Incremental SME LendingPotential: ₹500 bn

The performance and credit ratings are nowadays advised for the SME sector. **DR Dogra**, Managing Director & CEO, CARE Ratings, in an interview to **Mehul Dani**, enlightens about various rating and grading services that benefit both SMEs and the investor community:

• Mehul: What are your views regarding concept of performance and credit ratings for the SME sector in India? What products and services do you offer in this regard?

Dogra: The performance and credit ratings for the SME sector go a long way in bridging the information gap existing between the sector and the capital providers viz, lenders and investors. For banks, financial institutions and other investors the transaction and due diligence costs for taking an exposure to the SME sector are generally high relative to the large corporates, primarily due to this information asymmetry.

CARE Ratings offers various rating and grading services that benefit both SMEs and the investor community. A large number of SMEs have been assigned the Bank Loan Ratings. As per these norms, the risk weights assigned for loan exposures of banks for their capital adequacy calculation are linked to the credit ratings obtained by the borrowers from external credit rating agencies like CARE. Under Bank Loan Ratings, the SMEs are subject to relative assessment vis-a-vis large corporates and this largely constrains their ratings due to parameters like low level of capitalization, small size of operations, weak internal control systems, constitution of the entity as a partnership or proprietorship firms and positioning at the lower end of the industry value chain.

• How are you addressing SMEs disadvantage vis-à-vis corporates?

In order to address this issue, CARE has introduced SME Ratings which opines on the overall creditworthiness of an SME vis-a-vis other SMEs. The framework also includes a cluster approach for SMEs operating as a part of a recognized cluster. CARE also provides the NSIC-CARE SSI Performance and Credit Rating which are applicable for units registered as SSIs. This rating assesses a SSI unit on dual parameters of Performance Capability and Financial Strength. Again the assessment is done relative to the SSI universe and comparison is made with similar units.

DR Dogra feels Indian SMEs do not fare very well when benchmarked with their counterparts in competing economies in productivity or in knowledge intensive manufacturing sectors

• What is the total amount of SME loans given by banks and financial institutions up to Q3 in this FY and what is the YoY growth in amount and percentage terms?

As at the end of Q3FY11, bank credit to Micro, Small and Medium Enterprises stood at ₹3.80 lakh crore registering a YoY growth of just over 21% and a QoQ growth of 4.8%. The table below shows the trend in bank lending to MSME over past three quarters of FY11. Bank credit to the MSME sector has remained around 11% of the total gross bank credit outstanding over the past few quarters.

As at end of	Gross Bank Credit to MSME (₹billion)	YoY Growth	QoQ Growth
Q1FY11	3,508	14.7%	20.5%
Q2FY11	3,625	14.9%	3.3%
Q3FY11	3,798	21.1%	4. 8%
(Source: RBI)			

• Which particular 3 sub-segments in SMEs have resorted to highest amount of credit from banks and financial institutions?

While it is difficult to segregate the top three sub-segments within the SME space, a fair judgment can be made by looking at sector-wise advances of banks to industries which have a high degree of fragmentation thereby indicating presence of a large number of SMEs. The table below shows the sector-wise break-up of the total bank credit outstanding for industries as a whole.

Of the above, presence of SMEs would be greater in sectors where there is a significant degree of fragmentation. Such sectors are textiles, food processing, leather, wood products, rubber, plastic, construction, gems, jewelry and some sub-segments of chemicals and engineering sectors. SMEs belonging to these sectors are likely to have significant credit off take.

Sector	Bank Credit Outstanding as on Nov 2010 (₹Cr)	% of total bank credit to industries	% of total bank credit
Infrastructure	4,82,189	32.9%	14.3%
Metal & Metal Products	1,85,209	12.6%	5.5%
Textiles	1,27,458	8.7%	3.8%
Other Industries	1,27,164	8.7%	3.8%
Chemicals	91,912	6.3%	2.7%
All Engineering	86,364	5.9%	2.6%
Food Processing	69,890	4.8%	2.1%
Petroleum & Coal	58,095	4.0%	1.7%
Construction	43,506	3.0%	1.3%
Vehicles & Vehicle Parts	41,911	2.9%	1.2%
Gems & Jewelry	35,723	2.4%	1.1%
Cement	29,769	2.0%	0.9%
Paper & Paper Products	20,095	1.4%	0.6%
Mining & Quarrying	19,770	1.3%	0.6%
Rubber & Plastic	19,074	1.3%	0.6%
Beverage & Tobacco	10,498	0.7%	0.3%
Leather Products	6,857	0.5%	0.2%
Wood & Wood Products	5,185	0.4%	0.2%
Glass & Glassware	4,808	0.3%	0.1%
Industries	14,65,477	100%	43.5%

• What is the potential of SME segment in driving the growth of credit in next 5 to 10 years?

SMEs have been playing a vital role in providing employment opportunities and contributing to the industrial production and growth. In terms of value, the sector accounts for 8% of GDP, 45% of the manufacturing output, 40% of the total exports and 60 million in employment of the country. However, the SME sector is still not sufficiently catered to by the lending institutions. As per a recent study, the Indian banks funded, on an average, only around 60% of the incremental working capital requirement between 2006-07 and 2008-09 as against the common banking practice of funding up to 75% of an entity's working capital requirement. This shortfall was funded by the SMEs from their own funds.

While the volume of credit flow to the SMEs continues to be an area of concern for the sector, bankers have maintained that SME lending is growing by 20-22% YoY, even though the overall demand for credit appears to far outstrip the credit flow.

It is estimated that there is scope for banks to increase their lending to the sector by ₹500 bn. The funding opportunity is even greater for micro and small enterprises as they constitute the majority of the MSME universe.

• Which are the challenges the Indian SME segment will face from SMEs of China and other countries in future?

The SME sector is highly dependent on support from the government and lending policies of banks and financial institutions, and the same needs to continue for the sector to be more competitive in the national and international markets. Indian SMEs do not fare very well when benchmarked with their counterparts in competing economies in productivity or in knowledge intensive manufacturing sectors such as electronics. Besides, adequate bank finance, the various challenges faced by the Indian SMEs that creates a bottleneck for them while competing with foreign SMEs are limited capital and knowledge, non-availability of suitable technology, low production capacity, ineffective marketing strategy, identification of new markets, constraints on modernization and expansions, non-availability of highly skilled labor at affordable cost, follow-up with various government agencies to resolve problems, etc.

Indian SMEs seem to lag behind their Chinese counterparts with major challenges faced by them being lack of professional management (high reliance on promoter centric business), lack of qualified manpower, government support and innovation. Further, lack of supply chain efficiency and transportation infrastructure is the major roadblock faced by Indian SMEs. Indian SMEs also lagged behind Chinese SMEs in the resource management. The workflow management in Indian SMEs can improve a lot from the present level. The Chinese, on the other hand, have good systems and processes as well as economies of scale.

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