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RESEARCH ARTICLE

THE MSME SECTOR.

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Abstract

The small scale industry has been a focus of India's mixed economy for decades now. With the turnover to Micro, Small and Medium Enterprises (MSME) since 2006, small and medium businesses have re-emerged on the priority list of Indian government's policy agendas. In my research paper, I have studied the growth and performance of MSMEs in India within the last decade. Despite the challenges of financing such an ambitious project, the prospects of managing our 'Missing Middle' has been more promising, especially under the visionary schemes introduced by the government.

Introduction:-

After attaining independence in 1947, India adopted mixed economic planning as a technique to attain economic development. The large scale as well as small scale sectors were pushed equally; the latter because of its small size, indigenous technology, employment intensity, and suitability for rural areas with limited techno-economic structure. Industrial policies were targeted to market SSIs through numerous incentives associated with monetary, fiscal and infrastructural measures, along with a heavy industrial base.

The Government of India established the Ministry of Small Scale Industries (SSI) and the Agro and Rural Industries (ARI) in October 1999 as the nodal ministry for formulation of policies and central sector programmes/schemes. Their implementation and related coordination supplemented the efforts of the State and Union Territories for promotion and development of small scale, agro and rural industries in the country. Subsequently, in September 2001 the Ministry of SSI and ARI was bifurcated into two separate Ministries, namely, Ministry of Small Scale Industries, and Ministry of Agro and Rural Industries. In 2006, Micro, Small and Medium Enterprises Development Act (MSMED) were enacted by the parliament.

Pursuing to this enactment, the Ministry of Agro and Rural Industries and the Ministry of Small Scale Industries were merged into a single Ministry, namely – Ministry of Micro, Small and Medium Enterprises (MSMEs). Post-liberalization economic conditions have created huge growth prospects for the small scale industries. The Micro, small and Medium Enterprises in India are acting as power and spirit of economic growth within the twenty first century.

Credit History of India

The Indian financial market is categorised into the following:

1. The Organized Sector: created from public, private, and international co-operative banks and commercial banking institutions, collectively named as scheduled banks.

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2. The Unorganized Sector: Consisting of individual or local banking institutions held and operated by families or loan providers, and Non-Banking Financial Companies (NBFCs).

Microcredit, unorganized and unstructured sectors are still favoured over banking institutions in villages and sub-urban areas, notably for non- productive objectives ,such as short-term loans and family events. Small locations and unbanked population is still under the clutches of money lenders.

Then prime minister, Indira Gandhi nationalized 14 banks in 1969, trailed by six others in 1980, and made it obligatory for banks to give 40% of their net credit to need divisions like farming, small scale industry, retail exchange, independent ventures, and so on to guarantee that the banks fulfil their social and formative objectives. Banking industry's linkage with social fabric of our country was envisaged.

Since then, bank branches have increased from 10,120 in 1969 to 98,910 in 2003, and the population addressed by a branch reduced from 63,800 to 15,000 during that era. The total deposits saw steep jump and manifolded 32.6 times in 1971 and 1991 relative to 7 times between 1951 and 1971. Despite a rise of rural branches, from 1,860 or 22% of all the branches in 1969 to 32,270 or 48%, only 32,270 out of 500,000 villages are covered by a scheduled bank. Still a large chunk of population is left unbanked.

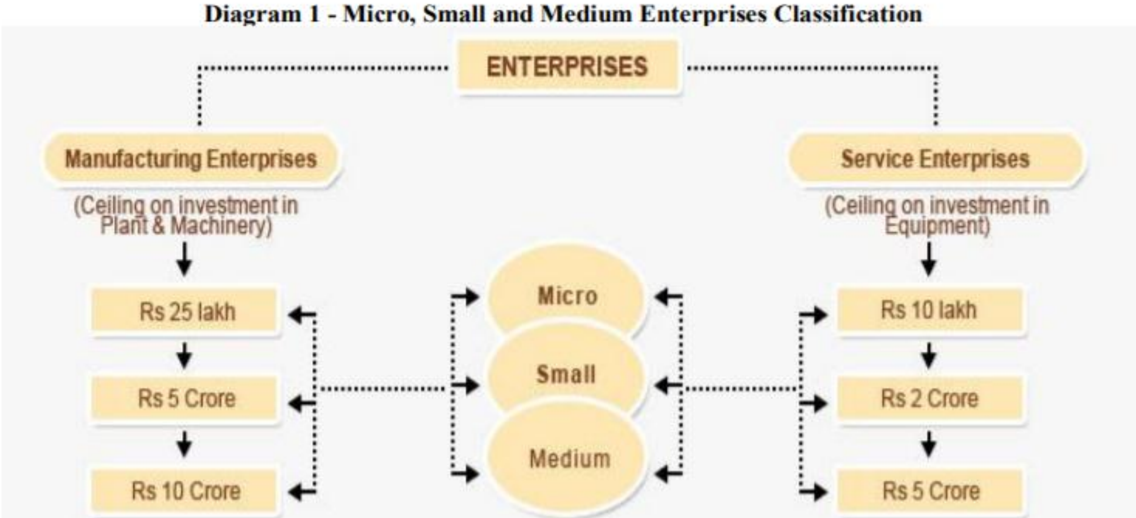
Since liberalisation, the government has approved some banking reforms which relate to nationalised banks (like encouraging mergers, reducing government interference and increasing profitability and competitiveness) and also some other reforms which open up the banking and insurance sectors to private and foreign players.

