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BANK CREDIT TO SME'S – MISSING LINK

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Abstract:

The concept of priority sector was evolved in the late sixties in order to focus attention on the need to ensure adequate facilities to certain neglected sectors of the economy; SSI is one among the neglected sector. The involvement of banks in SME financing has considerably since then. Various initiatives are taken by Government and RBI in smooth flow of credit to SME's. Different committees were also constituted. The amount of credit extended by commercial banks has consistently increased over the decades but the amount of credit extended is not in proportion to the number of enterprises. Number of SME's accessing institutional finance including commercial banks is very less. Around 1.56 lakh micro enterprises and .14 lakh small enterprises are availing institutional finance out of 26 million SME's. Literature review focusing on studies related to challenges faced by the SME's in accessing bank credit indicates that SME's are not able to get adequate and timely access to bank credit. There seems to be a finance gap between the supply and demand for SME bank finance irrespective of various initiatives taken by commercial banks. The effort of commercial banks in extending credit is not reaching the beneficiary. There is a need to link the efforts of banks to enable SME's to get adequate and timely credit.

KEYWORDS:

commercial banks, SME, Priority sector lending, finance gap

INTRODUCTION

Finance is one of the basic requirements of a business. A business needs financial assistance at every stage of its activity. It is the life blood of any business. Financial institutions serve as an agent of socio-economic activities. They continuously strive to promote rapid industrialization and growth of entrepreneurial activities in the society.

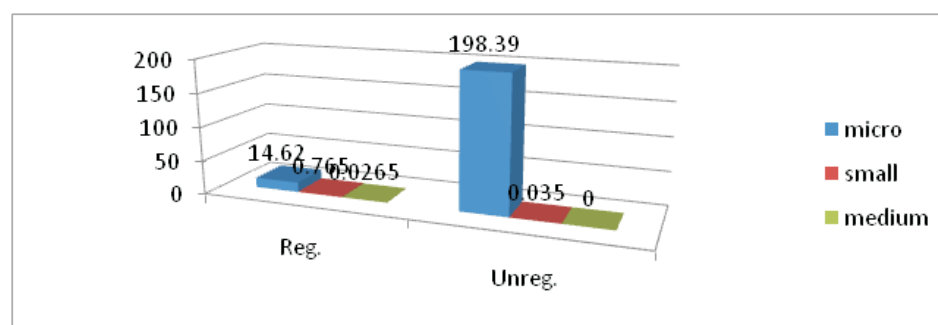
A growing economy needs the support of a financial structure which is responsive to the needs of development in India. The Indian banks form an important constituent of the Indian financial system. The banks are classified by Reserve Bank of India as scheduled & non- scheduled banks. These banks comprise Commercial banks, Regional rural banks and co-operative banks.

Commercial banks are organized on joint stock companies, primarily for the purpose of earning profit. They attract deposits of all kinds which are repayable on demand, so they attach much importance to the liquidity of their investment and as such they specialize in satisfying the short term credit needs of business. Therefore commercial banks follow a media between liquidity and profitability while employing its funds. In India, in the process of financial deepening, commercial banks had to shoulder special

responsibilities for meeting the financial needs of the diverse sectors of the economy at various stages of development. The commercial banks have emerged as the purveyor of credit for the small borrowers. They have been playing a major role in institutionalizing the community savings. The commercial banks in India are highly responsible organizations with respect to the economic development of the country. One of the objectives of nationalization of commercial banks was to provide financial support to neglected sectors of the economy, which includes SSI's. Tremendous changes have taken place in the concept of lending to SSI's and importance of funding to SSI (now SME's).

The SME's sector is emerging as one of the dominant sector of the Indian economy. SME's in developing countries like India are essential for various reasons. They are the powerful drivers of the economy towards a mode of self sufficiency and to a position of economic take off. Indian SME's have been contributing a lot toward the development of the country. It helps in income distribution and equal sharing of available resources in the economy for productive purpose. SME's having contributing to operational flexibility, mobility, export earning, domestic productions, GDP growth and competitiveness in domestic and international markets.

As per the quick estimates of 4th All-India Census of MSMEs, the number of enterprises is estimated to be about 26 million.

