Strengthening of Credit Flow to SSI Sector in India  
- New Approaches  

(Draft Proposal)

Introduction

In 1997, the Government of India (GOI) classified a Small Scale Industries (SSI) unit as an undertaking with an investment in fixed assets in plant and machinery upto Rs. 3 crores. Within the SSI, those with investment in plant and machinery upto Rs. 25 lakh are termed as Tiny Industries (TI) units. The ceiling on investment in plant and machinery in respect of SSI unit was slashed to Rs. 1.0 crore with effect from December 24, 1999. But in terms of credit limits, the Study Group on Development of Small Enterprises (Dr S P Gupta Committee), distinguished SSI and Medium industries and introduced the concept of Small and Medium Enterprises (SME) in terms of investment in plant and machinery. Accordingly, SME consist of Tiny sector (upto Rs. 10 lakh investment in plant and machinery), SSI sector (Rs. 10 lakh upto Rs. 100 lakh and Medium sector (Rs. 1 crore to Rs. 10 crores).

The SSI sector covers a wide spectrum of more than 7,500 products. It's contribution is reflected in terms of share of 6.3 per cent of the GDP, 95 per cent of all industrial units in the country, 34 per cent of total exports and provision of 20 million jobs. This dynamic and vibrant sector also acts as a nursery for promoting entrepreneurial talent and as a catalyst in industrial growth through an elaborate network of about 3.6 million units. The sustained growth of the SSI sector is, however, constrained by delayed payment of bills, technological obsolescence, marketing bottlenecks, weak infrastructure, lack of technological synergy between technology seekers and technology developers (R&D), high cost of patents, ineffective co-ordination among national level institutions involved in promoting fast-track
development and inadequate and delayed bank credit. While efforts are on to overcome constraints relating to non-credit inputs by emphasizing on investment and technology upgradation, infrastructure and marketing support, testing, quality certification, training to entrepreneurs, etc. the problems relating to credit flow to SSI are yet to be resolved. This is evident from the reports of several committees appointed by the Reserve bank of India (RBI) and Government of India (GOI). In this regard, it is worth analysing the present arrangements for the supply credit to the sector.

Credit Supply to SSI Sector

Entrepreneurs need short term (working capital), medium term and long term finance which are provided by public and private sector banks, Small Industries Development Bank of India (SIDBI), National Bank for Agriculture and Rural Development (NABARD), Regional Rural Banks (RRBs), Urban Co-operative Banks (UCBs) and foreign banks. Public sector banks (PSBs) were conceived and functioned as instruments of social change and also played a pivotal role in developing the SSI sector. The RBI’s consistent direction to PSBs to allocate 40 per cent of their lending towards the priority sector, i.e., agriculture, small scale industries, tiny sector, village and cottage industries, small traders, professionals and self-employed, housing loans, etc. is sometimes held responsible for a higher level of Non-performing Assets (NPAs) in these sectors. State Finance Corporations (SFCs) were mandated to serve as regional funding agencies for promoting regional growth through SSI by granting term loans for purchase of land/machinery and equipment/construction of factory premises for setting up new industries or modernising existing ones and participating in their equity base. In view of the genuine difficulty of many SSI units, particularly the first-generation entrepreneurs, in accessing to bank credit because of their inability to provide adequate collateral security, the Government of India (GOI) launched a guarantee scheme. The Credit Guarantee Fund Trust for Small Industries (CGTSI), set up by the GOI and SIDBI, is the nodal agency for the scheme. The CGTSI helps make collateral-free credit, both term loans
as well as working capital, by guaranteeing 75 per cent of the credit risk of eligible lenders, viz., banks and institutions subject to a loan cap of Rs. 25 lakh and guarantee cap of Rs. 18.75 lakh per borrower.

The overall framework of the credit dispensation is found to be inadequate in meeting the need for sufficient and timely institutional credit to the SSIs. Hence, an expert committee (Chairman : Dr Abid Hussain) and an informal group of the Planning Commission (Chairman : Dr G Thimmaiah) examined the role of bank credit in development of SSI sector. Subsequently, the SL Kapur Committee Report emphasised that only 15-20 per cent of the credit needs of the sector were being met. Accordingly, it suggested several initiatives to increase credit to the SSI sector. Regional Rural Banks (RRBs) and SFCs increased the flow of credit to SSI through bankable schemes. 27 PSBs through their countrywide network of over 45,000 branches, including 395 specialised SSI branches, meet the working capital needs of SSIs. Recently, the Ganguly Committee on Credit Flow to the SSI sector has suggested the banks to go in for a ‘cluster’ approach. Despite recommendations of these committees, credit flow to SSI is considered weak. To elaborate, while the outstanding credit to the SSI sector by PSBs rose from Rs. 42,591 crore in 1999 to Rs. 48,445 crore in 2001 and further to Rs. 49,743 crore in March 2002, the percentage share of SSIs in net bank credit (NBC) progressively declined from 16.1 per cent in 1998 to 14.4 per cent in 2001 and further to 12.5 per cent in 2002. Hence, this calls for introducing new approaches in bank lending.

