective MFIs / NGOs / SHGs and iii) negotiation on charges to be levied on end-users. Further, promotional expenses for information dissemination on the same (estimated to be around ₹ 50 Lakh, but would depend on target outreach levels) would also be incurred by the implementing bank / FI. The break-even levels would be determined by the value and volume of business obtained through such "prepaid cards" along with performance of such business portfolio.

[72]Source:http://reports.celent.com/PressReleases/20071126/ATMChinaIndia.htm

9.2. Best Practice ME/RMSMED-2: Facilitating branchless banking through "mobile branches"

Operating full-scale branches in rural/ remote areas is often uneconomical for banks/ FIs on account of lack of scale of operations to support the recovery of costs associated with setting up of a physical branch along with requisitely trained manpower. To overcome this bottleneck, banks/ FIs have been adopting innovative ways of offering branchless banking including operation of mobile branches. The branchless banking model of operations has been successfully adopted in various countries like Malawi, Singapore, etc.

Around 85% of Malawi's 13 mn population lives in rural areas wherein conventional banks do not have a physical presence. Opportunity International Bank of Malawi (OIBM) initiated a pilot project of bringing "mobile branch" based banking to these rural areas in an effort to meet the market demand avoiding the high costs of establishing numerous rural branch offices. Mobile branches are specially equipped vans or trucks fitted with basic infrastructure in terms of networks to ensure connectivity with central servers for real-time processing, biometric based automated teller machines (ATM), safe to carry cash, etc.

This pilot project was introduced in Malawi in the year 2005. As on September 2008, OIBM had a market share of 31.6% of micro loans outstanding and 52.2% of micro savings sector. One of the key reasons for the increased share of OIBM in the MSME deposit and lending business was the relative success of the "mobile branch" based banking pilot project. The details of the case study along with the corresponding best practices have been presented in Table 57.

Table 57: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Malawi: Opportunity International Bank of Malawi	1. Mobile vans equipped with requisite infrastructure operate on a circuit within 120 kilometers of a central operating point to bring financial services, such as loans and deposits, to rural areas. 2. The vehicles cover 26 service points in five districts on a weekly basis visiting designated market places on market days to ensure greater coverage. 3. Each van is manned by two bank employees who interact with the customers to create awareness regarding the products of the bank and assist customers in banking transactions through personalized solutions. 4. Each van has installed GPS tracking system and satellite technology linking the mobile van with the Bank's headquarters enabling real-time transaction processing; the vehicles are also fitted with ATM.	1. Mobile vans extend outreach to rural areas not served by fixed branches with visit to 26 points on designated market days where exposure is ensured to a wider audience. 2. Reduced investment requirement in terms of setting up of a dedicated branch which may not be economically feasible. Further, seasonal fluctuation of business associated with nature of operations of MSMEs in a particular region is negated through mobile branch based banking. 3. Vehicles travelling to remote locations relieve beneficiaries from travelling long distances to access banking facilities; it is estimated that residents had to travel long distances to visit the nearest bank branch prior to introduction of mobile van based branching.

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	5. To ensure safety of the mobile banking units, the vehicles are made bullet proof and are guarded by at least two armed Police Mobile Force guards. Further, they are provided with a safe to store cash, documents and other valuables. 6. The mobile banks build a clientele in rural areas by slowly increasing the frequency of visits to a particular area as the numbers of clients grow. Eventually, when a minimum threshold is reached, permanent "satellite branches" are developed which smaller branches are primarily offering only deposit and microloans. Usually, these "satellite branches" are established on achieving a threshold scale in MSME hubs.	4. Bank officials manning the mobile vans provide personalized solutions to the queries and requirements of customers. 5. Cost benefit analysis reveal highest return on capital for mobile vans in comparison to fixed bank branches or kiosks. 6. Assured scale of operations for the proposed "satellite branches" to secure break-even operations.

Implementation in the Indian context

The concept of mobile banking vans catering to remote and rural locations have been rolled out in India on a limited scale by few banks like State Bank of India and Bank of India. Private sector banks like ICICI Bank operate mobile vans in urban locations primarily to augment their ATM network wherein the bank is yet to be granted a branch license by the RBI. In line with the best practice detailed above, it is recommended that the following steps need to be taken for extending the reach of the banks to remote areas which are not served by any bank branch network in order to facilitate access to finance for respective MSMEs (Table 58).

Table 58: Indicative Implementation Roadmap

Action Points
As per RBI guidelines the mobile branches have to be attached to a branch of the Bank. Hence, requisite legal and regulatory enablers should be formulated to ensure that requisite branch licenses are granted to banks/ FIs establishing mobile branches to cater to MSME requirements.
Procuring vehicles and install satellite linkages/ GPRS to facilitate real time transaction processing.
Creating awareness among customers to develop customer confidence in branchless banking.
Finalizing visit schedule for the mobile van for each week and update local residents/ customers through various channels like advertisements, radio announcements, etc.
Leveraging prepaid cards proposed in best practice (Refer Best Practice H1) for cash transactions through ATM machines installed on these mobile vans.

It is expected that implementation of this best practice would take around 1 – 2 years, based on i) enactment of requisite regulatory provisions and addressing issues related to issue of mobile branch licenses and ii) customization of mobile branches with appropriate satellite linkages / GPRS, etc. The key costs for the implementing bank / FI would include i) procurement of vehicles with satellite linkages / GPRS (estimated to be around ₹ 0.8 - 1 Crore per vehicle, with actual expenses to be dependent on the facilities to be

offered through the mobile branches) and ii) promotional expenses for information dissemination on the same (estimated to be around ₹ 0.5 - 1 Crore for the initial pilot stage, with actual cost based on number of locations to be covered under the pilot stage along with target outreach levels). The break-even levels would be determined by the value and volume of business obtained through such mobile branches along with performance of such business portfolio.

9.3. Best Practice ME/RMSMED-3: Introduction of branchless banking through deployment of Mobile Banking for facilitating financial transaction

Mobile Banking (m-banking) has recently emerged as a potential delivery channel for bringing financial services to rural MSMEs, with lack of access to formal financial intermediation. The spread of cellular coverage in developing countries, along with the rapid growth in mobile phone subscribers has given rise to innovative m-banking programs, such as M-PESA in Kenya & Tanzania, G-Cash in Philippines, WIZZIT in South Africa, etc. The scope of services offered includes facilities to conduct bank transactions, administer accounts and access customized information. M-PESA in Kenya and G-Cash in Philippines have successfully used the Short Messaging Service (SMS) function of mobile phone to provide an innovative mode of “branchless banking”, backed with an agent network such as mobile phone vendors, airtime sellers, petrol pumps, retailers, etc. Leveraging the cellular technology backed with physical agent network, this m-banking model supports various types of transactions, including the following:

- Disbursement of loans to MSMEs along with payment collection, and
- Transfer of money among network participants, including provision for payment to suppliers by MSMEs (could be individual to individual or individual to business).

In 2005, Vodafone partnered with Safaricom, its local telecom affiliate in Kenya, to provide financial services over cell phone in Kenya. This service was named M-PESA, which is an online application designed to enable users to complete basic banking transactions without the need to visit a bank branch. The customer is not required to have a bank account, but has to register with a Safaricom agent for an M-PESA account. A M-PESA customer can use the mobile phone to move money quickly, securely, and across great distances, directly to another mobile phone user. The M-PESA service was piloted as a public-private venture with the UK Department for International Development providing funding, the Commercial Bank of Africa providing local banking services and interface to the regulatory system, and the microfinance organization (Faulu) providing local expertise. By 2009, M-PESA has gained 8.3 mn registered customers and of which the majority are deemed to be active, this corresponds to a penetration of 57% in Safaricom’s customer base and 21% of the entire population or 40% of adults. M-Pesa has also been launched in Tanzania by Vodacom, a subsidiary of Vodafone. In 2008, Afghanistan (known as M-Paisa) Vodafone partnered with Roshan, Afghanistan’s primary mobile operator, to provide M-Paisa, the local brand of the service. In September 2010, Vodacom and Nedbank announced the launch of the service in South Africa where it is estimated that there are more than 13 million “economically active” people without a bank account.

G-Cash has been successfully implemented in the Philippines and is an ideal channel for credit delivery to MSMEs lacking access to formal financial intermediation. In April 2005, Rural Bankers Association of Philippines (RBAP) and Microenterprise Access to Banking Services (MABS) Program partnered with G-Xchange Inc. (GXI), a leading telecom provider, to deliver banking services through GXI's mobile based financial service called G-Cash. G-Cash services are delivered with partners which include banks and distribution agents in form of utility companies & retailers along with support from Governmental bodies and non-profit organizations. GXI has around 1.1 mn G-Cash customers with 3,000 agents. The average transaction size is very low at USD 30 (₹ 1,500), reflecting its popularity among the lower income group.

Figure 15 depicts the modus of operation of the M-PESA model leveraging mobile banking. A similar operating model is also applicable for G-Cash services.

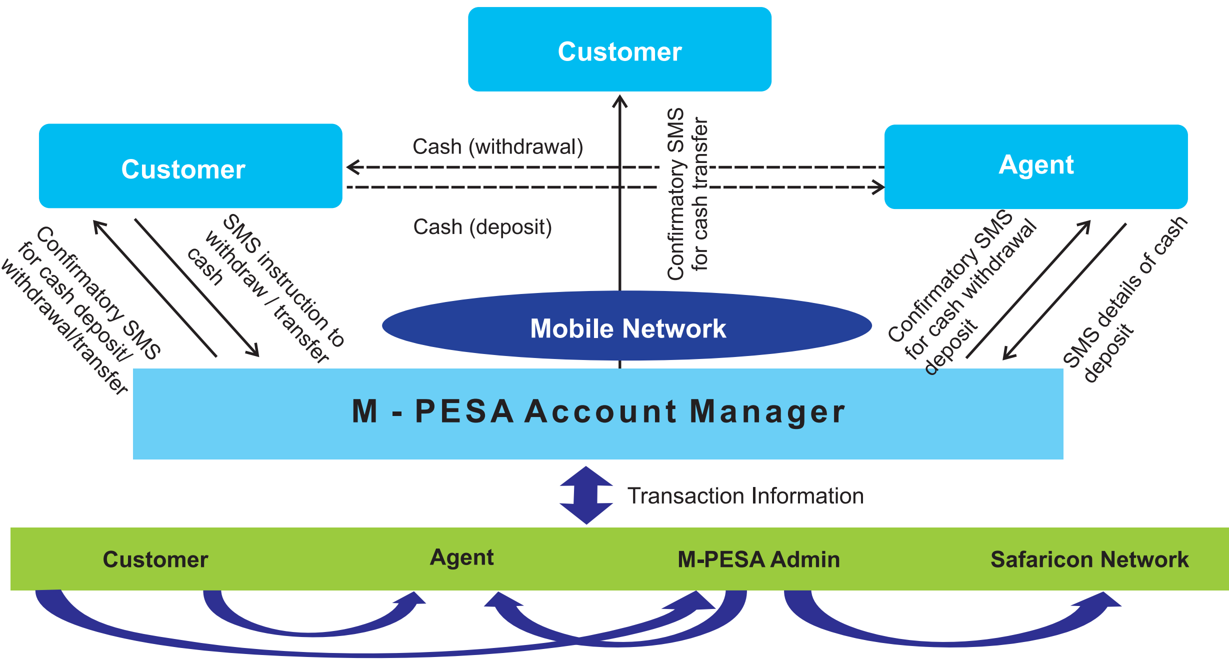


Figure 15 : Operating Model of M-PESA

The details of the case studies along with the corresponding best practices adopted in Kenya and Philippines have been presented under Table 59.

Table 59: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices / Critical Success Factors
Kenya: M-PESA program	1. Customer does not have a bank account; they register with Safaricom for an M-PESA account. Customers are provided with a unique account number and M-PESA PIN along with a special Safaricom SIM card customized to integrate with M-PESA application.	1. Banking services are provided in rural areas not served by any commercial bank.

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	2. Large and established network of Safaricom airtime dealer outlets serve as M-PESA agents. Further, the agent network has been expanded to include retailers / petrol stations, etc. 3. Each M-PESA agent buys M-PESA e-money by depositing real money into the M-PESA bank account maintained with the Commercial Bank of Africa; with the M-PESA users buying / selling the e-money against cash from the agents. 4. On deposit of physical cash by a M-PESA user at any of the M-PESA agent premises; e-money balance of the customer is updated with a SMS based confirmation of the same delivered to the depositor and the concerned M-PESA agent. 5. For purposes of cash withdrawal / transfer, respective M-PESA user sends instructions through SMS to the M-PESA online application. In case of cash withdrawal, the application intimates the concerned M-PESA agent along with the M-PESA user. In case of cash transfer, the application intimates the concerned M-PESA users along with the respective M-PESA agent – **the same is used for loan repayment / supplier payments / utility payments.** 6. All transactions have to validated by the unique account number and PIN; SMS is received by all the concerned stakeholders at the close of every transaction. 7. E-money held by any M-PESA agent matches with the real money held by the bank against respective M-PESA user accounts of the particular agent, based on daily cash settlement by M-PESA agent for transactions made by M-PESA users. 8. Transaction charges are levied at a nominal rate of less than 1 USD/ transaction.	2. M-PESA eliminates travel to distant bank branches for respective users. 3. Cashless transactions supported by M-PESA are more safe and secure for customers, especially with respect to carrying cash for deposit / withdrawn cash on account of significant distances between rural areas and physical branches. 4. M-PESA eliminates requirements of minimum balance for bank accounts, monthly fees and joining charges. 5. M-PESA provides simple, fast and efficient transaction processing with lower transaction costs. 6. As transactions can be completed at more convenient locations, the system has encouraged and enabled prompt and regular loan repayment (cash transfer to lenders), an outcome with clear benefits to the banking institutions.
Philippines: Microenterprise Access to Banking Services (MABS) Program *(Supported by USAID)*	1. G-Cash outlets are currently being utilized to facilitate banking transactions including deposit or withdrawal of cash by registered users. 2. Customers register with Globe Telecom by providing required personal details through SMS, with receipt of unique trace number. 3. Customers deposit money at G-Cash outlets along with respective forms & service fees (nominal charge of 1%). The G-Cash merchant verifies the identity through the unique trace number before processing the transaction. G-Cash balance of the customer is updated and SMS confirmation of the same is received by the customer as well as the concerned service outlet.	1. Card-less and cash-less micro payment over a mobile phone. 2. Large network of conveniently located merchants. 3. Eliminates travel to distant bank branches for respective users.

Country/ Organization	Case Study	Best Practices / Critical Success Factors
	4. For purposes of loan payment / supplier payment / utility payment / cash transfer, instructions are sent by SMS by the respective user with the unique mobile number of the corresponding lender / recipient. The fee charged for the same is 1 peso per transaction. Both the user and the lender receive confirmation of loan payment through SMS from the online application linked to cellular network. 5. All transactions have to validated by PIN of the customer; SMS is received by the concerned stakeholders at the close of every transaction with the corresponding trace number. 6. At the end of day, the G-Cash outlets deposit real cash in a settlement bank account (member of the G-Cash model) and obtains electronic cash of the corresponding amount.	4. Monitoring by Globe to comply with Anti-Money Laundering Act of Philippines. SIM cards are checked for multiple registrations to the service by same phone number, the same name or the SIM card. 5. MABS, together with Globe subsidiary G-Xchange Inc., conducts regular training-workshops for participating rural banks. 6. Reduced transaction costs for rural MSMEs.

Implementation in the Indian context

Access to finance for micro enterprises / rural MSMEs is mainly restricted to micro credit delivered as small loans from the informal sector and select formal sector institutions like banks / financial institutions, etc. However, the presence of formal sector is limited due to lack of economies of scale on account of i) widely dispersed population of rural MSMEs and ii) underdeveloped infrastructure, which lead to higher transaction costs.

The growing thrust of banks / financial institutions at “down scaling” in order to expand their service / product portfolio for MSMEs on account of underlying potential and regulatory norms, it is expected that there would be mutually beneficial partnerships between them and telecom operators to leverage m-banking for credit delivery to rural MSMEs. This could be supplemented by leveraging the extensive point of sales outlets of leading national & private telecom players, like BSNL, Airtel, Vodafone, etc. Further, the reach of post offices could also be leveraged in locations where the telecom players may not have their point of sales outlets. According to the Telecom Regulatory Authority of India (TRAI), there has been a rise of 18% in use of the mobiles by rural subscribers. Rising from 93.2 mn users at the end of last year, India today has a total of a massive 109.7 mn rural mobile subscribers. However, the greatest impediment to implementation of m-banking in India are the regulatory prohibitions which limits mobile banking to enquiries, alerts and bill payments only. A shift of stance to facilitate mobile banking has been observed in the recent RBI guidelines, which now allows transactional mobile banking to bank accounts/ credit card accounts in India which are Know Your Customer (KYC)/Anti Money Laundering (AML) compliant. An indicative roadmap for piloting m-banking in India leveraging physical network of telecom operators to improve rural clients’ access to financial services has been detailed in Table 60.

Table 60: Indicative Implementation Roadmap

Action Points
As per RBI regulations, banks can offer mobile based banking service only to their own customers. Hence, the scope of mobile banking in India should be widened through regulations to enable banks to offer mobile based banking services to any customer subject to compliance with KYC/ AML guidelines. The UID project may be leveraged to ensure compliance with KYC norms and also track credit history of MSMEs availing loans.
Addressing issues with respect to technology and security standards for financial transactions conducted using m-banking including assessment of ability to handle projected data flows, allocation of mobile PIN to authenticate, interface between bank & mobile operator, etc.
Conducting market study to quantify market demand for the "mobile banking" services for purposes of credit delivery along with associated challenges, constraints and opportunities.
Developing appropriate product features to ensure consistency with i) feedback from market study and ii) regulatory requirements governing the functioning of MFIs.
Conducting a cost- benefit analysis in order to ascertain the viability of the introduction of m-banking for financial transactions.
Assessing respective banks / financial institutions & telecom service providers with requisite i) geographical reach, ii) technology, iii) service orientation for purposes of establishing tie-ups, if required, and conduct negotiations for launching the required M-Banking service for credit delivery.
Designing and implementing a pilot in select districts in a state; make adjustments based on evaluation of findings from pilot implementation and incorporate the same for state-wide and national roll-out. Telecom partners like BSNL, Vodafone, Bharti, etc. could be tapped for providing the mobile banking services through their extensive agent networks. The state and national level roll-outs should not only leverage the existing channels for the "mobile" based banking but also target deploying other innovative channels to increase the outreach.
Information dissemination among concerned stakeholders as part of national roll out.

It is expected that implementation of this best practice would take around 1.5 – 2 years, based on i) enactment of requisite regulatory provisions and addressing issues related to technology and security standards associated with mobile banking and ii) conducting feasibility study to assess the viability of introducing mobile banking along with negotiation between respective banks / FIs and telecom companies. The key costs for the implementing bank / FI would include i) one-time cost associated with the feasibility study (expected to be around ₹ 30 – 50 Lakh) to assess market demand, ii) time costs associated with conducting detailed cost-benefit analysis followed by negotiations & formation of strategic alliances with respective telecom players and iii) fee-based mechanism negotiated with partner telecom company and its agents / network participants. Further, promotional expenses for information dissemination on the same (estimated to be around ₹ 50 Lakh, but would depend on target outreach level) would also be incurred by the implementing bank / FI. However, it should be noted that there may be some hidden costs associated with strengthening of existing infrastructure and systems to ensure i) compliance with regulatory technology & security mandates and ii) projected level of operations in terms of end-users. The break-even levels would be determined by the value and volume of business obtained through such mobile based banking along with performance of such business portfolio.

9.4. Best Practice ME/RMSMED-4: Working capital funding using derivatives-based financial instruments (“certificates of rural product”) as collateral with cash-based settlement

Agriculture is associated with underlying risks like i) production quality, ii) price volatility, iii) technical characteristics of productivity, iv) climate risk, etc. In order to address the risk associated with price volatility, forward and future contracts have been leveraged by producers in developed countries for hedging and also to serve as collateral to meet working capital requirements.