As of 2019, financial services in India is mature in terms of supply and product range however reach in rural India still remains a challenge for financial institutions.

What are MSMEs?

MSMEs are micro, small and medium enterprises. They are small sized firms which are defined by the amount of investment made. They are categorised broadly in terms of investment made in plant and machineries for the manufacturing sector and the investment made in equipment for service sector companies.

Diagram 1 - Micro, Small and Medium Enterprises Classification



Source: Micro, Small and Medium Enterprises Development Act, 2006

Growth and Performance of MSMEs in India

The MSMEs sector contributes significantly to the manufacturing output, employment and exports of the country. It is concluded that in terms of value, the sector accounts for 45 per cent of the manufacturing output and 40 per cent of the total exports India.

Further, this sector has regularly registered a better rate of growth than the rest of the commercial sector. MSME's in India manufacture over 6000 products ranging from traditional to high tech items. It is widely known that the MSMEs provide great opportunities for self and wage employment.

The Beginning of the Financial Inclusion Journey

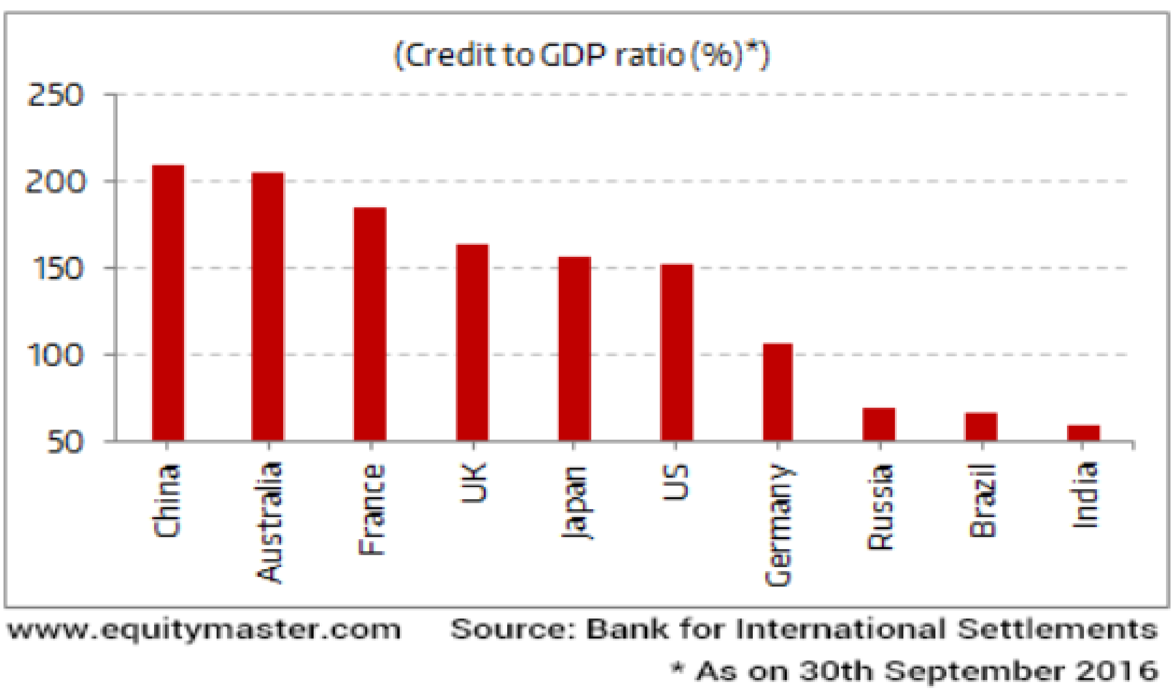
Financial Inclusion is the delivery of financial servicesand products at affordable costs to various sections of disadvantaged, unreached, unbanked and low income groups. Any growth which is not inclusive in nature can not last long and cannot be sustainable. It began to attract the attention of decision makers when Government of India realised the significance of connecting with more people for business growth. Provision of basic savings account and access to sufficient credit at cheap costs to low income households is one of the main motives of financial services.