**Need for New Approaches in Bank Finance to SSI**

The issues of adequacy, appropriateness and delivery of financial and promotional support to SSI sector as also creation of an enabling environment for enhanced private investment because of changed ground realities are significant. The way ahead for SSI sector is full of
challenges. Hence, a need for looking for new approaches clearly exists. These may include cash flow based lending, cluster approach based lending, strengthening of micro-finance to tiny units developing venture capital, reshaping credit guarantee scheme, factoring services etc. More importantly, banks have to introduce the concept of Business Process Re-engineering (BPR) to make their credit related products and credit delivery more customer friendly. Transaction cost in lending should be reduced to pass on the benefits of the same to the units. Zonal process centre, may be set-up to reduce the time in loan sanction besides opening more specialised branches. Alongwith this, the product-range of banks needs to be reviewed. A special attention requires to be paid to rapid spread of information and communication technologies (ICTs). E-commerce occurs through Business-to-Business (B2B), Business to Consumer (B2C), and Consumer-to-Consumer (C2C). SMEs can play an increasingly greater role in B2B and B2C transactions. Competitiveness transcends costs and prices to encompass close linkage of producers and customers. Innovative and fast track financing methods of SSI include creation of a common Facility Support Fund for clusters, a meaningful tiny sector package and an exit route for the large number of non-viable units. Above all, attitudinal change among the bank staff towards SSI is all the more important. Further, as on March 31, 1999 3.06 lakh sick SSI units locked up bank credit of Rs.4,313 crores. The Rehabilitation of sick SSI units requires identification of sickness, measuring the gravity of sickness, viability study, preparation of nursing proposals meticulous plan implementation and assessment of recovery. PSBs have a critical role in preventing incipient sickness and nursing the ailing sick units by a concrete time-bound action plan. Thus, it warrants a need for undertaking a study to suggest new approaches for strengthening the credit flow to the SSI sector. The broad outline of such study is discussed as under:
Methodology of the Study

Development of the SSI sector depends upon the adequate and timely supply of credit. Hence, it is proposed to assess how far development of the SSI sector on one hand and bank credit on the other, are correlated by studying the secondary data. Many expert committee recommendations relating to bank credit have already been implemented. But the study intends to measure the impact of the same on the credit supply by holding discussions with the top management in banks and RBI. In the context of economic liberalisation and globalisation, the SSI sector is expected to grow fast and its requirements of credit would be huge and of varied nature. Therefore, the study would clearly spell-out changing expectations of the units through interacting with the entrepreneurs. On the supply of credit side, banks have their own plans. So, it would be possible to assess gaps, if any, between demand for and supply of credit to the SSI sector in the coming years, for which a futuristic approach is called for. For filling up such gaps have to be evolved by holding discussions with field staff at bank branches and with the top management in banks, development agencies and the RBI. It is also proposed to look into the response pattern to new approaches adopted for strengthening the credit flow to the SSI sector, for which discussions with banks and financial institutions are essential. It would also be an interesting exercise to develop a few success stories so that many lessons on bank finance to the SSI sector, shall be drawn. Such success stories will be based on interactions with entrepreneurs and by going through the bank records.

From the available secondary data, trends in respect of growth of the SSI sector and bank credit are worth studying. To elaborate, bank credit as a critical input, facilitates the pace of development of the SSI sector. If the supply of credit is adequately and timely assured, the SSI sector is expected to grow at a faster rate. During the reform process, many developments have taken place to influence the supply of bank credit and at the same time, the SSI sector has also experienced numerous challenges. Hence, the study sets hypothesis as under:
During the financial sector reform period in India, growth rate in SSI sector and supply of bank credit are correlated. Adequate and timely supply of bank credit enhances the growth rate of SSI sector. Reverse is the case when there are constraints in the supply of bank credit.

