

MSME sector on GROWTH PATH



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Introduction

The last five decades have witnessed an emergence of Micro, Small and Medium Enterprises (MSME), as a highly vibrant and dynamic sector of the Indian economy. Over the years, MSMEs have earned the status of being indispensable to the growth of our economy, with a pivotal role vis-à-vis large employment opportunities at comparatively lower capital cost than in large industries, and industrialisation of rural and backward areas thereby reducing regional imbalances.

The MSME sector is the most dynamic and vibrant sector of the Indian economy, and has emerged as the thrust area for future growth of the country. As a critical part of the supply chain, for providing sub-assemblies and services to larger companies, the infinitely more flexible MSMEs can perform activities that are not economically viable for large enterprises. MSMEs have huge potential, which once tapped could unleash unprecedented growth, powering the Indian economy ahead.

There is a growing realisation that the MSME sector also has a huge employment potential at low capital cost, especially in rural and backward areas, enabling equitable distribution and financial inclusion. MSME sector is one of the still untapped high growth segments in India, and an essential partner for achieving socio-economic growth. MSMEs, which are spread across both urban and rural areas of the country, mostly form part of the unorganized sector.

India's economic growth has to be multi-pronged and industries at large, medium, small and micro level have all to contribute in this growth. It has been observed that contribution of small entrepreneurs has always been significant. They have worked with small funding, for sustaining their enterprise. Also the rise of social entrepreneurs has attracted larger number of persons needing small financial support to sustain. The two main mechanisms for delivery of financial services to such clients are i) relationship-based banking for individual entrepreneurs and small businesses; and ii) group-based models, where several entrepreneurs come together and apply for loans and other services, as a group.

Micro-Finance

Micro-finance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services. It is an economic development tool, whose objective is to assist poor to work their way out of poverty. Most countries, whatever their level of economic development or type of policy regime, have put in place laws and regulations framed specifically for smooth functioning MSMEs.

The Salient features of micro-finance are:

- Borrowers are from the low income group;
- Loans are of small amount- micro loans;
- Short duration loans;
- Loans are offered without collaterals;
- High frequency of repayment.
- Loans are generally taken for income generation purpose;

India has approx 500,000 villages, 80 percent of them have less than 1000 inhabitants. Most are nucleated settlements, while others are more dispersed. Indebtedness has been acknowledged, as one of the most infamous stumbling blocks in the way of rural prosperity. It is cancerous, self-perpetuating, malignant and mal-efficient.

Emergence of Micro Finance Sector

With financial inclusion emerging as a major policy objective in India, Micro-finance has occupied centre stage as a promising conduit for extending financial services, to unbanked sections of population. The micro credit programme was formally heralded in 1992, with a modest pilot project of 500 self help groups (SHGs). Today, micro-credit programme in India is the largest in the world. Financing for sustainability faces a plethora of challenges, both structural and behavioral. MSME sector is critical to spur India's development, through entrepreneurial and financial innovation.

The MSME sector is often driven by individual creativity. A major strength of the sector is its potential for greater innovation both in terms of products and processes. An inherent strength of the sector is that these enterprises can be set up with very small amounts of investments, and have the locational flexibility to be located anywhere in the country. Their employment potential is higher compared to large enterprises and are presently estimated to employ 6 crore persons. They are amenable to ancillarisation, and thus have natural linkages with large enterprises.

Support by the Government

On May 9, 2007, erstwhile Ministry of Small Scale Industries and the Ministry of Agro and Rural Industries were merged to form the Ministry of Micro, Small and Medium Enterprises (MSME). This is the ministry that has been bestowed with the responsibility of designing policies and promoting and facilitating programs, projects and schemes, along with monitoring their implementation, in a bid to assist MSMEs to help scale up. While the primary responsibility of promotion and development of MSMEs lies with the State Governments, the Central government supplements the efforts of the State Governments through various initiatives. Through the Ministry of MSMEs and its functioning bodies, the Central Government aids the States in their efforts to encourage entrepreneurship, employment and livelihood opportunities and enhance the competitiveness of MSMEs in the changing economic

scenario.

Today the 'Ministry of Micro, Small and Medium Enterprises' is gaining significance. The centre gives importance to develop MSMEs, as it is the only field after agriculture in which individuals can grow using their own ideas. Who would have thought that ordering groceries or transferring money can be done on our mobiles even 10 years back, but it is happening today thanks to our budding MSME entrepreneurs who have changed the life style and living. In the modern era, where technology is making rapid developments, collaborative entrepreneurship should also be encouraged.

A regulatory environment should ensure that it does not impose undue burdens on MSMEs, and is conducive to entrepreneurship, innovation and growth through, inter alia, promoting good governance and greater accountability in public administration, pursuing a fair and transparent competition policy, implementing effective anti-corruption measures; and fostering the implementation of transparent, stable and non-discriminatory tax regimes.

