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Research Paper | Finance

Facilitation of Collateral Free Loan to Improve Financial Linkages For Start Up & Growth – A Case Study

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ABSTRACT

Access to finance is one of the basic requirement for start up or growth for any enterprise. Financial inclusion and right kind of provision of finance leads to economic development of any country. Project is one kind of intervention to wealth creation for an enterprise and driver of growth for the country. Ideally project finance decision is to be taken on cash flow generation from the project and not the availability of collateral from the entrepreneurs which is the practice prevalent today. The new approach calls for change in paradigm in lending. Facilitation process by empanelled Business Development Service Provider can effectively bring this change in paradigm in lending. This process will also address other key gaps and will develop as well as strengthen financial linkages if systematically implemented. This case study elaborate the facilitation process undertaken to effect paradigm shift in introducing collateral free loan to improve financial linkages in Chennai Leather & leather Products Cluster & its outcome. The study also proposes the role of BDS clinic for sustaining the approach.

KEYWORDS: Collateral free loan, financial linkages, Facilitation, paradigm

1. Introduction

Due to opening of the economy lot of reforms took place in the banking & financial systems in the country as well as new products have been introduced to improve the financial inclusion and financial deepening. However at the same time it was difficult for Banks/Financial Institution to reach to MSMEs units with the changed financial regime & products. This leads to need of creating a structural facilitation process to bridge this gap.

"A cluster is a geographical concentration of micro, small, medium and large firms producing the same or a similar range of products (goods or services). Units in a cluster face same or similar set of threats and opportunities.[1] The number of cluster grew from 96 to 1500 during 1996-2007. Out of 1500 clusters around 1000 are of artisan nature & remaining industrials

In the present case study systematic, structural efforts were made to facilitate collateral free loan through BDS.

Business Development Services (BDS) comprise a wide range of non-financial services provided by private suppliers (BDS providers) to entrepreneurs who use them to efficiently operate and make their businesses grow. The types of services in a functioning BDS system are determined by the demand articulated on the part of the businesses. Business Development Services (BDS) are generally defined as:

"… Services that improve the performance of the enterprise, its access to markets, and its ability to compete; the definition of 'business development service'… includes an array of business services [such as training, consultancy, marketing, information, technology development and transfer, business linkage promotion, etc.], both strategic [medium to long term issues that improve performance and operational [day-to-day issues]. BDS are designed to serve individual businesses, as opposed to the larger business community."[2]

1.1 Background

Finance is always been considered as one of the key driver of growth, profitability and improving liquidity in all enterprises. The role of finance is more critical in leather cluster particularly Chennai due to some of the major constraints like background of the stakeholder, age of the cluster, non-maintenance of the accounts, perceived low priority by bank and issues related to environmental compliances.

In many developing countries including India, the use of collateral is the main way to secure bank financing. The ease of acquiring a loan depends on the ability to use assets such as real estate as collateral. Collateral, especially within banking, traditionally refers to lending, also known as asset-based lending. In the simplest meaning, asset-based lending is any kind of lending secured by an asset. This means, if the loan is not repaid, the asset is liquidated for recovery of loan.

Collateral based approach of lending creates barriers for availing the finance for first generation entrepreneur and restricts the use of finance for growth if entrepreneur does not have sufficient asset to provide security to bank. Ideally project finance should secure its repayment of interest as well as principal by way of operational cash flow generated due to project & primary security of the project. CGTSME has formulated schemes where in any enterprise can avail loan up to Rs 10 millions without providing collateral security if project is otherwise feasible & viable.

2.2Gap Analysis

Even if the CGTSME scheme is in operation for more than decade its acceptance is limited. While taking opinion from demand side as well as supply side, it was observed that there is a perceived demand for accessing finance which is non-asset-base.

While interacting with the existing private and public BDS providers, it was learnt that the capacity and penetration of the BDS providers was low; in terms of access to finance and loan syndication. There was no facilitation from any of the BDS providers which can address the key gaps for linking finance to the Chennai Leather MSME units.

2. BASE-LINE SURVEY FOR FINANCIAL LINKAGES:

The researcher has felt the need to develop the systematic approach of study & execute the same in the wider interest of macro economy.

2.1 Objectives & Approach:

The base-line survey was carried out in February 2011 to understand the need, expectation and gap in terms of product, linkage and service for availing finance by MSME leather units in Chennai.