The vulnerable groups who pay high interest rates to local moneylenders are potential borrowers of banks. An even broader objective of FI is to bring the poor community to the mainstream by removing them from the net of exploitative moneylenders. But despite such emphasis, the penetration of banking services was initially mostly confined to urban areas and major cities, after which they started expanding to the hinterland. FI thus became an integral part of the business domain of banks, with RBI (Financial services regulator) advising all public and private banks to submit a three-year FI plan (FIP) starting from April 2010.

These plans broadly included self-set and guided targets of bricks-and-mortar branches in rural areas, indicating coverage of unbanked villages with population above 2,000 and those with population below 2,000 – deployment of Business Correspondents (BCs), use of electronic/kiosk or alternate modes for provision of financial services, opening of no-frills accounts, and so on. For the deployment of credit, Kisan Credit Cards (KCC), General Credit Cards (GCC), and other banking products designed to cater to the financially excluded segments were introduced. Such accelerated reach of microcredit was an integral part of priority sector lending schemes of banks. Further, banks were told to interlink FIPs with their business plans and to include the criteria on FI as a parameter in the performance scorecard of their employees.

RuPay, an Indian domestic debit card, was introduced in early 2012 by the National Payments Corporation of India (NPCI). It has been a game changer in introducing better digital infrastructure for enabling faster penetration of debit card regime.

The Progress of Financial Inclusion



Credit Penetration in India remains the lowest

Low credit penetration means that very small proportion of people are getting loan as compared to the people who applied or deserve it. Faster implementation of FIPs were seen after 2010-11. Commercial banks opened new rural branches, enhanced reach to villages and small towns, set up ATMs and digital kiosks, deployed BCs, opened no-frills accounts, and made available credit through KCCs and GCCs. The advent of core banking technology and proliferation of alternate delivery channels helped the process of inclusion on a larger scale. The statistics on key banking network give a sense of the pace of progress of banking outreach as part of FI.

In the last 7-8 years, banks have expanded their presence and differentiated banks – payments banks and small finance banks – are set to take this further. When banks began pursuing three-year FI policies, innovations in providing better access to appropriate financial products and services came up. There was more focus on making banking accessible to vulnerable groups. Mainstream institutional players integrated fairness and transparency as part of their offerings, with basic products well-understood by the masses. As a result, FI became a critical factor for inclusive growth and development. Banks also realised that it can be an effective means for cross-selling and business growth.

Pursuing Financial Inclusion Going Forward

FI has been a policy with an objective to reach out to the masses that are financially excluded. While referring to the International Labour Organization (ILO) declaration of Philadelphia (1944), which states, "poverty anywhere is a threat to prosperity everywhere." The Indian policymakers also have an aim to curb poverty, they make policies which financially stabilize the poor and excluded sections of the society by connecting them to mainstream bankers. Financial and digital literacy in India is poor which inhibits full-scale implementation of FI. According to Dr. Kanungo, Deputy Governor, RBI, "This illiteracy transcends across all geographies and regions, not just rural or semi-urban, north or south and is equally true of the staff at the front desks of bank branches. Are we doing enough to educate the public? Should it be the responsibility of the regulator alone? The answer is no. Let us all strive to build consumer awareness consciously and rigorously. An informed customer is a crucial cog in the payment ecosystem."

The vision for FI as envisaged by the Committee on Medium-term Path is that over 90% of the hitherto underserved sections of society would become part of formal banking by 2021, and be active stakeholders in economic progress. This is very much possible but it requires concerted efforts by banks and coordinated support of stakeholders. Bank customers should also join the task. There is a great opportunity for banks to cater to the underserved sections of the society by taking the advantage of developments in digital technology. In order to sustain the momentum of achieving the FI objectives by setting FIP targets for banks, the third phase of FIPs for the next three years (2016-2019) is in place. The focus is on more granular monitoring of the progress made by banks under FIPs at the district level, under the third phase.

