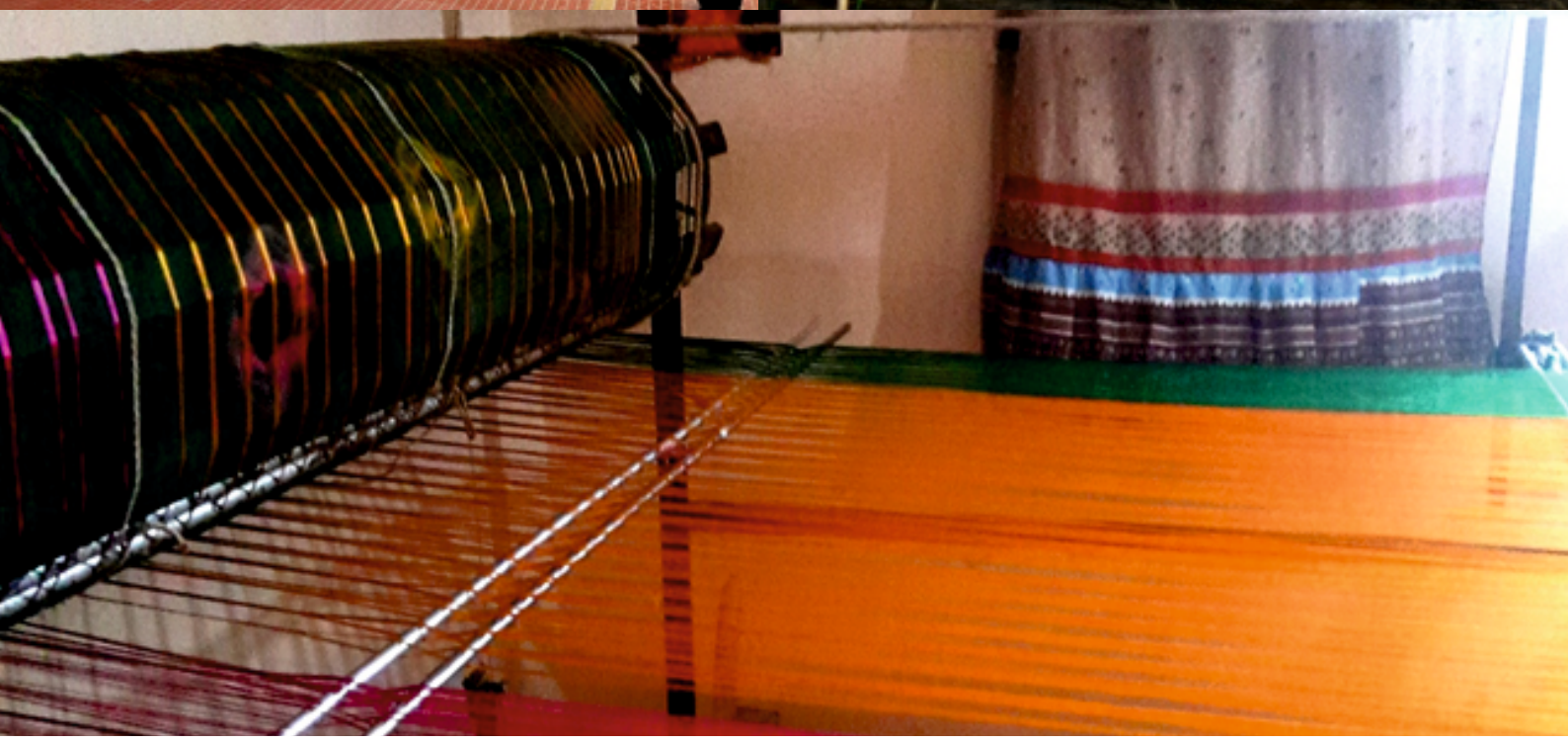
FICCI

MSMEs:
Towards a Sustainable Growth







Analysis by

resurgentindia

Debt | Equity | Advisory | Training

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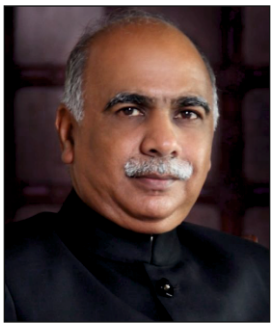
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Message



The Micro, Small and Medium Enterprises (MSME) sector contributes significantly in the economic and social development of the country by fostering entrepreneurship and generating employment opportunities.

The growth and development of MSME sector is closely interwoven with our quest for becoming a global economic power. One of the major challenges in this regard is easy and affordable access to finance to unleash the vast growth potential of this sector. MSMEs tap into various sources for funds and banks still form the largest lending source. Access to affordable capital at the right time throughout the growth stage of an MSME is essential and is still a major stumbling block.

Manufacturing sector is the base of revolution; the phase of new technology not only makes the work easier but also increases employment opportunities in this sector. The emergence of new technology, digitalisation, ZED scheme, innovative banking and energy efficient production ensures a better future for our manufacturing sector.

The report provides insight of financial arrangements and government schemes to boost the growth and development of MSME sector.