Certificate of rural products (“CPRs” – Cedulo de Producto Rural) were introduced in Brazil in 1994 with issue of financial instruments in nature of derivatives by rural farmers / associations / cooperatives in order to obtain financing for production. The physical CPR was designed and operated much like a forward contract, with the exception that payment for the goods is made when the certificate is issued, not at delivery. The producer received cash / inputs upon the issuance of certificate for facilitating production, with the obligation to deliver an agreed amount of production at an agreed location and future date. This obligation secured through legal protection served as the underlying collateral for the lender, resulting in higher level of participation from various banks / financial institutions. The CPR model has been presented in Figure 16.

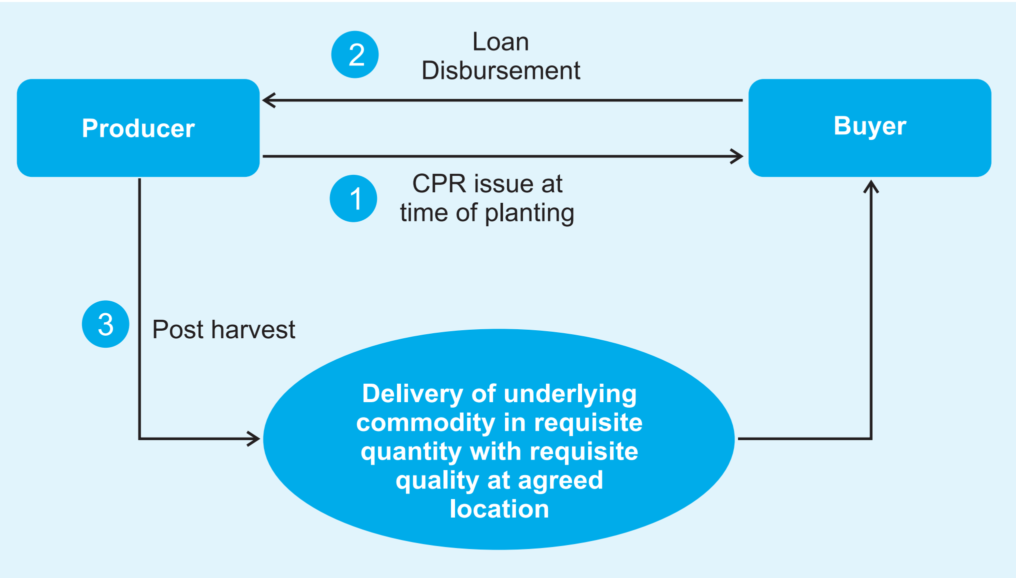


Figure 16 : Operating Model for "Certificate of Rural Products"

However, the physical delivery of the product posed a challenge for lenders, in case of failure to identify a buyer for the produce at a reasonable price. In order to address the same, a financial form of CPR was introduced with cash based settlement through adoption of requisite legal norms in 2000. The “settlement price” was fixed and was to be calculated as follows:

$$\textbf{Repayment Value} = \textbf{(Value of CPR)} * \textbf{(1+ Annual interest rate)}^{\text{CPR's duration (in days) / 252}}$$

Another variant of this “financial” CPR was developed by linking the settlement price of the contract, based on indexation to futures market, either local or a reference foreign future market.

With the adoption of cash-based settlement mechanism, a lot of banks / FIs like the Bank of Brazil have advanced working capital leveraging these derivatives as collaterals. Over a 10 year period, around

130,000 CPR contracts were negotiated through the formal banking system which financed more than USD 2.5 bn (₹ 125 bn) for various agricultural commodities, including livestock. Further, online posting and trading of these CPRs have been introduced on the Brazilian Commodity Exchange, allowing participation of retail & institutional investors in this asset class based on guarantees extended by the Bank of Brazil. Nearly 70,000 contracts had been registered with financial volume of around USD 0.9 bn (₹ 45 bn), within less than an year of operation of the exchange[73]. The current model in terms of CPRs with cash-based settlement has been presented in Figure 17.

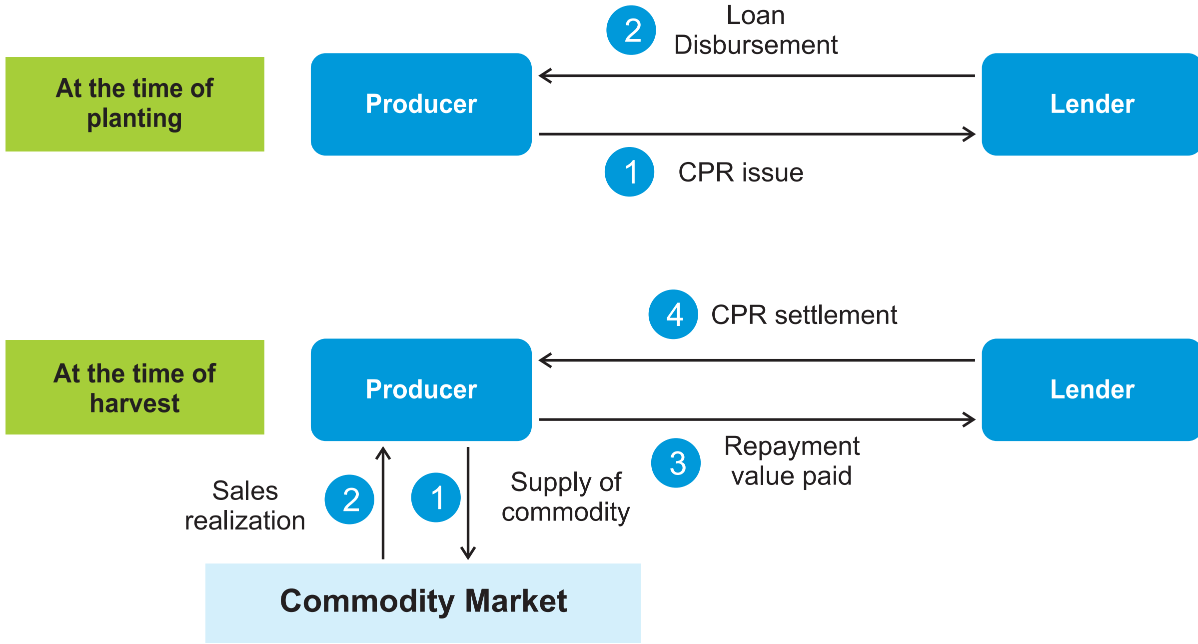


Figure 17: Operating Model for cash-based settlement of CPRs

The salient features of this best practice & associated critical success factors have been detailed in Table 61.

Table 61: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices /Critical Success Factors
Brazil: Bank of Brazil and various other banks / financial institutions	1. Producer enters into a contract with lender to provide liquidation proceeds of its production, negotiated in terms of quantity, quality, place and stipulated date. Lender advances credit in cash or kind (inputs required by producer) on basis of the above contract to meet working capital requirement of producer at time of signing the contract, typically at time of planting.	1. Provision for cash-based settlement for lender, without need to take delivery of underlying asset.

[73]Source: Publication titled "What is CPR and its importance to the Brazilian Agriculture Finance"

Country/ Organization	Case Study	Best Practices /Critical Success Factors
	2. Reference price for the contract is either i) fixed upfront based on a legally accepted formula or ii) linked to local or foreign futures market reference price or that calculated and published by a reliable source like a university. 3. On account of the risk associated with crop failure, absence of crop insurance, etc; lenders charge an interest rate higher than normal market rates. 4. Post harvest, producer has to repay the lender, based on the underlying reference price and other details as per the respective contract. 5. CPRs are permitted to be transferred to third parties through endorsement. 6. CPRs may also be negotiated in the secondary market, as a financial asset, before its expiration date. 7. CPRs have to registered with the Registrar of Deeds Office together with the registration number of the property where the crop was planted; with information on settlement of CPR to be compulsorily passed on to the Registrar.	2. Flexibility in terms of sharing of market price risk by producer / lender. In case of cash-based settlement without indexation to future market reference price, the repayment value is fixed upfront which transfers the pricing risk to producer. However, in case of future market linked reference price, price risk remains with the lender. 3. Legal and regulatory enablers to facilitate "out of court" settlement for contracts in case of non-performance or breach of contract. It reduced recovery time. 4. Development of capital markets, including commodity exchange, to deepen the market for trading of these agriculture commodity linked CPRs, based on provision for endorsement / negotiation of CPRs. 5. Monitoring of number of CPRs issued on a particular property through registry with Registrar of Deeds Office, thereby reducing risk of default to creditors. The information for the same was made available with National Institute of Colonization & Land Reform.

Implementation in the Indian context

Starting with only 8 commodities permitted for future trading in 2000, there has been a significant increase in the futures commodities market in India translating to trading of around 80 commodities by June 2004. This has been made possible with the policy of economic liberalization adopted by the country in early 1990s, which has contributed to setting up of multiple electronic exchanges for derivative based trading of commodities. Now in India there are 25 commodities exchanges for trading of various commodities. Out of these, commodity exchanges MCX, NCDEX and NMCEIL are the major Commodity Exchanges. Hence, these exchanges can be leveraged by producers to enter into contracts with banks / financial institutions like the CPRs for availing working capital funding and leveraging the exchange for trading the respective CPRs. However, further steps need to be considered for increasing credit flow from banks / financial institutions in form of working capital requirement leveraging products like CPRs as the underlying collateral in agribusiness value chains. An indicative roadmap for facilitating the same has been presented in Table 62.

Table 62 : Indicative Implementation Roadmap

Action Points
Information dissemination to producers, farmer associations and cooperatives about the potential of leveraging products like CPRs for purposes of working capital financing.
Developing products like CPR with cash-based settlement option for i) fixed price settlement based on a pre-approved formula or ii) floating price settlement based on linkage to reference rate in benchmark market.
Ensuring subscription to these CPRs by banks, financial institutions, other institutional investors, etc. through implementation of requisite legal / regulatory enablers and tax incentives, etc.
Developing secondary markets for trading of products like CPRs, backed with underlying guarantee.
Developing provision for registration of CPRs and updation of information on settlement of the same.
Formulating requisite Legal and Regulatory enablers relating to: ● Provision for out-of-court settlement. ● Permissibility of endorsement of CPRs to third parties / negotiation prior to expiration. ● Making provision of crop insurance mandatory for producer to reduce underlying risk to lender.

It is expected that implementation of this best practice would take around 1-1.5 years, based on development of derivative based products along with development of secondary market for trading of the same. The key costs for the implementing bank / FI would include i) time-costs associated with product development and ii) promotional expenses for information dissemination on the same (estimated to be around ₹ 50 Lakh, but would depend on target outreach levels). However, this would be dependent on development of a secondary market through effective liaisoning with capital market development agencies.

9.5. Best Practice ME/RMSMED-5: Leveraging access to information on markets to develop partnership between buyers and sellers, along with development of partnerships for underlying working capital finance

Pride Africa is a financial institution providing access to credit to more than 80,000 MSMEs in the African countries like Kenya, Malawi, Tanzania, Uganda and Zambia. It has piloted a project, viz. DrumNet, which is a virtual information and service network linking MSMEs to markets & financing through information dissemination. The products / services offered through this project have been summarized in the Figure 18.

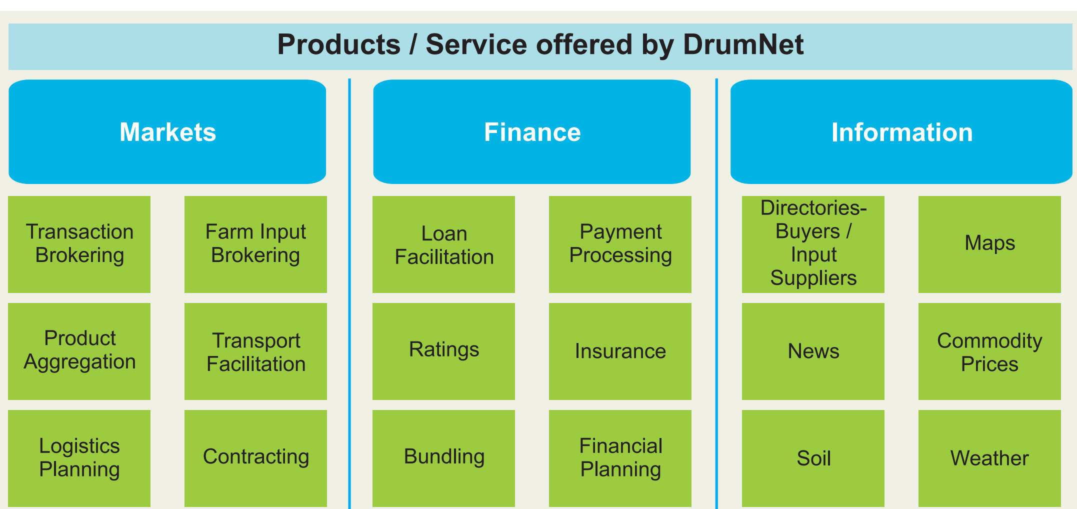


Figure 18: Products / services offered by DrumNet

DrumNet was formed to address the following key issues faced by rural MSMEs:

- Rural-based producers: Lack of access to information on markets and access to finance.
- Lenders (Banks / FIs): Incurrence of high transaction costs and default rates on lending to rural MSMEs.
- Buyers: Higher transaction cost associated with dealings with numerous small producers along with higher quality management related costs, etc.
- Suppliers: Reliance on credit-based procurement constrained their limited resources.

These key stakeholders were integrated through the DrumNet project to ensure that the benefit of information on access to markets and availability of financing leads to development of rural MSMEs. The key service provided to rural producers was information on potential export markets for their produce through on-field Transaction Agents (TAs) and leveraging IT platform of the DrumNet network along with its compatibility with the internet, mobile phone networks (calls and short messaging service) and other wireless devices. Further, sourcing support was provided in terms of securing export contracts on behalf of member producers, followed by access to finance to meet input requirements.

For purposes of facilitating the advancement of credit, rural producers were enrolled as co-guaranteed solidarity groups with initial contribution to a Savings Deposit account (Transaction Insurance Fund (TIF)) to serve as collateral for the initial line of credit. Subsequently, past credit history and the balances maintained in savings deposit account served as the basis for advancing credit. Adherence to strict export-related quality norms were ensured through i) capacity building support administered through on-field TAs and ii) limitation of procurement from empanelled list of suppliers only. Figure 19 presents the key interaction points among the concerned stakeholders in the virtual network.

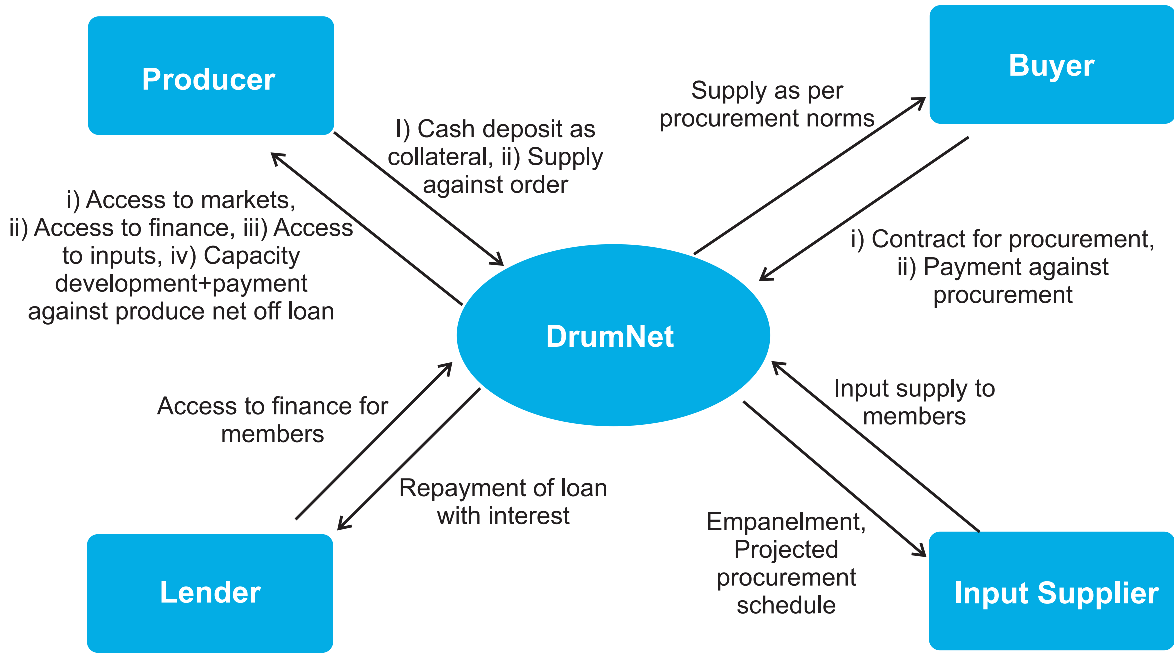


Figure 19: Key interaction points in DrumNet model

The impact of this programme can be assessed from the fact that since inception in October 2003, DrumNet has facilitated more than 7,700 marketing transactions on behalf of around 650 members, generating more than USD 40,000 (₹ 2,000,000) till April 2005. This represented more than 75 MT of produce supply from producers to large buyers in Africa. Further, DrumNet had provided credit in form of reimbursement of around USD 16,250 (₹ 812,500) to input providers with member contributions to Transaction Insurance Fund (TIF) growing to around USD 5,000[74] (₹ 250,000).

The salient features of this best practice & associated critical success factors have been detailed in Table 63.

Table 63: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practices /Critical Success Factors
Kenya & other African countries: Pride Africa - DrumNet[75]	1. Information on potential export orders is disseminated to member producers leveraging the i) IT platform & associated linked wireless devices and ii) on-field TAs along with feedback on interest in securing the contract. This includes access to updated online directory with details for potential buyers. 2. Export orders are negotiated and secured by DrumNet on behalf of member producers. Focus on export orders ensures higher realization vis-à-vis local orders (estimated at around 10-15%). 3. Based on initial level of contribution to TIF, credit is extended to respective producers through line of credit extended by participating bank / FI to DrumNet. 4. Credit is utilized for procurement of requisite inputs from empanelled suppliers. Payment is made to input suppliers from line of credit extended to DrumNet by bank / FI in 2 week cycles, post submission of receipts using mobile interface to online DrumNet platform. 5. Technical assistance is offered by TAs to producers to ensure production is in line with required quality norms.	1. Access to information on potential export markets to member producers, delivered leveraging technology interventions like SMS, etc. to improve responsiveness. 2. Reduction in transaction cost for lender in terms of extending single line of credit to DrumNet, vis-à-vis extending multiple lines to each member producer. 3. Lender assured of regular principal and interest repayment from DrumNet, thereby reducing collection related charges. 4. On account of lending based on negotiated contracts between large buyers and members of DrumNet, lenders minimize chance of loan default. 5. Continuous technical assistance from TAs appointed by DrumNet and limitation of procurement from empanelled list of suppliers, ensures production meets quality norms, thereby reducing rejection levels faced by member producers. Serves as additional comfort to lenders in terms of reduction of chances of default / non-acceptance of production.

