Final Year Dissertation on

LENDING OF CREDITS TO SMEs & BUSINESS BANKING

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CERTIFICATE FROM INSTITUTE

This is to certify that Final Year Dissertation on "**Lending of Credits to SMEs & Business Banking**" is a bona fide work carried out by **Gautam Sharma** of MBA 2015-17 Batch and submitted to Delhi School of Management, Delhi Technological University in partial fulfillment of the requirement for the award of degree of Masters of Business Administration.

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DECLARATION

I, Gautam Sharma, student of MBA 2015-17 of Delhi School of Management, Delhi Technological University, hereby declare that Final Year Dissertation on **"Lending of Credits to SMEs & Business Banking"** submitted in partial fulfilment of Degree of Masters of Business Administration is the original work conducted by me.

The information and data given in the report is authentic to the best of my knowledge.

This report is not being submitted to any other University for award of any Degree, Diploma and Fellowship.

Gautam Sharma

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ABSTRACT

This dissertation is a study on the objectives of Credit lending to SMEs and Business Banking in India, as to evaluate the credit lending mechanisms & to understand the other financing methods. However firstly, the focus has been asserted on understanding the Indian Banking Sector which comprises of Public banks, Private Banks, Cooperative Banks, and RRBs etc. Following which, a brief discussion has been made to understand the regulatory and credit lending norms followed by SMEs in accordance with RBI & Committees under the Ministry of Finance. The main purpose of this study is to evaluate the availability of credit for Small and Medium scale enterprises so that the entrepreneurs can participate in Business Banking & hence can move towards profitability. To conduct a uniform research and arrive at a relevant conclusion, the research has been made restricted to only Indian Banks.

The report examines the Business Banking performance of eight Indian Banks. In order to conduct this study, the use of secondary data has been made solely. The analysis mainly covers Credit rating policy, Risk Rating by RBI & other agencies, Calculation of Bank Finance and more such related parameters. In spite of all the measures, the availability of adequate and timely credit to SMEs continues to be a major concern. Despite the best intentions of the Government to expand the credit to SMEs, the results are far from satisfactory. With this study, I have tried to evaluate the various steps & measures taken by the Government to promote credit lending. Following this, suggestions have also been discussed in the report. In order to fulfill the objectives of the study, secondary research methods have been used.

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CHAPTER 1 – INTRODUCTION

1.1 Banking sector in India

Banks in India are the most significant and influential players in the Indian finance market. They are in some way the biggest purveyors of credits, and these banks also attract most of the savings from the people. Banks are dominated by public sector and the banking industry has so far acted as an efficient and major partner in the growth and the development of the India. They are basically led by the socialist ideologies and welfare concepts, and public sector banks are the supporters of agriculture and other priority sectors which earns more money. These banks act as crucial and very important channels for the Indian Government in the efforts to make sure proper economic development. The Banking system of India can be divided into nationalized (govt. owned), specialized banking institutions and the private banks. The RBI acts a centralized body monitoring any discrepancies and shortcoming in this system. Since the nationalization of banks, in 1969, the banks have acquired a place of prominence and prestige and has since then seen great progress. The need to become people focused has pushed the slow-moving public sector banks to finally adopting the quick approach. In India, the banks are divided in different groups. Every group has own processes and benefits and limitations for operating in Indian market. Every bank has its own dedicated target market and customers which they target. Some of banking institutions work only in rural sector, and some of them works in both urban and rural and many even believe only working in urban cities. There are many types of banks operating in India which can be categorized as:

- Public sector banks
- Private sector banks
- Cooperative banks
- Foreign banks.
- RRBs