Randhir Vikram Singh
Co-Chairman
FICCI Rajasthan State Council

Message



The Federation of Indian Chambers of Commerce and Industry is an apex organisation of India. The chamber has an indirect membership of over 250,000 companies from various regional chambers of commerce. It is involved in sector specific business polus building, and business promotion and networking. It has presence in 12 states in India and 8 countries across the world the goal of this organisation is to promote Business interest of various organisation. We are preparing this report with FICCI for its MSME SUMMIT.

MSME sector is the backbone of our economy, a country like India where Service sector is far ahead of manufacturing sector. The report provides insight of financial arrangements and government schemes to boost the growth.

Finance sector is the base of every sector and in this phase of new technology has made the work easier but also increases employment opportunities in this sector. The emergence of new technology, digitalisation, innovative banking and financing opportunities have led to new ways of business. New ways of funding for MSME sector is the core of this report We hope that this report serves the purpose of knowledge enhancement on MSME sector.

Jyoti Prakash Gadia
Managing Director
Resurgent India Limited

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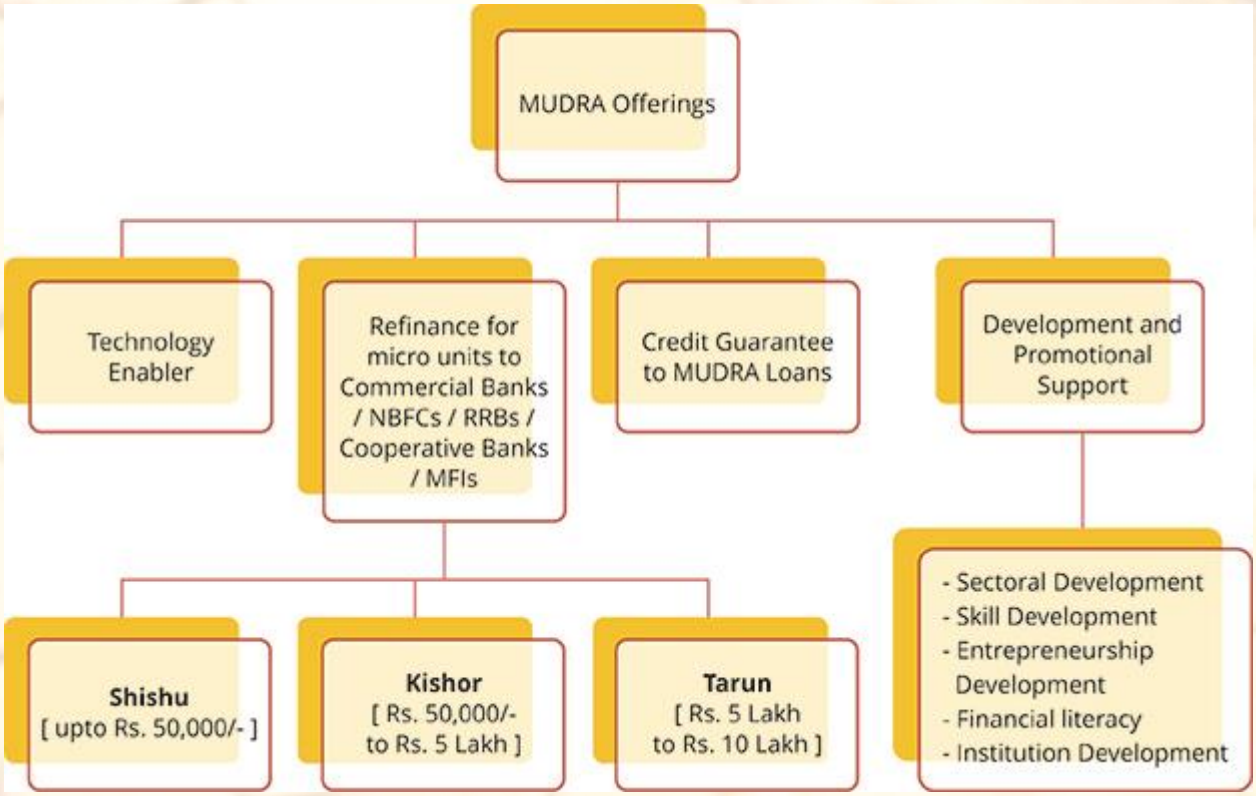
Enhancing the Competitiveness of MSMEs

Government Policies & Schemes

The Ministry of MSME runs various schemes targeted at **a)** providing credit and money assistances **b)**ability development coaching**, c)** infrastructure development, **d)** promoting assistance, **e)** technological and quality upgradation and **f)** different Services for the MSMEs across the country. An introductory overview of all the schemes is provided below:

Pradhan Mantri MUDRA Yojana (PMMY) MUDRA Yojana was announced during Union Budget for FY 2016, Under the Pradhan Mantri mudra Yojana (PMMY), gesture has created schemes The Government has decided to set up 'Mudra Bank', a refinance agency to be introduced with a corpus of Rs 20,000 crore, and with a credit guarantee fund of Rs 3,000 crore with focused lending to MSMEs. MUDRA Bank is a public sector financial institution in India. This bank will address the working capital and funding shortfall faced by MESs. The interventions are named 'Shishu', 'Kishor' and 'Tarun' to suggest the stage of growth / development and funding desires of the beneficiary small unit / businessperson and conjointly offer an indicator for succeeding part of graduation / growth to appear forward to:

Shishu : covering loans upto fifty,000/-
Kishor : covering loans on top of fifty,000/- and upto five large integer
Tarun : covering loans on top of five large integer and upto ten large integer



Credit and Financial Assistances to MSMEs

The scheme is all about to generate employment opportunities in rural as well as urban areas of the country through setting up of new self-employment ventures/ projects/ micro enterprises. Another objective is to provide sustainable employment to a large segment of traditional and prospective artisans and rural / urban unemployed youth of country, so as to help rural youth to urban areas. A third objective is to increase the wage-earning capacity of artisans and contribute in the growth rate of rural and urban employment.