Micro Finance Institutions Network (MFIN) is the industry body for RBI regulated NBFC-MFIs. Established in October 2009, MFIN was appointed as the Self-Regulatory Organisation (SRO) for the sector, by the Reserve Bank of India (RBI). MFIN through its members, helps provide financial services to low income households in a responsible & transparent manner, thereby helping them build sustainable livelihoods. MFIN also works closely with regulators and other key stakeholders, and plays an active part in the larger financial inclusion dialogue, through the medium of microfinance. As per its bye-laws, all financial institutions that are "substantially engaged in the business of microfinance", and are registered as NBFC-MFIs with the Reserve Bank of India, are eligible for membership of MFIN.

The vision of MFIN is to be an engine of inclusive growth for India, and help provide financial services to 10 crore low income households by the year 2020, in a responsible and transparent manner. MFIN's primary objective is to work towards the robust development of the microfinance sector by promoting responsible lending, client protection, good governance and a supportive regulatory environment. MFIN works closely with regulators and other key stakeholders, to play an active part in the larger financial inclusion dialogue through the medium of microfinance. MFIN's primary objective is to work towards the robust development of the microfinance sector by promoting responsible lending, client protection, good governance and a supportive regulatory environment. The membership of MFIN is open to RBI regulated, NBFC-MFIs. Currently MFIN has 51 members, diverse in size and geographic spread. With 8 MFIs becoming banks last year and bandhan being a universal bank already, about 60% of the portfolio has shifted. By August 2017, there were 77 institutions licensed by the RBI as NBFC MFIs. In addition there were 90 other institutions (trusts, societies & cooperations) that were undertaking micro-finance activities.

MSMEs under the new 'MSME Development Act 2012' would facilitate vertical growth, and help gain competitiveness by:

- Identifying strategic sectors of proven comparative advantage.
- Raising productivity and achieving low costs.
- Promoting vital linkages between large and small industries.
- Taking advantage of the immense potential of e-commerce.
- Simplification of procedures and Single Window System approach.
- MSME's awareness of important policy interventions initiated, and changes at the domestic and international levels.

- Tiny industries (with fixed investment below Rs. 2.5million) are likely to emerge, as the dynamic segment within the small industries category.
- Detailed study of the implications of the WTO provisions. The WTO regime will benefit countries who show enormous negotiating skills.
- World markets are opening up due to lowering of tariffs, and dismantling of other restrictions.
- Domestic markets will face an increasing threat as lowering of tariffs lead to freer entry of foreign goods.
- Export markets will become tougher, because of competition.

Governance of MSME

Despite the rapid spread of banking over the years, a significant segment of the population, predominantly in the rural areas, is excluded from the financial system. Despite phenomenal increase in the physical out reach of formal credit institutions in the past several decades, the rural poor continue to depend on informal sources of credit. Cumbersome procedures and risk perceptions of the banks have created a gap in serving the credit needs of the poor.

The Reserve Bank of India realized that non-banking financing institutions are playing an increasingly important role, and therefore they should have a system in place for their governance and functioning. Broader guidelines of non-banking financing institutions were covered under "Non-Banking Financial Companies – Corporate Governance (Reserve Bank Directions-2015)". RBI thereby laid a foundation of corporate governance structure that NBFC need to follow.

In the Indian micro-finance context, governance has assumed increasing importance in view of growing outreach and size of the assets; mission and responsiveness to client and stakeholders. Increasing number of MFIs are now more regulated and operating in increasingly competitive markets. MFIs therefore, have considered it necessary to look into the corporate governance aspects, which need to be developed out of provision in Companies Act 2013 and the RBI guidelines of 2015. Sa-Dhan, which is a federation of MFIs and is supported by the World Bank and SIDBI, are developing a Handbook for Directors in micro-finance sector. As Institute of Directors is the premier body of professional directors in India, and has been supporting Sa-Dhan on various training issues, IOD is developing this Manual for awareness and training of MFI members of Sa-Dhan. Small Industries Development Bank of India (SIDBI) has also been playing a pioneering role in the growth and development of micro finance movement in the country, and laying down standards for the sector.

MSMERA and M-ICRA are the exclusive rating agencies of the MSME sector. A rating estimates the probability as to whether a company will comply on time and in full, their repayment obligations. Recently a committee under the secretary, corporate affairs presented a 90 page report to the Finance Minister, which said 'MSMEs were the bed rock of the Indian economy, and so the government should make exemptions in the recent 'IBC rulings for MSMEs'.

Present Status

Despite the segment's high enthusiasm and inherent capabilities to grow, SMEs in India are smothered by pain points like sub-optimal scale of operations, technology obsolescence, supply chain inefficiencies, increasing domestic and global competition, working capital shortages, change in manufacturing strategies and turbulent and uncertain market scenario. To survive with such issues and compete

with large and global enterprises, SMEs need to adopt innovative approaches in their operations. SMEs that are innovative and inventive in business outlook, have strong technological base, competitive spirit and a willingness to restructure, can withstand the prevalent challenges and come out successfully. The link between entrepreneurship, regional development, and job creation is very strong. But there is huge variation in entrepreneurship across states in India. Some critical factors that affect overall entrepreneurship are education and skill levels, quality of local physical infrastructure, household banking quality, business environment and investment climate. Today, eleven states in India account for 80 percent of the MSME sector in the country.