1.2 SME Sector in India

With the advent of planned economies from 1951 and the subsequent industrial policy followed by Indian Government, both planers and Government marked a special role for SSIs and MSIs (medium scale industries) in Indian economy. Due protection was accorded to both sectors, and particularly for small scale industries from 1951 to 1991, when the nation adopted the policy of liberalization and globalization which is worldwide known. Some products were reserved for small-scale units for the longer time, since this list of products was decreasing due to change in industrial climate and policies. SMEs represent, the model of socio-economic policies almost always, of Indian Government which emphasized judicious use of foreign exchange for import of capital goods and inputs. Labor intensive methods of production; generation of jobs; non-concentration of diffusion of economic power in the hands of some (as in the case of big houses); discouraging monopolistic practices of production and marketing; and finally effective contribution to foreign exchange earning of the nation with low import-intensive operations are the factors responsible. It is also coupled with the de-concentration policy of industrial activities in some geographical centers. It is observed that, SMEs in Indian Economy met the expectations of the Govt. in this respect. SMEs in spite of having low Functional and financial capital base with concentration of functions into single or two persons, exposure to international environment and the inability to face the impact of WTO , contribution towards Research & Development and lack of professionalism in working, SMEs made a significant contribution towards exports & technological development. SMEs are now established in all-major sectors in the Indian economy like, Foods & Processing, Agricultural Input, Chemicals & Pharmaceuticals Engineering, Electricals & Electronics, Electro-medical equipment, Textiles & Garments; Leather and leather goods, Meat related products, Bio-engineering, Sports related goods, Plastics products, Computer Hardware and Software etc. The contribution of MSEs in the development of Indian economy has been huge. The sector currently has somewhat 39 per cent of the manufacturing outputs and approximately 33 percent of the total exports from the country. There are about 1.3 crore MSEs which employs around 3 crore people. This sector contributes close to 7% of our GDP. Hence, special thrust by the Government of India to the sector has been consistent with the objectives of employment generation and jobs creation, regional dispersal of industries and encouraging entrepreneurship.

1.3 Financing of SMEs in India

Small and Medium Enterprises (SMEs) have played a significant role world over in the economic development of various countries. India, certainly, is no exception. Keeping in view its importance, the promotion and development of SMEs has been an important plank in our policy for industrial development and a well- structured program of support has been pursued in successive five-year plans for the promotion and development of SMEs in the country. There exists a well-developed network of financial institutions at national and state level to channelize credit to SMEs. SIDBI is the national level principal financial institution for promotion, financing and development of SMEs. It provides direct assistance to the SSI sector through several schemes like direct discounting, project finance, assistance for technological up gradation and modernization, marketing, finance, resource support to institutions engaged in developing SSIs, venture capital, factoring services, etc. It also provides indirect assistance comprising refinance, bills re-discounting (equipment) and against inland supply of bills through an organized network of 910 Primary Lending Institutions (PLIs) including banks and SFCs with more than 65,000 outlets throughout the country. In order to enhance the flow of credit to the sector, various initiatives have been taken by the Government of India/Reserve Bank of India from time to time, viz.

• Enhancement of loan limit under Composite Loan Scheme

• Increase in project cost limit under National Equity Fund (NEF) Scheme

• Launching of Credit Guarantee Fund Trust for Small Industries

• Extension of concessional assistance under Technology Development and Modernization Fund Scheme

• Introduction of special schemes for modernization of units under Technology Up gradation Fund Scheme for textiles and jute industries

• Tannery Modernization Scheme and Credit Linked Capital Subsidy Scheme for Technology Up gradation.

• Public sector banks have so far opened 391 specialized SSI branches so as to give focused attention to the needs of SSIs

• Dedicated agencies for credit rating to SSI sector have been created with a provision of subsidized credit rating charges.

1.4 Objectives of the study

• To evaluate the structure of SMEs

• To evaluate the regulatory mechanism over SMEs

• To evaluate the financing for SMEs

• To evaluate the Indian Banking Industry

• To know evaluation of credit lending norms for SMEs by RBI and Committees under Ministry of Finance

• To evaluate the availability of credit among Indian banks.

