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Credit and Financial Requirements of Small and Medium Scale Enterprises thorough Institute Finance

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INTRODUCTION

India is an emerging economy with a population of more than One Billion. Nearly 40% of the population lives below the poverty line and 70% of the population is dependent on the agriculture for sustenance. The economic reconstruction of India depends on the balanced growth of economy in the fields of agriculture and industry. Because capital and finance have been scarce in India, the Government of India has encouraged alternatives to agriculture and heavy industries like small-scale industries, which can operate on limited resources. A small-scale industry can be operated by an entrepreneur without needing sophisticated machinery and modern technology. These small-scale industrial units can be established in semi-urban and rural areas where the infrastructure is underdeveloped. The objective is to use local raw material for raising production with the help of local skills. Small-scale industries provide employment without affecting the main occupation -agriculture- of illiterate people in rural areas in India. The other advantages of small-scale units are that these units need short gestation period in establishment, are less dependent on imported raw material and machinery and help in meeting a substantial part of demand for consumer goods. These units also help in solving the problem of regional disparities in economic growth (Gyan Prakash, 1991).

In recent years, the small-scale sector in India has emerged as a progressive and decentralised sector on its own. Small-scale Industries have made a significant contribution to employment generation in the non-agricultural sector in India. The data available from the Ministry of Small-scale Industries, Government of India (Annual Report 1999-2000) indicates that there has been an excellent growth in small-scale industries in India in recent years. The number of SSI units in India has increased from 2.082 million in 1991-92 to 3.121 million in 1998 -99. The value of production in these units has increased from Rs.1786.990 Billion to Rs.5275.150 Billion in 1998-99. The volume of employment in small-scale sector has increased from 12.98 million in 1990-91 to 17.158 million in 1998-99. The growth of employment in small sector is significantly large in small sector than other organised sector in India. Small-scale industrial units have a large potential and an important role to play in India. Sickness or financial distress in small-scale sector is however of great concern to the government of India and the entrepreneurs. The number of sick units has increased from 221,472 in 1991 to 306,221 in 1999 Reserve Bank of India, 1999- 2000). The magnitude of sickness in last 9 years has prompted Reserve bank of India aid the Government of India to take certain policy initiatives to eradicate sickness. The problem however still persists.

The SSI sector has grown rapidly over the years. The growth rate is very impressive. The number of small-scale units has increased from an estimated 874 thousand units in 1980-81 to 3.121 million units in the year 1998-99. The employment in SSI sector has increased from 12.53 million persons in 1990-91 to 17.16 million persons in 1998-99. The rate of growth in the number of SSI units in India is given in Figure 1.

From the year 1990-91 this sector has exhibited a lower growth trend. This has to be viewed in terms of general recession in the economy. The transition period of the process of economic reforms was also affected for some period by adverse factors such as foreign exchange constraints, credit squeeze, demand recession and high interest rates. During 1994-95 and 1995-96, the trend was reversed. After 1997-98 the growth rate was reduced possibly due to the effect of Asian Financial Crisis and also due to the change in the legal definition of SSI units, which resulted in the decrease in the original cost of plant and machinery, which could be covered in SSI sector.

The rate of employment growth in SSI sector in India between 1990 and 1999 is about 3-5% per year as is evident from Table 1. The SSI sector is particularly suited for employment growth in a country like India because SSIs are more labour intensive than larger industries, which are capital intensive. The labour intensity of SSIs enables them to provide employment to millions. Further SSIs also help in solving the problem of regional disparities in employment in India by maximising employment opportunities in rural and semi-urban areas. One of the disadvantages of

Table 1: Growth in number of units and employment in SSI sector in India

Year	Number of Units In thousands	% Growth in no. of units	Employment (No.of persons) in millions	% Growth in employment
1990-91	1948	6.86	12.53	4.77
1991-92	2082	6.88	12.98	3.59
1992-93	2246	7.98	13.406	3.28
1993-94	2381	6.14	13.938	3.97
1994-95	2571	7.66	14.656	5.15
1995-96	2724	8.05	15.261	4.13
1996-97	2857	4.88	16.00	4.84
1997-98	3014	5.5	16.72	4.5
1998-99	3121	3.55	17.158	2.62

Data source. Ministry of Small-scale Industries & Agro and Rural Industries, Government of India, Annual Report 1999 - 2000, Page 4.