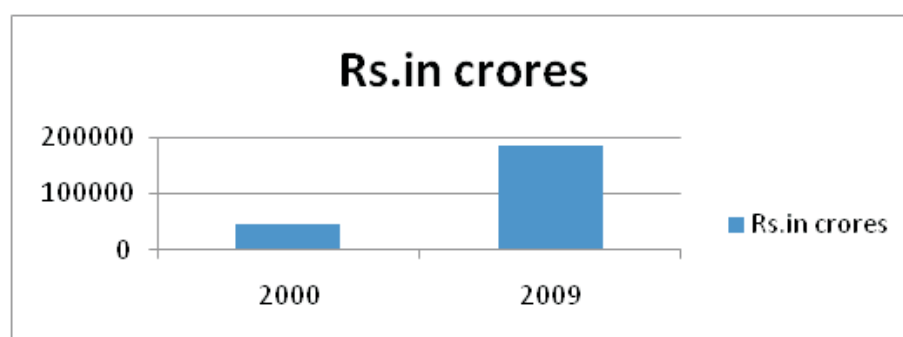


Source: 4th All India census of MSME

SME sector is emerging as a vibrant sector of Indian economy, promising wide opportunities to other sectors.

STATEMENT OF PROBLEM

It has been very aptly stated that the SME's are crucial to a country's long term development. In order to develop SME's, sustainable access to finance is essential. The growth of SME's sustained only with financial support and funding by banks and financial institutions. Banks and financial institutions are providing long term and short term finances not only to large corporate but also to various sectors of SME's. In addition term loans and working capital, banks are providing services such as overdraft facilities bills discounting, guarantees portfolio investment remittances and factoring services. Banks provide these facilities based on the firm's financial soundness, credit worthiness, cash flow, net worth and volume of business. The quantum of advances from the public sector banks (PSBs) to the MSEs has increased over the years in absolute terms, from Rs.46,045 crore in March 2000 to Rs.1,85,208 crore in March



Source: www.rbi.org.in

The data published by RBI indicates that the credit dispensed by commercial banks to SME sector has shown an improvement consistently over the years. Various literatures show that SME sector is unable to obtain adequate and timely finance from banks and this has led to the problems in its growth and development. Commercial banks are supporting RBI in shouldering social responsibilities and it is evident from the statistical data and policy initiatives that it has taken various initiatives in dispensing credit to SME's, irrespective of issues like NPA, lack of collaterals, financial soundness etc. Despite of these efforts commercial banks are not able to meet the expectations of receiving end which is evident from few cited literature. There seems to be an existence of credit gap and link that brings banks efforts in extending credit facility and SME's is missing. As per 4th census of MSME's, 1.56 lakh micro enterprises and .14 lakh small enterprises are only availing institutional finance out of 26 million SME's.

OBJECTIVES

The purpose of the study is:

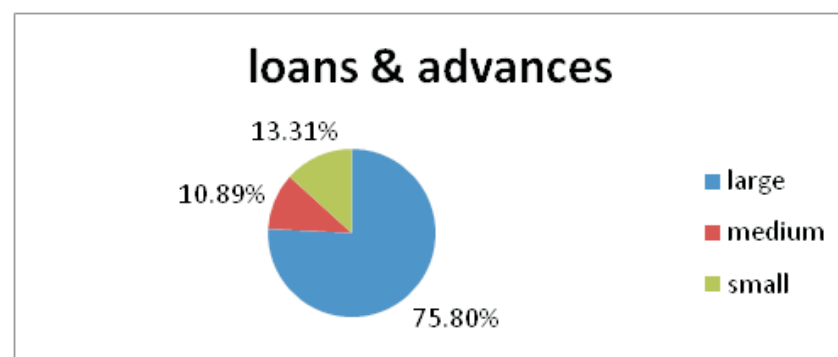
- To examine the trends and progress of banks credit to SME's
- To understand the issues in accessing finance by SME's through literature review.
- To identify whether the finance gap between supply (banks) and demand (SME's) exists.

RESEARCH METHODOLOGY

The study is based on the secondary source of data. Total loans to SME's were analyzed from 2000 to 2010. Data were collected from RBI website and Ministry of MSME website and represented in the forms of graphs and charts. Books, articles from news papers and journals were also source of data.