[74]Source: World Bank publication on “Rural Finance Innovations – Topics and Case Studies”

[75]Source: World Bank publication on “Rural Finance Innovations – Topics and Case Studies”, website of Pride Africa (http://www.drumnet.org) and Presentation on “DrumNet – Financing the Agricultural Value Supply Chain” on http://www.ruralfinance.org

Country/ Organization	Case Study	Best Practices /Critical Success Factors
	6. Information on market trends, weather updates, etc. are provided to member producers leveraging the IT platform and its linkage with various wireless devices. 7. Exporter is kept updated on the progress made in fulfilling their orders in terms of area of plantation, monitoring progress over crop cycle, etc. with any feedback for producers also communicated back leveraging IT platform. 8. At time of harvest, transfer of finished produce to DrumNet's collection centres is ensured through logistics planning and transportation facilitation. 9. On aggregation of supply from producers at designated collection centres of DrumNet, the same is delivered to exporter. Monitoring of collection vis-à-vis expected supply is also supported by the IT platform for visibility and transparency in information. 10. On receipt of payment from buyer against supply, loan repayment amount is deducted along with service fee charged by DrumNet from reimbursement to producer. All payment processing associated with the transaction is done leveraging the IT platform. 11. Producers are encouraged to deposit their surplus cash in TIF accounts, which serves as the basis for credit advancement to respective producer. Further, credit history of respective producer is monitored using the online application.	6. Preference is given to lender over producer in terms of recovery of proceeds from sale of production. 7. Emphasis on linking savings performance to access to credit serves as additional guarantee to lenders, with monitoring & evaluation of credit history of respective borrower through online system facilitating decision making and reducing chances of default. 8. On account of single interface for the buyer in form of DrumNet and its TAs vis-à-vis individual producers, transaction costs are reduced for buyer. Further, reliability on quality of product and timely availability of the same is assured. 9. Input suppliers / stockists have access to new customers and no longer need to bundle credit services with products.

Implementation in the Indian context

Access to information on potential markets for micro enterprises / rural MSMEs is one of the key constraints impacting their development and resulting in exploitation by middlemen providing in-kind credit and offering low prices for their produce. However, access to finance in order to fulfill orders secured from organized buyers would be an additional constraint considering the limited presence of formal sector banking mechanism due to lack of economies of scale on account of i) widely dispersed population of rural MSMEs and ii) underdeveloped infrastructure, which lead to higher transaction costs.

However, on account of the growing thrust of banks / financial institutions at "down scaling" in order to expand their service / product portfolio for MSMEs on account of underlying potential and regulatory norms, it is expected that there would be a need to establish mutually beneficial partnerships in collaboration with other supply chain partners. These partnerships could be established leveraging the adoption of a virtual platform like the one developed through the DrumNet project by the banks / financial institutions to increase their outreach in a profitable manner. In this context, an indicative roadmap for piloting the virtual linkage of supply chain members in India to improve rural clients' access to information on markets & financial services along with the respective roles of key stakeholders has been detailed in Table 64.

Table 64: Indicative Implementation Roadmap

Action Points
Developing an IT platform in line with DrumNet features, detailed above, with linkage through email, mobile phones, SMS, etc. for relevant information dissemination to all concerned stakeholders. IT platform to take care of payment processing involving all concerned stakeholders, through linkage with secured online authentication networks.
Identifying on-field partners for securing linkages with potential large-scale buyers & providing technical assistance to producers, along with development of incentive mechanism for the same.
Empanelling input suppliers / stockiest for purposes of quality control, along with negotiation on credit period to be extended by them.
Organizing member producers into co-guaranteed groups, to ensure group monitoring of utilization of credit & access to group guarantee.
Developing a Savings Deposit account with the balance in the same functioning as underlying collateral for line of credit extended to the group.
Training member producers on various advantages of increasing deposits in their respective accounts, with underlying access to credit dependent on balance in account along with past credit history.
Facilitating collection, transport and dispatch to respective buyer, in line with purchase order terms.

It is expected that implementation of this best practice would take around 1 - 2.5 years, based on development of IT platform based on DrumNet model, post identification of IT vendor, along with forging of partnerships with on-field partners and training to end-users in form of MSMEs. The key costs for the implementing bank / FI would include i) investment in development of IT platform based on DrumNet model (estimated to be at least ₹ 2 - 4 Crore on a one-time basis with recurring maintenance support of ₹ 0.4- 0.8 Crore on an annual basis for a pilot on a district basis, with actual expenses dependent

on the number of participants and volume of transactions to be supported through this model) based on proposed scale of operations with the break-even levels dictated by the number of participants in this virtual network, ii) promotional expenses for information dissemination on the same (estimated to be another ₹ 30-50 Lakh, but would depend on target outreach levels) and iii) training of end-users (to be based on the number of users registering for the facility).

CHAPTER 10

CREDIT ADVISORY

Highlights

- From a lender's perspective, refers to services associated with conducting the credit appraisal to ascertain the underlying repayment ability of borrower in order to decide on whether to lend or not
- In the MSME context, associated with lack of information availability in terms of access to past credit history, well-documented financial statements in terms of cash flows, profit & loss accounts, etc.

Theme Description & Benefits to MSMEs

Credit advisory is a high-end consultancy service in form of technical assistance to the prospective lender (banks / FIs) in conducting credit appraisal of any project / individual / organization to ascertain the viability of lending funds to the same. This forms the basis for the decision to advance credit to any particular project / individual / organization along with the associated terms and conditions in terms of tenor of loan, interest rate, moratorium, underlying collateral, etc. These services are based on standard tools & methodologies in terms of assessment of underlying credit risk through i) business due diligence in terms of operating plan, financial projections and management ability, ii) industry research to identify key trends, risks, potential market share, etc., iii) fraud and forensic investigations, iv) appraisals of offered collaterals, etc.

However, as noted above, a customized approach may be necessitated in case of MSMEs on account of absence / lack of information on a number of parameters listed above. For MSMEs, credit advisors tend to focus on available financial information, valuation of underlying collateral, host of qualitative parameters in terms of past credit history, management experience, supplier & customer linkages, etc.

Benefits to MSMEs from access to credit advisory

Obtaining of credit rating through credit appraisals facilitates access to credit from banks / FIs in line with perceived risk for MSMEs. Once the MSMEs get the rating from the credit advisors, they enjoy the benefit of permanent accreditation for taking loan from banks/ FIs at any point of time, after factoring in any changes to ratings on account of operational parameters.

10.1. Best Practice 1: Leveraging credit advisory expertise to establish partnership with localized financial institutions to increase outreach

Smaller financial institutions having better localized access to MSMEs through local presence / outreach suffer from absence of staff with requisite underwriting expertise to offer credit advisory services for their borrowers. Further, the cost of developing staff with these requisite skills and retaining them may be prohibitive. Hence, they typically depend on larger and established banks / FIs to provide credit advisory services.

Accion USA is an affiliate of Accion International, a global microfinance and microlending organization, with limited physical network in the US comprising only 3 branches. On account of the limited physical outreach, it depended on developing partnerships with smaller FIs to increase its outreach in all parts of US and Puerto Rico to target hitherto inaccessible MSMEs. It leveraged on the lack of expertise of smaller FIs like local credit unions in conducting credit appraisal along with limited credit disbursement ability to offer its credit advisory services to MFIs. Based on findings from credit appraisal, it either extended credit to these MSMEs with reference fee paid to credit union for bringing in the MSME to Accion USA or provided an option to participating credit unions to buy back the loan.

A specific example of this partnership was that entered into with HOPE community credit union to provide support to people affected by the Hurricane Katrina. This partnership disbursed around 50 loans to MSMEs totaling to around USD 0.4 mn (₹ 20 mn) in 1.5 years in Louisiana and Mississippi. The total exposure of Accion USA encompasses around 18,500 microloans since inception in 1991, valued at around USD 117 mn.[76] (₹ 5,850 mn).

The details of the identified case study along with the corresponding best practices adopted in the US have been presented in Table 65.

Table 65: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practice/Critical Success Factors
USA: ACCION USA[77]	1. Formation of a partnership with the Credit Union, with a dedicated marketing & public relations resource from ACCION USA interacting with the respective credit union staff on ground to generate interest among MSMEs.	1. Partnerships with credit unions helps Accion increase its geographical outreach to access MSMEs without any need to invest in physical infrastructure in the respective geographies.

[76]Source: www.cdcu.coop/files/public/D2_ASPullas_6-13-08.pdf: Presentation on Accion USA Micro Loan Program for Small Businesses: Partnerships at work and http://www.accionusa.org

[77]Source: www.cdcu.coop/files/public/D2_ASPullas_6-13-08.pdf: Presentation on Accion USA Micro Loan Program for Small Businesses: Partnerships at work

Country/ Organization	Case Study	Best Practice/Critical Success Factors
	2. Submission of credit disbursement requests from member MSMEs by credit unions to Accion, with pre-screening done by credit union based on soft data available to them on account of existing relationships. 3. Loan Officer from Accion conducts interview of concerned MSME and ensures requisite information required as per standard forms available in online credit appraisal application is filled in appropriately, in collaboration with referring credit union representatives. Credit appraisal based on the following: i) loan purpose, ii) cash flow and / or financial projections, iii) experience in respective business, iv) quality of business plan, v) past credit history information, vi) quality of collateral / guarantee offered, etc. 4. Based on credit appraisal, disbursement amount and terms & conditions of loan are decided. 5. The same may be extended by Accion or the referring credit union. In case of credit union deciding to advance the same, Accion charges a credit advisory fee for packaging the loan, decided on a case-to-case basis. In case of Accion extending the loan, a referral fee is paid to the credit union based on value of loan.	2. Partnership allows credit unions to leverage the underwriting expertise credit advisory expertise of Accion while generating referral fee based income. Option exists for buying back the loan from Accion with payment of a fee to Accion for packaging the loan after conducting the credit appraisal. 3. Saving in administrative cost to credit unions as they don't have to incur cost of developing staff and underwriting expertise, loan systems, processing and documentation for MSMEs. 4. Faster processing and disbursement of loan to MSMEs.

Implementation in the Indian context

Access to finance for MSMEs is mainly restricted to micro credit delivered as small loans from the informal sector and select formal sector institutions like banks / financial institutions, etc. However, the presence of formal sector is limited due to lack of economies of scale on account of i) widely dispersed population of MSMEs and ii) underdeveloped infrastructure, which lead to higher transaction costs. In view of the same, there is a significant potential for proposed "downscaling" by private sector banks / FIs to tap the financing requirements of MSMEs, subject to ability to increase outreach with minimum investments in physical infrastructure.

Select initiatives taken by banks / FIs in India with respect to downscaling include those taken by leading private sector banks like ICICI Bank and HDFC Bank in partnership with MFIs / SHGs / NGOs. ICICI Bank has been the pioneer in India with respect to its attempts ate downscaling leveraging these partnerships, which have involved the following three models[78] :

- Linkage with SHGs wherein ICICI Bank lends directly to the SHGs which are typically promoted by NGOs. The entire credit risk is borne by ICICI Bank with no recourse to SHG promoters resulting in limited incentive for these promoters to generate good quality loan portfolio. Under this model, the SHG promoters typically play the role of loan portfolio supervisor after linking the SHG with the bank.

- Financial intermediation role played by MFIs, with receipt of funds from the bank for on-lending to MSMEs. This has helped banks limit the need to develop physical infrastructure to increase its outreach and also ensured source of funds for MFIs in absence of ability to raise deposits. However, risk capital allocation happens at the end of both the bank and the MFI, which impacts the end-pricing to MSMEs. On account of credit risk being borne by MFIs, they have a strong incentive to monitor loan portfolio performance.

- Partnership model with the bank executing loan contract directly with MSME borrowers, based primarily on leads provided by MFIs. These MFIs then assume responsibility for monitoring of loan portfolio against fee-based payment mechanism; with requirement of providing a guarantee in form of first-loss default guarantee (upto 10-20% of loan portfolio). The bank accepts a fixed pay-off in form of interest income, with sharing of performance based benefits / losses with the partner MFIs.

As part of these downscaling models, ICICI Bank is working with more than 30 Indian MFIs with loan outstanding of around USD 150 million (₹ 750 Crore) as on March,2005. Similarly, HDFC Bank has also partnered with 104 MFIs and 203 NGO and extended credit facilities exceeding ₹ 700 Crore, covering 17 states and financially included 2 million households[79]. Among the public sector banks, Canara Bank has till now formed 2.89 lakh SHGs and linked 2.43 lakh SHGs to credit since inception. Besides benefitting over 3 lakh women through over 150 MFIs, SIDBI has also , under MSMEFDP support, initiated through its SIDBI Foundation for Micro Credit a downscaling project wherein Micro enterprise loans (MELs) will be extended through its own dedicated offices (who have already been extending MELs) as also MFI network. Simultaneously it has entered into collaboration with the Asian Development Bank for a funding support of USD 50 million for upscaling micro finance and micro enterprise lending. The project aims at bridging the gap between the demand and supply of financial services for the enterprises that have become too large to tap traditional microfinance but are unable to access conventional bank funds – the so called 'missing middle sector' of MSMEs.

[78]Source : http://www4.gsb.columbia.edu/null/download?&exclusive=filemgr.download&file_id=646440 : Document titled "Financing Microfinance – the ICICI Bank partnership model" by Bindu Ananth published in Small Enterprise Development Vol 16 No1 (March 2005)

[79]Source: HDFC Bank's annual report for FY 09

Another popular downscaling technique followed by Indian commercial banking sector is off-balance sheet funding like securitization of micro loan. Under this model, banks provides term loan to the MFIs, for originating micro loan which the commercial bank buy back from MFIs. In these transactions, MFI typically takes a first loss position in the portfolio sold, ranging from 3% to 8%, while continuing to service the portfolio post securitization. Some of the banks involved with implementation of this model include ICICI Bank, Dhanalakhsmi Bank and Axis Bank.

An indicative roadmap for increasing outreach by leveraging credit advisory expertise through mutually beneficial partnerships with localized financial institutions has been detailed in Table 66.

Table 66: Indicative Implementation Roadmap

Action Points
Identifying potential partners in form of SHGs / NGOs / co-operative banks / MFIs, cluster development agents, etc. to increase outreach to MSMEs without requirement to invest in physical infrastructure.
Developing incentives for potential partners, identified as above, in form of i) referral fee linked to underlying performance of borrowers referred, ii) ability to provide loan from its books by payment of structuring and advisory fee.
Disseminating information on need for getting credit rating for purposes of access to credit.
Developing standard template for collection of information required for conducting credit appraisal.
Developing in-house underwriting skill for MSME credit appraisal.

A representative flow chart has been presented below to highlight the steps involved in leveraging credit advisory expertise to establish partnership with localized financial institutions to increase outreach, along with the roles of the associated stakeholders.

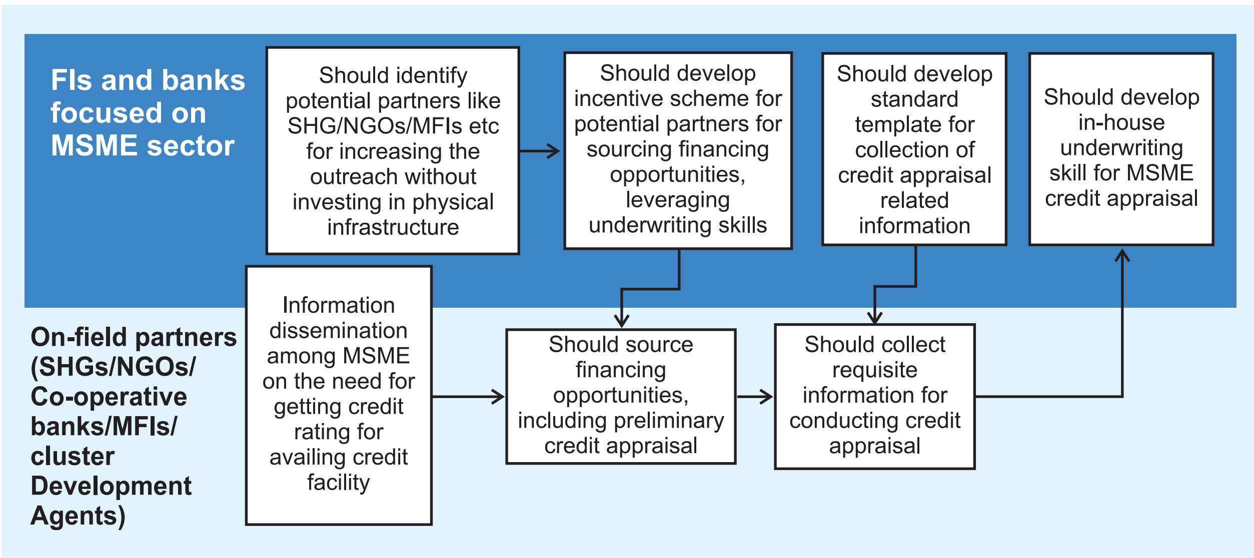


Figure 20: Indicative Flow Chart

It is expected that implementation of this best practice would take around 6 months – 1.25 years, based on identification of potential partners by respective banks / FIs along with negotiation on incentive structure. The key costs for the implementing bank / FI would include limited investment in development of MSME credit appraisal skills for its own staff based on proposed scale of operations. The margins would be dictated by the negotiation on respective incentive structure with potential partners.

CHAPTER 11

FOREX / INTERNATIONAL FUNDING

Highlights

- Given the size and scale of operations of MSMEs and limited expertise to deal with foreign exchange (forex) risks, exposure to foreign risk can erode capital base of the firm and impact operations significantly.
- Availing input financing in foreign-denominated currency for purposes of import of requisite goods / services; need for hedging against adverse movement of local currency vis-à-vis foreign-denominated currency.
- Need for managing foreign currency risk associated with receipt of payments in foreign-denominated currency for goods / services provided.
- Hedging could involve deployment of products like forward / future contracts, options, currency swaps etc.

Theme Description & Benefits to MSMEs

On account of the underlying nature of operations of MSMEs, they can be exposed to foreign currency payments / settlements in the following two scenarios:

- Need to pay in foreign currency for importing any services / goods in form of raw materials, plant & machinery, etc. This exposes MSMEs to forex risks on account of need to make payments in foreign currency; while the revenue streams accrue primarily in local currency.
- Realization from sale of finished goods / services rendered in a currency other than local currency, primarily on account of exports. This again exposes the MSMEs to forex risks on account of need to convert the foreign currency received to the local currency along with the issue of timing of receipt & conversion of the foreign currency along with the respective currency conversion rates.

This leads to underlying forex risk which may impact the profitability and capital base of MSMEs on account of limited expertise of these MSMEs to address the same on their own. Further, the scale of forex exposure of these MSMEs may prevent them from ensuring hedging against forex risk on account of higher transaction costs charged by domestic lenders. Additionally, the domestic sources of finance

typically insist on collateral based lending for these MSMEs, which constrains the ability of these MSMEs to access finance economically. The best practices detailed in this section relates to availing local currency loan from domestic lender against a foreign deposit raised from a foreign lender with transfer of forex risk to the domestic lender.

11.1. Best Practice F/IF-1: Loan against foreign currency deposit to hedge the foreign exchange fluctuation risk

Some of the key reasons for the potential borrowers in the developing countries to raise fund from the overseas market include i) lack of availability of financial resources in the local market, ii) tenors in the local market being relatively shorter, or iii) borrowing offshore offers lower interest rates. Hence the MFIs like other borrowers also seek to secure foreign currency borrowing. However, on account of exchange fluctuation risk which MFIs may not be able to hedge them economically on account of scale of operation, they either depend on the foreign lenders to hedge it or they can use a foreign currency loan as a security deposit for availing a local currency loan from domestic banks. The mechanism for same has been detailed in the Figure 21, highlighting the cash flow in respective currencies.