CREDIT AVAILABILITY

Table 2 shows the position of credit flow to SSI sector in India. Most of the credit to SSI sector in India is provided by public sector banks, which are expected to follow the government policy in the flow of credit. The SSI sector is covered as a priority sector for lending purpose by the public sector banks according to the policy laid down by the Reserve bank of India. However this policy does not apply to private sector and foreign banks in India.

Table 2
Credit to SSI sector from Public Sector Banks in India (Amount in Rs. Billions)

Net Bank Credit	At the end of March				
	1995	1996	1997	1998	1999
Net Bank Credit	1690.38	1843.81	1896.84	2182.19	2462.03
Credit to SSI	258.43	294.85	315.42	381.09	426.74
No. of SSI accounts (in thousands)	3225	3377	N.A	2964	N.A.
SSI credit as % of Net Bank Credit	15.29	15.99	16.6	17.5	17.33

Data source: Small Industries Development Organisation: Small-scale Industries in India.

The percentage of net bank credit to SSI units from public sector banks has increased from 15.29% in 1995 to 17.33% in 1999 against a target of 16% set by Reserve Bank of India for public sector banks. Although the private sector banks and foreign banks are exempt from these regulations, the outstanding credit deployment to the SSI sector from private sector banks was at Rs.64.51 Billion at the end of March 1999 forming a share of 18.9% of their net credit. Outstanding advances to SSI sector from foreign banks aggregated Rs.24.50 Billion at the end of March 1999, accounting for 11% of their net bank credit.

According to Raju (2001), the lack of access of timely and adequate credit is a big hurdle for the development of SSI sector in India. The Adid Hussain Committee constituted by the Reserve bank of India in 1997 examined the problem of credit to SSI sector and recommended

the restructuring of financial support to SSI sector because the overall credit availability to SSI sector during 1991-96 was only 13% of the value of production. It is very clear that legislative measures and government policies in regard to financing of SSI units have not been able to address the issue of credit availability to this vital sector of India economy adequately. The involvement of private sector and foreign banks in India in this regard has been very limited. The private sector banks do not have a vast network of branches in India as do the public sector banks. Foreign banks are mostly confined to big cities of India reducing their availability as a creditor to vast number of SSI units, which are located in small towns.

Table 3 gives the status of credit flow to tiny sector, within SSI sector since 1995. As per RBI guidelines; 40% of priority sector lending to SSI has to go to tiny units with investment in plant and machinery below Rs. 500,000 and another 20% to tiny units with investment in plant and machinery between Rs. 500,000 and Rs 2.0 million.

Table 3 Credit to Tiny Sector as a part of SSI sector in India

Net Bank Credit (Amount in Rs. Billions)	At the end of March			
	1995	1996	1997	1998
Net Credit	77.34	81.83	95.15	102.73
Tiny Credit as a Percentage of credit to SSI	29.93	27.76	30.2	27.0

Data source: Small Industries Development Organisation: Small-scale Industries in India,

Thus against a target of 60% of SSI credit to tiny units, actual flow is at 27%. RBI has taken a number of steps in recent years to improve the credit delivery mechanism to SSI units such as encouraging public sector banks to open more specialised SSI branches at centres where there is a potential for financing SSI borrowers.

As on March 1998, 370 specialised branches were already working in the country. Other measures include extending single window scheme to meet all financial requirements of term loan and working capital, delegation of enhanced power to branch managers of SSI branches and according the benefit of less spread over prime lending rates to SSI units with a good track record. In spite of all these measures the problems remains.

The directed credit policy of the Government of India has helped in raising the investment in the small-scale industries in India considerably as evidenced by the work of Eastwood et. al (1999; p.58), who are of the opinion that "the view that the efforts minimising official of public sector banks are unlikely to lend to small firms unless forced to do so should not be discounted, making the directed credit somewhat stronger in the case of such banks." Eastwood et. al (1999; p.57) conclude that "directed credit policy in India was well conceived and successful in the case of small modern sector firms; the financial constraints that the policy was designed to relax does appear to have existed and the extra bank credit channelled to small firms does seem to have raised their investment appreciably".

a. Financial Concessions

From time to time the SSI units have been given a number of financial concessions.

