LENDING TO MSME SECTOR

Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 enacted in June 2006 classifies units as under:-

Category	Manufacture, processing or preservation of goods	Providing/rendering services **
Micro Enterprises	Investment in Plant & Machinery (original cost excl. land & building) not to exceed Rs. 25 Lakh.	Investments in equipments not to exceed Rs. 10 Lakh
Small Enterprises	Investment in Plant & Machinery (original cost excl. land & building) above Rs. 25 Lakh but not to exceed Rs. 5 crore.	Investments in equipments above Rs. 10 Lakh but does not exceed Rs. 2 crore.
Medium Enterprise	Investment in Plant & Machinery (original cost excl. land & building) above Rs.5 crore but not to exceed Rs.10 crore.	Investments in equipments above Rs 2 crore but not to exceed Rs. 5 crore.

**These will include small road & water transport operators, small business, retail trade, Professional & self-employed persons and other service enterprises.

♥ Lending by banks to medium enterprises will not be considered for the purpose of reckoning of advances under the priority sector.

♥ No clubbing of investments of different enterprises set up by same person/company for the purpose of classification as Micro, Small and Medium enterprises,

Direct Finance

Lending to:-

♥ Micro and Small enterprises engaged in the manufacture or production of goods to any industry specified in the first schedule to the Industries (Development and regulation) Act, 1951 and notified by the Government from time to time.

♥ Food and agro processing units provided the units satisfy investments criteria prescribed for Micro and Small Enterprises, as provided in MSMED Act, 2006.

♥ Micro and Small Enterprises engaged in providing or rendering of services up to Rs.5 crore per borrower / unit to and defined in terms of investment in equipment under MSMED Act, 2006.

♥ Export credit to MSE units (both manufacturing and services) for export of goods/services produced / rendered by them.

♥ Units in the KVI sector, irrespective of their size of operations and location and amount of original investment in plant and machinery. Such loans will be eligible for classification under the sub-target of 60% prescribed for micro enterprises within the micro and small enterprises segment under priority sector.

♥ Micro and Small Enterprises under General credit Card (GCC) scheme should be classified under respective categories of MSE;

is treated as direct finance under MSME.

Indirect Finance

Lending to:-

♥ Persons involved in assisting the decentralized sector in the supply of inputs to and Marketing of outputs of artisans, village and cottage industries;

♥ Cooperatives of producers in the decentralized sector viz. artisans, village and cottage industries.

♥ Micro Finance Institutions (MFI) or on-lending to micro and small enterprises (manufacturing as well as services);

is considered as Indirect Finance under MSME.

Scheme of Small Enterprises Financial Centres (SEFCs)

The scheme refers to strategic alliance between branches of banks and SIDBI located in clusters named as "Small Enterprises Financial Centres". This has been formulated in consultation with Ministry of SSI and Banking Division, MOF, GOI, SIDBI, IBA and select banks. Under this scheme, SIDBI has so far executed MOU with 15 banks.

<u>Targets</u>

In order to ensure that sufficient credit is available to micro enterprises within the MSE sector, targets are fixed as under:-

Sector	Domestic Commercial Banks and Foreign Banks operating in India
Total Priority Sector Advances	40% of ANBC or credit equivalent amount of off-balance sheet exposure whichever is higher. 32% of ANBC or credit equivalent amount of off-balance sheet exposure whichever is higher. (**For Foreign Banks with less than 20 branches**)
Total advances to MSE sector	Out of the total advances to MSE sector, 40% should go to micro (Mfg.) enterprises having investment in plant and machinery up to Rs. 10 lakh and micro (service) enterprises having investment in equipment up to Rs. 4 lakh.
Total advances to MSE sector	Further 20% to micro (Mfg.) enterprises with investment in plant and machinery above Rs. 10 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 4 lakh and up to Rs. 10 lakh. In other words, **60 % of MSE advances should go to the micro enterprises.**
Cut-off date	Targeted 60% of the MSE advances will be computed with reference to the outstanding credit to

	MSE sector as on preceding March 31st.

♥ Bank loans above **Rs.5 crore per borrower / unit** to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006 shall **not** be reckoned in computing achievement under the overall above Priority Sector targets.

♥ Bank loans above Rs. 5 crore can be taken into account while assessing the performance of the banks with regard to their achievement of targets prescribed by the Prime Minister's Task Force on MSMEs for lending to MSE sector.

♥ Public sector banks were advised to fix their own targets for funding SMEs in order to achieve a minimum 20% year-on-year growth in credit to SMEs. In terms of the recommendations of the Prime Minister's Task Force on MSMEs, banks are advised to achieve a **20 per cent year-on-year growth** in credit to micro and small enterprises and a **10 per cent annual growth** in the number of micro enterprise accounts.

Common Guidelines / Instructions for Lending to MSME Sector

♥ It is mandatory on the part of banks to acknowledge applications submitted manually or online by MSME borrowers and to ensure that a running serial number is recorded on the application form as well as on the acknowledgement receipt.