Our country is going to witness a more sustainable MSME sector, which will contribute to a considerable extent to the GDP and exports of the country in future. Employment intensity, low factor costs, and even spreads will be the best balancing factors in the reform agenda of developing economies like India. Huge growth opportunities exist for Indian MSMEs. To tap the potential that exists in the domestic and export markets, MSMEs would have to prepare themselves for the following challenges.

- Lack of support from government departments, banks, financial institutions and corporate have been major issues of concern.
- Limited capital availability, lack of knowledge, infrastructure, and technology also pose threat to the development of the sector.
- MSME sector needs high end research, and more penetration in rural areas.
- Skill Development for entrepreneurship, and enterprise creation through Talent Mela.
- MSMEs to take full advantage of the removal of restrictions for foreign trade by the Government. These enterprises should now penetrate the global markets.

While the commercial micro-finance world is dealing with its own issues of sustainability and consolidation, the new generation institutions are being nurtured to further the cause of inclusion as the larger ones become more and more professional. Sa-Dhan is an association of Community Finance Institutions. Sa-Dhan last year has taken initiative to nurture new generation MFIs with the help of SIDBI. The criteria was to have a portfolio of less than Rs 500 million, and they were relevant and sustainable. Presently Sa-Dhan is working with 16 organisations, that are into early stage of micro-finance. Sa-Dhan is undertaking training programmes and governance manuals to support them.

Micro-Finance sector with a deepening of the engagement, has shown steady 15% growth year over year. In financial year 2016-17 the amounts disbursed by it was Rs 1188.47 billion. The spread of MFIs across the country has been impressive. Bandhan continued to operate as a universal bank, with gross loan portfolio on micro-finance growing at 28% during FY- 2016-2017, with an outstanding of Rs. 164 bn towards inclusive finance customers. The current trend is the takeover of these MFIs, with NBFCs like- Muthoot, Mannapuram, India infoline, etc.

During 2016-17 customers of MF had an outstanding of Rs 1.07 trillion. The banking system funded the clients by giving term loans to the MFIs, who in turn managed the clients on their books. Banks are more concerned with controlling the value chain. Reporting on MFI type of loans will become complicated, unless RBI creates a separate category for their reporting.

In the Union Budget 2018, the Government of India acknowledged the

emergence and evolution of digital economy, a significant transformation that will unfold new business opportunities for going forward. It reiterated the need for deployment of technology with high computational and analytical capabilities, to stand out in the market place and maintain cost competitiveness. This will be backed by necessary infrastructure that will help them quickly respond to the changing business situation. The government has decided to further strengthen the 'Make in India' Programme and is expected to provide considerable boost to domestic producers. The Budget has announced several proposals for certain key MSME sectors, which are expected to boost growth, create employment opportunities, and enable increased access to formal finance. INR 37.94 billion has been allocated to the MSME Sector towards credit support, capital and interest subsidy and innovations.

Conclusion

Microfinance sector has grown rapidly over the past few decades. Today it has evolved into vibrant industry, exhibiting a variety of Business Models. Microfinance Institutions (MFIs) in India exist as NGOs (registered as societies or trusts), section 25 companies, or Non-Banking Financial Companies (NBFCs). Commercial Banks, Regional Rural Banks (RRBs), cooperative societies and other large lenders have played an important role in providing refinance facility to MFIs. Banks have also leveraged the 'Self-Help Groups' (SHGs) channel to provide direct credit to group borrowers.

MSMEs today are considered to be the supplementary units to large industries. Confirming its significance in the Indian economy, the sector consists of 36 Million units. Productive MSME lending of the future lies in the post-harvest operations, in the farm sector. There are tremendous opportunities in financing agri-clinics manned by qualified management and Agriculture graduates.

Micro, Small & Medium Enterprises (MSMEs), are contributing substantially for India's economic growth and development. The sector has a huge employment potential at low capital cost, given the labour intensive nature of the industries it covers. It helps industrialization of rural and backward areas, thereby, assuring more equitable distribution of national income and wealth and also enabling financial inclusion. As per the data available, the Micro, Small & Medium Enterprises provide employment to about 805.24Lakh persons. The sector through more than 6,000 products contributes about 8% to GDP, besides 45% to the total manufacturing output, and 40% to the exports from the country.

To conclude MSMEs will continue to play a very important and vital role in our economy, where the twin problems of unemployment and poverty constitute a major developmental challenge. In fact, if India were to have a growth rate of 8-10 percent for the next couple of decades, it needs a strong micro, small and medium sector. MSMEs are the best vehicle for inclusive growth, to create local demand and consumption. The MSMEs of yesterday are the large corporates of today, and could be the MNCs of tomorrow. Thus, the banks and other agencies should take pride, while servicing the MSMEs, as they are playing an instrumental role in the formation of MNCs of tomorrow. The future of India's MSME sector in the new global environment will be determined, by the scope and effectiveness of the policy interventions that are framed in the next decade. ■

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