CHAPTER 2 – LITERATURE REVIEW

2.1 Basel Norms for Indian banks

Basel-I is the first accord issued in 1988 and focused mainly on credit risk by creating a bank asset classification system. The Basel Capital Accord is an Agreement concluded among country representatives in 1988 to develop standardized risk-based capital requirements for banks across countries. The Accord was replaced with a New capital adequacy framework (Basel-II), published in June 2004. Basel-II accord focuses on operational risk along with market risk and credit risk. Basel II tries to ensure that the anomalies existed in Basel I are corrected. Basel II is based on 3 pillars that allow banks and supervisors to evaluate properly the various risks that banks face. These three pillars are: (i) Minimum capital requirements, (ii) Supervisory review of an institution's capital adequacy and internal assessment process; (iii) Market discipline through effective disclosure to encourage safe and sound banking practices. Basel II guidelines have come in force on Indian banking companies and are implemented since March 31, 2009. The first phase of Basel II was implemented in India with foreign banks operating in India and Indian bank shaving operational presence outside India complying with the same effective end of March 2008. With Basel II norms coming into force in 2009, maintaining adequate capital reserves has become a priority for banks. Basel II mandates Capital to Risk Weighted Assets Ratio (CRAR) of 8%and Tier I capital of 6%. The RBI has stated that Indian banks must have a CRAR of minimum 9%, effective March 31, 2009. All private sector banks a real ready in compliance with the Basel II guidelines as regards their CRAR as well as Tier I capital. Further, the Government of India has stated that public sector banks must have a capital cushion with a CRAR of at least 12%, higher than the threshold of 9% prescribed by the RBI.

Capital to Risk Weighted Assets Ratio (CRAR) is also known as Capital Adequacy Ratio which indicates a bank's risk-taking ability. The RBI uses CRAR to track whether a bank is meeting its statutory capital requirements and is capable of absorbing a reasonable amount of loss. CRAR = (Tier I capital + Tier II capital) / Risk-Weighted Assets Capital funds are broadly classified as Tier 1 and Tier 2 capital. Two types of capital are measured: Tier one capital, which absorbs losses without a bank being required to cease trading, and Tier two capital, which absorbs losses in the event of winding-up and so provides a lesser degree of protection to depositors. Tier I capital (core capital) is the most reliable form of capital. The major components of Tier I capital are paid up equity share capital and disclosed reserves viz. statutory reserves, general reserves, capital reserves (other than revaluation reserves) and any other type of instrument notified by the RBI as and when for inclusion in Tier I capital. Examples of Tier 1 capital are common stock, preferred stock that is irredeemable and non-cumulative, and retained earnings. Tier II capital (supplementary capital) is a measure of a bank's financial strength with regard to the second most reliable forms of financial capital. It consists mainly of undisclosed reserves, revaluation reserves, general provisions, subordinated debt, and hybrid instruments. This capital is less permanent in nature.

2.2 Types of financial requirements

The business organizations generally be having these main requirements

1. Term loans

Term loans are the long term debt provided by the banks to the industry. It's generally for financing large expansion, modernization of diversified projects. Hence they are also referred to as project financing. Banks and specially created financial institutions are the main sources of term loans in India. Commercial banks advance term loans for a period of 3 to 5 years. Or it may be 6 to 10. Term loans are always secured.

2. Working Capital Financing

Working capital is used for funding current assets. Broadly these would consist of raw materials, work in progress, finished goods, and advance payments to suppliers, account receivables and cash. Once the build- up of current assets is assessed one should look for sources of funding those assets, credit available on supplies and so on. The difference (gap) needs to be met. A part of this gap should come from the borrower's long term sources and the balance can be financed by working capital lender. Depending on the long term sources available for working capital and the anticipated build-up of current assets the lender takes a view about the loan proposal.

3. Bridge Loan

A bridge loan is interim financing for an individual or business until permanent or the next stage of financing can be obtained. Money from the new financing is generally used to "take out" (i.e. to pay back) the bridge loan, as well as other capitalization needs. Bridge loans are typically more expensive than conventional financing to compensate for the additional risk of the loan. Bridge loans typically have a higher interest rate, points and other costs that are amortized over a shorter period, and various fees and other "sweeteners" (such as equity participation by the lender in some loans). The lender also may require cross-collateralization and a lower loan-to-value ratio. On the other hand they are typically arranged quickly with relatively little documentation.