Moreover, the Financial Inclusion Advisory Committee (FIAC) set up in 2012 has been reconstituted in June 2015 to review FI policies on an ongoing basis and to provide expert advice to accelerate FI. FIAC has been given task to formulate National Strategy for Financial Inclusion (NSFI). Given the recent focus on digital FI, and in line with international best practices, NSFI also seeking the G-20 High-Level Principles for Digital Financial Inclusion, adapted to meet India-centric requirements.

Prominent Government Schemes

MSMEs Business Loan in 59 Minutes :

Perhaps the most talked about business loan scheme right now is the 'MSME Business Loans in 59 Minutes' scheme first announced in September 2018. The loans under this scheme are given for financial assistance and encouragement of MSME growth in the country. Both new and existing business can utilize the scheme for a financial assistance up to ₹1 crore. The actual process takes 8-12 days to complete, while the approval or disapproval is granted within the first 59 minutes of application. It is a refinancing scheme, wherein five authorized public sector banks will grant the funds. The interest rate depends on the nature of your business and credit rating. No information has been given on subsidizing the principal amount or interest subvention.

To apply for business loan under this scheme, you need GST verifications, Income Tax verifications, bank account statements for the last 6-months, ownership related documentation, and KYC details. Further information on application and approvals can be sought by visiting the SIDBI portal for this business loan.

MUDRA Loans :

Micro-units Development and Refinance Agency (MUDRA) is an organisation established by the government of India to provide business finance to micro-business units. The loans under the scheme are given on the pretext of 'funding the unfunded'. Since small companies and start-ups are often left to their own devices for financing their venture, the government has created the concept of low-cost credit to such undertakings. MUDRA loans are also a refinanced business loans, approved and disbursed through public sector banks, private sector banks, co-operative societies, small banks, scheduled commercial banks and rural banks that come under the scheme. The loans are generally given to micro or small businesses operating in the manufacturing, trading and services sector. The MUDRA Loans are structured as under,

1. Sishu Loans up to □ 50,000/-
2. Kishor Loans up to □ 5,00,000/-
3. Tarun Loans up to □ 10,00,000/-

Credit Guarantee fund scheme for Micro and Small Enterprises :

The CGMSE was first launched in the year 2000 as a monetary support scheme for micro and small enterprises. It offers collateral-free credit for both new and existing business units that satisfy its eligibility criteria. The scheme provides working capital loans up to □10 lakhs without any collateral. However, for all credit facilities above □10 lakhs and up to □1 crore, only primary security or mortgage of land and building associated with the building is obtained and such eligible accounts are covered under Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). Asset created through the credit facility which are associated with the business unit are also considered as security when the loan amount exceeds □10 lakhs.

The business loans under this scheme are financed by various public and private sector banks covered under the scheme.

However, the collateral requirements by banks are one of the major issues when MSMEs want to raise their capital.