In the above backdrop, the study sets the following objectives:

1. To measure the relationship between growth of the SSI sector and supply of credit during the recent past.
2. To assess the progress made in implementation of recommendations of the expert committees, appointed by the Government of India and Reserve Bank of India during the financial sector reform period.
3. To spell out expectations of the SSI units from banks taking into account their future plans.
4. To draw lessons from the success stories in the SSI sector in which banks have been found to be more customer friendly.
5. To examine various constraints associated with the credit supply and suggest strategies to resolve the same. More importantly, the study is expected to suggest new approaches in bank finance to the SSI sector and work out plan for effective implementation of the same.

To fulfill the above objectives it is proposed to adopt different methodologies for data collection and analysis. To start with, the available literature on bank finance to the SSI sector in India and abroad will be reviewed to assess trends in credit supply to the same. It is proposed to hold discussions with senior executives in RBI and few nationalised banks in Pune and Mumbai to assess the progress made in implementation of the recommendations of the expert committees relating to credit supply to the SSI sector. A sample of 50 SSI units and 10 bank branches will be adopted in Pune and Mumbai to understand the nature and extent of expectations of the SSI sector from banks and examine constraints, if any, in
fulfilling the same. A case study approach will be adopted to develop 10 success stories to draw various lessons. The innovative approaches in banks and financial SSI sector will also be studied by perusing the available literature and through interactions with bank executives. At the end, the study will offer various strategies to strengthen the credit flow to the sector. Data/information will be collected by referring to the secondary sources and holding discussions with entrepreneurs, branch managers and executives in banks and financial institutions by developing structured questionnaires.

Scope of the Study

The study is intended to address various issues relating to the credit supply to the SSI sector. Based on data analysis, it would be possible to suggest new approaches in regard to strengthening of credit flow to the SSI sector. This would be an extensive field survey besides carrying out an analysis of the secondary data. The proposed study has a lot of relevance in today’s context when the new Government in India is keen to step up the credit flow to the SSI sector which is expected to grow at the rate of 12% during the tenth Five Year Plan. Credit being the critical input for the development of the sector, it is proposed to examine various constraints in its supply and corrective strategies. Towards this end, the proposed study aims at contributing a lot.

Scheme of Chapterisation

Chapter 1 Development of SSI Sector in India – Problems and Prospects
Chapter 2 Trends in Credit Supply to the SSI Sector – Some Concerns
Chapter 3 Methodology
Chapter 4 Survey of SSI Units
Chapter 5 Survey of Branch Managers
Table 1 : Performance of Village and Small Industries Sector

<table>
<thead>
<tr>
<th></th>
<th>Production (Rs. Crore)</th>
<th>Employment (Lakh Nos.)</th>
<th>Exports (Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1990-91</td>
<td>2002-03</td>
<td>1990-91</td>
</tr>
<tr>
<td><strong>Modern SSIs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SSIs</td>
<td>1,55,340</td>
<td>7,60,844</td>
<td>125</td>
</tr>
<tr>
<td>Powerlooms</td>
<td>14,306</td>
<td>27,838</td>
<td>52</td>
</tr>
<tr>
<td>Sub-Total</td>
<td>1,69,646</td>
<td>7,88,682</td>
<td>177</td>
</tr>
<tr>
<td><strong>Traditional Industries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Khadi and Village Industries</td>
<td>2,280</td>
<td>8250</td>
<td>48</td>
</tr>
<tr>
<td>Handlooms</td>
<td>3,974</td>
<td>16,900</td>
<td>92</td>
</tr>
<tr>
<td>Sericulture</td>
<td>866</td>
<td>1,477</td>
<td>52</td>
</tr>
<tr>
<td>Handicrafts</td>
<td>11,325</td>
<td>22,765</td>
<td>44</td>
</tr>
<tr>
<td>Coir</td>
<td>279</td>
<td>1,458</td>
<td>5</td>
</tr>
<tr>
<td>Sub-total</td>
<td>18,724</td>
<td>50,850</td>
<td>241</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,88,370</td>
<td>8,39,532</td>
<td>418</td>
</tr>
</tbody>
</table>

Source: SIDBI’s Annual Reports, various years.

