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Empowering **MSMEs** for National Growth

We all know how crucial the MSME sector is to India's economy, given that it contributes over 30% to GDP and employs more than 11.1 crore people – the second-largest after agriculture.

Today, there are a mind-boggling 6.33 crore MSMEs in India, 90% of which are micro enterprises.

It tells you how crucial they are to the national objectives of growth with equity and inclusion.

So what's the global picture like? SMEs account for 57% of GDP in Japan, 46% in Korea and 60% in China and more than 50% of the employment in these countries. It is a similar case in the OECD economies as well.

Clearly, the Indian MSME sector has to play an even bigger role in employment generation and GDP growth in the road ahead.

Given the sector's importance, it is great to see the Government of India taking several steps to change the game and pursue the agenda of inclusive growth to help more MSMEs flourish.

These include the launch of Udyog Aadhaar to improve the ease of doing business, startup India & Make in India to promote innovation & indigenous manufacturing and the Pradhan Mantri Mudra Yojana.

The government's MSME-focused initiatives such as the Government Electronic Marketplace (GeM) and Trade Receivables Electronic Discounting System (TReDS) to support financing of MSME receivables, should help address limited market access and liquidity issues faced by small businesses.

Lenders, particularly banks, often cite lack of adequate and timely information and collateral as a reason for not being able to extend credit.

MSMEs also form a critical part of supply chains by working in areas such as sub-assemblies and services for larger companies.

CRISIL's analysis shows that among small manufacturers, those engaged in auto-components, chemicals and metal sectors are doing well.

And among services providers, those doing well include small IT/ITeS players, entities providing commercial services such as printing services, professional services, security control systems, solar panel installation services.

Those providing consumer-related services such as car rental services, cold storage services, repairs & maintenance services, event organizing services, technical advisory services are also among good performers.

But despite strong potential, MSMEs find it hard to secure adequate and timely credit from banks and other lending institutions at

competitive interest rates, which significantly hampers their competitiveness and comparative advantage.

Hence while these enterprises have the operational expertise and viable business model, they lack the capital needed to scale up businesses. Not surprisingly, over 78% of MSMEs rely on self-financing to meet their credit requirements.

There are several reasons for the poor access to institutional finance – lack of reliable background information and standard accounting practices, delayed payments, high risk perception of banks and other lending institutions, to name some.

Banks face challenges in credit risk assessment of MSMEs due to absence of information such as historical cash flows, credit track record and tools to assess credit risk and creditworthiness of these enterprises. These limitations have led to credit to MSME only accounting for 18% of bank credit despite their contributions to GDP and the country's exports. In the recent past, bank credit to SMEs has slowed down due to risk aversion and capital constraints faced by public sector banks.

However, NBFCs have been quick to sense an opportunity in this space and have garnered market share. Consequently, the share of NBFCs in credit to this segment stands increased to 18% from 8% five years ago.

We at CRISIL are very positive about MSME credit registering a high growth rate in the long term with improved availability of data. And the introduction of the goods and service tax (GST) and the government's digital push have a major role to play.

CRISIL believes that linking data on GST with credit evaluations can help determine the creditworthiness of MSMEs like never before. Such a facility will also encourage more [MSMEs](#) to register with the GST Network and accelerate their formalisation.

Let me also take a few minutes to delve on how CRISIL has worked in the SME space for more than a decade to bring about a meaningful change.

As you may all be aware CRISIL, is India's foremost provider of ratings, data, research, analytics and solutions. We are also the first mainstream rating agency in the world to launch ratings for SMEs and microfinance institutions. CRISIL has achieved the distinction of having assessed more than 1.25 lakh MSMEs, the most in the world. We have also, so far, assessed over 270 microfinance institutions. This is a matter of great pride for us!

Apart from lenders, CRISIL also works closely with large corporates and government ministries on varied assignments helping improve their supply chains which largely comprises MSMEs.

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CRISIL believes in that MSMEs in India have a great future ahead and the journey has just begun.

As a result we are continuously investing in this space focus towards building a digital ecosystem and creating offerings for lenders with accurate credit assessments.

For the MSME sector, CRISIL has launched Performance Ratings which assess a firm's financial viability, its management team and business model etc, and analysing these to ascertain its capability to repay debt.

These performance ratings not only help lenders take credit decisions but also help benchmark an organisation's overall health and its performance within the industry.

Therefore, adoption of performance ratings have boosted financial discipline, disclosure and governance practices among MSMEs, thereby reducing the risk perceived by lenders in lending to these entities.

We also recently launched smefirst.com, our digital platform to provide one-stop solution to lenders and borrowers alike to meet their credit assessment requirements. Given that MSMEs are spread far and wide in this country, an easy to use digital platform can go a long way in helping them develop a strong credit culture.

Another recent innovative offering from CRISIL is a robust commercial risk management solution called CCAS – or the CRISIL Credit Assessment Score.

I believe CCAS will play a revolutionary role in the financial inclusion of MSEs by giving them access to formal finance and shortening their loan approval process.

It is a critical tool that provides institutional lenders an accurate evaluation on the credit profile of an MSE in relation to their peers, based on the assessment of the borrowers transaction history, management and financial risks. It can be accessed and verified in a few clicks on smefirst.com.

Recently this year, CRISIL and SIDBI launched India's first MSE

sentiment index called CriSidEx.

Since data on MSEs comes with a significant lag, CriSidEx will act as a lead-cum-lag indicator, will provide ground-level intelligence and insights for regulators, trade bodies, lenders as well as economic and financial analysts.

The first findings of the index were released by the Honourable Finance Minister Shri Arun Jaitley-ji in January. The findings revealed optimism among both MSEs and lenders. For the survey quarter (Oct-Dec 2017), CriSidEx value debuted at 107 representing mildly positive sentiment. In the next quarter (i.e. January to March 2018), the sentiment is expected to move to more positive territory. The CriSidEx survey highlights access to funding, availability of skilled labour and technology, infrastructure and raw materials as some of the key challenges faced by MSMEs today.

I would like to emphasize that the MSME sector has the potential to reshape the economy like no other segment can. The need of the hour, therefore, is to strengthen the overall ecosystem for MSMEs.

Access to credit has been cited as the main limiting factor for decades now.

To change that game, we need to facilitate better financial reporting from them in a timely manner and moving to cash flow-based lending – away from the traditional collateral-based lending – along with periodic credit assessments.

That'll ensure near-constant monitoring of the MSME's health.

It will also encourage formalisation, and save millions of MSMEs from being trapped in informal lending channels by paying very high interest rates.

It will also improve their confidence and efficiencies, and put them on the path to scalability for India to achieve a strong 8% + GDP growth – a vibrant MSME segment with access to credit in imperative.

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