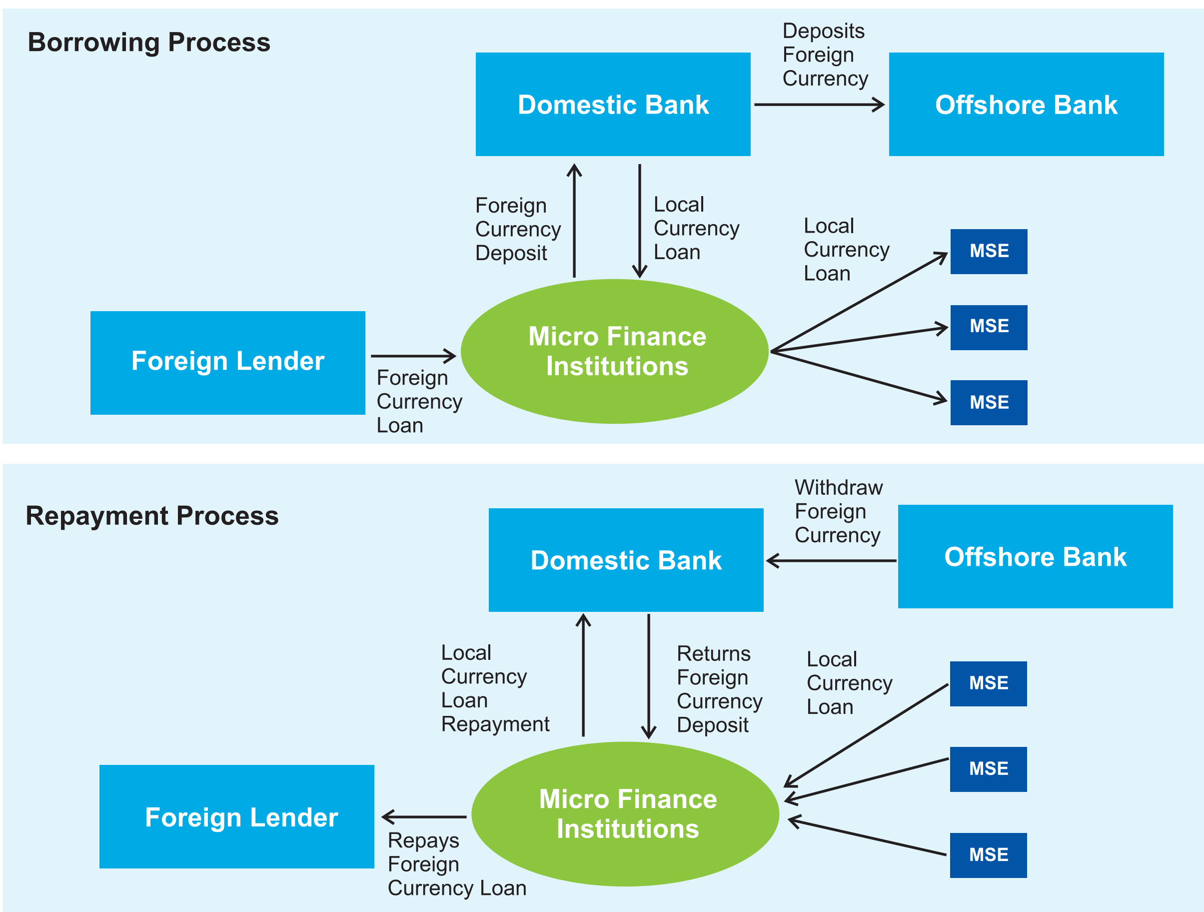


Figure 21: Mechanism for borrowing and repayment for loans availed against foreign currency deposit

From the figure 21, it is observed that an MFI takes a foreign currency loan from a foreign lender. The MFI deposits the proceeds of foreign currency loan as a security deposit with a domestic bank and avails equivalent local currency loan against that. Domestic bank deposits the foreign fund in foreign currency account which is either in the country or in a foreign branch of the domestic bank for the purpose of hedging. When the MFI repays the local currency loan to the domestic bank, it releases the foreign currency amount to the MFI which the MFI uses to repay the foreign lender. In case of a fluctuation in the exchange rate neither the borrower MFI nor the foreign lender suffers any capital loss, as the domestic bank returns the same amount of foreign exchange to the MFI, which it had deposited with the bank for availing foreign currency loan. Even in case of domestic bank asking for additional security from the MFI in case of local currency appreciation, the additional security requested for by the domestic bank is also refunded to the MFI on successful repayment of the loan.

This model was adopted by Deutsche Bank Microcredit Development Fund (DB MDF), which is a non-profit organization established in the UK and Germany. DB MDF is capitalized through donations received from private wealth management clients, other individuals, the Deutsche Bank Americas Foundation, and DB Citizenship UK. It aims to help MFIs to reach a level of sustainability so that they can help in improvement of the life of the poor. For this purpose they provide soft dollar loan at an interest as low as 2%, which the MFIs can offer as collateral to domestic bank and get a local currency loan for on-lending to the Micro & Small Enterprises (MSE). All services involved in managing the DB MDF are provided on a regular basis by the Deutsche Bank Community Development Group in New York. The Bank's extensive network of offices throughout the world has further facilitated the placement of loans and the brokering of relationships with in-country commercial banks. The details of this identified case study of the Deutsche Bank Microcredit Development Fund along with the corresponding best practice adopted have been presented in Table 67.

Table 67: Highlights of case studies with corresponding best practices

Country/ Organization	Case Study	Best Practice/Critical Success Factors
Global: Deutsche Bank[80]	1. DB MDF evaluates an MFI based on i) management capacity, ii) portfolio quality, iii) profitability and efficiency, and iv) amount leveraged through local commercial institutions. If found acceptable based on above parameters the MFI eligible for getting a dollar dominated loan from DB MDF. 2. DB MDF makes loans to the MFIs that are structured as low cost financing (1% - 3%) with maturity of one to five years. Maximum loan amount is USD 250,000. (₹ 12.5 mn).	1. Subsidized interest rate on the foreign currency loan makes the overall borrowing cost lower as the MFI earns interest on dollar deposit maintained with the local commercial. 2. The maturity of the foreign currency loan and the deposit made out of it should be carefully matched.

[80]http://bfsd.server.enovum.com/en/index2.php?option=content&do_pdf=1&id=86 : The Deutsche Bank Microcredit Development Fund

Country/ Organization	Case Study	Best Practice/Critical Success Factors
	3. MFI uses this fund as collateral security for borrowing from the commercial banks (typically DB MDF affiliate banks in respective countries) in domestic currency. 4. MFI earns interest on the dollar deposit maintained with the local commercial bank which offsets the borrowing cost from the local commercial bank. The local commercial bank assumes the foreign exchange risk. 5. On repayment of local currency loan by the MFI, the local commercial bank releases the dollar deposit taken as a collateral. 6. MFI repays the dollar loan of DB MDF with this released collateral.	3. Monitoring the lending practices of the MFI by the foreign lender DB MDF.

Implementation in the Indian context

From FY 2005-06, MFIs in India are allowed to borrow foreign fund maximum up to USD 5 mn (₹ 250 mn) per annum though ECB route, provided they have been in existence for 3 years and have a satisfactory banking track record[81]. Based on the same, MFI can access foreign funds directly from any foreign lenders.

DB MDF has been active in India also with support offered to a NGO named Spandana is in Andhra Pradesh with a loan of USD 75000 (₹ 3.75 mn) at an interest rate of 2.625%. Considering the potential of increasing access to finance from foreign lenders with associated hedging mechanism, it is expected that this model could be leveraged by a number of MFIs raising fund from overseas market for on-lending to MSMEs. This model would be successful only when the net borrowing cost for the domestic borrower including i) spread on the local currency loan charged by domestic bank against the foreign deposit and the ii) cost of servicing the foreign currency loan from foreign lender is cheaper as compared to the cost of local loan availed from a domestic lender. In India, the spread on loan made against deposits is usually capped at 1%[82]. Considering interest rate on foreign currency loan charged by DB MDF being around 3%, the net borrowing cost will come to 4% which is much lower than prime lending rate charged by any bank in India. Hence, the model is expected to be successful subject to the availability of funding in foreign currency at subsidized rates from agencies like DB MDF, Citi Foundation, etc. or other foreign investors providing loans at soft interest rates.

In this context, an indicative roadmap for strengthening this model in India has been proposed in Table 68.

[81] http://www.business-standard.com/india/news/foreign-microfinance-firms-may-need-home-ministry-nod/206997/

[82] http://www.dhanbank.com/nri/dhanam_multiplier.asp

Table 68: Indicative Implementation Roadmap

Action Points
Should determine eligibility criteria for borrowing by the MFI from foreign lenders. Developing the modalities for lending against foreign currency deposit i.e. extent of funding, margin, interest rate, etc.
Should identify funding agencies like DB MDF which are focused on MFI development and can be tapped for fund raising by MFIs.
Information dissemination by Central Bank and public sector financial institutions / banks focused on MSME sector regarding the above model to the concerned stakeholders. MFIs to approach financial institutions / banks in India focused on MSME sector for securing loan against the foreign fund.
Ensure careful monitoring of the portfolio of the MFI, by both the domestic commercial bank as well as foreign lender.

It is expected that implementation of this best practice would take around 1-2 years, based on identification of funding agency and forging of partnerships by MFIs with domestic banks to secure lending against a foreign deposit. The success of the implementation would be governed by the differential in the cost of borrowing from foreign vis-à-vis domestic lender, after factoring in forex hedging costs (if applicable).

Securitization

Definition / Highlights:

- Financing or refinancing of income yielding assets by converting it into tradable securities
- Risk transfer mechanism for the Bank/FI
- Potentially lower cost of refinance

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Using public sector guarantees for encouraging SME Securitization	**US-SBA 7(a)**	True Sale Securitization of Federal government guaranteed SME asset portfolio	• Government guarantee on SME loan • Regulatory Capital relief • Standardized scoring and rating model for creating homogeneous pool of asset	• Creation of Credit Guarantee Schemes for MSME portfolio securitization by banks / FIs, leveraging CGTMSE scheme (Timeline: 1 Year) • Promotion of SPV for purchasing SME loan portfolio by select Government / other financial institution	• Putting in place legal and regulatory enablers like i) adoption of uniformly accepted definition of securitization, ii) permissibility of assignment of future receivables for securitization, iii) rationalization of stamp duty structure & registration charges associated with securitization transactions	• Risk transfer • Potential for bank / FI to reduce exposure to a particular asset class • Potential for MSMEs to i) reduce cost of raising funds, ii) increased access to funds on account of re-investment of securitization proceeds in MSME loan portfolio • Diversification potential for investors, through exposure to MSME assets	• On-lending of sales receipts leading to interest income, with the spread estimated at 1% • Fee income in form of administration fees, estimated at 0.25% of the securitized portfolio • Release of regulatory risk capital thereby facilitating additional lending, with spread of 1% on the additional amount lent	• % of MSME loans securitized by respective banks / FIs • % of securitization proceeds re-invested in MSME lending • Extent of retail participation in MSME ABS

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
	Germany PROMISE program of KfW	Synthetic Securitization of KfW guaranteed SME asset portfolio	• Regulatory Capital relief • State funded subscription for MSME asset backed securities • Increased investor appetite through KfW's presence • Standardized platform	• Development of due diligence & rating methodologies for asset backed securities (ABS) by MSME focused rating agencies like SMERA (Timeline: 1-3 Months depending on the portfolio size) • Creation / Development of a vibrant market for issue and trading of MSME ABS, including applicable incentives for retail / institutional investors (Timeline: 2-3 Years)	iv) credit insurance facilities for providing pool insurance to asset-backed structures, v) clarity on foreclosure laws for transfer of asset in case of default			
Pooling of assets through multi-originator structure	**Spain** FTYPME (Fondos de Titulizacion de Pequenas y Medianas Empresas which means securitization fund for SME)	True Sale Securitization through multi-originator structure	• Standardized platform • Pooling of assets from multiple originators through a standardized platform makes the transaction economically viable	• Creation of a platform and appointment of an intermediary (SPV) for pooling SME assets from various banks by select Government / other financial institution (Timeline: 1 Year)				

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			• Centralized data collation and due diligence reduces cost of portfolio evaluation • Formation of an intermediary to perform the function of selecting and transferring assets from the originators to make a homogeneous portfolio, ongoing reporting and transaction flow	• Discussion with banks for identification of assets by select Government / other financial institution (Timeline: 1-3 months) • Due diligence of the portfolio prior to pooling by SPV (Timeline: 1-3 months) • Collation of data and monitoring performance of the portfolio by the intermediary (SPV). Government / other financial institution to help in the exercise (Timeline: 1-3 months)				
	Japan JFC Synthetic CLO	Synthetic Securitization through multi-originator structure	• Addresses issues related to diversification and scale of finance on account of pooling of assets from multiple originators Improves investor understanding through disclosure of the portfolio performance • Credit enhancement by JFC strengthens the portfolio					

Risk Capital

Definition / Highlights:

- Refers to unsecured funds in form of pure equity and quasi equity / mezzanine financial products
- Debt capital is excluded from the ambit of risk capital
- Source & quantum of risk capital required depends on the stage an MSME is in its life cycle

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Formation of Business Angel Network (BAN) to link angel investors and MSMEs	**UK** NatWest Angels Service (NatWest Bank)	• Physical match making through bank intermediaries between investment preferences of business angels and risk capital requirements of respective MSMEs; supplemented with development of online databases with the above details	• Creation of a database with investment preferences of business angels and risk capital requirements of respective MSMEs • Development of a secure online platform to directly link MSMEs and angel investors, with limited physical intermediary intervention	• Conduct research & surveys to create a database of i) potential angel investors & their investment preferences and ii) MSMEs and their respective risk capital requirements (Timeline: 3 to 6 months) • Liaison with existing / proposed angel forums focused on Indian MSME sector for their inclusion in these databases	• Not Applicable	• Reduced search cost for angel investors • Potential for tapping angel investors as a reliable source of risk capital for MSMEs	• Per reference fee to be charged by operator of BAN from MSMEs for providing investor leads • Funding of around 50-60 investment proposals of MSMEs likely to ensure break-even for BAN operator	• Number of member angel investors • Number of member MSMEs • Number of investor leads provided by BAN to member MSMEs • Number of MSME investment proposals funded leveraging BAN

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
	USA CaliforniaInvestmentNet-work.com (California Investment Network Inc)	• Online match making between investment preferences of business angels and risk capital requirements of respective MSMEs	• Leveraging existing physical branch network to increase outreach to MSMEs not conversant with internet related technologies • Database management to ensure regular updation; serves as an important connect with the online platform	• Design the database with development of filters for matching angel investors to investment requirements of MSMEs (Timeline: 2 months) • Design & implement a secure online platform to the database detailed above (Timeline: 3 to 6 months) • Identification & appointment of intermediaries to increase the physical outreach to address MSMEs not conversant with internet use				

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Development of public-private partnerships with incentives for participation of business angels in form of public guarantees & preferential returns	**Brazil** FINEP (Brazilian Innovation Agency), a public sector financial institution	• Creation of “fund of funds” for investment in seed capital of MSMEs • Managed by professional fund managers • Capital protection to angel investor through public guarantee • First right on fund returns to angel investors	• Management of seed capital funds limited to Fund Manag-ers, authorized / registered by CVM (SEBI equivalent) to offer portfolio management services • Marketing to angel investors is responsibility of fund man-ager in order to secure their commitment for investment • Diversifica-tion of risk for angel investors through invest-ment of funds in multiple MSMEs • Multi-stage evaluation process of proposed funds to identify measures for improving management structure	• Identify sectors / industries requiring seed capital funding, which may be attractive to angel investors (Timeline: 1-3 months) • Establish a pool of funds to be invested in seed capital of MSMEs in the identified sec-tors / industries (Timeline: 1 year) • Identify mechanism for offering guarantees for capital protection of angel investors (Timeline: 1 year)	• Consideration of extension of scope of existing credit guarantee scheme, viz. CGTMSE OR creation of a new credit guarantee scheme for purposes of offering guarantee for capital protection of angel investors in seed capital funds	• Greater involvement of angel investors in seed capital of MSMEs, thereby increasing avenues for raising risk capital • Reduced cost of identifying MSME investment opportunities for angel investor on account of the same being done by Fund Manager • Incentive for banks / FIs to participate in the funds on account of presence of professional fund manager and angel investor	• Net returns for angel investors and participating banks / FIs, estimated at around 10% (underlying assumptions detailed above) • Net returns for financial institution / bank, which facilitates development of seed capital funds, estimated at around 8.9% (underlying assumptions detailed above)	• Number of MSMEs, getting risk capital through these seed capital funds • Number of operational seed capital funds, along with their corpus & no. of investments

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			• Competitive bidding ensures cost structure proposed by the fund manager is in line with the projected / expected returns and associated risks	• Identify list of potential fund managers interested in managing a "seed capital" fund focused on MSMEs, with requisite experience and knowledge (Timeline: 1-3 months) • Develop robust evaluation procedure for appointment of respective fund managers, including ability to commit investments from angel investors (Timeline: 1-3 months) • Information dissemination on the above model to MSMEs and potential partner banks / FIs in order to secure their participation (Timeline: 1-3 months)				

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Integrated lending comprising sub-ordinate debt and refinancing of senior debt portion of partner banks, with appropriate risk-reward sharing mechanism	**Germany** KfW	• Advancement of credit through partnership between a FI / bank focused on MSME sector and other financial intermediaries including private sector FIs and banks • Integrated lending with sub-ordinate debt advanced by FI / bank focused on MSME sector along with senior debt from other financial intermediaries including private sector FIs and banks	• Involvement of potential partners in form of commercial banks at time of conceptualization of model • Development of internal rating mechanism by KfW for selection of partner banks based on due diligence & underwriting expertise • Physical outreach of commercial banks along with access to MSMEs helped KfW tap MSME segment without investing in physical infrastructure	• Development of mezzanine financing structure in close collaboration with potential partner banks / FIs (Timeline: 6 months – 1 year) • Identify mechanism to reduce risk burden associated with sub-ordinate portion of loan, through appropriate credit guarantee mechanism (Timeline: 1-3 months) • Determination of respective sectors to be focused on along with loan eligibility criterion (Timeline: 1-3 months) • Selection of partner banks / FIs along with segregation of respective rights & obligations through a legal agreement (Timeline: 1-3 months)	• Putting in place requisite legal and regulatory enablers to ensure enforcement rights of lenders in case of default in loan payment	• Potential to raise additional debt with the same capital base on account of nature of sub-ordinate debt • Reduced requirement for physical collateral to match the senior debt portion only • One-time Transaction structuring fee, estimated @ 0.5% of investment for each concerned lender • One-time Management fee, estimated @ 0.5% of investment for each concerned lender • Recurring commitment fee, estimated @ 2% of investment for each concerned lende	• One-time Transaction structuring fee, estimated @ 0.5% of investment for each concerned lender • One-time Management fee, estimated @ 0.5% of investment for each concerned lender • Recurring commitment fee, estimated @ 2% of investment for each concerned lender • Recurring interest rate spread, estimated @ 2% for senior debt holder and 4% for sub-ordinate debt provider	• % of MSME loan portfolio of partner banks corresponding to the integrated lending model • Rate of delinquency associated with MSME loan portfolio advanced using the integrated lending model

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Senior debt advanced by other financial intermediaries including private sector FIs and banks is in turn refinanced at soft rates by the FI / bank focused on MSME sector	• In case of loan failure, partner bank had the right on underlying physical collateral. Downside for KfW protected through legal arrangement with partner bank to repay the soft-loan advanced by KfW in any eventuality • Introduction of success fee component for partner banks, provided the loans were paid in full by the concerned MSMEs	• Ensuring viability of financing arrangement through structuring of one-time upfront and recurring fees for both the parties along with a success fee for the partner bank / FI (Timeline: 1-3 months) • Capacity building of partner banks / FIs with focus on underwriting / due diligence for MSME clients (Timeline: 6 months – 1 year) • Develop legal agreements to be signed with respective borrowers in conjunction with partner bank / FI (Timeline: 1-3 months)			• One-time success fee for partner bank / FI on successful loan repayment, estimated at 2% of investment made	