COMMERCIAL BANKS AND INDUSTRIAL FINANCE

Of the total loans and advances granted by the commercial banks to large enterprises are 75.80%, medium enterprises 10.89%, and small enterprises receive 13.31 %.(Jan 2012). The banks extend to industries the facility of hypothecation. They generally follow the traditional theory of commercial banks by confining their advances to short term loans.



Source: www.rbi.org.in

COMMERCIAL BANKS & SME FINANCING

Starting essentially as an urban based financial service, real efforts began only in 1956 through a pilot project scheme by SBI to look in to the credit needs of SSI. Until nationalization of banks in 1969, the portfolio of commercial banks advances was largely geared to finance trade & commerce. Since 1985, as per directives of the Government commercial banks begun to provide 40% of their total credit to priority sector at concessional interest rate. This was mandatory because the commercial banks had neglected the SSI sector hither to. At the meeting of the National Credit Council held in 1968, it was emphasized that commercial banks should increase their involvement in financing priority sector Viz. agriculture and SSI.

BANK CREDIT TO SME'S – MISSING LINK

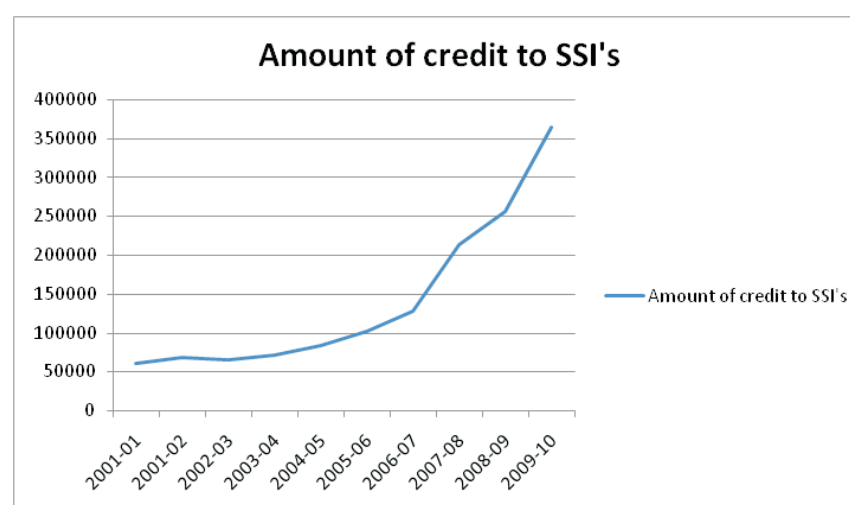


The description of the priority sector was later formalized in 1972, on the basis of the report submitted by the informal study group on statistics constituted by the RBI in 1971. Although initially there was no specific target fixed in respect of priority sector lending, in 1974 banks were advised to raise the share to this sector in their aggregate advances to the level 33 1/3% by March 1979. At the meeting of the union finance minister with the chief executive officer of public sector banks held in March 1980, it was agreed that banks should aim at raising the proportion of their advances to priority sector to 40%. Recommendations of working group on the modalities of implementation of PSL by banks, all commercial banks were advised to achieve a target at 40% of aggregate bank advances. Lending to Micro & Small scale Enterprises (MSE's) is part of priority sector lending, where as lending to Medium Enterprises is non priority sector.

EVALUATION OF BANK CREDIT TO SME'S

| | |
|---------|--------|
| 2000-01 | 60141 |
| 2001-02 | 67107 |
| 2002-03 | 64707 |
| 2003-04 | 71209 |
| 2004-05 | 83498 |
| 2005-06 | 101285 |
| 2006-07 | 127323 |
| 2007-08 | 213539 |
| 2008-09 | 256128 |
| 2009-10 | 364001 |

Source: www.rbi.org



The amount of credit granted by banks to SSIs has consistently increased by almost 6 times from the year 2000.

COMMERCIAL BANKS MSME SERVICES Commercial banks extend credit services like loans, guarantees, portfolio investment, remittances, cash credit facilities, collection, overdrafts, bills discounting and factoring services to SME's.