2.3 Methods of Lending

Like many other activities of the banks, method and quantum of short-term finance that can be granted to a corporate was mandated by the Reserve Bank of India till 1994. This control was exercised on the lines suggested by their commendations of a study group headed by Shri Prakash Tandon. The study group headed by Shri Prakash Tandon, the then Chairman of Punjab National Bank, was constituted by the RBI in July 1974 with eminent personalities drawn from leading banks, financial institutions and a wide cross-section of the Industry with a view to study the entire gamut of Bank's finance for working capital and suggest ways for optimum utilization of Bank credit. This was the first elaborate attempt by the central bank to organize the Bank credit. The committee even suggested the maximum levels of Raw Material, Stock-in-process and Finished Goods which a corporate operating in an industry should be allowed to accumulate. These levels were termed as inventory and receivable norms. Depending on the size of credit required, the funding of these current assets (working capital needs) of the corporates could be met by one of the following methods:

First Method of Lending:

Banks can work out the working capital gap, i.e. total current assets less current liabilities other than bank borrowings (called Maximum Permissible Bank Finance or MPBF) and finance a maximum of 75 percent of the gap; the balance to come out of long-term funds, i.e., owned funds and term borrowings. This approach was considered suitable only for very small borrowers i.e. where the requirements of credit were less than Rs.10 lacs.

Second Method of Lending:

Under this method, it was thought that the borrower should provide for a minimum of 25% of total current assets out of long-term funds i.e., owned funds plus term borrowings. A certain level of credit for purchases and other current liabilities will be available to fund the buildup of current assets and the bank will provide the balance (MPBF).Consequently, total current liabilities inclusive of bank borrowings could not exceed 75% of current assets. RBI stipulated that the working capital needs of all borrowers enjoying fund based credit facilities of more than Rs. 10 lacs should be appraised (calculated) under this method.

Third Method of Lending:

Under this method, the borrower's contribution from long term funds will be to the extent of the entire CORE CURRENT ASSETS, which has been defined by the Study Group as representing the absolute minimum level of raw materials, process stock, finished goods and stores which are in the pipeline to ensure continuity of production and a minimum of 25%of the balance current assets should be financed out of the long term funds plus term borrowings.

2.4 Sources of Credit to SME Sector

The principal source of institutional credit of MSE sector is the public-sector banks. Besides, credit is extended to this sector through the private sector banks and foreign banks operating in India. The RRBs and LABs supplement the efforts of the SCBs to some extent. Credit to this sector is also provided bucks, State and District Central Cooperative Banks, State Financial Corporations, NBFCs and Small Industries Development Bank of India (SIDBI).

Refinance Facilities and Funding Support for MSEs

In the context of the global developments and the knock on effects in the domestic credit markets, Reserve Bank has taken several measures to enhance credit delivery to the employment intensive MSE sector. One of the measures was that a refinance amount of Rs. 7,000 crore was provided to the SIDBI under the provisions of Section 17(4H) of the Reserve Bank of India Act, 1934 on December 6, 2008 to enhance credit delivery to the sector. This refinance will be available against:

(i) The SIDBI's incremental direct lending to MSE; and

(ii) The SIDBI's loans to banks, NBFCs and State Financial Corporations (SFCs) against the latter are incremental loans and advances to MSEs. The incremental loans and advances will be computed with reference to outstanding as on September 30, 2008. This refinance facility will be available up to March 31, 2010. The utilization of funds will be governed by the policy approved by the Board of the SIDBI.

iii) Special Refinance Facility in order to provide liquidity support to SCBs (excluding RRBs), a special refinance facility was introduced on November 1, 2008 under Section 17. (3B) of Reserve Bank of India Act1934, whereby banks were advised to draw up to 1 per cent of their NDTL as on October 24, 2008, for a period of 90 days. Banks were encouraged to use this facility for the purpose of lending to MSEs. This facility has been extended up to March 31, 2010.

iv) Focused attention in 388 Identified Clusters:

The Reserve Bank's Annual Policy Statement for 2007-08 announced that banks were required to review their institutional arrangements for delivering credit to the MSE sector, especially in 388 clusters identified by United Nations Industrial Development Organization (UNIDO) spread over 21 States in the country.