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Diversification of investor profile with greater participation from pension funds in risk capital of MSMEs through venture capital funds	**Brazil** FMIEE	• Involvement of pension funds in risk capital of MSMEs through venture capital fund based investment vehicles	• Participation of pension funds through applicable regulation authorizing them to invest 20% of their equities in venture capital funds • Long-term investment horizon of pension funds stabilizes the fund and helps attract investments from other investors like banks / FIs, private investors etc	• Implementation of requisite legal and regulatory enablers to permit investment by pension funds in venture capital funds structured as unit-linked Mutual Fund (Timeline: 6 months – 1 year)	• Putting in place requisite legal and regulatory enablers to permit investment by pension funds in venture capital funds structured as unit-linked Mutual Fund	• Additional source of risk capital for MSMEs in form of pension funds • Potential to attract investors with a relative shorter term investment horizon, based on long term commitment of pension funds	• Returns on investments made in risk capital of MSMEs	• Returns for pension funds from investment in these venture capital funds structured as unit linked Mutual Funds • % of equity holding of pension funds in listed MSMEs
Establishment of investment vehicles in form of Mutual Funds through public-private partnerships for channelizing venture capital funds into risk capital of MSMEs	**Brazil** FMIEE	• Venture capital based investment vehicles focused on MSMEs in technology and information technology sector	• Pools deals with sizes of less than USD 1 mn, thereby building scale for venture capitalists to be interested • Participation of institutional investors like pension funds	• Prioritize focus MSME sectors for channelizing venture capital funds, based on perceived interest of venture capitalists (Timeline: 1-3 months)	• Putting in place requisite legal and regulatory enablers to permit investment by pension funds in venture capital funds structured as unit-linked Mutual Fund	• Additional source of risk capital for MSMEs in form of pension funds, private venture capitalists	• Provision for market determined returns to fund shareholders through trading of fund units in a stock exchange	• Returns to investors from investment in these venture capital funds structured as unit linked Mutual Funds • % of equity holding of private & institutional investors in listed MSMEs

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Structured as closed ended public-private partnerships, with management by professional fund managers • Investments primarily in CVM (SEBI equivalent) regulated MSMEs • Investments in MSMEs structured as units which can be traded on the local stock exchange	• Appointment of fund managers through a competitive tendering mechanism • Empowerment to FMIEE shareholders in taking decision related to appointment & replacement of fund manager based on performance • Development of local stock exchange for trading of units of respective FMIEEs • Fiscal incentives for private venture capitalists	• Development of unit-linked Mutual Fund based investment vehicle for channelizing venture capital funds into focus MSME sectors (Timeline: 3-6 months) • Limiting participation of professional fund managers to those listed with SEBI • Development of exit option for fund shareholders through permission of trading of fund units in secondary market (Timeline: 1 – 2 years -> dependent on establishment of a dedicated SME related stock exchange)	• Putting in place requisite legal and regulatory enablers in terms of rationalization of taxes to facilitate greater participation of private venture capitalists			

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Strengthening the MSME sector by encouraging FDI and fostering linkages between foreign investors and local MSMEs	Various countries (China, Malaysia, Singapore etc)	• Encouragement to Foreign direct investment in MSME sector through requisite policy enablers, information dissemination, infrastructure development, cluster formation, provision of single window clearance mechanism etc	• Commitment and willingness of respective Governments to invest in infrastructure, skills, technology etc for upliftment of MSMEs along with development of appropriate regulatory environment • Development of robust database of MSMEs to facilitate informed decision making • Provision of single-window clearance to reduce processing time and related issues	• Identification of potential sectors in which FDI is required for development of respective MSMEs (Timeline: 3 – 6 months) • Establishment of single-window clearance mechanism for all FDI investment proposals for MSME sector (Timeline: 1 month – 1 year) • Development of national-level database with details of MSME in terms of sectors / industries / geographies/ availability of clusters etc (Timeline: 3 – 6 months)	• Putting in place requisite legal and regulatory enablers to facilitate FDI inflow in MSME sector in terms of i) tax incentives, ii) adherence to international trade norms, iii) flexible labour laws etc	• Potential of additional source of risk capital for MSMEs in form of foreign investors	• Potential for foreign investors to earn higher returns vis-à-vis investments in their respective countries	• % of foreign investors investing in MSMEs • % shareholding of foreign investors in MSMEs in focus sectors

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			• Clarity on domestic rules, laws & regulations governing FDI in MSME sector in respective countries • Development of policies and fiscal / monetary incentives for development of MSME clusters, which serve to attract FD	• Conduct promotional tours / road-trips to facilitate interaction between foreign investors and MSMEs (Timeline: on a continuous basis)				

Credit Delivery

Definition / Highlights:

- Lending models are either transaction or relationship based, depending on data, collateral availability and legal environment
- Focus on non-physical collateral based lending models and non-traditional credit delivery channels for MSMEs
- Risk associated with credit delivery to MSME include borrower and portfolio credit risk
- Qualitative and quantitative risk management tools are used to assess, measure and mitigate credit & portfolio risks to improve the quality of underlying assets

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Deployment of web based application for loan processing and risk management through analysis of financial parameters updated real-time	**China** SME loan	• E-platform to facilitate the loan origination and underwriting process • Risk based scoring tool selects the acceptable customers for processing their application • Continuous monitoring of sales, debtor and cash flow with a dynamic exception handling tool to identify potential credit risks	• On line submission and processing of credit request reduces overhead cost and processing time • Web based application maintains an audit trail for the credit approval • Exception based monitoring reduces chances of default through early warning signal • Real-time updation of borrower's financial performance with associated decision making on increasing or decreasing future credit exposure to the respective borrower. • Password protected access control to avoid any un-authorized access	• Partnership with SME loan for deployment of their application with suitable customization (Timeline: 6 months to 1 year) • Training and capacity building of the users (Timeline: 3 to 6 months)	• Awareness building among MSMEs about the web based tool for loan application and processing	• Reduced processing time • Real time monitoring with a dynamic exception handling tool	• Reduced overhead cost • Dynamic approval of increase in credit limit on increase in sales based on the data submitted by the borrower on-line has the potential of increasing associated interest spread • Better monitoring through dynamic exception handling tool leads to lower default rate and lower levels of provisioning for potential NPAs	• % reduction in turn-around-time for MSME loan approval • % growth in MSME portfolio and associated interest spread • % drop in delinquency level in MSME portfolio

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Deployment of a web-based auction-based mechanism for identification of lenders offering the most competitive rates	**USA** Prosper	• Online platform for borrowing and lending • Deployment of auction system to identify most competitive lending rates for respective funding requirements of borrowers	• Reduction in overhead costs for online lender on account of no need to invest in physical branch network helps it offer lower rate to borrowers • Risk mitigation for the lender by allowing diversification, with minimum investment capped as low as USD 25 • Customer selection is based on analysis of past credit history, with credit ratings sourced from an external rating agency in addition to maintenance of an own score by Prosper	• Development of online P2P lending platform (Timeline: 6 months to 1 Year) • Awareness building among MSMEs and retail/institutional investors about accessing finance through P2P lending platform (Timeline: 3 months to 6 months) • Arranging tie-up through credit bureaus and rating agencies for conducting reference check of the respective borrower and lender (Timeline: 1 month to 3 months)	• Developing approach and guidelines of P2P lending in India • Regulatory & Policy enablers to facilitate access to finance through P2P lending model like i) KYC norm to ensure identification, ii) PMLA-2002 to counter suspicious transactions	• Access to potential low source of fund in the form of participation of retail investors in addition to institutional investors	• Potentially reduced borrowing cost for MSMEs on account of lower overhead cost for lender on account of no need to maintain physical branches • Potential to get higher return for retail investors vis-à-vis other forms of investments available to them	• Number of MSMEs and lenders participating in the web based auction based lending • % drop in cost of borrowing for the MSMEs participating in this borrowing-lending platform • Number of disputes with respect to collection • Proportion of loans turning bad • Difference in return on investment received by the lender compared to prevailing bank fixed deposit rates

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			• Online application issues certificate/ notes to the lenders which are tradable. Greater liquidity due to provision of trading of these note/certificates through the online application	• Securing tie-ups with the collection agents to ensure timely collection (Timeline: 1 month to 3 months)				
	UK Zopa	• Online platform for borrowing and lending • Deployment of auction system to identify most competitive lending rates for respective funding requirements of borrowers	• Minimum borrowing cost for MSMEs through competitive bidding through online application • Risk minimization for lenders through mandatory diversification of the portfolio • Reduction in the search time due to automation of the investment identification leveraging risk-return profile submitted by the lender • Recovery of bad loan though external collection agent which is independent of Zopa					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Leveraging the deployment of web-based warehouse receipt system with underlying physical inventory to increase on-lending to MSMEs	**Dubai** Dubai Metal Commodity Centre (DMCC)	• Web based warehouse receipt facilitating financing against inventory pledged • Collateral manager certifies the description of the goods in the Global Multi-Commodity Receipt (GMR), thereby giving assurance to the lender about the quality of inventory pledged	• Avoids multiple financing against a particular warehouse receipt without effecting speed and efficiency • Transaction within closed user group of DMCC ensures standardized and secured trade • Ensuring credibility of the system by allowing DMCC as the sole custodian of the receipts. DMCC mitigates credit risk by keeping audit trail of pledging and withdrawal of pledge after repayment through the web-based system • Periodic inventory report by collateral manager for monitoring purposes • Reduced monitoring cost for the financier on account of assurance of quality of the underlying inventory by the issuer	• Roadmap for formation of closed user group with identification of the group members and electronic warehouse receipt system similar to the DMCC (Timeline: 3 to 6 months) • Identification of the agri and industrial commodities for which the above system can be implemented (Timeline: 1 to 3 months) • Formation of the central registry to ensure system efficiency and integrity (Timeline: 3 to 6 months) • Development of the web-based warehouse receipt system (Timeline: 6 months to 1 year)	• Development of adequate rules and regulations governing negotiability & transferability of the warehouse receipts to facilitate lending • Development of national grading system for independent determination and verification of the quality and quantity of the stored commodity • Permitting banks to deal in agri-commodity based derivative products for purposes of hedging • Development of a pan-India spot market and clearing facility for trading of warehouse receipts	• Reduced processing time due to quick title transfer and lower chances of fraud • Periodic monitoring of the inventory	• Reduced monitoring cost for the financier • Additionaly in loan disbursement leading to potential increase in interest income for the lender	• % growth of loan against web-based warehouse receipt • % reduction in turnaround time for release of loan against warehouse receipt

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Appointment of trained "SME Account Managers" to facilitate credit delivery to MSMEs	**Sweden** Swedbank	• Selection of staff to be designated as "SME Account Manager" based on requisite due diligence in terms of knowledge and understanding of MSME sector • Training and capacity building of identified participants through class room learning and mentoring by senior staff • Award of diplomas only when participants have passed all examinations and on demonstration of requisite standards	• Careful planning and development of the course content through effective liaisoning with academicians • Feedback from the participants clearing the program is incorporated for the purpose of future training initiative • Networking with classmates and teachers facilitates access to their experience in solving issues in future • Strengthening of back office operation to enable SME Account Managers to focus on business development • Single point of contact for MSME clients for all banking and financing requirements	• Designing eligibility criteria for selection of candidates for role of "SME Account Manager" (Timeline: 3 to 6 months) • Development of courseware and training module (Timeline: 3 to 6 months) • Certification after completion of the course • Design of performance linked incentive scheme to encourage participation in this programme along with a detailed career road-map (Timeline: 1 to 3 months)	• Not Applicable	• SME Account Managers can focus on management of dedicated clients leading to better retention • Customized service through single point of contact	• Potential increase in cross-sell income from the MSME client	• Number of "SME Account Manager" certified • % growth of loan portfolio post implementation of this scheme along with the delinquency level of loan portfolio • % increase in cross sell income • % drop in customer complaints
	India ICICI Bank; **UK** NatWest and **Ireland** Bank of Ireland	• Segmentation of SME customers in different categories	• Effective segmentation which forms the basis for customization of service approach					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Appointment of dedicated or shared “Account Manager” based on perceived level of business with each category of SME clients	• Appointment of relationship managers / account managers supported with systems & processes to facilitate ease of transaction processing. Role of relationship / account manager is then restricted to development of client relation for cross-selling, handling exceptions etc	• Incorporation of necessary changes in the courseware and training module, based on feedback from the participants regarding the course/training and the performance of the SME portfolio of the banks/FIs implementing this programme (On an ongoing basis)				
Introduction of credit scoring / rating tool to reduce turnaround time associated with MSME lending	**India** SIDBI	• Automated credit appraisal and rating system, with deployment of different rating logic based on size of the proposal, i.e. one for loans below ₹ 10 Lakh and other for loans between ₹ 10 - 200 Lakh • In-built automated document flow system integrating the	• System driven standardized process helps in quick decision making • Automated workflow reduces the loan processing turnaround time and facilitates paperless transaction, thereby reducing associated transaction costs • Risk based pricing leading to greater transparency	• Development of a performance based incentive structure to ensure accountability for quality of loan portfolio sanction by respective employee	• Not Applicable	• Frees up time for bank staff to focus on key areas like client relationship management • Reduced turnaround time for loan processing	• Potentially lower interest rate for MSME clients with good track record • Potentially lower transaction cost on account of lower level of human intervention resulting in lower overhead costs	• % growth of SME loan portfolio post implementation of this software • % reduction in turnaround time related to MSME lending • Delinquency level for loan portfolio built leveraging this evaluation tool, for each score / rating segregation

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		loan approval process from the time it is received by the credit officer till the sanctioning by the respective authority • Generation of two dimensional rating (obligor and facility rating), which improves the transparency in pricing and helps in determination of the interest rate • Rating is arrived based on assessment of parameters relating to management, financial, industry, market risks etc	• Creates a repository of business data/ information which can be used for subsequent decision on credit disbursement to respective category of MSME clients • Software is platform independent, on account of open system architecture • Addresses issues related to adherence to KYC and PMLA norms					
	Bulgaria United Bulgarian Bank (UBB)	• Development of an integrated application processing system (APS) along with a credit scoring model based on 17 factors related to 5 Cs of credit	• Integrated loan application processing and scoring improves the turnaround time of loan approval leading to customer satisfaction and retention					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Loan proposal is i) rejected (if score<175), ii) accepted (if score >350), iii) reviewed (if score is 175-350) • Interest rate to be charged to the borrower is decided based on the credit score thereby rewarding clients with good credit track record	• Automated process for loan origination and processing reduces the transaction cost as it reduces the overheads associated with human intervention • Improves the risk management capability as the loan proposals are segregated based on the automated scoring application system • Performance based incentive scheme backed by performance tracking in APS imposes accountability on the sanctioning / recommending authority resulting in better quality of loan portfolio					

Cluster Financing

Definition / Highlights:

- Hard externalities such as a larger company pool to provide requisite scale, specialized and customized input providers, lower costs of supplies in form of raw materials / components, skilled labour with sector-specific skills and potential partners
- Soft externalities that produce access to tacit knowledge of technologies, markets, opportunities to network, and to aggregate interests & needs

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Leveraging value-chain linkages among cluster participants for credit appraisal, loan disbursement and collections	**Paraguay Finaciera El Comercio**	• Financing cluster participants leveraging underlying purchase agreements/contracts amongst themselves • Credit appraisal based on the input given by the cluster participant acting as the Buyer	• Reduced time and cost for customer acquisition for participating bank/ FI through referrals from cluster participants based on underlying value chain relationship • Loan monitoring and collection entrusted to cluster participants acting as the Buyer on the basis of underlying purchase agreement/ contract	• Identification of agricultural and industrial value chains based on involvement of MSMEs and tie-ups with the potential buyers (Timeline: 1 to 3 months) • Identification of the value-chain intermediaries for forging poten-tial partnership based on their relationship with the MSMEs (Timeline: 1 to 3 months) • Development of terms and conditions of the above partnership with	• Putting in place legal & regulatory enablers like recourse in the event of default in terms of delivery of products/ services and rejection	• Facilitating access to finance without physical collateral security • Better credit terms through up-scaling on the demand side	• Potential increase in on-lending to MSME leveraging underlying purchase agreement/ contract/ order, leading to higher interest income	• % of MSME loans ad-vanced by participat-ing bank/FI which are backed by purchase order/ contract/ agreement • % growth in MSME portfolio for the participat-ing banks / FIs
	Bolivia FIE (MFI)	• Financing cluster participants leveraging underlying purchase order placed by a cluster participant on other	• Subsidies given by the donor funding agency lowers the market entry cost for the participating banks / FIs resulting in long term association					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Tender based selection of financial institutions to offer purchase order based financing as a part of a donor funded project, with subsidies for opening branches in MSME clusters	• Competitive mechanism for selection of implementation partner and need to deploy own fund led to greater commitment of the participating banks / FIs • Reduced time and cost for customer acquisition for participating bank/ FI through referrals from cluster participants based on underlying value chain relationship • Loan monitoring and collection entrusted to cluster participants acting as the Buyer on the basis of underlying purchase agreement/ contract • Up-front payment given to the suppliers acts as incentive to supply good quality produce to Buyer	intermediaries focusing on credit appraisal, disbursement and collection (Timeline: 3 to 6 months) • Loan disbursement to value chain participants on pilot basis and monitoring (Timeline: 1 to 3 months) • Technical Assistance to the seller for timely delivery of the goods (Timeline: ongoing till delivery)				

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
	India National Small Industries Corporation (NSIC)	• MSMEs in textile cluster of Tirupur are provided with bill financing facility by NSIC • Maximum tenor of the bills discounted are 90 days and it is duly accepted by the buy-ers who are reputed enterprises	• Loan disbursement for working capital financing based on relationship of MSMEs engaged in textile production and prominent buyers from the cluster					
	Brazil Tribanco and Martins Group with support from IFC	• Martins Group focuses on serving the small retailers in order to distinguish itself from competitors • Tribanco acts as financial solution integrator for participants linked with value chain of Martins group, offering an integrated solution covering working capital and re-modeling loans. These participants include suppliers, customers (retailers) and final consumers	• Ready access to potential MSME clients engaged in retailing through reference from Martins group, thereby reducing associated cost & time in acquiring new customers along with providing access to new segment of customers • With Tribanco addressing financing requirements of participants in value chain of Martins group, the group					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Leveraging IFC support, Tribanco got its credit officers trained in order to facilitate strengthening of financial intermediation role of retailers of Martins group • Adoption of "train the trainer" concept by Tribanco to ensure imparting of training by trained credit officers to retailers	can focus on developing the business & operating aspects associated with retail business for MSMEs • Training and capacity building of the retailers increases the outreach of Tribanco and facilitates success of financial intermediation					

Credit Guarantee

Definition / Highlights:

- Risk sharing arrangement reduces capital adequacy requirement and improves return on equity of the lender
- Encourages bank/FI to lend to those sectors where risk perception is higher
- Encourages bank/FI to have a proper monitoring and evaluation in place

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Extension of multi-level partial guarantees to increase on-lending to MSMEs	**Italy CONFIDI (Association of Small Entrepreneurs)**	• CONFIDIs serve as intermediary between banks/ FIs and member MSMEs • Aggregation of multiple CONFIDIs (regional/ sector focus) at the national level to form Mutual Guarantee Consortia (MGC) • CONFIDIs provides partial guarantee to member MSMEs, which is counter-guaranteed by respective MGCs	• Guarantees higher proportion of loan sanctioned by banks to members of CONFIDI by creation of guarantee fund through contribution from member CONFIDIs (MSMEs therein) • Regulatory enablers like allowing lower risk weight for the loan disbursed against guarantee / counter-guarantee of CONFIDI and MGC respectively • Standardized due-diligence for credit assessment by the CONFIDIs themselves • Aggregation of financing requirements of	• Formation of local/ regional Mutual Guarantee Societies (MGS) on pilot basis with sectoral/ geographic focus (Timeline: 6 months to 1 year) • Creation of guarantee fund with association of multiple local / regional MGSs at the central/state level (Timeline: 3 months to 6 months) • Development of standard credit assessment methods to assess creditworthiness of members of the MGS (Timeline: 3 months to 6 months) • Credit disbursement to the members of the MGS through multi-level guarantee (Timeline: 1 to 3 months)	• Ensuring capitalization of Guarantee Fund by leveraging CGTMSE and /or develop incentives for participation of private sector in Guarantee Fund • Development of requisite regulatory policy enablers to incentivize credit disbursement to members of MGS by banks/ FIs in terms of reduced risk weight for guaranteed loan to MSMEs	• Reduces risk perception about MSME • Potentially lower collateral requirement benefits MSME in terms of borrowing with reduced level of physical collateral security	• Up-front one-time transaction structuring fee for the lender @ 1.5% of the loan disbursed • Interest spread @ 4% of loan disbursed to cover cost of guarantee • Potential additional on-lending to MSME resulting in interest spread due to release of regulatory capital on account of lower risk weight assigned to guarantee backed loan disbursement	• Number of national level MGS offering counter-guarantees to local/ regional MGS • % of MSME loans advanced leveraging multiple-level guarantee offered along with interest spread on the same • % drop in delinquency level for MSME loan portfolio compared to the delinquency level prior to participating in the guarantee program

