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PROBLEMS OF CREDIT IN MSME'S

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ABSTRACT

The International Society for Small and Medium Enterprises (ISSME) is a not-for-profit leading global organisation working for the promotion of SMEs across the globe since its establishment in 2010. ISSME Foundation Day is celebrated on 29th July each year. ISSME had a very humble beginning with "establishing a true international organization for the wellbeing of SMEs" as its central focus. In the past three decades, the significant contributions of SMEs in any economy were widely acknowledged across the globe, and caught attention of all quarters including policy makers and international and UN agencies. Recognizing the stellar role played by SMEs, international and UN organizations like World Bank, WIPO, etc. opened special SME division to extend their support to this sector. Many national governments have recently come up with separate Ministry for SMEs and institutionalized various SME support institutions in order to help this key segment perform in a much better way and contribute further to their respective economies. Their number in total enterprise population world over is the most encouraging factor that naturally exhilarates the policy makers, experts and think tanks.

KEYWORDS: *International Society for Small and Medium Enterprises (ISSME) , leading global organisation .*

INTRODUCTION

While the world witnessed so much so in the SME sector, there was hardly any international SME association that was truly working for this vibrant sector with representation from all the countries of the world. Although many initiatives had been taken to spearhead the growth of SMEs in all the countries, there was absence of an international platform that would consolidate the works done for the benefits of the SMEs. Among a very few international organizations that are in existence, some are either non-functional rendering hardly any services to the sector and some exist just to organize an annual conference on SMEs. This was the main driving force behind establishing this international organization. This was established with the commitment to enhance the state of SMEs and create a dedicated platform exclusively for SMEs, their support institutions, concerned agencies and other stakeholders.

CREDIT GUARANTEE

The third party guarantee free credit facility (both fund as well as non fund based) extended by eligible institutions, to new as well as existing Micro and Small Enterprise, including Service Enterprises, with a maximum credit cap of of Rs200 lakh (Rupees Two Hundred lakh only) are eligible to be covered. Recently, guarantee coverage made eligible to select NBFCs. The guarantee cover available under the scheme is to the extent of 75% / 80% of the sanctioned amount of the credit facility, with a maximum guarantee cap of `62.50 lakh / `65 lakh for credit facilities upto `50 lakh. The extent of guarantee cover is 85% for micro enterprises for credit up to `5 lakh. The extent of guarantee cover is 50% of the sanctioned amount of the credit facility for credit above `50 lakh with a maximum guarantee cap of `100 lakh.

The extent of guarantee cover is 80%(i) Micro and Small Enterprises operated and/or owned by women; and (ii) all credits/loans in the North East Region (NER) for credit facilities upto `50 lakh. In case of default, Trust settles the claim up to 75% (or 80%) of the amount in default of the credit facility extended by the lending institution for credit facilities upto `50 lakh. The extent of guarantee would reduce to 50% for the loans above `50 lakh upto `200 lakh. The lender should cover the eligible credit facilities as soon as they are sanctioned. In any case, the lender should apply for guarantee cover in respect of eligible credits sanctioned in one calendar quarter latest by end of subsequent calendar quarter. Guarantee will commence from the date of payment of guarantee fee and shall run through the agreed tenure of the term credit in case of term loans / composite loans and for a period of 5 years where working capital facilities alone are extended to borrowers, or for such period as may be specified by the Guarantee Trust in this behalf.

Credit scoring and Credit Rating: With a view to facilitating credit flow to the MSME sector and enhancing the comfort-level of the lending institutions, RBI issued guidelines in May 2009, advising banks to adopt scoring models for lending in case of all advances upto Rs.2 crore. Further, information required for scoring model had to be incorporated in the application form itself. Credit scoring combines several financial characteristics to form a single score for assessing borrower's credit worthiness and usually include financial characteristics from both the business and the business owner. The model facilitates lending procedures leading to availability of low cost credits and faster decision making yielding significant growth in consumer credit availability. Credit rating is a manual method for determining a borrower's ability to repay, based on a pre-determined set of criteria. It requires a similar level of credit analysis for all loan applications and is more comprehensive in nature, hence increasing the transaction cost per loan.