Table 2 : Flow of Credit to SSI Sector by Public, Private Sector and Foreign Banks

(Balance outstanding as at end-March) (Rs. crore)

<table>
<thead>
<tr>
<th>Banks</th>
<th>1969</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBs</td>
<td>257</td>
<td>42,591</td>
<td>46,045</td>
<td>48,445</td>
<td>49,743</td>
</tr>
<tr>
<td></td>
<td>(8.5)</td>
<td>(16.1)</td>
<td>(14.6)</td>
<td>(14.2)</td>
<td>(12.5)</td>
</tr>
<tr>
<td></td>
<td>NA</td>
<td>6,451 (18.9)</td>
<td>8,000 (16.5)</td>
<td>8,158 (14.4)</td>
<td>8,613 (13.7)</td>
</tr>
<tr>
<td>------------------</td>
<td>-----</td>
<td>--------------</td>
<td>--------------</td>
<td>--------------</td>
<td>--------------</td>
</tr>
<tr>
<td><strong>Indian Private</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Banks</strong></td>
<td>NA</td>
<td>2,460 (11.0)</td>
<td>2,990 (10.6)</td>
<td>3,716 (11.0)</td>
<td>4,561 (11.6)</td>
</tr>
<tr>
<td><strong>Foreign Banks</strong></td>
<td>NA</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>-</td>
<td>51,502</td>
<td>57,035</td>
<td>60,319</td>
<td>62,917</td>
</tr>
</tbody>
</table>

Figures in parentheses represent percentage share of Net Bank Credit (NBC).
Source: RBI Reports on Trend and Progress of Banking in India (various issues).
Respected Dr Mishra Sir,

I am submitting revised draft chapters (Nos. 1 to 11) for your approval, please.

With this, All chapters are written and submitted after incorporating your suggestions on the first draft. My next plan is to submit the Synopsis after receiving your approval of the enclosed revised draft chapters. I will also carry out changes, if any.

I would like to draw your attention to the two changes made by me in the first draft chapters referred to you earlier and the same may be seen in the enclosed revised draft chapters. These include:

1. I have updated the data after receiving the Annual Report of the Ministry of Small Scale Industries for 2005-06 and the RBI Annual Report for 2005-06 and also incorporated the latest developments such as enactment of Micro, Small and Medium Enterprises and Development Act, 2006.

2. I have incorporated all your suggestions which include:
   - Limitations of the study.
   - Scope for measuring the relationship between growth in production value and bank credit to the SME sector over the years by calculating CAGR and ANOVA techniques.
   - PEST and MOST of SSI.
   - Every chapter to be written keeping the objectives of the study in mind and connect one chapter to another.
   - Critical analysis in done wherever required and inferences are drawn from data analysis.
   - Factoring, Forfeiting and export financing.
   - Delayed payments to SMEs by large corporates by referring the MSMED Act, 2006.
   - Agency Cost of banks is suggested by you but difficult to calculate for want of data but suggestions are made to pass on benefits of Financial Sector Reforms, use of advanced IT and linking Rating of SMEs and Loan Pricing.

Lastly, I would like to state that I am lucky to receive guidance from you as well as from my father, as advised by you. This helped me to finish the write up in time. My father has gone through the enclosed draft chapters carefully and advised me to change, wherever required.

I look forward to hearing from you.

Yours Sincerely,

Shilpa Kulkarni

(November 14, 2006)
September 26, 2005

Dr K C Mishra
Director
National Insurance Academy
Pune

Dear Sir

Sub: Progress Report on my Ph. D. study, for November 2004 to April 2005 and May to September 2005

I am submitting herewith the progress report in respect of my Ph.D. study on Strengthening of Credit Flow to SME Sector, undertaken under your guidance.

November 2004 to April 2005

- Reviewed literature on the subject at NIBM library – Reports of the Committees and Working Groups, RBI publications, GOI publications, Annual Reports of SIDBI, relevant books and articles.
- Prepared draft Chapter I highlighting the Role of SME sector in India.
- Collected statistical data from RBI and GOI publications and prepared Tables.

May to September 2005

- Received suggestions from the Guide on draft Chapter I.
- Prepared draft Chapter II highlighting credit related aspects – RBI guidelines statistics relating to credit flow to the SME sector, recommendations of RBI committees and study groups, initiatives taken by RBI and GOI, issues etc.
- Prepared draft Chapter III on Industrial Sickness in SME sector.
- Prepared draft questionnaire for conducting survey of branch managers and entrepreneurs.
- Received suggestions from the Guide on draft Chapter II.

This is for your information, please.

Thanking you

Yours faithfully

Shilpa S Kulkarni
Ph.D. Student (Faculty - Commerce)

c.c. to: Deputy Registrar, Academic Department, Ph.D. Section, University of Pune
September 26, 2005

Dr K C Mishra
Director
National Insurance Academy
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Shilpa S Kulkarni
Ph.D. Student (Faculty - Commerce)

c.c. to: Deputy Registrar, Academic Department, Ph.D. Section, University of Pune