This Scheme is implemented by Khadi and Village Industries Commission (KVIC), as the nodal agency at the National level. At the State level, the Scheme is implemented through State KVIC Directorates, State Khadi and Village Industries Boards (KVIBs) and District Industries Centres (DICs) and banks.

The maximum cost of the project/ unit admissible under manufacturing sector is Rs.25 lakh and under business/service sector is Rs.10 lakh.

Credit Linked Capital Subsidy Scheme (CLCSS)

The main objective of the Scheme is to facilitate technology up-gradation in Micro and Small Enterprises (MSEs) by providing capital subsidy of 15 % (limited to maximum of Rs.15.00 lakhs) on institutional finance availed by them for induction of well-established and improved technology. Maximum limit of eligible loan for calculation of subsidy under the Scheme is investment in approved plant & machinery upto Rs.1.00 crore for induction of well-established and improved technologies. MSEs are particularly disadvantaged due to insufficient investment and lack of awareness of both the quality standards and access to modern technologies. A large percentage of MSEs are running with outdated technology and plant and machinery. The CLCSS is envisaged to address this issue. Presently, 51 Sectors / sub-sectors with approved Machinery/Technologies are covered under the scheme. The scheme is applicable to new and existing Micro & Small Enterprises (MSEs) engaged in manufacturing. Office of the Development Commissioner (MSME) is implementing the scheme through 12 Nodal Banks / Agencies. The eligible MSEs are required to apply online through Primary Lending Institutions (PLIs), from where the MSEs availed term loan for up-gradation of technology. The completed application is uploaded by PLI through Online Application and

Tracking System to the attached Nodal Agency, which, in turn, recommends the application online to Office of DC (MSME) for release of subsidy. After processing of application and subject to availability of funds, due approval is accorded from competent authority and concurrence of Internal Finance Wing, after which funds are released to Nodal Agencies. Funds are then transferred by the Nodal Agencies to the PLIs where the account of the MSE is operated.

The scheme has been immensely successful in enabling MSEs in technology upgradation. This in turn has resulted in productivity improvement, increase in turnover and productivity. A substantial improvement in product quality has also been reported.

The scheme has also led to energy reduction in terms of electricity consumption and fuel consumption besides having a positive impact air, water and noise pollution.

Credit Guarantee Trust Fund for MSEs (CGTMSE)-Provision of collateral free credit for MSMEs

Guarantees are provided for extending collateral free lending to Micro and Small Enterprises through banks and financial institutions (including NBFCs). The Scheme covers collateral free credit facility (term loan and/ or working capital) extended by eligible lending institutions to new and existing micro and small enterprises up to Rs. 200 lakh per borrowing unit. The guarantee cover provided is up to 75% of the credit facility upto Rs. 50 lakhs (85% for loans up to Rs. 5 lakhs provided to micro enterprises, 80% for MSEs owned / operated by women and all loans to NER) with a uniform guarantee at 50% of the credit exposure above Rs. 50 lakh and up to Rs. 200 lakhs. A composite all in Annual Guarantee Fee of 1.0% p.a. of the credit facility sanctioned (0.75% for credit facility upto Rs. 5 lakh and 0.85% for above Rs. 5 lakh and upto 200 lakh for women, Micro Enterprises and units in NER including Sikkim) is charged. This Scheme has been tremendously successful if we consider the fact that the scheme has facilitated loans which were 20 times the corpus and has thus been able to promote entrepreneurial activities in the country. It is the only of its kind guarantee scheme which has covered more than 29 lakh beneficiaries in last 10 years. The beneficiaries experienced a boost in their turnover as well as employment generation in the years following approval of CGTMSE funding. CGTMSE funding has had a positive impact on six major areas in the MSE sector - technology upgradation, skill upgradation, market development, sustainability of scheme, economic impact, and social Impact. The scheme has been successful in spanning itself geographically across the country with a special focus in the North East. The benefits of the scheme have also reached more than 100 industrial sectors in which MSEs are operating. The beneficiaries are spread over even tier 3 towns and not limited to major industrial hubs. CGTMSE has been highly effective in settling the claims wherein the first instalment was settled within 3 weeks in majority of the cases.

India Aspiration Fund (IAF) and SIDBI Make in India Loan for Enterprises (SMILE): -

Two funds the India Aspiration Fund (IAF) and SIDBI Make in India Loan for Enterprises (SMILE) under SIDBI in line to fulfil the funding for the start-ups and to help the small enterprises in India have been launched. SIDBI and Life Insurance Corp. of India (LIC) as a partner and co-investor under the IAF would invest in the venture capital funds for meeting the equity requirement of MSME start-ups.the initial corpus of Rs. 2,000 crores have been set for this. In the second debt fund, the SMILE will meet the soft term loans to MSMEs to meet debt-to-equity norms and pursue growth opportunities. SIDBI has set the Initial corpus of Rs. 10, 000 crore under this fund. Finance Ministry has launched these funds under SIDBI.