LOANS BY COMMERCIAL BANKS

BANK CREDIT TO SME'S – MISSING LINK



Commercial banks provide short term and medium term loans to MSME's. The purpose of short term lending is to meet working capital requirement to procure raw material, to hold stock and to pay wages salaries, fuel power and water. Medium terms loans are provided for acquisition of land, machinery and to meet pre operative expenses.

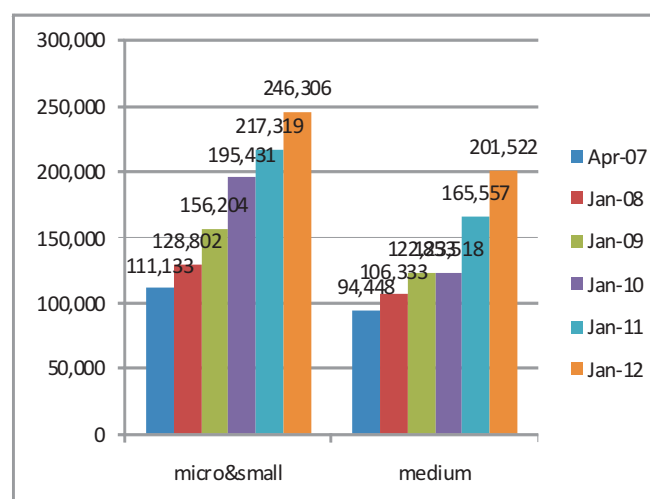
Thus commercial banks provide both direct and indirect financial assistance to MSME's. Commercial banks are also part of execution of various guarantee and capital subsidy schemes.

DIRECT FINANCE

Direct finance to SSI shall include all loans given to SSI unite which are engaged in manufacturing, processing or preservation of goods and whose investment in plant & machinery excluding land & building does not exceed the amount specified.

Flow of credit to Micro & small Enterprises (April2007- Jan 2012)

| | micro&small | medium |
|--------|-------------|---------|
| Apr-07 | 111,133 | 94,448 |
| Jan-08 | 128,802 | 106,333 |
| Jan-09 | 156,204 | 122,853 |
| Jan-10 | 195,431 | 123,518 |
| Jan-11 | 217,319 | 165,557 |
| Jan-12 | 246,306 | 201,522 |



Source: www.rbi.org.in

INDIRECT FINANCE

Indirect finance to SSI shall include finance to any person providing inputs to or marketing the outputs of producers of this sector.

TARGETS AND SUB TARGETS FOR SME LENDING

Financing to SSI's (now MSME's) will be reckoned in computing performance under the overall priority sector target of 40% of average net bank credit or credit equivalent amount of off balance sheet exposure whichever is higher. No sub targets for MSME financing, but 60% of SSI advances should go the micro enterprises.

TARGETS FOR DOMESTIC COMMERCIAL BANKS -- Domestic Banks can fix their own target in lending to MSME's to achieve a minimum of 20% year on year growth and 15% annual growth in number of micro units.(PM task force)

FOREIGN COMMERCIAL BANKS – Foreign Banks lending should not be less than 20% of average net bank credit. Any short fall in MSME lending, foreign banks required to contribute to Small Enterprises Development Fund.

The concept of priority sector was evolved in the late sixties in order to focus attention on the need to ensure adequate facilities to certain neglected sectors of the economy; SSI is one among the neglected sector. The involvement of banks in MSME financing has considerably since then. Right from nationalization of banks by RBI, commercial banks shouldering the responsibility of supporting these neglected sectors. Various initiatives are taken by Government and RBI in smooth flow of credit to MSME's. Different committees were constituted such Nayak committee, Kapoor committee, Ganguly committee, & C. S. Murthy committee and recommendations are being implemented by the commercial banks in order to meet financial requirement of a sector whose growth and development will have impact on development of Indian economy. Recently RBI had constituted the committee under the chairmanship of Sri.M.V.Nair on Aug 25, 2011. Committee has made recommendation to improve direct lending to MSE's.