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			the MSMEs with sectoral/ geographic focus de-risks the portfolio through mutualization	• Roll-out at the national level on success of the pilot project (Timeline: 6 months to 1 year)				• % of regulatory capital freed up and re-invested for MSME lending
	Colombia FNG (Fondo Nacional De Garantias)	• Formation of regional level Fondo Regional De Garantias (FRG) which provides primary guarantee to MSMEs • The above primary level guarantee is counter-guaranteed by FNG, operating at a national/ central level	• Partial guarantee avoids indiscriminate loan approval by the participating bank through better risk assessment, book-keeping and monitoring • Additional lending to MSME due to freeing up of regulatory risk capital on account of multi-level guarantee • Decentralized operation increases the outreach of the guarantee program • Incentive to the lender by charging higher fee for higher coverage					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Partial guarantees to mutual guarantee societies and banks / FIs to facilitate direct on-lending to MSMEs or through MFIs	**Portugal** Mutual Guarantee Societies along with SPGM and FCGM	• Creation of a counter-guarantee fund (MCGF) to provide guarantee to MGS • Counter-guarantee fund is managed by SPGM which was formed as a public-private holding with participation by National SME agencies, private sector commercial banks etc	• Deal origination and guarantee approval by MGSs ensures continuous evaluation and monitoring by MGS thereby decreasing overhead of the lender • Homogeneous credit assessment by all the MGSs • As part of risk-reward mechanism, every MSME is required to invest 3% of the guaranteed loan as equity in the MGS • Shared-service support from SPGM in the form of loan administration, monitoring, collection and payment of requisite guarantee fee etc. • Level of physical collateral required is lower vis-à-vis guarantee less borrowing	• Creation of Credit Guarantee Fund with the objective of providing counter-guarantee for on-lending to MSMEs (Timeline: 6 months to 1 Year) • Marketing of the credit guarantee fund (Timeline: 3 to 6 months) • Identification of administrator of the credit guarantee fund (Timeline: 1 to 3 months) • Tie up with potential partner MGSs and Banks/FIs which will leverage the guarantee for lending to MSMEs (Timeline : 1 to 3 months) • Issuing guarantee to MGSs for on-lending to member MSMEs or to banks/FIs for lending to MFIs who in turn can on-lend to MSMEs (Timeline : 1 to 3 months)	• Development of regulatory and legal policy enablers to incentivize investors in the credit guarantee fund by providing tax incentive • Incentivizing bank/FI by reducing risk weight on the loans guaranteed under this model • Enhancing corpus and scope of CGTMSE to cover MGS			

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
				• Development of standard credit assessment methods to assess creditworthiness of member MSMEs (Timeline : 1 to 3 months) • Credit disbursement to MFI/MSMEs leveraging guarantee from credit guarantee fund on a pilot basis, with national roll-out based on success of pilot (Timeline: 6 months to 1 year)				
	Latin American Countries ACCION International	• Creation of a Central Guarantee Fund, viz. Global Bridge Fund (GBF) by raising money from multiple sources like government grant, trust, private investor, foundation etc	• Indirect lending through MFIs helps the bank to reach to MSMEs without investing in physical infrastructure and resources • Forex risk is mitigated through local currency lending by banks to local MFIs					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Partial guarantee advanced to respective bank/FI to issue stand-by letter of credit to MFIs using GBF as collateral	• Effective monitoring of credit risk by GBF continuously on account of its association with ACCION, which is one of the large global microfinance institution with access to information on affiliate members • Creates the linkage of MFI with formal financial sector • Maintenance of a “loss reserve fund” at around 5% of all outstanding obligations to bear any loss in case of defaults exceeding reserves of a MFI. In case of losses exceeding the “loss reserve fund”, the same is borne by the investors in GBF on a pro-rated basis					

NPA Management

Definition / Highlights:

- NPA as a % of total asset is an important financial indicator for any bank and reduction of NPA improves risk rating of a bank
- NPAs are classified into sub-standard, doubtful and loss assets depending on the aging and availability of collateral security
- NPA management involves rehabilitation of non-performing loan accounts by rescheduling, restructuring and/or asset sale. This can be done by a bank either in-house or through sale to an Asset reconstruction Company (ARC)
- To become successful in NPA management, a ARC needs government support by way of i) initial funding, ii) guarantee on bonds issued and iii) tax and profit incentives to the banks

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
NPA management though formation of government supported Asset Management Company (AMC)	**China** Chinese Asset Management Corporation (Four state owned AMCs of China)	• Formation of four state owned Asset Management Companies (AMC), with each attached to the four largest banks of China • For NPA buyout, funding options included loan from central bank and AMC issued bonds	• Financial support to AMCs from the government in form of loan from central bank, cash bonus on successful recovery • Exemption in value added tax and real estate tax • Presence of well functioning capital market, facilitating trading of AMC bonds • Supportive legal environment like bankruptcy and foreclosure law allowing quick resolution and recovery	• Formation of an Asset Reconstruction Company (ARC) to deal with NPAs associated specifically with MSME sector (Timeline: 6 months to 1 Year) • Facilitating acquisition of NPAs by this ARC through issue of bonds backed with government guarantee (Timeline: 3 to 6 months) • Development of the secondary market for trading of ARC bonds (Timeline: 3 to 6 months)	• Ensuring zero risk weight on the bonds issued by ARC on account of underlying Government guarantee • Development of incentives for bank/FI for selling MSME related NPA to ARCs focused on MSME exclusively, in terms of a profit sharing mechanism	• Removal of potential NPAs from books of participating banks/ FIs thereby leading to better credit rating, which facilitates access to funds at lower cost • Reduction in overhead in terms of investment in loan recovery and collection enabling the personnel to focus on business development, customer service delivery etc.	• Lower overhead cost for recovery and collection • Lower provisioning and improved profitability for the bank/FI	• % change in gross, net NPA and provisioning of participating bank/FI • % change in net profit of participating bank/FI • Change in risk rating of participating bank/FI

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
	Malaysia Malaysian Asset Management Corporation DANAHATA (Wholly owned subsidiary of the Ministry of Finance, Malaysia)	• Formation of a wholly owned subsidiary of Ministry of Finance (MoF) to take over NPAs from banking system to maximize the recovery • Funding for NPA buy-out through government equity, loan from MoF and AMC bonds issued to public	• Disincentive for bank to retain the NPA in their books with regulations mandating the respective bank to write down the value of NPA to 80% of value offered by Danaharta in case of its refusal to sell NPA • Incentive for the banks to sell assets to Danaharta on account of higher recovery rate achieved by Danaharta and profit sharing in case of recovery over and above the purchase price • Bonds issued by Danaharta are government guaranteed, which facilitates reduced risk weightage for these bonds					

Marketing Products & Information Dissemination

Definition / Highlights:

- Supply-side marketing of product offerings from banks / FIs, including information dissemination among target MSME segments

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Appointment and capacity building of intermediaries for marketing of products & information dissemination	**Indonesia** Promoting Enterprises Access to Credit (PEAC) Pilot project implementation by Bank Perkreditan Rakyat, Commercial Banks in Indonesia along with Bank of Indonesia (Central Bank)	• Identification of MSME hubs requiring financing • Appointment of cluster intermediaries for providing services like marketing, credit advisory and loan disbursement & collection • Training of identified intermediaries through specific agents, appointed through PEAC project	• Strong partnership among international donor agency & commercial banks along with supervision by the apex bank of the country • Trained intermediaries/ Business Development Service Provider (BDSP) acted as a linkage between the bank/FI and MSME providing marketing of various products of bank/FI, pre and post credit related services • Commitment of PEAC project to the ultimate goal of developing market for credit related services in the MSME clusters	• Identification of the clusters where PEAC like projects can be implemented (Timeline: 3 to 6 months) • Identification of the intermediaries like BDSPs in these clusters who can provide marketing and credit delivery related services (Timeline: 3 to 6 months) • Lenders to enter into MoU with the trainings institutes/ rating agency like SMERA for training and certification of the identified intermediaries (Timeline: 1 to 3 months) • Development of incentive scheme for the intermediaries in the form of performance linked	• Development of the policy enablers for allowing intermediaries to act as credit related service provider	• Improves the bankability and access to finance for MSMEs	• Potential increase in on-lending to MSME leveraging the cluster development intermediary, leading to higher interest income	• Number of intermediaries certified to act as BDSPs • Number of intermediaries successful in facilitating marketing & credit disbursement • No of MSMEs accessing credit through above intermediaries • Performance of MSME loan portfolio of the bank/ FIs in the clusters leveraging BDSPs

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			apart from developing an overall understanding of SME financing trends	pay structure (Timeline: 1 to 3 months) • Continuous monitoring of the performance of the intermediaries and evaluation of pilot project prior to rolling out at the national level				
	India SIDBI	• Identification of economically under devel-oped districts where there is a significant potential for industrialization • Appointment of Implementing Agency (IA) Development professionals, in form of a technical consultancy organization / NGO • Training and capacity building of IA so that they can offer requisite support to the MSMEs in the selected district for accessing finance from banks/FIs	• IAs act as key linkages between the formal financial sector and the MSMEs. They offer support related to marketing of various financial products of banks / FIs • Post implementation support to ensure sustainability of MSMEs is also offered by IAs					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Monitoring & evaluation of performance of Business Member Organizations (BMOs) with respect to services offered	**Southeast European Countries** IFC - SEED	• Development of a framework for rating of BMOs based on objective assessment of performance • Rating parameters considered are capacity, financial sustainability, market development, business development services and advocacy	• Selection of BMO partners based on World Bank defined criteria • Capacity development support to respective BMOs in order to deliver business development services along with discharge of advocacy role • Mobilization of additional resources for BMOs through cooperation & partnership with other donor agencies • Continuous updation of monitoring & evaluation framework for tracking performance of BMOs	• Identification of the clusters where BDS providers would be deployed on a pilot basis (Timeline: 1 to 3 months) • Identification of cluster intermediaries like cluster development agents / BDSPs in these identified pilot clusters who will be offered training / capacity building support (Timeline: 3 to 6 months) • Development of framework to assess the performance level of these trained cluster intermediaries in form of BDS providers (Timeline: 1 to 3 months) • Monitoring performance of these intermediaries in terms of existing level of performance vis-à-vis baseline level (Continuous)	• Not Applicable	• Improves the bankability and access to finance for MSMEs	• Potential increase in on-lending to MSME leveraging the cluster development agents/ BDSPs, leading to higher interest income	• Number of BDSP intermediaries offered training • Number of intermediaries successful in facilitating marketing & credit disbursement • No of MSMEs accessing credit through above intermediaries • Performance of MSME loan portfolio of the bank/ FIs in the clusters leveraging BDSPs

Micro Enterprise / Rural MSME Development

Definition / Highlights:

- Refers to development initiatives in terms of i) access to finance, ii) access to markets, iii) training & capacity development, etc primarily for relatively small entrepreneurs
- Targets specific segments of the population in terms of low income groups / agriculture dependent entrepreneurs based in villages etc through focus on community economic development, poverty alleviation and economic self sufficiency

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Introduction of branchless banking through deployment of "prepaid cards" for purposes of loan disbursement	**Mexico** Foundation for International Community Assistance International (FINCA International, MFI)	• FINCA entered into a partnership with HSBC-Mexico to issue "prepaid bank cards" which can be used at ATM and merchant-POS • Helped in reduction of operational cost by avoiding disbursement through cheque • Offers convenience to client clients by allowing transaction without visiting a physical branch	• Design of product features in line with regulatory norms like i) card was designed as a "prepaid card" vis-à-vis "debit-card", ii) client data not shared with partner bank with exception on account of anti-money laundering and terrorist financing requirements • Design of product features in line with customer requirement like i) personalization as per market survey, ii) extension of validity from 24 to 30 months reducing re-issuance fees for FINCA and increasing chances of increased number of loan cycles per card,	• Commission studies to quantify the market potential for "prepaid card for loan disbursement" along with related challenges, constraints and opportunities (Timeline: 3 to 6 months) • Identification of product features to be introduced, based on market feedback (Timeline: 1 to 3 months) • Conduct cost-benefit analysis to ascertain the viability of requisite products along with its features (Timeline: 1 to 3 months)	• Not Applicable	• Customer comfort in the form of disbursement of loan through conveniently located ATM/ POS vis-à-vis need to visit branches which may be located at far-off places • Increased outreach with limited investment, for the partner bank	• Reduced transaction and overhead cost by eliminating the cheque based disbursement • Additional alternate source of revenue for the partner bank in terms of card activation fee, interest on loan disbursed	• % reduction in operation cost for the MFI/bank/FI implementing prepaid card based system • % increase in other source of revenue for the partner bank participating in prepaid card based loan disbursement • Performance of the loan portfolio advanced through the prepaid card system in terms of delinquency level

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Flexibility of loan disbursement in multiple tranches • Technology platform that can be applied to new products • Helps bring clients into the formal financial sector by introducing them to banking cards and regular use of banks • Prepaid cards are electronically loaded with cash derived from a single pooled account managed by FINCA. FINCA enjoys a credit line with HSBC which is reconciled based on the monthly card transaction reports	thereby recouping associated fixed cost • Training of staff and information dissemination to potential clients regarding prepaid cards through brochures, guides, practical training on ATM usage • Regular monitoring and evaluation through a dedicated call centre in order to collect data related to card. Data gathered from call center along with transaction data from HSBC facilitated monitoring of efficiency of implementation and identification of intervention measures	• Conduct negotiation and forge alliances with banks/FIs having requisite reach, technology and service orientation (Timeline: 3 to 6 months) • Launch the card on pilot basis in select districts in a state followed with national level roll out on success of the pilot (Timeline: 6 months to 1 year)				

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Facilitating branchless banking through "mobile branches"	**Malawi** Opportunity International Bank of Malawi	• Extending the banking service in the rural areas through mobile vans carrying GPS tracking system, connected with the central server of the bank using satellite technology and fitted with ATM to facilitate real-time transaction processing • Though this facility, microloan and deposit services are provided. Once the client base reaches a critical mass, a permanent "satellite branch" is established in respective rural area	• Extension of outreach to areas not served by physical branches with optimum scheduling of mobile van visits to a locality based on "market days" ensuring exposure to a wider audience • Reduced investment requirement in comparison to setting up of a dedicated branch apart from negating the seasonal fluctuation of MSME business through mobile branch based banking • Vehicle travelling to remote locations relieve the beneficiaries from travelling long distance to avail banking facilities • Personalized service by bank staffs accompanying the mobile van • Assured scale of operation for proposed satellite branches to secure break-even in operation	• Procure vehicles and install satellite linkages/GPRS (Timeline: 6 months to 1 year) • Create awareness among MSME customers to develop customer confidence in branchless banking (Timeline: 3 to 6 months) • Finalize visit schedule for the mobile vans (Timeline: 1 to 3 months) • Update local resident/ customers on visit schedule through various channels like advertisement, radio announcements etc. (Timeline: 1 to 3 months) • Leverage prepaid card (refer Best Practice on "prepaid cards") based on its success for cash transaction on the ATMs installed on mobile vans	• Formulate requisite legal and regulatory enablers to ensure requisite branch licenses are granted to banks/FIs introducing mobile van based banking services for rural areas	• Increased outreach with limited investment for the participating bank • Improved access to finance for micro-enterprises lacking access to formal financial system	• Potentially higher return on capital for mobile van based banking compared to fixed branch/ kiosk in rural areas	• % reduction in operation cost for the bank/FI implementing the mobile van based banking system • % increase in revenue for the bank/FI participating in mobile van based banking • Performance of the loan portfolio disbursed through mobile van based banking in terms of delinquency level

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Introduction of branchless banking through deployment of Mobile Banking for facilitating financial transaction	**Kenya** M-PESA Program	• Cash deposit, withdrawal and money transfer using mobile network and physical network of mobile service provider agents • Service offered was named M-PESA, which is an online application integrated with mobile network to enable users to conduct routine banking transactions leveraging their mobile handsets with customized SIM cards	• Banking services made available and convenient in rural areas by eliminating the travel time to distant branches • Safe and secure as it does not require carrying physical cash for deposit or withdrawal to far-off branches • No need of maintaining minimum balance for bank accounts, paying monthly fee or joining charges • Simple fast, efficient transaction processing time with lower transaction cost • Prompt and regular loan repayment which clearly benefits the banking institution	• Commission studies to quantify market potential for mobile based banking (Timeline: 3 to 6 months) • Identification of the product features to be introduced, based on the study (Timeline: 1 to 3 months) • Conduct cost-benefit analysis to ascertain the viability of the products and its associated features (Timeline: 1 to 3 months) • Conduct negotiation and forge alliance with telecom service providers with requisite reach, technology and service orientation (Timeline: 3 to 6 months) • Launch a pilot in select districts in a state followed with national level roll-out on success of the pilot (Timeline: 6 months to 1 year)	• Enact regulation to facilitate mobile banking in terms of allowing the banks to offer this service to any customer, subject to compliance with KYC & AML norms • Address issues with respect to technology and security standards for conducting financial transaction through mobile banking	• Customer comfort in the form of cash deposit, withdrawal and transfer without visiting the bank branch • Increased outreach for the partner bank • Improved access to finance for micro-enterprises lacking access to formal financial system	• Reduced transaction and overhead cost for both MSME and bank • Scope of increased revenue for the partner bank in terms of interest on loans disbursed leveraging mobile banking	• % reduction in operation cost for the bank/FI implementing mobile banking system • % increase in interest income for the partner bank offering mobile banking • Performance of the loan portfolio advanced through the mobile based banking system in terms of delinquency level
	Philippines Microenterprise Access to Banking Services (MABS)	• Credit delivery to rural MSMEs lacking formal financial intermediation through a	• Card less and cash less micro payments over a mobile phone • Large network of conveniently located merchants					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		mobile based financial service model called G-Cash • Facilitation of banking transaction leveraging G-Cash through various partners including banks, distribution agents like retail and utility companies along with the support of government bodies and NGOs	• Eliminates need for travel to respective rural branches for cash withdrawal / loan repayment • Monitoring by Globe, a leading telecom service provider, to comply with Anti-Money Laundering Act of Philippines. SIM cards are checked for multiple registrations to the service by same phone number, the same name or the SIM card • MABS, together with Globe subsidiary G-Xchange Inc., conducts regular training-workshops for participating rural banks • Reduced transaction costs for rural MSMEs					

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Working capital funding using derivatives-based financial instruments (“certificates of rural product”) as collateral with cash-based settlement	**Brazil** Bank of Brazil and various other bank/FI	• Deployment of derivatives based financing instrument, viz. certificate of rural products(CPR), for purposes of raising working capital funding • Issue of CPR in favour of lender with loan disbursement at the time of harvest • Settlement of CPRs, post harvest, either involving physical settlement through delivery of underlying commodity to the lender or cash based settlement based on linkages to standard indices with repayment of loan component to the lender	• Provision for cash-based settlement for lender, without need to take delivery of the underlying asset • Market risk borne by producer/lender based on settlement mechanism, with lender bearing the risk in case of reference price linked to an index & producer bearing the risk in case of reference price being fixed upfront • Legal and regulatory enablers to facilitate “out of court” settlement for contracts in case of non-performance or breach of contract. • Provision for endorsement of CPR to a third party along with the development of capital markets, including commodity exchange, to deepen the market for trading of these agriculture commodity linked CPRs	• Development of derivative based products with provision of cash based settlement at pre-determined fixed or market determined floating price (Timeline: 3 to 6 months) • Information dissemination/ marketing to stakeholders about the potential for leveraging derivative based products for working capital financing (Timeline: 1 to 3 months) • Creation of a secondary market for trading of derivative based products (Timeline: 3 to 6 months)	• Development of requisite legal & regulatory enablers relating to registration of derivative products along with updation of status on settlement • Develop requisite legal & regulatory enablers & tax incentives to ensure subscription to these products by institutional investors • Develop requisite legal and regulatory enablers for dispute	• Access to finance for MSME against future production/ inventory without creating a charge on other physical asset • Reduction in uncertainties associated with price movement for MSME with index based price linkage	• Scope of increased revenue for the partner bank in terms of interest on loans disbursed leveraging this model • Lower transaction cost for the lender	• % increase in interest income for the bank/FI participating in working capital funding using derivatives-based financial instruments as collateral • Performance of the loan portfolio advanced through above system in terms of delinquency level