♥ All loan applications up to a credit limit of Rs. 25,000/- and upto Rs. 5 lakh should be disposed of within 2 and 4 weeks respectively provided the loan applications are complete in all respects.

♥ Not to accept collateral security in the case of loans upto Rs.10 lakh to units in the MSE sector. Banks to extend collateral-free loans upto Rs. 10 lakh to all units financed under the Prime Minister Employment Generation Programme of KVIC. Banks may, on the basis of good track record, increase the limit of dispensation of collateral up to Rs. 25 lakh.

♥ A composite loan limit of Rs.1 crore can be sanctioned by banks to enable the MSE Entrepreneurs to avail of their working capital and term loan requirement through Single Window.

♥ Public sector banks to open at least one specialized branch in each district and to categorize their MSME general banking branches having 60% or more of their advances to MSME sector to specialized MSME branches. The existing specialized SSI branches also to be redesignated as MSME branches.

Delayed Payment

♥ As per MSMED Act 2006, the payments in respect of supplies made by MSE units should be received on or before the date agreed on between him and the supplier in writing or, in case of no agreement before the appointed day. The agreement between seller and buyer shall not **exceed more than 45 days.**

♥ In case of any failure to effect the payments, the buyer is liable to pay compound interest with monthly rests to the supplier on the amount from the appointed day or on the date agreed on, at **three times of the Bank Rate** notified by Reserve Bank.

♥ In case of dispute with regard to any amount due, a reference shall be made to the Micro and Small Enterprises Facilitation Council, constituted by the respective State Government.

♥ Further, banks have been advised to fix sub-limits within the overall working capital limits to the large borrowers specifically for meeting the payment obligation in respect of purchases from MSMEs.

Rehabilitation of sick SSI (now MSE) units

Based on the recommendations of the Committee (Chairman: Dr. K. C. Chakrabarty), appointed for changing the definition of sickness and the procedure for assessing the viability of sick MSE units, RBI has revised the guidelines for rehabilitation of sick units in the MSE sector. The objective of the revised guidelines is to hasten the process of identification of a unit as sick, early detection of incipient sickness, and to lay down a procedure to be adopted by banks before declaring a unit as unviable.

As per the new guidelines:-

a) A Micro or Small Enterprise unit is said to have become sick if (a)any of the borrowal account remains NPA for 3 months or more or (b) there is erosion in the net worth due to accumulated losses to the extent of 50% of its net worth during the previous accounting year.
b) Decision on viability of the unit should be taken by the bank at the earliest but not later than **3 months** of becoming sick under any circumstances and the rehabilitation package should be fully implemented within **6 months** from the date the unit is declared as 'potentially viable' / 'viable'.

Financial Literacy Consultancy Support

In view of the high extent of financial exclusion (92%) as also to address the various handicaps the MSME sector face, SCBs have been advised that the banks could either separately set up special cells at their branches, or vertically integrate this function in the Financial Literacy Centres (FLCs) set up by them, as per their comparative advantage. The bank staff should also be trained through customised training programs to meet the specific needs of the sector.

Structured Mechanism for monitoring the credit growth to the MSE sector

Based on the recommendations of the IBA led Sub- Committee (Chairman Shri K.R.Kamath) set up, in the light of the concerns emerging from the deceleration in credit growth to MSE Sector, banks have been advised to:

a) strengthen their existing systems of monitoring credit growth to the sector and put in place a system-driven comprehensive performance management information system (MIS) at every supervisory level (branch, region, zone, head office) which should be critically evaluated on a regular basis.
b) put in place a system of e-tracking of MSE loan applications and monitor the loan application disposal process in banks, giving branch-wise, region-wise, zone-wise and State-wise positions. The position in this regard is to be displayed by banks on their websites; and
c) monitor timely rehabilitation of sick MSE units. The progress in rehabilitation of sick MSE units is to be made available on the website of banks.

Other initiatives

a) Revised General Credit Card (GCC) Scheme

The General Credit Card (GCC) Scheme has been revised w.e.f. 02.02.14 so as to ensure the coverage and credit linkage for all productive activities within priority sector guidelines.

b) State Level Inter Institutional Committee

- State Level Inter-Institutional Committees (SLIICs) have been set up in all the States and Union Territories to deal with the problems of co-ordination for rehabilitation of sick micro and small units with defined guidelines for functioning. A sub-committee of SLIIC looks into the problems of individual sick MSE unit and submits its recommendations to the forum of SLIIC for consideration.