Some of the concessions currently available are:

- Excise exemptions for branded goods to units located in rural areas. General Excise
- Exemption to industries such as those engaged in cotton yarn and glazed tiles, packaged tea.
- Increase in MOD VAT Credits to manufacturing units
- The other fiscal incentives are by way of concession in credit to SSI units from banks.
- Important changes in recent budget include:
- Enhancement in the limit of composite loan from Rs. 200,000 to Rs. 500,000.
- Delegation of more powers to branch managers to grant ad-hoc facilities to the extent of 20% of limit sanctioned.
- Special training programs for branch managers.
- Opening of more SSI branches.
- Credit insurance scheme.

b. Reservation

The reservation of items of exclusive manufacture in SSI sector is statutorily provided for in Industries (Regulation and Development) Act. The reservation policy aims to ensure that the bulk of increased production of consumer goods is in the small-scale sector. The reservation policy also helps in expanding employment opportunities through setting up of more SSI units. 812 items are currently reserved for exclusive manufacture in SSI sector. Non-SSI units can undertake manufacture of reserved items only if they undertake 50% export obligations. There is no regulation or restrictions on marketing of reserved items by large units.

c. Infrastructure Support

The government has launched a program of infrastructure development in regional and rural areas. Infrastructure facilities like power, water, communications are funded by the government and SIDBI with the government providing equity and SIDBI providing the loans.

d. Training

The Small Industries Development Organisation, through its network of Small Industries Service Institutes is conducting training programs such as Entrepreneurship Development Programs for various target groups for generating employment and upgrading skills in industries such as hosiery, food products, leather products, herbal cosmetics etc. These trainees are given equity assistance and loans for setting SSI units.

e. Technology Support

SIDBI had set up a Technology Development and Modernisation Fund for direct assistance of Small-scale Industries to encourage existing industrial units in the sector, to modernise their production facilities and adopt improved and updated technology to strengthen their export capabilities. Assistance is available for meeting capital expenditures, acquisition of technical know how, upgrading of process technology and total quality management in SSI units. The other forms of technology support include:

Setting up tool rooms and Product cum Process Development Centres Providing assistance to industry associations/voluntary agencies to set up testing centres.

Industry Specific Institutes for training such as Central Leather Institute.

Export promotion

Export promotion from the small-scale sector has been accorded a high priority in the India's export promotion strategy because export from this sector accounts for about 40% of total exports. Export strategy for SSI sector includes simplification of export procedures, providing export incentives, trainings and awards etc.

g. Credit Guarantee Scheme

The objective of the Credit Guarantee Scheme is to help the SSI units to access credit without the need for a collateral security from eligible financial institutions. The loan limit under the scheme is Rs.2.5 million. The Government of India and SIDBI, the apex development bank have set up a corpus fund of Rs.25 Billion. The fund, which is known as Credit Guarantee Fund Trust for Small Industries (CGTSI) helps in the availability of collateral free credit to the SSI sector. The Member Lending Institutions sanction credit to the eligible borrowers based on the viability of the projects and seek guarantee cover from CGTSI against the payment of one time guarantee fee 2.5% of the sanctioned credit facility and thereafter, annual service fee of 1% on the outstanding credit. CGTSI guarantees up to 75% of the credit subject to loan cap of Rs.2.5 million and guarantee cap of Rs. 1.875 million per borrower. The current trend in percentage of default is around 20% (Venkatsubramanyam, 2001). The success of the guarantee scheme will get reflected only when Member Lending Institutions treat the guarantee scheme as an incentive to support the SSI units.

ANALYSIS OF POLICIES AND PERFORMANCE

The performance of SSI sector in India can be analysed based on the economic rationale for intervention by the governments in support of small and medium scale enterprises developed by The World Bank and discussed in the paper by Hallberg (2000). According to Hallberg (2000), the economic importance of SMEs can be investigated based on a number of factors such as share of firms and employment, labour intensity of SMEs, efficiency and social, political and equity justifications.