Technology & innovation



The “Make in India” campaign aims to transform India as a manufacturing powerhouse by promoting exports, encouraging Foreign Direct Investment (FDI), improving industrial productivity, and by lowering the barriers to doing business. The government hopes to create 100 million jobs by 2022 and to increase the share of manufacturing in GDP to 25%. In this context, an important question is: What are the industries which hold the greatest potential for growth and what are the opportunities for MSMEs in those industries? Given that India holds a comparative advantage in labour-intensive production activities, that there are two groups of industries that holds the greatest potential for export growth. First, there exists a huge unexploited export potential in India’s traditional unskilled labour-intensive manufactured products such as clothing, footwear, toys etc. Second, based on imported parts and components, India has a huge potential to emerge as a major hub for final assembly in a range of products, where the manufacturing process is internationally fragmented and is mainly controlled by multinational enterprises (MNEs) within their global production networks (GPNs).

In general, these products are not produced from start to finish within a given country. Based on the available literature, some product groups have been identified, where GPN is most prevalent. These product groups, referred to as "network products", include: office machines and automatic data processing machines, telecommunication and sound recording equipment, electrical machinery, road vehicles, professional and scientific equipment, and photographic apparatus.

A number of leading automobile companies have established assembly plants in India and some of them have begun to use India as an export base within their global production networks. Further, a number of large MNEs in electronics and electrical goods industries have set up production bases in India, but they are mainly involved in production for the domestic market. Overall, though India's exports of assembled vehicles recorded some growth, the country remains as a minor player of network product exports, particularly in electronics and electrical goods.

From government policies to technological advancement, SME look forward to carious opportunities in the coming year: Leveraging the e-commerce trend SMEs now can make their presence in the online world by going digital. For many years, the SME sector was struggling with the intense competition, but going digital can give them the required edge.

Adoption of technology since social media, mobile phones, and cloud technology is the talk of the town now, SMEs can take help of these platforms. Embedding the social and cloud platform will open up vast opportunities for revenue growth and operational efficiency.

Taking advantage of Government schemes SMEs need to receive benefits of Government initiatives such as 'Make in India', 'Start-up India' and 'Skill India'. These schemes introduced by the government are aimed to promote an entrepreneurial culture to grow the current SME status. Abundance of Fintech firms with the number of Fintech firms and lenders on the rise, SMEs will have the opportunity to get accessible and affordable financing options. SMEs always had to worry about

the gap in their cash flows while taking the SME loan from the traditional lender. But now, they will be able to focus on their business entirely, as enhanced speed, transparency, and quick SME loan facilities are about to increase significantly. SME loans have always helped the enterprises to meet all their business needs that arise from time to time without facing any difficulty.

Financial Management for SME in current business scenario Good financial management is critical to the success of any business, but it is particularly important in small to medium enterprises (SMEs)where the risk of insolvency is often little more than an unpaid invoice away. A key concern for small business owner-managers is cash flow management, or more specifically the cash conversion cycle. This is the firm's ability to generate cash from its customers' invoices, and the time it takes to collect these accounts receivable Closely related to the cash conversion cycle is the working capital cycle, which is the movement

of cash and other liquid assets through the business as a process of regular trading. How efficiently a business manages its working capital, and speed of its cash conversion cycle will impact on firm's overall profitability.

The relationship between working capital management and profitability in relation to the linkage between working capital management and profitability within the firm, the review found several things that are worth summarizing.

The research shows that there is a significant relationship between the firm's profitability and its cash conversion cycle, although this is influenced by firm size, age and the industry within which it operates. Small business owner-managers can enhance their firm's profitability through the improvement of how efficiently they manage their working capital, as this frees up the amount of liquidity in the business.

The faster a business can turn around its cash conversion cycle the more efficient it will manage its working capital. This can be driven by more effective management of inventory and attention to the turnover of stock within the business. Inventory management is likely to be more important in periods of economic downturn than during boom times, due to the fluctuations that occur in customer demand.

In addition to the efficient management of inventory and working capital, SMEs can also boost their profitability through the effective management of accounts payable and receivable. Good management of the account's receivable helps the business bring in its customer payments faster thereby speeding up the cash conversion cycle. However, prompt payment of accounts payable also avoids late payment costs, interest charges or the loss of supplier discounts. In fact, the efficient management of accounts payable and receivable might be more important than inventory management.

Mutual Supply of Technologies: A number of appropriate technologies for the MSME sector have developed in various sectors. While each MSME has its areas of strengths and weaknesses, therefore, it would be mutually valuable if already developed technologies made available to each other. A comprehensive list of all sorts of technologies should be prepared and made available accordingly to

the MSMEs requiring it. Constitution of a Panel of Consultants: For the purpose of technological advancement and guidance a panel of experts and consultants should be prepared, who can help the MSMEs within the region for effectively transfer the available technologies. The constitution of panel of these consultants could be nature wise of the activities of the MSME. At the time of constitution of panel of experts, there should be inclusion of the owners of different sectors of MSME'S

Determination of Technological Needs: There should be detailed survey to assess the technical and financial needs of the SME. So that, the proper arrangement could be made to fulfil the needs of the SME'S.

