

## General Studies-3; Topic: Indian economy – issues

### Credit Requirements of MSMEs

#### 1) Introduction

- Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades.
- MSMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country.

#### 2) Importance of MSME Sector

- MSMEs are a source of massive job creation mainly for less-skilled job seekers.
- Economically, any improvement in the sector's operating environment will help the Indian economy.
- The share of MSMEs in the country's gross value added is estimated to be about 32%.
- It also contributes about 40% to total exports and 45% to manufacturing output.
- They help in industrialization of rural & backward areas, thereby, reducing regional imbalances, assuring more equitable distribution of national income and wealth.

#### 3) Access and Cost of Credit

- Recently there was a big announcement of support to micro, small and medium enterprises (MSME)
- Apart from improving ease of doing business, the most important announcements were regarding access and cost of credit.
- MSMEs can now get in-principle approval for loans of up to ₹1 crore in 59 minutes.
- GST-registered MSMEs will get an interest subvention on fresh or incremental loans.
- Interest rate rebates have also been announced for exporters.

#### 4) Informal Nature of MSME Sector

- India has a large number of tiny firms that work in the informal sector and do not scale up.
- More than 90% of MSMEs operate in the informal sector.
- These firms largely depend on informal sources of credit at higher interest rates.
- It is difficult for these firms to get loans from banks because they do not maintain proper documents and records.
- Most firms in the informal sector are unlikely to attract skilled labour.
- This has not only affected growth and output, but also employment generation.
- This illustrates that the problem is much bigger than the availability of credit.

#### 5) Liberal Lending Challenges

- While incentivizing credit flow will help improve activity in the sector, government intervention and directed lending can affect proper credit appraisal.
- This could not only result in higher NPAs, but also affect the flow of credit in the future.
- Raghuram Rajan had recently cautioned: "Both MUDRA loans as well as the Kisan Credit Card, while popular, have to be examined more closely for potential credit risk.
- He also said that the Credit Guarantee Scheme for MSME (CGTMSE) run by SIDBI is a growing contingent liability and needs to be examined with urgency.

- Public sector banks already have significant NPAs in the MSME sector and a push by the government can increase the risk.

### 6) Concerns / Challenges

- MSMEs are largely depend on informal sources of credit at higher interest rates.
- Availability of credit from formal sources has been a problem for the sector.
- The share of credit to MSMEs has declined as a proportion of overall bank credit in recent years.
- MSME credit was also one of the reasons behind the recent rift between the government and the RBI.
- They are also not in a position to adopt technology to improve productivity.
- The gradual shift of consumer demand towards organised channels is creating additional growth challenges.

### 7) Way Forward

- The government should work to improve the overall regulatory architecture in order to incentivize smaller firms to scale up
- What is needed is a simplification of processes so that more firms can access formal finance.
- Banks should improve their credit appraisal capability to work with firms that are perhaps dealing with a financial institution for the first time.
- The progress made in Ease of Doing Business (EODB) rankings is real, but it's time for another exercise that takes a ground-up look at our current regulatory frameworks.
- India's next wave of EODB should have three vectors—rationalization (cutting down the number of laws), simplification (cutting down the number of compliances and filings) and digitization (architecting for true paperless, presence-less and cashless).
- Simplifying the regulatory architecture will also help in the progress of MSMEs.