There seems to be a lack of clarity among banks on credit scoring and credit rating. While credit scoring is used for small loans, credit rating is used for larger loans which have relevant financial data. Many banks have not implemented a separate scoring model for MSMEs, but continue to use the same scoring sheet that is used for general advances. Most of the banks resort to external ratings only when the quantum of credit exceeds Rs.5.00 crore. Thus the small borrowers are deprived of availing the benefits of NSIC subsidy of 75% for getting credit rating from external agencies. These banks may be advised to follow the credit scoring / rating models for processing and sanctioning the loans beyond a cut off limit and the limits may be decided by banks.

BAD CREDIT HISTORY

An adverse borrowing history of SMEs particularly if it is involving a sister organization will discourage the lender. The logical presumption is that if you do not have a good credit history then that is indicative of a personality pattern which means that in the future you will face the same problems as you are trying to clear you refinancing initiative. The bank is then well advised to stay away from you or at the very most offer you some very stringent terms for borrowing.

Poor business plans

Most SMEs applying for loans do not present convincing feasibility studies or attractive business plans. They are therefore regarded as high-risk ventures.

Lack of Collateral

Thirdly, even those SMEs with business plans not backed by adequate collateral. The lack of adequate collateral would be unacceptable risk for the lender. As banks cannot afford to take any chances of non-repayment of loans, they insist on these collateral requirements being met. In as much as they have nothing to fall back on should you default on your loan repayment obligations? Good financial management requires that they do not accept a refinancing initiative until they are sure that you are more than capable of covering the full loan if circumstances demand it. Collateral is the final reserve to meet this criteria and if it is missing, then the decision is likely to be negative.

The impact of regulatory and monetary factors on bank loan

The result is that monetary policy effects on bank lending depend on the capital adequacy of the banking sector; lending by banks with low capital has a delayed and then amplified reaction to interest rate shocks, relative to well-capitalized banks. Other implications are that bank capital affects lending even when the regulatory constraint is not momentarily binding, and that shocks to bank profits, such as loan defaults, can have a persistent impact on lending.

Financial crisis

Again bank financial distresses may also be an important determinant of credit availability during periods of 'credit crunch' and accompanying financial crises. However, there are very few small firms that will satisfy the rigorous condition set by the traditional feasibility appraisal model, which is often designed for both small and big firms. While some aspects of the criteria of the feasibility model are met by some small firms, others are not met at all, therefore for banks to lend , they need to develop lending rules that accommodate the peculiar characteristics both for the SMEs and their owners.

Other reasons

In addition, many SMEs do not hold deposit accounts in the formal banking sector, which the banks require from loan applicants. Another reason SMEs were not given any concessions in terms of loan conditions was that in Nigeria no law exists to protect bankers against default. Yet another reason banks resist loans to SMEs is the unwillingness of owner/managers to acquire formal training. Such training is useful in providing added expertise and competence in a chosen field of business and in improving chances of obtaining loans.(Mambula, 2002).

CONCLUSION

The present credit delivery structure of banking system does not meet the "Four A's" of financial Inclusion of MSMEs, viz., Access, Availability, Affordability and Awareness. It does not facilitate easy access to credit due to lack of awareness about on-line credit facility. Availability of credit is limited due to reluctance of banks in sanctioning loans. MSME loans are relatively non-affordable as interest subvention is not extended to MSME borrowers unlike other category of borrowers viz., agriculture, housing, education, exports, SHGs etc., The suggestions may be considered for implementation for creating an eco system of ensuring credit availability to all existing and aspiring entrepreneurs for achieving the twin goals of rapid economic growth and providing jobs to millions. Let us first transform ourselves and our mind set towards MSMEs before we think of transforming and conquering the world.

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