Two separate sets of questionnaires were designed – one for tannery segment and another for products segment; the BDS [3] provider approached 165 tanners and 228 units in leather product sector either by personal visits or by telephonic contacts for getting response for the questionnaire. The details of number of units responded and reasons for non-responding are summarized as under:

2.2 Summary of responses & reasons for low-response

Table-1; Responses from Tanners

Total number of units contacted	165
Closed or no response from owners	10
Net contacts	155
Units not willing to provide information on names of banks, credit limits etc	109
Units provided information – responded positively	46

Table-2; Responses from Leather Products Manufacturers

Total number of units contacted	228
Closed or no response from owners	25
Net contacts	203
Units not willing to provide information on names of banks, credit limits etc	168
Units provided information – responded positively	35

Despite convincing the respondents about the objective of the survey and highlighting the various schemes available from SIDBI and banks for improving the performance of the leather cluster units, many of them have not provided the required information on account of the following illustrative list of facts.

(a) They feel the information on bankers and credit limits are confidential information to them and they found that it is not necessary to disclose the same to outsiders as there is no imminent need to make any formal application to bank/financial institution.

(b) Many private banks/lenders often approach these units offering credit facilities for personal loans and other easy loans with lesser compliances from the units and many of them have availed such facilities in the past hence they are not interested in further increasing their credit facilities.

(c) Generally the units in the cluster are facing the adverse effects of global recession which started in October 2008 and the performance of the financial year 2008-09 and 2009-10 have not been satisfactory with decline in sales and profits. This resulted in mounting up bank borrowings, outside private borrowings and therefore many of the units are not interested to increase further borrowings unless the revival in the industry is started in full swing. However there is flow of increased orders from the third quarter of 2009-10.

(d) Additionally, the small sized units are also involved in leather product sector. Being small sized units they depends on their won sources instead of borrow.

From above it can observed that reasons for non-disclosure of financial information were

1. Believe it is strictly confidential
2. Using un-organised finance market facilities even if it is costly
3. Business cycle effect
4. Believe to use own fund

2.3 Key Objectives & Gap

The dissemination seminar was organised by researcher along with colleagues for key findings of base-line survey wherein elaborate discussion was carried out among the bankers, MSME units, BDS providers and owners of leather MSMEs units. Based on the discussion, following key observations have been noted along with key source of gap in accessing the finance.

Table-3; Key observation & Key Perception Gap

Sr. No.	Key Observation	Key perception Gap among parties involved
1	Those who have responded well to the questionnaires are willing to furnish the entire information further if any bank/financial institution is willing to consider their working capital and term loan requirements.	Lack of trust & linkages between Bank & MSMEs.
2	A few units have availed the IDLSS scheme of SIDBI and many of them are not aware of this.	Lack of awareness
3	Many of them do not have collateral securities to be offered for Banks and financial institutions simultaneously. Therefore they prefer the working capital and term loan requirements to be funded from one source like SBI International leather division meeting the requirements of working capital and term loans of their clients cluster.	Lack of awareness and difficulty in getting collateral free loan.
4	The existing bankers financing the sector do not have any future plans to improve the lending to the sector as a part of Sectoral credit approach excepting that they are willing to consider the applications for fresh lending based on the applicants' past performance and track record and collaterals offered. There is no concerted approach to improve the lending to the sector.	Low priority for leather sector in lending by Banks / Financial Institutions
5	The private lenders and personal loans lenders such as Fullerton India, ICICI bank, City Bank, Standard Chartered Bank, Credit card lenders have marketing team wooing well run units and their owners who borrow from these agencies even though they have regular bank borrowings and term loans from their respective banks. They find procedurally these lenders are more comfortable to deal with compared to banks and institutions like SIDBI. Normally these borrowings are costlier than the banks and institutions but due to easy procedural formalities they are preferred.	Procedure & formalities is important consideration than cost of borrowing.
6	Some of the units in the cluster have shown interest to procure second hand reconditioned machinery for installation which is cheaper than new ones. They find it difficult to source finance for such machines even though such machines are able to work satisfactorily for 10 to 15 years.	Lack of customized financial products
7	Even though the individual units' pollution problems have been sorted out years back as well as larger degree of quality control and streamlining of production and export operations have been brought into by individual units in Leather cluster; the "untouchability" of leather sector is prevailing among bankers considering that the leather industry is high risk industry for financing, notwithstanding its emergence as one of the top 10 Foreign exchange earning industries in India and its share in global trade being significant.	Bank perceived high risk on the ground that environment compliance is lacking in the leather sector

3. FACILITATION FOR IMPROVING FINANCIAL LINKAGES;

Based on the analytical study of key perception gap on either side a need was thought for to exercise facilitation programme.

3.1 Awareness, Sensitization Programmes:

Considering the observation gap analysis and findings in base-line survey report, two awareness & sensitization programmes on 'Collateral Free Loan' as well as 'Credit Rating' was organised by researcher and colleagues the Chennai leather cluster.

In Collateral Free Loan Programme the details of key features were provided along with the procedure both by BDS providers, bankers and representatives from CGTMSE Trust. Similarly, information on credit rating, its advantages was provided by representative of SMERA. During the Collateral Free Loan and SMERA awareness programme 45 participants from the cluster took advantage. At the end of the programme, 10 MSME units came forward for Collateral Free Loan.