The first criterion discussed by Hallberg(2000) is the share of firms and employment. From the data given in Tables 1,2,3 it is observed that

the SSI sector in India has shown considerable growth from 1990-91 in terms of number of units, employment numbers, production and exports. Nearly 40% of India's G.D.P. is contributed by SSI sector. Although the employment numbers in this sector of economy could be high compared to production levels this could be explained as being due to the nature of product composition in India, as suggested by Hallberg (2000). The reservation policy of the Government of India in regard to production of consumer good items in small-scale sector could possibly contribute to large labour force working in SSI sector in

India. Nearly 812 items of consumer goods are reserved for exclusive manufacturing by SSI sector and large labour force could be working in these sectors.

Hallberg (2000) further suggests that "small firms have higher job creation and destruction rates than large enterprises and may offer lesser job security than large firms." In India the destruction rate of SSI firms is close to 9-10% and revival rate of SSI units is very small (only 6-7% of the sick units are revived). This data supports the contention of Hallberg(2000) in regard to destruction of small firms.

Another important issue in regard to SSI units is the efficiency of these units. According to Hallberg (2000), "smallest firms are least efficient". This view of Hallberg (2000), is supported by Goldar (1988) in regard to SSI sector in India. According to Goldar (1988),"while small Indian modern sector firms are more labour intensive than larger firms they are less efficient". Given the suggestions of Hallberg (2000) and Goldar (1988), it may therefore be more appropriate to compare the relative efficiency of SSI units in India over a period of time instead of comparing their efficiency with larger firms in India. shows the employment per unit in SSI sector in India from 1990-91 to 1998-99.

The production per unit and production per person employed in SSI sector in India from 1990-91 to 1998-99. It is observed that the employment per unit in India has declined progressively from 1990-91 to 1998-99 whereas the production per unit and production per person employed has increased during the same period. This suggests that the SSI sector in India is progressively increasing their efficiency in regard to production and employment.

This increase in relative efficiency has resulted from a very low fixed investment pei unit of Rs208056 and fixed investment per person of Rs.37,844 (smeindia.com, 2001) These ratios are important for SSI sector in a country like India because India has an intense capital shortage and SSI units in India face a credit shortage as discussed in Section 4.

Table7: Efficiency parameters of SSI sector in India

Year	No. of persons employed per unit	Production (in Rs.)	
		per unit	per person employed
1990-91	6.43	797,433	123,974
1991-92	6.23	858,305	137,672
1992-93	5.96	931,878	156,124
1993-94	5.85	1014,901	173,373
1994-95	5.70	1143,485	200,593
1995-96	5.60	1307,683	233,413
1996-97	5.60	1444,298	257,897
1997-98	5.54	1543,367	278,212
1998-99	5.50	1724,950	313,764

Another important issue in regard to SSI sector is the issue of social, political and equity justification for the promotion this sector in India. According to Hallberg (2000), "the desire of the governments in promoting SMEs is often based on social and political consideratbns rather than on economic grounds." In the case of India, the support given to the SSI sector by the government does not seem to be entirely on the social and political considerations because the SSI sector serves a very useful economic purpose in terms of employment, production and exports as is evident from the data given above although the SSI sector also helps in the regional development. The social, political and equity justification of SSI sector in India should also be taken into consideration. The political justification of support to SSI sector is evident from the fact that the legal definition of eligibility of SSI units, have changed off and on, which is based on political considerations (Raju, 1991). The various policy initiatives in regard to financial concessions and lending, reservations of items exclusively for manufacture in SSI sector, infrastructure and technological support given by the Government of India points to an equity and social justification. However, it should be understood that India is a very diverse country with a huge population and many social, cultural and political problems, which can have a considerable impact on the economy as well. The consequences of not providing support to SSI sector can be disastrous for India. Therefore, Hallberg's (2000) argument that the government support to SMEs is because "they are there" could have some validity for SSI sector in India.

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