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
			• Monitoring CPRs issuance on a particular property through registry with Registrar of Deeds Office, thereby reducing risk of default to the creditors		resolution, permissibility of endorse-ment, crop insurance etc.			
Leveraging access to information on markets to develop partnership between buyers and sellers, along with development of partnerships for underlying working capital finance	**Kenya & Other African Countries** Pride Africa-DrumNet	• DrumNet project ensures a virtual information and service network linking MSMEs to markets & financing through information dissemination • Involves rural MSMEs and their suppliers & customers along with lenders leveraging such linkages • Key service provided to rural MSMEs included information	• Reduction in transaction cost for lender in terms of extending single line of credit to DrumNet, vis-à-vis extending multiple lines to each member producer • Lender assured of regular principal and interest repayment from DrumNet, thereby reducing collection related charges • Contract based lending minimizes chances of default for the lender • Improved quality and lower rejection due to effective monitoring by concerned intermediaries reduces the chances of default	• Identifies sectors/ commodities where the DrumNet model can be adopted (Timeline: 1 to 3 months) • Development of IT platform based on DrumNet model with secured online payment gateway and compatibility with internet, wireless devices network (Timeline: 6 months to 1 year) • Securing tie-ups for online payment authentication services • Identify on-field partners for securing linkage with buyers & providing technical assistance to execute	• Not Applicable	• Access to information on potential ex-port markets leveraging technology interventions to reduce response time, leading to potentially higher mar-gins from ex-port markets • Potential improvement in quality of the products produced • Reduced chance of loan default on account of contract based lending	• Potential reduction in transaction cost for the lender as well as buyer • Lower loss provision for the lender	• % increase in interest income and operating profit for the bank/FI participating in working capital funding using this model • Performance of the loan portfolio advanced through the above system in terms of delinquency level

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		on potential export markets for their products through on-field Transaction Agents (TAs) and leveraging IT platform of the DrumNet network along with its compatibility with various wireless devices and technologies. • Sourcing support was provided in terms of securing export contracts on behalf of member producers, followed by access to finance to meet input requirements	• Emphasis on linking savings performance to access to credit serves as additional guarantee to lenders • On account of single interface for the buyer in form of DrumNet and its TAs vis-à-vis individual producers, transaction costs are reduced for buyer • Input suppliers / stockists have access to new customers and no longer need to bundle credit services with products	orders along with respective incentive mechanism (Timeline: 1 to 3 months) • Empanel input suppliers to facilitate order execution while maintaining quality (Timeline: 1 to 3 months) • Organize producers into co-guaranteed group (Timeline: 1 to 3 months) • Train members of co-guaranteed groups about importance of maintaining requisite balances in online savings account for availing credit (Timeline: 1 to 3 months) • Facilitate production, collection, transport and dispatch of goods as per purchase order terms on an ongoing basis				

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Financing facilitated through formation of co-guaranteed groups of MSMEs with initial deposit serving as a collateral						

Credit Advisory

Definition / Highlights:

- From a lender's perspective, refers to services associated with conducting the credit appraisal to ascertain the underlying repayment ability of borrower in order to decide on whether to lend or not
- In the MSME context, associated with lack of information availability in terms of access to past credit history, well-documented financial statements in terms of cash flows, profit & loss accounts etc

Best Practice	Country	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
• Leveraging credit advisory expertise to establish partnership with localized financial institutions to increase outreach	**USA** • **ACCION**	• ACCION leverages physical outreach of credit-unions to MSMEs to meet their credit requirements • ACCION leverages its credit advisory skills to ascertain credit worthiness of MSMEs seeking credit • Option to the credit-union to extend the loan, based on assessment of credit worthiness, with payment of credit advisory fee to ACCION	• Access of credit unions to MSMEs is leveraged by ACCION to increase its geographic outreach without investing in physical infrastructure, with additional revenue stream • Partnership allows the credit unions to avail the underwriting capability of ACCION while generating referral fee based income. Flexibility to buy back the loan from ACCION with payment of fee for packaging the loan	• Identification of potential partners like SHG/NGO/ MFI etc by banks / FIs for increasing the outreach to MSME without investing in physical infrastructure (Timeline: 3 to 6 months) • Development of incentive scheme for the partners for sourcing financing opportunities (Timeline: 1 to 3 months) • Information dissemination on importance of credit appraisal and development of standard template	• Not Applicable	• Potentially improved access to credit for MSME • Improved outreach for participating bank/FIs	• Reduced turn-around-time (TAT) of loan disbursement to the MSME • Saving in administrative cost for SHG/ NGO/MFI in training its staff in credit appraisal, loan documentation and disbursement • Reduced overheads for participating banks / FIs in terms of setting up a physical branch to increase outreach	• Volume & quantum of loan advanced to MSMEs by leveraging partnership between bank/FIs and MFI/NGO/ SHGs • Performance of loan portfolio leveraging the above partnerships • Increase in interest income for bank/FI and / or MFI/SHG/ NGO

Best Practice	Country	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• Alternate option of ACCION extending the loan with payment of referral fee to credit union for bringing the MSME to ACCION		for collection of information for credit appraisal (Timeline: 1 to 3 months) • Development of in-house underwriting skill for MSME credit appraisal (Timeline: 1 to 3 months)				• Increase in referral or advisory fee for MFI/ NGO/ SHG and bank/FI respectively

Forex /International Funding

Definition / Highlights:

- Given the size and scale of operations of MSMEs and limited expertise to deal with foreign exchange (forex) risks, exposure to foreign risk can erode capital base of the firm and impact operations significantly
- Availing input financing in foreign-denominated currency for purposes of import of requisite goods / services; need for hedging against adverse movement of local currency vis-à-vis foreign-denominated currency
- Need for managing foreign currency risk associated with receipt of payments in foreign-denominated currency for goods / services provided

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
Loan against foreign currency deposit to hedge the foreign exchange fluctuation risk	**Global Deutsche Bank** Microcredit Development Fund (DB MDF)	• DB MDF advances FC denominated soft loan to the MFI after requisite due diligence • FC denominated loan offered as collateral by MFI to a domestic bank to avail local currency loan for on-lending to MSMEs. Forex risk assumed by local domestic bank	• Subsidized interest rate on the foreign currency loan and the interest earned on the deposit makes the overall borrowing cost lower for the MFI • Maturity of the foreign currency loan and deposit should be carefully matched • Monitoring of the lending practices of the MFI by DB MDF to ensure optimum deployment of funds	• Identification of the funding agencies like DB MDF which are focused on MFI development and can be tapped by MFI for fund raising (Timeline: 6 months to 1 year) • MFI to approach commercial banks in India for securing loan against deposit consequent to information dissemination by central bank/ government agency about this model (Timeline: 3 to 6 months)	• Developing the eligibility criteria for borrowing by the MFI from the foreign lender • Setting up the modalities for lending against foreign currency deposit like margin, tenor etc.	• Hedging of forex risk for the MFI • Additional source of funding for MFI in terms of access to foreign lenders	• Saving in the borrowing and hedging cost for the MFI	• Volume and quantum of loan raised by MFIs leveraging loan against foreign currency deposit • % drop in net borrowing cost for MFI participating in this model

Best Practice	Country Experience & Program	Features	Critical Success Factors	Suggested Customized Offering	Policy inputs required	Qualitative Benefits	Quantitative Benefits	Indicators
		• On repayment of the local currency loan to domestic bank, the domestic bank releases the foreign currency deposit held as collateral to the MFI. MFI returns the same to DB MDF along with associated interest		• Monitoring of the portfolio of the MFI by domestic bank as well as foreign funding agency (Timeline: 3 to 6 months)				

REFERENCES

Assumptions

For purposes of currency conversion in Indian Rupees (₹), the following currency conversion rates have been assumed:

Table 1: Foreign Currency conversion rates

Foreign Currency	Indian Rupees equivalent
1 US Dollar (USD)	₹ 50.0
1 Euro	₹ 65.0
1 Great Britain Pound (GBP)	₹ 75.0
1 Brazilian Real (R$)	₹ 25.0
1 Japanese Yen (JPY)	₹ 0.5
1 Malaysian Ringgit (RM)	₹ 13.5
1000 Indonesian Rupiah (IDR)	₹ 5.0
1 Mexican peso (peso)	₹ 3.6

SECURITIZATION

Best Practice S-1

Websites and Documents Referred :

1. Presentation on SME Financing and the SME ABS Market in Europe by Michel Noel, Lead Finance Sector Specialist, World Bank
http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV Resources/570954- 1211578683837/Noel_World_Bank_SME_asset-backed_financing_instruments.pdf

2. Special Report on Structured Finance by Moody's Investors Service dated August 25, 2006
www.moodys.com

3. Report titled "Banking on the SBA" by Veronique de Rugy, Mercatus Center, George Mason University dated August 2007
http://www.mercatus.org/sites/default/files/publication/20070924_onpolicyno1.pdf

4. Final report on SME Securitization, published by European Commission
http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=1067&userservice_id=1

5. Study on Asset-Backed Securities: Impact and Use of ABS on SME Finance, dated November 30, 2004
http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/EU_study_on_ABSs_impact_on_SME_finance.pdf

6. SME Securitization in Europe - The German Perspective, dated May 16, 2008
http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/5709541211578683837/Rahe_KfW_SME_securitisation_market_in_Germany.pdf

Relevant Contact details in World Bank for securitization

Name	Mr. Michel Noel (Lead Financial Sector Specialist, World Bank)
Contact Number	1-202-473-0062 & 1-410-212-1677
Email	mnoel@worldbank.org

Best Practice S-2

Websites and Documents Referred:

1. Roundtable between bankers and SMEs: SME Securitization, EU
http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=1067&userservice_id=1

2. Study on Asset-Backed Securities: Impact and Use of ABS on SME Finance, dated November 30, 2004 http://siteresources.worldbank.org/EXTECAREGTOPPRVSECDEV/Resources/EU_study_on_ABSs_impact_on_SME_finance.pdf

3. Role and Characteristics of JASME, based on Annual report for 2007-08 http://www.c.jfc.go.jp/jpn/summary/disclosure/AR_2007-2008_02.pdf:

Relevant Contact details in KfW for securitization

Name	Mr. Andreas Rahe (Vice President, KfW)
Contact Number	+49 69 7431-3687
Email	andreas.rahe@kfw.de

RISK CAPITAL

Best Practice RC-1

Websites and Documents Referred:

1. http://www.californiainvestmentnetwork.com

2. http://www.unctad.com: United Nations Conference on Trade and Development: Improving the competitiveness of SMEs in developing countries- The Role of Finance to enhance Enterprise Development

Best Practice RC-2

Websites and Documents Referred:

1. http://www.finep.gov.br/

2. http://www.infodev.org: InfoDev publication on Brazilian country study with focus on “Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities”, dated June, 2008

Best Practice RC-3

Websites and Documents Referred:

1. http://www.usaid.gov/ - Publication titled “HBOR Mezzanine Financing Program” (July 2006)

2. http://www.kfw.de/EN_Home/index.jsp: Presentation made in “the SME Guarantee Facility

Conference 2005" on "SME Access to Finance: New Developments in SME Financing (Mezzanine Capital for SMEs)" by Dietrich Suhlrie, Head of the Secretariat for Domestic Credit Affairs

Best Practice RC-4

Websites and Documents Referred:

1. http://www.infodev.org: InfoDev publication on Brazilian country study with focus on "Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities", dated June, 2008

2. http://www.infodev.org: InfoDev publication on Peru country study with focus on "Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities", dated June 2008

Best Practice RC-5

Websites and Documents Referred:

1. http://www.finep.gov.br/

2. http://www.infodev.org: InfoDev publication on Brazilian country study with focus on "Financing technology entrepreneurs & SMEs in developing countries: Challenges & Opportunities", dated June, 2008

3. http://www.ic.gc.ca/scdt/bizmap/interface2.nsf/vDownload/IMI_9101/$file/X_3418998.PDF: *Study titled "Private Equity and Venture Capital in Brazil", dated April 2008*

4. http://www.dlapiper.com/latinamerica/publications/detail.aspx?pub=4460

5. http://www.latinlawyer.com/article.php?id=15061

6. http://www.capitalaberto.com.br/english/ler_artigo.php?pag=2&i=2342&sec=88

Best Practice RC-6

Websites and Documents Referred:

1. www.unwe.acad.bg/yearbook/2007/2.pdf - Study titled "Foreign Direct Investment and SME Development: Some Policy Issues for Transition & Developing Countries"

2. http://www.gfptt.org/uploadedFiles/ac85ad3f-04d5-409c-a32f-2ea5a3a2a16e.pdf - Study titled "Enabling SMEs to enter the international supply chain" dated June 2005

3. http://machinist.in/index.php?option=com_content&task=view&id=1272&Itemid=2-

CREDIT DELIVERY

Best Practice CD-1

Websites and Documents Referred:

1. http://www.tradeforum.org/news/fullstory.php/aid/414/Innovation,_Specialization_and_ E-finance_for_SMEs.html
2. http://www.unctad.org/en/docs/sdteedc20051_en.pdf : United Nations Conference on Trade and Development: Information Economy Report 2005
3. http://www1.fee.uva.nl/fm/PAPERS/Claessens/wpapers/EFinance_DP6.pdf : E-Finance in Emerging Markets: Is Leapfrogging possible by Stijn Claessens, Thomas Glaessner, and Daniela Klingebiel (June 2001)

Relevant Contact details in SMEloan, China

Name	Mr. Ming Siu, (Chairman & CEO-SMEloan Hong Kong Limited)
Contact Number	852-21107300
Fax	852-21109777

Best Practice CD-2

Websites and Documents Referred:

1. www.european-microfinance.org/data/file/Babyloan%20-%20P2P.pdf: The Revolution of Peer to Peer Lending in Microfinance (June 2009)
2. http://www.prosper.com
3. http://uk.zopa.com

Relevant Contact details in Prosper, USA

Name	Mr. Chris Larsen (CEO & Co-Founder)
Address	Prosper Marketplace, Inc. 111 Sutter Street, 22nd Floor San Francisco, CA 94104
Contact Number	1-866-615-6319

Best Practice CD-3

Websites and Documents Referred:

1. Study titled "Creating an Enabling Environment for Microenterprises Development"
2. www.dmcc.ae/media-files/2007/12/23/20071223_Euromoney-Final.pdf: Study titled "Trade & Commodity Finance in the Middle East" presented in the Trade Finance Middle East Conference by Director, Commodity Finance, Dubai Multi Commodities Centre, Dubai; dated December 2007

Best Practice CD-4

Websites and Documents Referred:

1. UNCTAD Publication titled "Improving the competitiveness of SMEs in developing countries" (2001)
2. http://ec.europa.eu/enterprise/policies/finance/files/rt2_en.pdf : The Second Round Table of Bankers and SMEs, Final Report

Best Practice CD-5

Websites and Documents Referred:

1. http://www.sidbi.in
2. http://www.msmefdp.net/events/frmViewEvents.aspx?Id=103

THEME: CLUSTER FINANCING

Best Practice CF-1

Websites and Documents Referred:

1. http://www.accion.org/ - Publication titled "Providing cost-effective credit to small-scale single-crop farmers: The case of Financiera El Comercio", dated August 2006
2. http://www.usaid.gov/ - Publication titled "Hortifruti in Central America: A case study about the influence of supermarkets on the development and evolution of creditworthiness among small & medium agricultural producers"; dated April 2006
3. http://www.usaid.gov/ - Publication titled "Purchase Order Finance in Bolivia"; dated April 2009
4. http://www.usaid.gov/ - Presentation titled "Value Chain Financing in Rural Bolivia: Introducing Purchase Order Financing"; dated February 2009
5. http://www.scribd.com/doc/7015796/T-Irupur-Case-Studies - Study titled "Cast Study on Tirupur"

6. Publication titled "Business Linkages: Lessons, Opportunities and Challenge" for IFC, Harvard University & International Business Leaders Forum (2007)

CREDIT GUARANTEE

Best Practice CG-1

Websites and Documents Referred:

1. www.aecm.be/PDF/Fiches_organismes/fiche13_uk.pdf - *Study titled "The Italian Confidi Networks"*
2. http://mpra.ub.uni-muenchen.de/17052/1/MPRA_paper_17052.pdf - *Study titled "The effects of mutual guarantee consortia on the quality of bank lending" (April 2009)*
3. Credit guarantee schemes for SMEs an international review (June 1997) http://siteresources.worldbank.org/INTEXPCOMNET/Resources/Levitsky_1997.pdf
4. UNIDO: Credit Guarantee Scheme for Small Enterprises-An Effective Instrument to Promote Private Sector-Led Growth? - dated August 2003
   http://www.unido.org/fileadmin/user_media/Publications/Pub_free/Credit_guarantee_schemes_for_small_enterprises.pdf
5. USAID: Designing Loan Guarantees to spur growth in developing countries by Paul L. Freedman (2004)
   http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/designing_loan_guarantees.pdf
6. http://www.bnamericas.com/news/banking/Dep_minister:_FNG_is_key_to_boosting_SME_lending

Best Practice CG-2

Websites and Documents Referred:

1. www.eastagri.org/meetings/docs/.../08_Jose%20Figueiredo.ppt : Presentation on "Portugese Mutual Guarantee Scheme"
2. www.mctes.pt/archive/doc/Jose_Barros.pdf: Presentation on "Mutual Guarantee schemes and other financial instrument" – dated November 13, 2007
3. Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises-World Bank Institute – dated August 2006 http://info.worldbank.org/etools/docs/library/236032/SMEAccessToFinance_Final_083106.pdf
4. Study titled "Expanding Access to Finance: Good Practices and Policies for Micro, Small, and Medium Enterprises" -World Bank Institute; dated August 2006

Relevant Contact details in ACCION

Name	Luz Gomez, Senior Director-Marketing
Address	115 East 23rd Street, Seventh Floor New York, NY 10010
Contact Number	305-548-3360 Ext. 1826; (866)245–0783
Email	lgomez@accion.org; info@accionusa.org

NPA MANAGEMENT

Best Practice NPA-1

Websites and Documents Referred:

1. http://www.bis.org/fsi/fsipapers03.pdf: BIS: Public Asset Management companies in East Asia-Occasional paper by Ben Fung, Jason George, Stefan Hohl and Guonan Ma (February 2004)
2. http://www.bis.org/fsi/fsipapers03cs.pdf: BIS: Public Asset Management companies in East Asia-Case Studies by Ben Fung, Jason George, Stefan Hohl and Guonan Ma

Relevant Contact details in Financial Stability Institute, Bank for International Settlement (BIS)

Name	Josef Tosovsky
Contact Number	+41 61 280 9989
Email	fsi@bis.org

MARKETING PRODUCTS & INFORMATION DISSEMINATION

Best Practice MP&ID-1

Websites and Documents Referred:

1. http://www.bdsknowledge.org/dyn/bds/docs/347/Bissegger.pdf - PEAC: Promoting Enterprises Access to Credit or How to develop the market for credit- related business services-Swisscontact
2. http://pdf.usaid.gov/pdf_docs/PNADP081.pdf Models of financial business services case studies and lessons from financial intermediaries (March 2009)