Training and development, awareness programs: There must be conduction of training and development programs by the MSME ministry. The currently running programs are not so effective and sufficient. One of the important reasons for slow intake in the utilization of schemes is the lack of knowledge about schemes and their likely benefits. The current knowledge dissemination system is limited in its outreach. There is a need to develop a better communication strategy and use of new age media tools.

Sufficient availability of the credit- Our banking system does not provide sufficient amount of credit to fulfil their requirement of establishment of SME and as well as not for the operational activities. Therefore, there must be availability of credit according to the requirement at cheaper rate

Relaxation in labor laws and red tape-There should be relaxation in complex labor laws to avoid the inconvenience in compliance. There should not be uniform labor Laws to each SME. The must be sooth running of the concern not to create a problem for them. Every effort must do to avoid the unnecessary red tape

Proper research and development: There should proper research and development in respect of innovative method of production and service rendering. The innovative products will provide the cheaper products and the SME'S will be able to cope up with the situation.

Financial Training sessions for SMEs: There should be proper training sessions for Small and Medium Enterprises before applying for any funds or loans. Also, knowledge enhancement about new ways of raising funds and investing in the right business opportunity can be of much help.

Focus on Technology

Technology is increasingly seen as business enabler and a vital tool for bringing in process efficiencies and higher degree of standardisation. In order for MSMEs to develop a competitive advantage to operate in the global market, a strong focus on implementing new age technology, developing indigenous technology as well as technology collaboration with global partners are likely to play a crucial role. Technology plays a pivotal role for MSME to help them stand up to the stiff competition from large enterprises and imports. A strong technology-enabled sector levels the playing field, to a great extent, between MSMEs and their established counterparts globally. The increasing pace of change is rapidly driving customer, businesses and technology firms in a tight embrace, with the convergence of disruptive technologies eroding the boundaries separating them. Businesses are becoming more and more agile, and technologies such as social media, mobility, analytics and cloud computing are coming together to unleash great value and opportunity. This convergence – also known as SMAC (Social Media, Mobility, Analytics and Cloud Computing) – will emerge as a key business enabler over the next few years.

In the context of the Indian MSME sector, there is a gradual adoption of the SMAC amongst the urban enterprises – at least aspects of mobility and social media. With respect to developing

indigenous technology, across sectors like IT, Electronics, Manufacturing, Pharmaceuticals and Biotechnology, various industry stakeholders, industry bodies and associations, academia, government and large enterprises – need to come together to help pull MSME one notch up in the value chain and lead them to focus on innovation and automation. Local institutions and academia can help set-up cluster specific incubation cells to provide guidance in terms of technology implementation, development and scaling up. Institutions should also collaborate with the industry, particularly MSME, on research initiatives and help provide technology support to commercialise innovative products and service ideas. A new wave MSME framework which considers the global context and benchmarks, the emerging opportunities in the top industry growth sectors and specifically considering India's top socio-economic imperatives can provide an impetus by rewarding growth, innovation, productivity and global competitive edge the sector. The MSME coverage therefore needs to consider appropriate changes, taking into account the global economic environment as well as the changing domestic economic scenario. Current coverage MSME in India is based on capital investment in plant and machinery and is separate for services and manufacturing sectors.

Access to Affordable Credit & Risk Management

Alternative Source of Financing

PRIORITY SECTOR LENDING

Priority sector lending include only those sectors as part of the priority sector, that impact large sections of the population, the weaker sections and the sectors which are employment-intensive such as agriculture, and Micro and Small enterprises.

Bank lending to the micro, small and medium enterprises (MSMEs) will rise sharply after Reserve Bank of India (RBI) allowed lenders to classify all working capital limits to these units as priority sector lending (PSL).

Earlier, only working capital loans up to Rs 5 crore to the micro and medium and up to Rs 10 crore to the small-scale industries were allowed to be classified as priority sector lending. Investment into plant and machinery, however, will not qualify for PSL beyond certain limits.

In another announcement, RBI has now given the GST-registered MSME units a 180-period window to repay their dues between September 1, 2017, and January 31, 2018, if their dues to the banks were standard as on August 31, 2017. All loans up to a limit of Rs 25 crore will enjoy the extended repayment schedule.

In the Union Budget announced this year, the government also reduced the corporate tax rate for the MSME sector from the existing 30% to 25% for units with a turnover of Rs 250 crore.

"Policy relaxation given to MSME sector for the overdue payment and the removal of credit caps on MSMEs (services) under priority sector augurs well for both MSMEs and banks and will help in increasing the credit flow to the MSME sector which has been affected by the demonetization and GST".

Some of the lenders, especially the private sector banks, struggle to meet their priority sector obligations, which is 40% of the total bank credit during the financial year.

Rajkiran Rai, chief executive director and managing director, Union Bank of India, said, "This will be a big relief for the MSME sector as working capital limits will go up sharply as this will also be counted as priority sector exposures. Many units had huge working capital demand seven if investment in plant and machinery was low."