LITERATURE HIGHLIGHTING PROBLEMS FACED BY SME'S IN ACCESSING BANK CREDITS.SIVA(2012) - “ASTUDY ON PROBLEMS FACED BY ENTREPRENEURS OF SSI'S”

The objective of the study is to picturize the problems faced by the entrepreneurs of small scale industries. It was found that 46% of enterprises have problems of financial crises while starting the enterprises. 56% of entrepreneurs feel that no proper assistance for getting finance.

DR. DAMJI. B.H (DEC 2011)- “ CHALLENGES BEFORE SSI SECTORS IN INDIA”

Author concentrates on challenges before SSI sector in India, especially raw materials, finance and marketing. SSIs are not able to obtain capital from banks as they cannot furnish sufficient security. Industrial team has admitted that in most of the workshops visited, real finance did not exist at all. Article highlights the need to strengthen the SSI sectors in India, keeping in mind the importance of SSI for development of Indian economy.

S.N GHOSAL (2010) carried out a study on some specific challenges and impediments faced by SME's. The author calls for a pragmatic model which would bridge the gap between the financial institutions and SME's. The study identifies the challenges faced by SME's and one of such is lack of funds.

P.VASANTALAKSHMI & M SAKTHIVEL MURUGAN (2009) - “A MARKET STUDY ON BANK CREDIT FACILITIES TO SMALL & MEDIUM ENTERPRISES”

The study focus on the importance of SME's to the Indian economy and emphasis the need for bank finance and suggest the banks to explore various avenues to approach SMEs and familiarize them with various working capital financing options available.

GOURI PARVASUMAL (2008) – “THE MISSING BACKBONE OF SMALL BUSINESS UNITS”

This paper analyses the problems faced by SSI's and finds that in spite of several developmental programs by the government and various banks, SSI advances has reduced gradually.

B.SHOPA RANI & D. KOTESWARA RAO (2008) in their study financing small enterprises highlights the need for special treatment through delivery of credit for strengthening their competitiveness.

CHAKRAVARTHI ANAND (2005) – The article explains the contribution of SME sector in India & as well as in the global environment. One of the issues identified by the author is obstacle in business development in SMEs is financing. Bankers are reluctant to lend to SMEs because of high transaction costs as perceived risks of SME lending. According to him Indian banks & financial institutions catering to SMEs sector will have to focus more on providing marketing, finance, venture capital & factoring assistance at reasonable cost.

One of the major causes of sickness of SME's as reported by 4th All India census of MSME is shortage of working capital (20.49%) and major source for its working capital requirement is Banks.

.FINDINGS

From the above information on flow of credit by commercial banks to SME's right from its conceptualization has consistently improved.

RBI has taken various policy measures, has set up various committees from time to time to improve flow of credit to MSME's.

An effort to provide adequate amount of direct finance to SME's seems to be made by commercial banks.

Number of SME's accessing institutional finance which includes commercial banks is very less. 1.56 lakh micro enterprises and .14 lakh small enterprises are only availing institutional finance out of 26 million SME's.

Various literature reports that SME's are facing problems in accessing bank credit and demands for Government intervention through policy measures to smoothen the flow of bank credit to SME's.

The increase in the amount of credit is not in proportion to the number of enterprises.

Adequate credit facility is made available by RBI to this sector but unable to reach the target.

CONCLUSION

Literature review focusing on studies related to challenges faced by the SME's in accessing bank credit indicates that SSI's are not able to get adequate and timely access to bank credit. In spite of efforts by RBI in enhancing credit to this sector MSME's are still facing problems and remained excluded by commercial banks.

It is also observed that adequate efforts have been made by RBI in providing adequate finance to this sector and lending to SME's continues to be a priority sector lending. Moreover lending to this sector is not optional but compulsory with a view of its importance in development of Indian economy. This sector employs about 6 crore people accounting for 45% of the total employment. MSME account 8% of the GDP and 50% of the manufactured exports. It constitutes 95% of all industrial units in the country. Examining both the aspects of supply and demand for finance, there seems to be a link missing between the lending institutions i.e. banks and SME's which are in the receiving end. This calls for identifying the gap that exists between supply and demand for SME credit and need to bridge this gap by linking the efforts of commercial banks to the receiving end for the benefit for banking sector, SME sector and in turn to Indian economy.

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