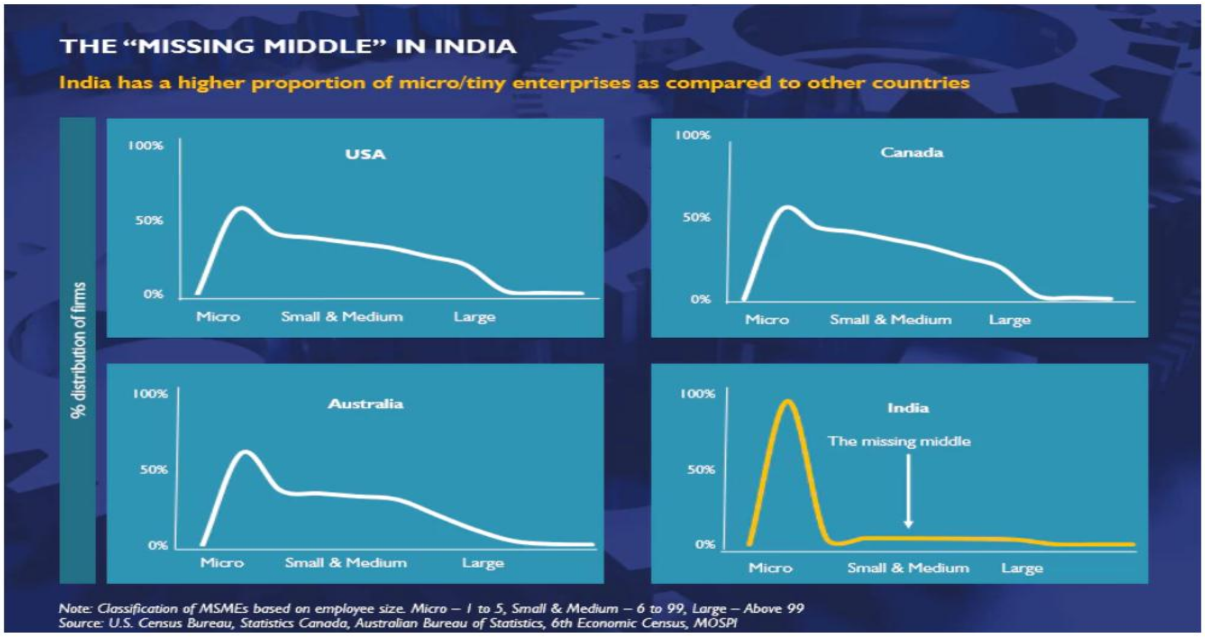
MSME: A Vast and Growing Opportunity

The Missing Middle: India has around 100 micro businesses for every 5 small, medium and large enterprises. Compared to developed countries such as the US, Canada and Australia, there is an alarming lack of small and medium enterprises in India. This is called as the 'Missing Middle' a concept brought to the fore by commercial data and analytics firm Dun and Bradstreet (D&B).

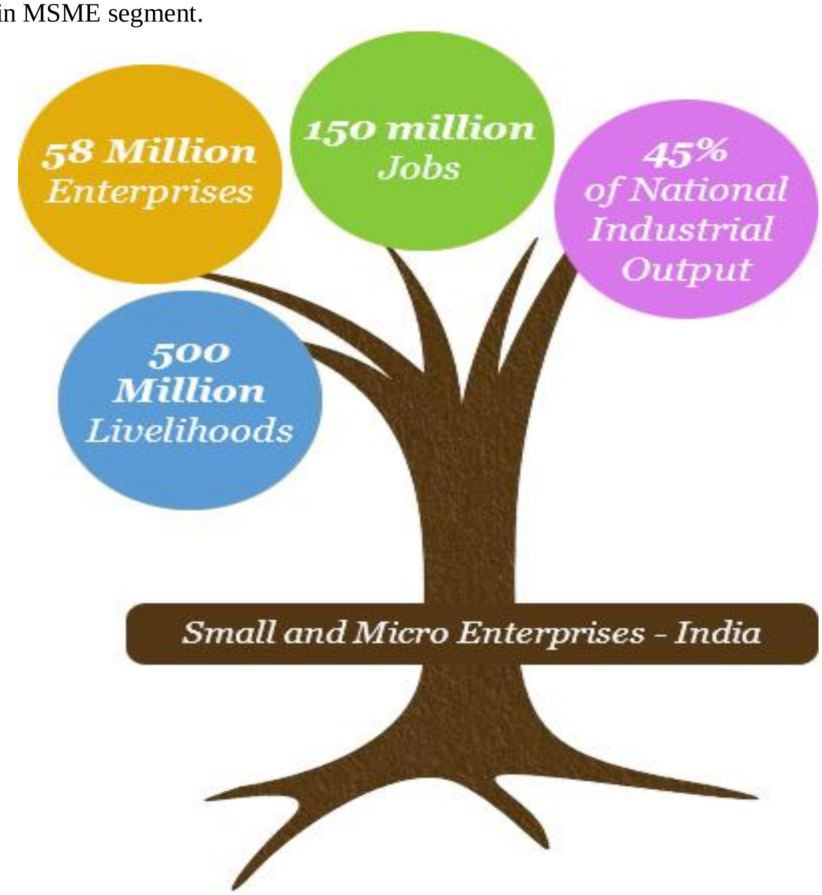
D&B's research on Micro, Small and Medium Enterprises (MSMEs) across countries suggests that most entities evolve from micro, to small, to medium and (sometimes) to large entities. Thus, at any point in time there is a distribution of these entities across the spectrum. In India, the distribution is skewed towards micro enterprises as desired growth has not taken place.

For every 100 companies in India, there are more than 95 micro enterprises, four small-to-medium businesses, and less than one large company. Developed countries, however, feature around 50 micro entities, and 40 small-to-medium companies in the same sample size. This gap is the absence of small and medium companies in the optics of the India distribution.