3.2Demonstration through Voucher Cost:

For creating demonstration effect in cluster, 5 MSME Leather units during 2010-11 and 5 units during 2011-12 were facilitated by the SIDBI-project fund; through BDS Provider. The cluster had enrolled 3 BDSp to extend their service to avail credit facility to MSME units in Chennai Leather Cluster.

With active involvement and Excellent Service of BDSP, all the 10 MSME units are able to approach banks for their credit requirement and 4 MSME units were sanctioned credit facility as on November 2011 and other 6 MSME units were at difficult stage of approval of loan.

Table-4; Beneficiary collateral loan by facilitation process

Sl. No.	Name of MSME Unit	Amount applied Banks	Present Status
1	Mitra	Rs.85.00 lakhs; Indian Overseas Bank, Guindy, Chennai-32.	Sanctioned Rs.85 lakhs
2	Keerti Exports Pvt. Ltd.	Rs.20.00 lakhs State Bank of India, Ekkattuthangal, Chennai-32.	Sanctioned of Rs.20lakhs
3	Airolite Rubber Industries	Rs.19.00 lakhs Punjab National Bank, Chennai.	Sanction Term Loan of Rs.19lakhs for IDLS.
4	R.R.Overseas	Rs.40.00 lakhs Karur Vysya Bank, Chromepet, Chennai-32.	Sanctioned of Rs.20lakhs. Bill discount Rs.20lakhs.

3.3 Outcome

Summary of benefit Experienced by beneficiary due to implementation of intervention of availing collateral free loan is as under:

M/s. MITRA [4]

i. 10% increase in turnover after availing Rs.85 lakhs from Indian Overseas Bank.
ii. Penetration into market increased due to fund availability.
iii. Further benefits like liquidity will be experienced over years.
iv. A service of BDSP is excellent.

M/s. Keerti Exports (P) Ltd. [5]

i. The company was not enjoying any credit facility earlier. Subsequent to sanction of Rs.20 lakhs as OCC by State Bank of India, the turnover has increased by 20%.
ii. Liquidity has improved.
iii. Working capital cycle improved.

M/s. R. R. Overseas [6]

i. Expected increase in turnover by 15%.
ii. Working capital cycle will improve.
iii. BDSP service is good.

M/s. Airolite Industries [7]

i. Due to modernization, the turnover/sales is expected to increase by 40%.
ii. Profit will increase by 5%.

From the above, it can be realized that on an average turnover of the units increased by 10% with Collateral Free Loan; over and above, improvement in reduction in working capital cycle as well as liquidity position.

4. FUTURE SCOPE

Considering the difficulty in continuation of facilitation process on permanent basis, as a sustainable exit strategy; BDS clinics approach was developed by researcher & his colleagues with the help of Business Management Organisation (BMO); BMO shall work as natural facilitator & bridging the gap between Banks/FI & MSMEs units by organizing BDS clinic.

4.1 Outcome of BDS Clinic

The dissemination seminar as well as 3 BDS clinics were organised for individual counseling of MSME units for availing collateral free loan. Out of 3 BDS clinics, 2 clinics were organised in BMO's premises. During the BDS clinics, 13 MSME units came forward for availing finance. Out of 13 units, application preparation was under progress for 5 units.

4.2 Impact at cluster level

From the experience and success story of those units who have availed collateral free loan, it can be safely presumed that the turnover will increase at least 10% apart from other benefits of improvement in working capital cycle, profit; as well as liquidity. Considering the above, one can see the scope of improvement in turnover to the extent of Rs 400 crores on assumption that estimated production of Chennai Leather Cluster is Rs 4000 crores.

If the efforts are replicated in all 500 clusters in India, the impact of such facilitation will be 10% increase in the present turnover of the cluster & it will take the MSMEs on growth projectile.

5.0 Conclusion;

If the intervention is systematically planned & implemented by deploying competent BDSp who in turn will play crucial role in facilitation to improve financial linkages of MSMEs units. This process of facilitation will also address the "Key Gaps" & induce more units to avail collateral free finance leading to financial inclusion. Further BMO & public BDSp including Banks can play proactive role of the "Natural Facilitation" by organizing BDS clinics on regular basis for their members & customer to sustain the effort.

List of abbreviation

BDS; Business Development Service

BDSp; Business Development Service Provider

CGTSME; Credit Guarantee Fund Trust for Micro and Small Enterprises

ICICI; Industrial Credit & Investment Corporation of India

IDLS; Integrated Development of Leather Sector Scheme

SIDBI-; Small Industrial Development Bank of India-

SMERA; SME Rating Agency of India

MSMEs; Micro Small & Medium Enterprises

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