ACCESS TO ALTERNATE SOURCE OF CAPITAL

MSMEs in India play a crucial role in contributing to the overall economic growth. In India, MSMEs account for more than 80% of total industrial enterprises and employ an estimated 117 million people. Moreover, MSMEs make a significant contribution of more than 40% to

industrial output and exports. However, there is a huge and unidentified potential in this sector which is yet to be harnessed to make it an economic powerhouse of employment creation and innovation. As per the MSME census of 2006-07, it has been found that more than 92% of MSMEs in India did not have access to finance from institutional sources. Besides, the bank credit to this sector has remained largely flat over the past two years at INR4.7 lakh crore (as of September 2017). Undoubtedly, access to finance has been the biggest challenge for the MSMEs in India to grow, innovate and create jobs. Notably, over 50% of the MSMEs in India are rural enterprises widely distributed across the low-income states, making them an important sector for promoting inclusive economic growth and poverty reduction. (World Bank, Aug 17).

Indian MSMEs face several constraints to access credit from the formal financial system

In the light of above, it is evident that the present banking system in India is needed to go through radical transformation to cater to the financing needs of MSMEs. The traditional banking though very predominant in India even today, involves lengthy procedures to grant loans to the MSMEs. Hence, MSMEs fail to obtain timely credit during their various crucial stages of growth. Besides, the quantum of credit approved is also based on the collateral offered to the banks, thereby limiting the required access to credit.

Alternative sources of financing for small businesses- finding grip in India Notably, the new alternative sources of funding in India are at their nascent stage and yet to become proven and sustainable models. However, given the large unbanked population, there is a good space for these financing channels to flourish and establish. Some of these innovative and transformative approaches are discussed below:

Factoring Mechanism: Factoring is a very effective tool as it helps in managing the cash flows of the company who have deficient working capital arrangements. The tool involves selling of accounts receivable (debtors) to a third party (factor) at a discounted rate. The companies facilitating factoring services pay cash against the credit sales of the client and obtain the right to receive the future payments on those invoices from the debtors. This tool proves to be very effective for MSMEs in addressing liquidity issues and finance operations which otherwise may result in loss of opportunities from the revenue that it may be able to garner. In India, the potential for this tool is very huge, as the use of this facility though suitable is overlooked. However, there are several service providers in India at present after the regulatory obstacle was addressed by The Factoring Regulation Act in 2011, which came into effect in February 2012. This Act now regulates the factoring business in India and focuses on promoting the factoring concept and spreading awareness. However, the factoring market is not yet robust compared to other international markets and this could be attributed to lack of awareness, low customer reach by factoring companies, etc. It is essential to encourage use of this tool as it results in higher utilization of resources, higher profits margins and more importantly enables smooth functioning of business operations. Markedly, international factoring also appears to be an attractive tool for exporters compared to traditional letter of credit.

Private equity: Another financial solution would be to cater to the equity needs of the small businesses which would be essential to expand the business and bring about sustainable growth. Though private equity (PE) investments have gathered momentum in India they are skewed towards the larger businesses while private equity investments in small businesses are yet to establish a firm footing. The venture capital funds and angel investors have shown interest in MSMEs; yet there is still a significant push needed in the MSME space. The listing of companies on the MSME exchange has been an important initiative taken by the regulatory authority. However, currently there is a real challenge of market making which is absent and the underwriters to support public issues of MSMEs. Alternatively, the heavy reliance of MSMEs on debt has been creating pressure on their balance sheets. Besides, the present environment is confronting many regulatory actions like demonetization and implementation of GST which have slowed the growth in industrial segment and banks are reeling under the pressure rising NPAs. In such circumstances, raising fresh loans from banks, MSMEs are likely to face several challenges with increased uncertainty over future cash flows. It is thus important for the MSMEs to shift their focus from debt alone to funding mix with equity capital to grow in healthier manner. This alternative source offers plenty of positives in terms of strengthening the balance sheet, increased capacity to withstand volatile business environment, higher flexibility in deciding the return on investment, etc. Moreover, raising funds through private equity is easier as opposed to public issue and requires minimum regulatory compliance.

Crowd funding: Crowd funding also called as democratized funding is web-based tool which involves seeking mainly smaller funds from multiple lenders through a social platform to fund new ventures. It is a big opportunity for small borrowers who are unable to raise funds through traditional means due to credit scores or higher interest rates. This concept is also in its nascent stage in India as yet. SEBI, the regulatory authority in India has been actively considering this concept and has proposed a framework to encourage and streamline the crowd funding market. A solid regulatory framework is expected to go a long way in enabling a sustainable business model in an emerging market like India. This concept is likely to gain traction in India given that it requires huge social media penetration. Interestingly, India has outpaced the US to gain the leading position for Facebook (a social networking platform) users. This Facebook usage could prove to be a useful tool because in crowd funding the "single most predictive factor for the rate of emergence is social media penetration", as mentioned in the World Bank report titled 'Crowd funding's potential for the developing world'. Presently, the US, UK and China are big key players in the crowd funding market. In India, there are merely 10 crowd funding platforms as of 2013, as per World Bank notes.