MSME contribute nearly 10% of the country's GDP, 45% of the manufacturing throughput and 40% of the exports. They account for the largest share of employment after agriculture. They are the breeding ground for entrepreneurship, innovation and ideation. Huge Employment potential at affordable capital cost is the major advantage of this sector.



As per available statistics, this sector employs an estimated 6 crore of the population, spreading over 2.6 crore enterprises. The labour deployment in the MSME sector is estimated to be almost 4 times higher than the large enterprises. Within unmet credit gap of Rs. 3 trillion, arising from approximately60 million micro enterprises, this is a big opportunity. India's future rests on the productivity, efficiency and success of its massive young population, most of who work in MSME segment.



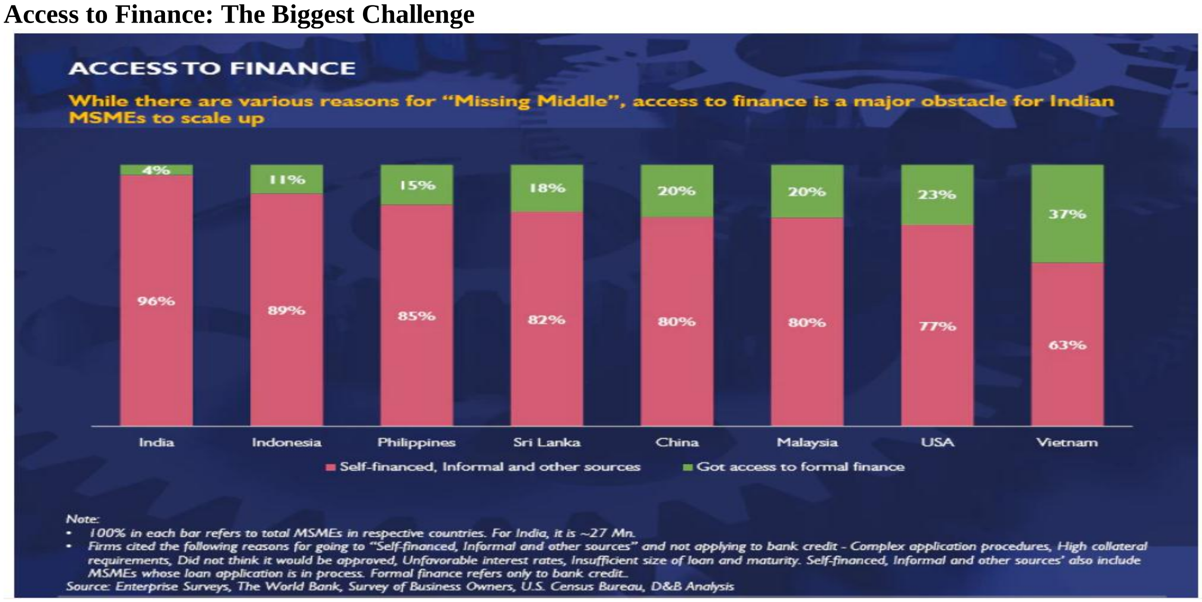
Within MSME sector, there are various industries and every industry has a differentiated need, a unique challenge.

These are the various challenges faced by traditional credit products, policies and processes -
1. Absences in credit history
2. Seasonal businesses
3. Poor banking practices
4. Cash flow analysis
5. Variety of collaterals
6. Properties in Rural areas

Need of hour is to continuously evolve product offerings which efficiently caters to such large unmet demands.

We should aim to focus on such profiles that generate daily cash, have good margins with smaller funding requirements. Some of the targeted profiles under this segment are illustrated below -
1. Barber
2. Tea Stall Vendor
3. Fruit/Vegetable Vendor
4. Milk Supplier
5. Milk Collection Center
6. Electrician
7. Plumber
8. Carpenter
9. School
10. Grocery Store
11. Dhobi
12. Mechanic with set up
13. Snacks Parlor (Samosa/Kachori Etc.)
14. Collage
15. Sweet Shop
16. Pan Shop
17. Halwai etc.