Working Group on Rehabilitation of Sick MSEs

In recognition of the problems being faced by the MSE sector, particularly with respect to rehabilitation of potentially viable sick units, the Reserve Bank constituted a Working Group under the Chairmanship of Dr. K.C. Chakrabarty. The Working Group, in its report submitted in April 2008, dealt with the entire gamut of issues and problems confronting the sector. The Group recommended setting up of several funds namely

(i) Rehabilitation Fund,

(ii) Fund for Technology Up gradation

(iii) Marketing Development Fund and

(iv) National Equity Fund This is all set up by the Government of India to facilitate credit flow tithe MSE sector. These recommendations have been forwarded to the Government of India and SIDBI for their consideration and necessary action.

2.5 Banking Code for SME Customers

The Banking Codes and Standard Board of India (BCSBI) have formulated a Code of Bank's Commitment to Micro and Small Enterprises. This is a voluntary Code, which sets minimum standards of banking practices for banks to follow when they are dealing with MSEs as defined in the MSMED Act, 2006. It provides protection to MSEs and explains how banks are expected to deal with MSEs for their day to-day operations and in times of financial difficulty. The Code is expected to(a) Give a positive thrust to the MSE sector by providing easy access to efficient banking services,(b) Promote good and fair banking practices by setting minimum standards in dealing with MSEs,(c) Increase transparency (d) Improve understanding of business through effective communication(e) Encourage market forces through competition, to achieve higher operating standards(f) Promote a fair and cordial relationship between MSEs and banks(g) Ensure timely and quick response to banking needs, and(h) Foster confidence in the banking system.

Availability of bank credit without the hassles of collaterals/ third party guarantees would be a major source of support to the first generation entrepreneurs to set up MSE of their own. Keeping this object in view, Ministry of Micro, Small and Medium Enterprises (MSME), Government of India launched Credit Guarantee Scheme (CGS) so as to strengthen credit delivery system and facilitate flow of credit to the MSE sector. To operationalize the scheme, Government of India and SIDBI set up the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). The main objective of the scheme is that the lending institution should give importance to project viability and secure the credit facility purely on the primary security of the assets financed instead of insisting the secondary collateral. Any collateral/ 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 Rs.1 crore, are eligible to be covered under the CGS. For the unit covered under CGTMSE and becoming sick due to factors beyond the control of management, assistance for rehabilitation extended by the lender could also be covered under the scheme provided the overall assistance is within the credit cap of Rs.1 crore.

2.6 Targets Involved

Targets for priority sector lending by domestic Commercial Banks (excluding RRBS)

The domestic commercial banks are expected to enlarge credit to priority sector and ensure that priority sector advances (which include the small enterprises sector) constitute 40 per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. In order to ensure that credit is available to all segments of the Small Enterprises sector, banks should ensure that:-(a) 40 per cent of the total advances to small enterprises sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to Rs. 5 lakh and micro (service) enterprises having investment in equipment up to Rs. 2 lakh(b) 20 per cent of the total advances to small enterprises sector should go to micro (manufacturing) enterprises with investment in plant and machinery above Rs. 5 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 2 lakh and up to Rs. 10 lakh.

Targets for Foreign Banks

Foreign banks are expected to enlarge credit to priority sector and ensure that priority sector advances (which include the Small Enterprises sector) constitute32 per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Within the overall target of 32 per cent to be achieved by foreign banks, the advances to small enterprises sector should not be 10 per cent of the adjusted net bank credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher

2.7 Common lending guidelines to Small enterprises

1. Disposal of Applications

All loan applications for SSI up to a credit limit of Rs. 25,000/- should be disposed of within 2 weeks and those up to Rs. 5 lakh within 4 weeks provided the loan applications are complete in all respects and accompanied by a 'check list'.

2 Collaterals

The limit for all SSI borrowable accounts for abstention of collateral security is Rs5 lakh. Banks may on the basis of good track record and financial position of the SSI units; increase the limit of dispensation of collateral requirement for loans up to Rs.25 lakh (with the approval of the appropriate authority).