Peer to Peer (P2P) lending: P2P lending, a form of crowd funding, has become increasingly popular globally post financial crisis of 2008. P2P based lending platform seeks to connect interested investors and borrowers with matching requirements without any involvement of a formal financial institution, unlike other Fin-tech companies which act as intermediaries between the banks and borrowers. It caters to the borrowers without the need for collaterals

and at affordable rates which are lower than the bank rates. Meanwhile, the investors holding idle cash have the options to fetch lucrative returns. However, this lending concept is at its initial stage in India and still remains unregulated. However, these start-ups have been the recent buzz in the financial market. Several start-ups have been catching up in India to cater to the needs of the MSMEs. These start-ups not only aim to provide affordable credit in a simplified manner but also ensure real-time loan approvals for applicants within a fixed time frame Apparently, concerns over rising non-performing loans (NPLs) in the Indian banking segment and the implementation of more stringent Basel III capital adequacy norms, banks have become extremely cautious in lending to risky ventures and individuals. Moreover, the lack of credit information of the MSMEs also prevents banks from extending financial aid. Unsurprisingly, the restrictive banking system in India has led to a much wider funding gap, restraining the MSME sector's growth prospects.



Alternative financing-a boon toe merging market like India

Alternative financing in India though it is yet to establish its roots in India; it is certain to give positive push to growth of the MSMEs. The key hurdle i.e. inaccessible timely credit at competitive cost which has been a major challenge faced by MSMEs over the past several years, the alternative platforms aim to provide simplified and customized access to finance along with more active participation and guidance in the overall growth and operations of the enterprises. Besides, in the era of rapidly changing technology, it is also essential for enterprises to overcome the risk of becoming technologically obsolete. Hence, alternative sources are expected to be the key drivers, providing convenient and cost-effective funding during the crucial stages of growth of the small and medium enterprises, thereby aiding sustainable growth. These alternative solutions are known to be popular among advanced countries suggesting that these alternatives are more likely to thrive if implemented in India as they help in bringing the borrowers and investors closer. However, these innovative methods would prove to be fruitful if established with strong legal framework involving greater transparency which would not only encourage borrowers but also build greater confidence among investors.

Equity Financing Opportunities

Equity financing is the process of raising capital through the sale of shares in an enterprise. Equity financing essentially refers to the sale of an ownership interest to raise funds for business purposes. So, the MSME have an option to raise the funds through Equity or issuing of shares.

Access to Equity Capital through SME Exchanges: Access to equity capital from the stock market is a genuine problem for MSMEs. Till some years ago, there was no great flow of equity capital into this sector. Absence of equity capital poses a serious challenge to the development of knowledge-based industries, particularly those promoted by the first-generation entrepreneurs with the requisite expertise and knowledge. Further, for efficient capital structure decisions, an optimal mix of equity and debt is very important. Keeping this in mind, the Report of the Task Force on MSME Chairman (Shri. T.K.A. Nair, 2010) had recommended the setting up of a dedicated Stock Exchange/Platform for MSMEs to access institutional and retail capital. This would also facilitate greater financial inclusion in the country. Following this, SEBI laid down the regulatory framework for the SME Exchanges with relaxed listing conditions and accorded approval to BSE and NSE to launch an SME Exchange in September 2011 and October 2011 respectively. Successful examples of SME Exchanges across the World include AIM (London), Canada (TSXV), Hong Kong (GEM), Japan (Mothers), Korea (KOSDAQ) and US (NASDAQ).

In March 2012, both BSE and NSE launched their SME exchange platforms to enable MSMEs to raise funds and get listed as public entities. BCB Finance Ltd. was the first Indian SME to get listed on the BSE SME Exchange. This was an event of immense significance for MSMEs as they have a huge listing potential but mostly had debt-financing options. The launch of SME exchanges will play an important role in growth of MSMEs and the need of the hour is to improve the awareness among MSMEs about equity capital, stock markets and funding options, other than banks. The capital markets can play a crucial role in helping MSMEs improve their visibility and raise capital for their growth and expansion, offering an effective way to improve financial inclusion. They can also offer investors opportunities to invest in growing businesses at an early stage. Since its launch in March 2012, 13 companies have listed with BSE SME exchange, and BSE is negotiating with other companies for listing. BSE's rival NSE has also followed suit and launched its own SME platform called 'Emerge' with the proposed listing of Chennai-based SME Thejo Engineering. A vibrant equity market for MSMEs would also provide an added incentive for private equity and venture capital investments by providing an exit option for them. Listing on exchanges will also offer MSMEs an opportunity to offer equity ownership to their employees, thereby, increasing their commitment to their company and working for its future success.

The MSME sector is an important factor for growth of the country's economy, and presents a significant business opportunity for both banks and alternative finance providers. The improvements of financial exclusion in MSMEs is high and in spite of the increase in credit

outstanding in recent years, fetching the adequate and timely credit from a bank is still a critical problem faced by the Indian MSME sector. So, the alternative sources of finance can step in and assist MSMEs in their growth and development. In recent years, the amount of alternative finance options has improved and have proven to be an important source of financing for Indian MSMEs. The alternative financing avenues discussed above truly have the potential to bridge the financing gap for MSMEs from banks. Access to finance is essential for improving MSMEs competitiveness, as MSMEs have to invest in new technologies, skills and innovation. On their part, the MSMEs should be responsible borrowers, should use the finance in a judicious manner and take advantage of the business opportunities both within and outside the country. They should improve their governance and risk management practices, maintain proper books of accounts, submit correct information to banks and all authorities, and make their operations more efficient and productive to get easier access to finance from banks and other investors. This way the MSME sector would become more competitive and efficient and contribute further to the economic development of our country.