Access to Finance: The Biggest Challenge



Access to Formal Finance in India Source: D&B research

As per D&B, there have been four consistent concerns raised by MSMEs over the years:
1. Access to Finance
2. Availability of Adequate Infrastructure
3. Availability of Skilled Labour

4. Inadequate Power Supply

All these issues have played a role in limiting the growth of MSMEs but D&B's research reveals that access to finance and mindset issues are the major areas of concern. **"**This is rightly so because in India, only 4 percent of MSMEs have access to a formal source of finance, whereas the number in a country like Vietnam is 37 percent.**"** More than 20 percent of MSMEs in other markets, such as Indonesia, Philippines, China, Malaysia, the US and Sri Lanka, have access to formal sources of finance. "Despite efforts to address lack of bank credit for MSMEs, the share of bank credit to small businesses in total bank credit to industries has been declining since the early 2000s."

"Closing this gap will yield opportunities for Indian micro enterprises. We have observed that the small share of Indian micro enterprises that do have access to external finance has witnessed 19 percent Return on Capital Employed. When we compared this with the micro enterprises that did not have any access, their Return on Capital Employed was only two percent."

Manish Sinha, Managing Director at Dun & Bradstreet, India.

The Source of Their Finance: NBFCs

After acquiring the knowledge that the MSMEs require finance, I was intrigued to know the difficulties they might face in accessing the same. So I decided to visit a tea vendor who has taken loan from an NBFC named Finova Capital Pvt. Ltd. During the visit, I asked him the reason for not taking a loan from the bank and rather choosing a NBFC. "I went to the bank but I didn't have documented income, banking habits and documents which were required by the bank, so I was searching for a suitable alternative. Then I found Finova Capital which didn't require the documents" said the tea vendor.

Finova didn't require the documents as they have developed innovative methods to calculate the cash flow without documents. NBFCs have outperformed banks in the financial services by leveraging technology in credit assessment. Technology has made NBFCs expand into underserved segments where the banks don't serve or don't dare to reach. They have carved niche business areas for themselves by understanding local customers and building customized products which commercial banks have insofar failed to do.

Lessons from Corporations

Some Income Assessment Templates Used By **Finova Capital Private Limited (FCPL)**, a growing NBFC based out of Capital city of Rajasthan, to evaluate credit worthiness of its customers are listed below:

Tea Vendor

DETAILS OF MONTLHY INCOME CALCULATION							Verification mode
AVG PER DAY DETAILS OF MILK CONSUMPTION				32 litre			Pd, Kacche Bills ,Banking
Tea manufactured in per litre				25 cup			Pd, Kacche Bills ,Banking
Total cup sold in a day				800			Pd, Kacche Bills ,Banking
Rate of a cup				Rs.5			Pd, Kacche Bills ,Banking
Daily sale amount				Rs.4000			Pd, Kacche Bills ,Banking
	Income Total	Monthly	Rs 4000*30			**Rs.120000**	
EXPENCES				Per Day	Days		
MILK CONSUMPTION		**Details per day**	32*36	1152	30	34560	
TEA LEAF		1.5 kg @ Rs 240		360	30	10800	
Sugar		7 Kg @ Rs 36		252	30	7560	
Ginger		1.5 Kg @ Rs 120		180	30	5400	
Cylinders		8 per month @ Rs 900				7200	
Rent of Shop		Rs 4000 Per Month				4000	
Expences Total(B)						**Rs.69520**	
Monthly Income (A-B)						**50480**	
Deduction							
Tea Cup Sell by employee on commission			Avg 200 Cups per days			6000	
			Income after obligation			44480	
	Income	**Income Asssesed**	**Deviation**				
Customer	44480	40000	10%				

Hair Dresser

DETAILS OF MONTHLY INCOME OF ABC FROM GLOW & STYLE (UNISEX) PARLOR					
Services Offered	**Avg Footfall of Customer/day**	**Avg Charge(In Rs)**	**Total charge/day**	**Total Monthly charges**	**Varification mode**
Cutting					**PD,TVR**
Simple	8	75	600	15600	
Stylish	4	150	600	15600	
Ladies	4	150	600	15600	
Shaving					
Without foam	6	50	300	7800	
With foam	3	100	300	7800	
Massage					
Simple	2	100	200	5200	
Head Massage	1	100	100	2600	
Face scrub	1	75	75	1950	
Face Bleaching	1	150	150	3900	
Dye	4	150	600	15600	
Facial	1	350	350	9100	
Facial fruitcream	1	550	550	14300	
Eyebrow threading	4	150	600	15600	
Hair wash and dryer	3	75	225	5850	
Total(A)				**136500**	
Expenses:-					
Fixed-					
Rent				40000	
Salary				27000	
Variable-					
Goods consumed				8000	
Electricity and other charges				5000	
Total(B)				**80000**	
Income after expenses(A-B=C)				**56500**	
Income eraner	**Source of Income**	**Income**	**Income Assessed**	**Deviation**	
Sanjay Sain	Hair dresser	56500	50000	12%	
		56500	**50000**		