3. http://www.sidbi.com/rip.asp

Best Practice MP&ID-2

Websites and Documents Referred:

1. Draft Report on “SEED Impact Evaluation: Linkages, BMOs, Access to Markets and Leasing” sourced from http://www.ifc.org *(February 2006)*

MICRO ENTERPRISE / RURAL MSME DEVELOPMENT

Best Practice ME/RMSMED-1

Websites and Documents Referred:

1. http://www.usaid.gov/ - Publication titled “Bank – Microfinance Alliances: FINCA’s Pilot Program for Prepaid Cards in Mexico” (2009)
2. http://www.villagebanking.org
3. http://www.seepnetwork.com

Best Practice ME/RMSMED-2

Websites and Documents Referred:

1. http://www.opportunityinternational.ca/learn/current.html - Current Innovations of Opportunity International
2. http://www.seepnetwork.org/Resources/Developing_Cost-Benefit.pdf - Study titled “Developing a Cost Benefit Tool: Experiences and Lessons from Malawi and Mozambique” (2009)
3. http://pdf.usaid.gov/pdf_docs/PDACM494.pdf - “Deepening Malawi’s Microfinance Sector Project (DMS) FY 2008 Annual Report” – dated October 31, 2008
4. http://rbidocs.rbi.org.in/rdocs/Content/PDFs/84140.pdf - “Report on the Internal Working Group to Examine the Recommendations of the Radhakrishnan Expert Group on Agricultural Indebtedness” (April 2008)

Best Practice ME/RMSMED-3

Websites and Documents Referred:

1. http://www.safaricom.co.ke/
2. http://philippines.usaid.gov/eg_mabs4.html

3. www.vodafone.com/m-transactions

4. http://www.wbcsd.org/ - Document titled “Financial Services for the Unbanked: Vodafone”

5. Document titled “M-PESA: Mobile Money for the “Unbanked” Turning Cellphones into 24-Hour Tellers in Kenya” by Nick Huges and Susie Lonie (2007)

6. Presentation titled – “Mobile financial services for the 3rd world: Kenya Pilot” by Susie Lonie (2006)

Best Practice ME/RMSMED-4

Websites and Documents Referred:

1. https://www.researchgate.net/publication/23512521_What_is_CPR_and_Its_Importance_to_the_Brazilian_Agriculture_Finance - Publication titled “What is CPR and its importance to the Brazilian Agriculture Finance” (2005)

2. http://www.agrosecurity.com.br/arquivos/CPR_Estudo_Banco_Mundial.pdf?PHPSESSID=77037713b48dab9429cacdeef2da1306 – World Bank publication titled “Study on Cedula de Producto Rural (CPR) – Farm product bond in Brazil”

Best Practice ME/RMSMED-5

Websites and Documents Referred:

1. http://www.worldbank.org : Publication on “Rural Finance Innovations – Topics and Case Studies” (April 2005)

2. http://www.drumnet.org

3. www.ruralfinance.org/cds_upload/1176485707833_DrumNet_final.pdf : *Presentation on DrumNet, dated March 15, 2007*

CREDIT ADVISORY

Best Practice CA-1

Websites and Documents Referred:

1. www.cdcu.coop/files/public/D2_ASPullas_6-13-08.pdf: *Presentation on Accion USA Micro Loan Program for Small Businesses: Partnerships at work (2008)*

2. http://www.accionusa.org

3. http://www4.gsb.columbia.edu/null/download?&exclusive=filemgr.download&file_id=646440: Document titled "Financing Microfinance – the ICICI Bank partnership model" by Bindu Ananth published in Small *Enterprise Development Vol 16 No1 (March 2005)*

4. HDFC Bank's annual report for FY 09

FOREX / INTERNATIONAL FUNDING

Best Practice F/IF-1

Websites and Documents Referred:

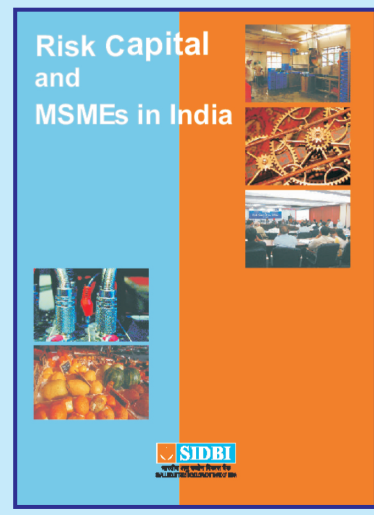
1. http://bfsd.server.enovum.com/en/index2.php?option=content&do_pdf=1&id=86 : The Deutsche Bank Microcredit Development Fund

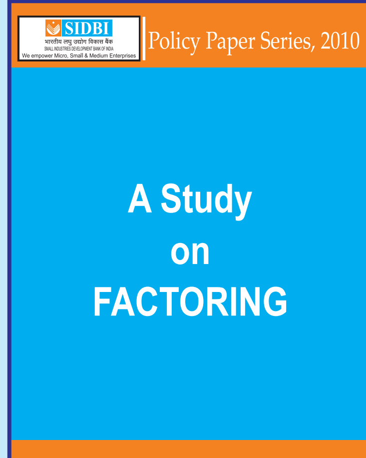
2. http://www.business-standard.com/india/news/foreign-microfinance-firms-may-need-home-ministry-nod/206997/

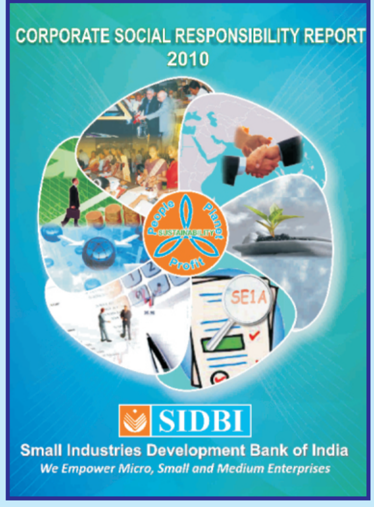
Relevant Contact details in Deutsche Bank America Foundation

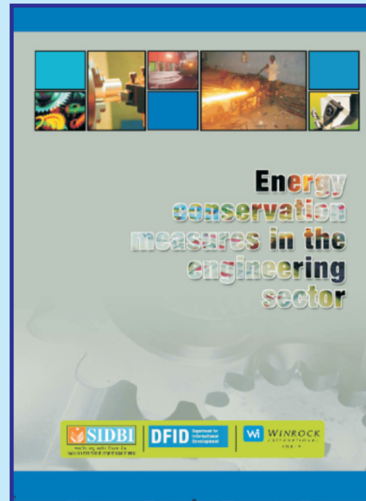
Name	Gary Hallem
Contact Number	
Email	gary.hattem@db.com

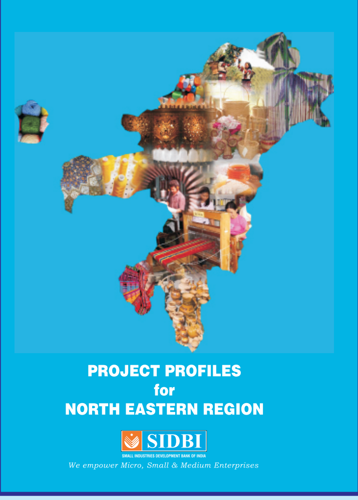
SIDBI Publications









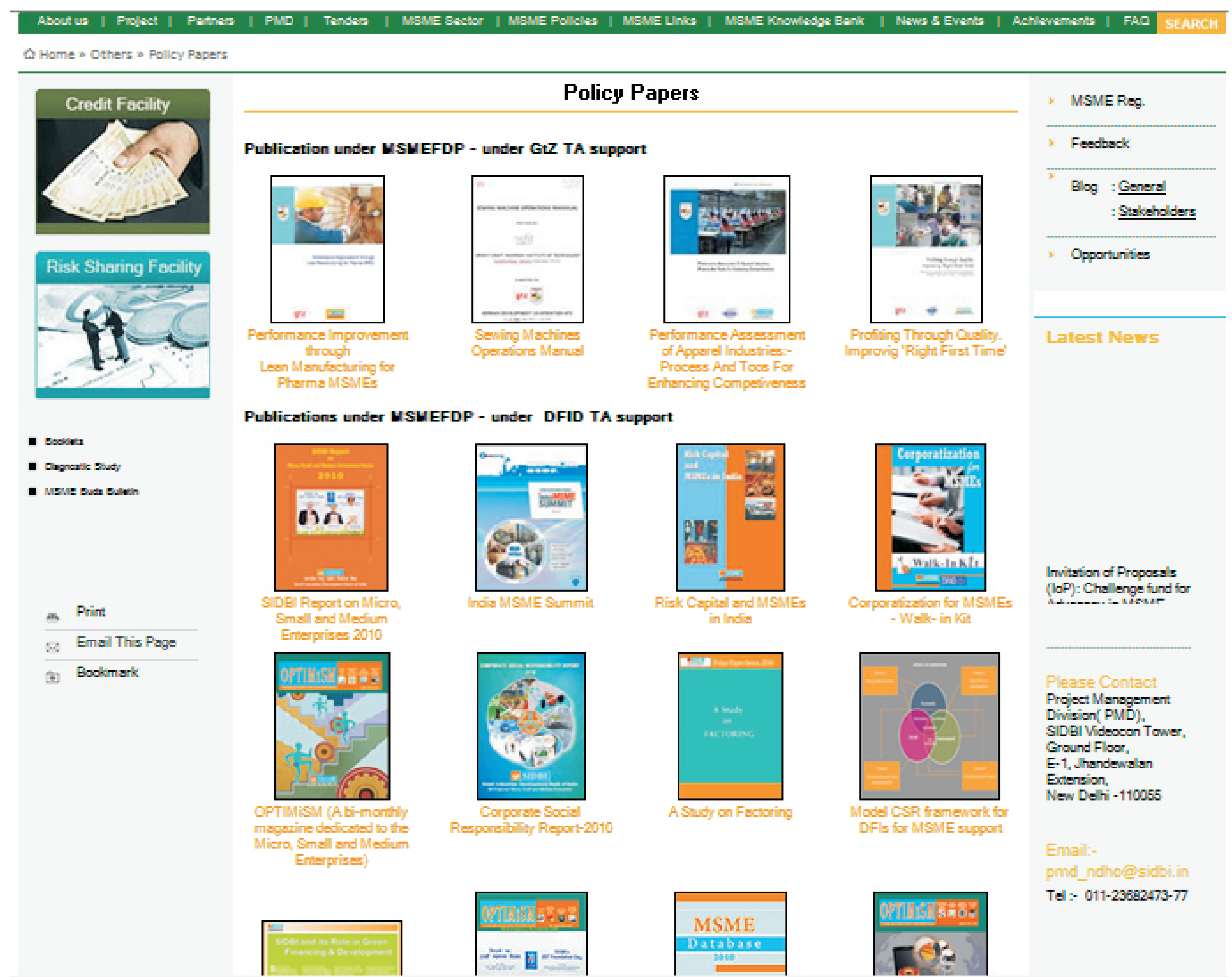


SIDBI Publications

MSME STUDIES/ REPORTS

- Cluster Diagnostic Studies – 18 Clusters
- India MSME Sunmmit - Dossier
- Walk-in-Kit on Corporatization for MSMEs
- Project Profiles for North Eastern Region
- Assessing Development Impact of Micro Finance Programmes

... other publications on Micro Finance in India, Energy Conservation and more



…for more information & downloads…

… please visit www.sidbi.in / www.msmefdp.net

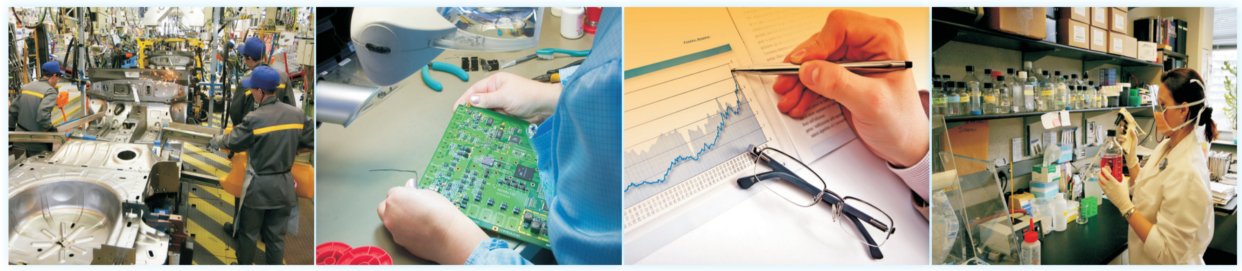
भारतीय लघु उद्योग विकास बैंक

SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

We empower Micro, Small & Medium Enterprises

with **SIDBI** it's

Advantage MSMEs



Avail assistance under our different schemes.

DIRECT CREDIT SCHEME Finance at competitive interest rates for setting up, expansion, modernisation, technology upgradation and diversification of your business enterprise

Credit against bills / invoices raised on Corporates, PSUs & other Service Enterprises.

Credit to Micro Finance Institutions for on-lending and Capacity Building support for MFIs.

RISK CAPITAL Meeting capital requirements of start-ups and existing MSMEs.

ENERGY EFFICIENCY INVESTMENT Credit for energy efficient projects at special interest rates.

And more.....

MSME Financing and Development Project (MSMEFDP)

The Project is a multi-agency, multi-activity initiative aimed at making MSME lending an attractive and viable financing option as also facilitating increased turnover and employment in the sector.

Three major components:
A. Credit Facility
B. Risk Sharing Facility
C. Technical Assistance

The Project, besides augmenting flow of credit to MSMEs, addresses demand side issues of credit and streamlining access to qualitative financial and non-financial services in clusters, policy advocacy, capacity building of banks/ FIs and support for credit information and rating.

Please visit MSMEFDP at www.msmefdp.net & SIDBI at www.sidbi.in

Toll Free No. 1800-22-6753

भारतीय लघु उद्योग विकास बैंक

सिडबी शाखा नेटवर्क / SIDBI BRANCH NETWORK

प्रधान कार्यालय : सिडबी टावर, 15 अशोक मार्ग, लखनऊ —226001, उत्तर प्रदेश, भारत
दूरभाष : 0522-2288546-50 फैक्स : 0522-2288455-59 तार : लघुविकास
Head Office : SIDBI Tower, 15, Ashok Marg, Lucknow-226001, Uttar Pradesh, India
Tel.: 0522-2288546-50 Fax : 0522-2288455-59 Telegram : LAGHUVIKAS

पूर्व अंचल की शाखाएँ / Eastern Zone Branches

कोलकाता अल्प वित्त शाखा	कोलकाता	पटना	Kolkata-Micro Fin. Br.	Kolkata	Patna
गंगटोक	जमशेदपुर	राउरकेला	Gangtok	Jamshedpur	Rourkela
भुवनेश्वर	राँची	धनबाद	Bhubaneswar	Ranchi	Dhanbad
भुवनेश्वर अल्प वित्त शाखा	दुर्गापुर	खड़गपुर	Bhubaneswar-Micro Fin. Br.	Durgapur	Kharagpur

उत्तर अंचल की शाखाएँ / Northern Zone Branches

नई दिल्ली	चंडीगढ़	शिमला	New Delhi	Chandigarh	Shimla
नोएडा	बद्दी	फरीदाबाद	Noida	Baddi	Faridabad
जम्मू	ओखला	गुड़गाँव	Jammu	Okhla	Gurgaon
जयपुर	अलवर	जालन्धर	Jaipur	Alwar	Jalandhar
कुंडली	लुधियाना	जोधपुर	Kundli	Ludhiana	Jodhpur
जनकपुरी	उदयपुर	किशनगढ़	Janakpuri	Udaipur	Kishangarh
ग्रेटर नोएडा	गाजियाबाद		Greator Noida	Ghaziabad	

दक्षिण अंचल की शाखाएँ / Southern Zone Branches

चेन्नई	कोच्चि	इरोड	Chennai	Kochi	Erode
बँगलूरु	पुडुचेरी	त्रिचि	Bengaluru	Puducherry	Trichy
हैदराबाद	अम्बत्तूर	हुबली	Hyderabad	Ambattur	Hubli
विशाखपट्टणम	होसूर	कोझीकोड	Visakhapatnam	Hosur	Kozhikode
तिरुपुर	विजयवाड़ा	बालानगर	Tirupur	Vijayawada	Balanagar
कोयम्बतूर	बेलगाम	बेल्लारी	Coimbatore	Belgaum	Bellary
मंगलूर	नेल्लूरु	पीन्या	Mangalore	Nellore	Peenya
हैदराबाद अल्प वित्त शाखा	राजमुन्द्री	मदुरै	Hyderabad-Micro Fin. Br.	Rajamundry	Madurai
बंगलूरु अल्प वित्त शाखा	चेन्नई अल्प वित्त शाखा	मैसूर	Bengaluru-Micro Fin. Br.	Chennai-Micro Fin.Br	Mysore

पश्चिम अंचल की शाखाएँ / Western Zone Branches

नरीमन पॉइंट	पणजी	औरंगाबाद	Nariman Point	Panaji	Aurangabad
बान्द्रा–कुर्ला कॉम्प्लेक्स	अहमदाबाद	नासिक	Bandra-Kurla Complex	Ahmedabad	Nashik
अंधेरी	चिंचवाड़	राजकोट	Andheri	Chinchwad	Rajkot
ठाणे	कोल्हापुर	गाँधीधाम	Thane	Kolhapur	Gandhidham
पुणे	बड़ोदा	वापी	Pune	Baroda	Vapi
नागपुर	सूरत	जामनगर	Nagpur	Surat	Jamnagar
अंकलेश्वर	अहमदनगर	वालुज	Ankleshwar	Ahmednagar	Waluj
वटवा			Vatva		

मध्य अंचल की शाखाएँ / Central Zone Branches

कानपुर	वाराणसी	आगरा	Kanpur	Varanasi	Agra
लखनऊ अल्प वित्त शाखा	लखनऊ	बरेली	Lucknow-Micro Fin. Br.	Lucknow	Bareilly
देहरादून	रुड़की	इन्दौर	Dehradun	Roorkee	Indore
भोपाल	बिलासपुर	रायपुर	Bhopal	Bilaspur	Raipur
रुद्रपुर	अलीगढ़		Rudrapur	Aligarh	

उत्तर पूर्व अंचल की शखाएँ / North-Eastern Zone Branches

अगरतला	गुवाहाटी	ईटानगर	Agartala	Guwahati	Itanagar
आईज़ॉल	इम्फाल	शिलांग	Aizwal	Imphal	Shillong
गुवाहाटी अल्प वित्त शाखा	दीमापुर		Guwahati-Micro Fin. Br.	Dimapur	

Call Toll Free No. : 1800 22 6753 or visit *www.sidbi.in*

Notes

Team for the preparation of

The Global Best Banking Practices in Micro, Small and Medium Enterprises (MSME) Financing and Development

Steering Committee

Shri. Rakesh Rewari
Deputy Managing Director, SIDBI

Shri. N K Maini
Deputy Managing Director, SIDBI

Shri. N Raman
Executive Director, SIDBI

Shri. K G Alai
Chief General Manager, SIDBI

Project Consultant

Deloitte Touche Tohamtsu India Pvt. Ltd.

Shri. Arindam Guha

Shri. Anindya Mallick

Shri. Shubham Gupta

Project Team at SIDBI

Shri. R K Das
General Manager (Project Team Leader)

Dr. R K Singh
Deputy General Manager

Shri. Niranjan Kothari
Assistant Manager

Small Industries Development Bank of India
E-1, Ground Floor, Videocon Tower, Rani Jhansi Road,
Jhandewalan Extension, New Delhi - 110 055
www.msmefdp.net

भारतीय लघु उद्योग विकास बैंक

अत्यंत लघु, लघु एवं मध्यम उद्योगों को हम बनाते हैं सक्षम

Toll Free No.: 1800226753

www.sidbi.in