Challenges for MSMEs in Equity Infusion: -

The legal structure will influence the ability of an enterprise to accept external equity funds. The investors can invest in the firms through that the enterprise will be extent their liability is limited to their respective shareholding in case of Limited companies and limited liability partnerships. In the case of proprietorship and partnership transfer unlimited liability to the equity investor, hence discouraging equity infusion in such enterprises.

Approximately 96 percent of MSMEs in India are proprietorships or partnerships. Because of that the MSMEs can't able to attract external equity. While change in the legal form of an enterprise to limited company or limited liability partnership is an option, it entails taxation and compliance overheads for the enterprises, often rendering the business model financially unviable. Most of the entrepreneurs do not have much awareness of alternative sources of finance. So, the benefits of changing their legal structures are not always obvious. Limited presence of external equity, entrepreneurs use informal sources (usually debt) to meet the needs of their enterprise.

Most of the mature small enterprises and medium enterprises which are able to keep their financials transparent, and tend to attract more equity investors. Also, the legal structure of mature small enterprises and medium enterprises allows for inclusion of external equity. It is because the external equity investors expect transparency in both financial record-keeping and governance.

Credit Rating and Risk Management

- **Importance of Credit rating for MSMEs**

GST and MSMEs

IMPACT

• Compelled to register to claim tax-credits
• Lower tax burden and easier compliance
• Single tax enhances efficiency improve demand and competitiveness
• Ease in starting new business – lower costs
• Faster logistics and delivery – better use of capital and lower interest costs

Implications for credit rating

• Formal accounts to be made available
• Efficiency increases, costs decrease and rating can improve

SME Rating Model Parameters

Management

• Track record • Experience • Professionalism • Succession planning •Group support • Constitution

Business

• Cluster presence • Product diversification / Uniqueness / Level of value addition • Product certification • RM fluctuation • Forex fluctuation • Size of ops. •Geographical reach • Customer/supplier dealing and diversification

Industry

• Level of competition • Regulatory issues • Threat of substitutes

Financial

•Growth in OI, PAT • Profitability level and variability • Solvency Ratio (TD/GCA, TOL/TNW etc.) • Liquidity ratio (Current ratio, Op cycle).

Benefits of Credit Rating – Lenders

Long Term Sustainability

- Timely planning for riskier assets
- Better financial discipline

Credit Growth

- Tapping MSME sector falling under high growth trajectory
- Facilitates faster decision making

Risk Return management

- Reducing information asymmetry
- High interest rates for high risk assets

Asset Liability Management

- Capital adequacy norms
- Independent opinion on credit quality

Risk Management Process

The major functions of risk management are to measure and more importantly monitor the risk. Risk management is a pro-active action in present for securing the future. Managing risk is nothing but managing change, before the risk manages the persons concerned.

How does a business identify and manage these particular risks?

- The first step is to identify the events which could cause a loss or disruption to the business.
- Those events should then be analysed to ascertain the likelihood of their occurring and how serious the result would be if they did occur. Start simply by assessing each event as „very likely", „moderately likely" or „very unlikely". Prioritize them by putting a dollar value on each one (e.g. the replacement cost of a critical piece of machinery; or in the case of potential bad debts, the total value of amounts owed by customers).
- Attend to the most likely and the most expensive events first.
- For each possible event, develop procedures commensurate with the level of risk the business is willing to accept.
- Once a procedure is put in place, it should be monitored to ensure it is properly implemented and is effective. As per the RBI guidelines, there are basically three types of risks viz Credit Risk, Market Risk and Operational Risk. While the credit risk is associated with the default of counter party, market risk relates to changes in the earnings as well as capital on account of changes in the market variables and the operational risk is the residual risk which does not directly relate to credit or market risk. Conclusion Functions of risk management should actually be the entity specific, dictated by the size and quality of the balance sheet, complexity of functions, technical/professional manpower and the status of Management Information System in place. Any risk management model is as good as the data input. In the present scenario, where profits are derived mainly from trading in the market, one can no longer afford to avoid measuring risk and managing its implications thereof. To the extent the SME entity takes risk consciously, anticipates adverse change and hedges accordingly, it becomes a source of competitive advantage as it can offer its products at a better price than its competitors. What can be measured can also be managed. It should be clearly understood that risk mitigation efforts are more important and vital than capital allocation against inadequate risk management system.

Notes

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About Resurgent India Ltd

DEBT I EQUITY I ADVISORY
Resurgent India is a full service investment bank providing customized solutions in the areas of debt, equity and merchant banking. We offer independent advice on capital raising, mergers and acquisition, business and financial restructuring, valuation, business planning and achieving operational excellence to our clients.

Our strength lies in our outstanding team, sector expertise, superior execution capabilities and a strong professional network. We have served clients across key industry sectors including Infrastructure & Energy, Consumer Products & Services, Real Estate, Metals & Industrial Products, Healthcare & Pharmaceuticals, Telecom, Media and Technology.

In the short period since our inception, we have grown to a 100 people team with a pan-India presence through our offices in New Delhi, Kolkata, Mumbai, and Bangalore. Resurgent is part of the Golden Group, which includes GINESYS (an emerging software solutions company specializing in the retail industry) and Saraf& Chandra (a full service accounting firm, specializing in taxation, auditing, management consultancy and outsourcing).

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