Vegetable Seller

DETAILS OF MONTHLY INCOME of Applicant and Co-Applicant					
Vegetable Broking Purchase location					Verification Mode
Lady Finger, Chilly , Tomato	Surat				PD
Corainder	U.P				PD
Corainder	M.P				PD
Corainder	Udaipur				PD
These are the places from where he is getting the wholesale vegetables in bulk and broking commission is fixed on these sales.					
Broking business	Avg. Sale	Commission %	Per Day Income	P.M Income	
Vegetable Broker	10K-15K /day	8-10%	900	27000	PD & TVR
	Per Day Sale	Margin	Per Day Income	P.M Income	
Vegetable Selling	7K-9K	30-35 %	2640	79200	PD
Expenses	Per Day			P.M Expenses	
Loading Tempo	200			6000	PD
Salary to employee	1500			45000	PD
Rent of Shop				3000	PD
	P.M Income After Obligation from Vegetable Sell			25200	
	Income Assessed	Income Consider	Deviation		
Broking Business	27000	22000	19%		
Vegetable Sell	25200	20000	21%		
Total	52200	42000			

Product Offering Arising Out of Research Done

1. Given the unmet demand, quantum of risk undertaken, and overall cost involved to reached out to the missing middle, the Rate of Interest (ROI) and Processing Fee (PF) could be kept around 22% and 3% respectively.
2. Tenure of loan could be set to around 7 years.
3. Property Insurance and Life Insurance of borrower/co-borrower could be done to protect erosion of money, in case of any eventuality.
4. Two to three EMI cycle date should be offered to customer depending upon the assessed nature of flow of income. For instance, EMI cycle date could be kept as 3rd or 10th or 15th of every month.
5. A financial guarantee ought to be taken on loan structure.
6. Loan to be backed by suitable mortgage of property like JDA Patta, Society Patta, RHB, Patta issued by Gram Panchayat, Nagar Palika, Municipal Corporation, UIT etc.
7. Appropriate mechanisms can be instituted for recovery of overdues/loan. Awareness throughcoldcalling, SMSsgenerated to customers, confirmation calling, taking legal recourse like initiation of arbitration proceedings, filing an FIR, etc. are a few measure to be considered.

Overall, this segment offers immense opportunities for growth and shall be a major growth driver for Indian economy, given the increasing Government attention on this sector.

Conclusion:-

The major obstacle to the growth of the important Indian MSME sector is its lack of adequate access to finance.It has been observed that over the last five decades MSMEs have emerged as a highly vivid and dynamic sector of the Indian economy. MSMEs play a very crucial role in providing large employment opportunities that too at a lower capital cost as compared to the large industries. They also help in the industrialization of the rural areas as well as low-income areas.This would help in reducing the regional imbalances which assure more equitable distribution of national income and wealth.

MSMEs are complementary to the large industries. This sector contributes enormously to the socio-economic development of the country. MSME in India contributes to financial growth, reducing poverty, a creation of employment, etc. It provides support for the development of new business and thus an innovation wave. MSME have the special role in balanced regional development along with rural development as well as outsourcing support and linkages with large units. MSMEs act as a backbone for the Indian economy.

Thereby, the opportunity is equally enriching for those lending as well as borrowing the loan. Banks and NBFC's have stayed away from this opportunity as their conventional approach is unsuited to lending with informal documented income. This un-served customer segment constitutes the 'missing middle'. Assessing income of this unorganized sector is daunting task hence, there is a need to develop an innovative and radically different approach based on detailed cash flow analysis at customer doorstep.

This segment provides immense growth opportunities. Service to this growth catalyst shall go a long way in strengthening the 'Make in India' campaign, as envisioned by Prime Minister Narendra Modi.
It will not only bolster the economic growth of country, but would also serve under mentioned purpose :

1. Meeting the credit need of the financially excluded, unreached, and unserved segment of society.
2. Upliftment of weaker sections of the society.
3. Reducing regional imbalances and inequalities in society.

Thus, there is a growing need to come up with innovative solutions and amazing product offerings, as stated above, in order to cater toand capitalize on the huge unmet opportunity presented by this sector.

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