- Besides SLIICs, an empowered Committee on MSMEs has been constituted to review the progress in MSME financing as also rehabilitation of sick Micro, Small and Medium units. The committees may decide the need to have similar committees at cluster/district levels.

c) Empowered Committee on MSMEs

Empowered Committees on MSME have been set up at Regional Offices of RBI to review the progress in MSME financing as also rehabilitation of sick Micro, Small, and Medium units in coordination with banks, financial institutions, and the state governments in removing bottlenecks, if any, to ensure smooth flow of credit to the sector.

d) Setting up of Debt Restructuring Mechanism

A debt restructuring mechanism for units in MSME sector has been formulated by RBI for implementation by banks. The guidelines are applicable to viable or potentially viable MSME units as under:-

♥ All non-corporate MSMEs irrespective of the level of dues to banks.

♥ All corporate MSMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.

♥ All corporate MSMEs, which have funded and non-funded outstanding up to Rs.10 crore under multiple/ consortium banking arrangement.

♥ Accounts involving willful default, fraud and malfeasance and “Loss Assets” are not be eligible for restructuring.

♥All corporate including MSMEs, which have funded and non-funded outstanding of Rs.10 crore and above, included under Corporate Debt Restructuring Mechanism (CDR).

♥ Banks are further required to put in place loan policies governing extension of credit facilities, Restructuring/ Rehabilitation policy for revival of potentially viable sick units/enterprises and non- discretionary One Time Settlement scheme for recovery of non-performing loans for the MSE sector, etc. with the approval of the Board of Directors (Working Group on Rehabilitation of Sick MSEs).

e) Cluster Approach

As per the Ganguly Committee recommendation, 60 clusters have been identified for focused development of small enterprises sector by Ministry of MSME

f) Credit Linked Capital Subsidy Scheme (CLSS)

The CLSS which was originally launched in 2000 for facilitating technology upgradation by providing upfront capital subsidy to SME units, has been extended for X Plan to XI Plan (2007-12) by the Ministry of Micro, Small & Medium Enterprises (MSME). The scheme provides:-

- The maximum loan under the scheme is restricted to Rs.1 crore.
- The subsidy available is 15% for all units of MSEss up to loan.
- Subsidy should be based on the purchase price of plant and machinery instead of term loan disbursed to the beneficiary unit.
- SIDBI and NABARD will continue to be model agencies for implementation.

g) Banking Codes and Standard Board of India (BCSBI)

BCSBI has formulated a voluntary code which sets the minimum standards of banking practices for banks to follow when they are dealing with Micro and Small Enterprises (MSEs) as defined in the MSMED Act, 2006.

(The complete text of the Code is available at the BCSBI's website (www.bcsbi.org.in)

h) Committees on flow of credit to MSE sector

RBI has constituted various committees to suggest measures for improving the delivery system, simplification of procedures, adequacy of credit, etc. to SSI (now SME) sector, few of which are mentioned as under:-

a) High Level Committee on credit to S.S.I i.e. Kapoor Committee
b) Committee to examine adequacy of credit to S.S.I. (now MSE) i.e. Nayak Committee
c) Working Group on flow of credit to S.S.I. (now MSE) i.e. Ganguly Committee
d) Working Group on Rehabilitation of Sick SMEs (Chairman: Dr. K.C. Chakrabarty)
e) Prime Minister's Task Force on MSME (Chairman: T.K.A. Nair)

f) Working Group to review the Credit Guarantee Scheme for MSME (Chairman: V.K.Sharma). The Group has recommended, among others, doubling of the limit for collateral free loans to micro and small enterprises (MSEs) sector from Rs.5 lakh to Rs.10 lakh which has been accepted by RBI and advised to banks accordingly.

Items to be excluded while calculating cost of investment in Plant & Machinery

a) Equipment such as tools, jigs, dyes, moulds and spare parts for maintenance and the cost of consumables stores;
b) Installation of plant and machinery charges;
c) Research and development equipment and pollution controlled equipment
d) Power generation set and extra transformer installed by the enterprise as per regulations of the State Electricity Board;
e) Bank charges and service charges paid to the National Small Industries Corporation or the State Small Industries Corporation;
f) Procurement or installation of cables, wiring, bus bars, electrical control panels (not mounded on individual machines), oil circuit breakers or miniature circuit breakers which are necessarily to be used for providing electrical power to the plant and machinery or for safety measures;
g) Gas producers plants;
h) Transportation charges (excluding sales-tax or value added tax and excise duty) for indigenous machinery from the place of the manufacture to the site of the enterprise;
i) Charges paid for technical know-how for erection of plant and machinery;
j) Such storage tanks which store raw material and finished produces and are not linked with the manufacturing process; and
k) Firefighting equipment.

While calculating the investment in plant and machinery, the original price thereof, irrespective of whether the plant and machinery are new or second handed, shall be taken into account provided that in the case of imported machinery, the following shall be included in calculating the value, namely;

a) Import duty (excluding miscellaneous expenses such as transportation from the port to the site of the factory, demurrage paid at the port);
b) Shipping charges;
c) Customs clearance charges; and
d) Sales tax or value added tax.

(Source: RBI M. Circular dt. 1.7.14)

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