3. Composite loan

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

4. Specialized SSI/SME branches

Public sector banks have been advised to open at least one specialized branch in each district. Further banks have been permitted to categories their SSI general banking branches having 60% or more of their advances to SSI sector. Though their core competence will be utilized for extending finance and other services to SME sector, they will have operational flexibility to extend finance/render other services to other sectors/borrowers

5. Delayed Payment

Under the Amendment Act, 1998 of Interest on Delayed Payment to Small-scale and Ancillary Industrial Undertakings, penal provisions have been incorporated to take care of delayed payments to SSI units which inter-alia stipulates. Agreement between seller and buyer shall not exceed more than 120 days) Payment of interest by the buyers at the rate of one and a half times the prime lending rate (PLR) of SBI for any delay beyond the agreed period not exceeding 120 days. 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 SSI. After the enactment of the Micro, Small and Medium Enterprises Development (MSME), Act 2006, the existing provisions of the Interest on Delayed Payment Act, 1998 to Small Scale and Ancillary Industrial Undertakings, have been strengthened as under:

(i) The buyer to make payment 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.

(ii)If the buyer fails to make payment of the amount to the supplier, he shall be 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.

(iii) For any goods supplied or services rendered by the supplier, the buyer shall be liable to pay the interest as advised at (ii) above.

(iv) 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.

6. Guidelines on rehabilitation of sick SSI units (based on Kohl Working Group recommendations)

As per the definition, a unit is considered as sick when any of the borrower account of the unit remains substandard for more than 6 months or there is erosion in the net worth due to accumulated cash losses to the extent of 50% of its net worth during the previous accounting year and the unit has been in commercial production for at least two years. During the six months period of identifying and implementing rehabilitation package banks/FIs are required to do “holding operation” which will allow the sick unit to draw funds from the cash credit account at least to the extent of deposit of sale proceeds. Following are broad parameters for grant of relief and concessions for revival of potentially viable sick SSI units:

(i) Interest on Working Capital Interest 1.5% below the prevailing fixed / prime lending rate, wherever applicable

(ii) Funded Interest Term Loan Interest Free

(iii) Working Capital Term Loan Interest to be charged 1.5% below the prevailing fixed / prime lending rate, wherever applicable

7. State Level Inter Institutional Committee

In order to deal with the problems of co-ordination for rehabilitation of sick small scale units, State Level Inter-Institutional Committees (SLIICs) have been set up in all the States. The meetings of these Committees are convened by Regional Offices of RBI and presided over by the Secretary, Industry of the concerned State Government. It closely monitors timely sanction of working capital to units which have been provided term loans by SFCs, implementation of special schemes such as Margin Money Scheme of State Government, National Equity Fund Scheme of SIDBI, and reviews general problems faced by industries and sickness in SSI sector based on the data furnished by banks.

8. Debt Restructuring Mechanism for SMEs

As part of announcement made by the Honorable Finance Minister for stepping up credit to small and medium enterprises, a debt restructuring mechanism for units in SME sector has been formulated by Department of Banking Operations & Development of Reserve Bank of India These detailed guidelines have been issued to ensure restructuring of debt of all eligible small and medium enterprises. These guidelines would be applicable to the following entities, which are viable or potentially viable: a) All non-corporate SMEs irrespective of the level of dues to banks') All corporate SMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank's) All corporate SMEs, which have funded and non-funded outstanding up toRs.10 crore under multiple/ consortium banking arrangement.(d) Accounts involving willful default, fraud and malfeasance will not be eligible for restructuring under these guidelines.(e) Accounts classified by banks as "Loss Assets" will not be eligible for restructuring

For all corporate SMEs, which have funded and non-funded outstanding of Rs.10crore and above, Department of Banking Operations & Development has issued separate guidelines.

9. Committees on flow of credit to SSI/SME sector

9.1Report of the Committee to Examine the Adequacy of Institutional Credit to SSI Sector and Related Aspects

Kayak Committee

The Committee was constituted by Reserve Bank of India in December 1991under the Chairmanship of Sheri P. R. Kayak, the then Deputy Governor to examine the issues confronting SSIs in the matter of obtaining finance. The Committee submitted its report in 1992. All the major recommendations of the Committee have been accepted and the banks have been inter-alia advised to:

(i) Give preference to village industries, tiny industries and other small scale units in that order, while meeting the credit requirements of the small scale sector

(ii) Grant working capital credit limits to SSI units computed on the basis of minimum 20% of their estimated annual turnover whose credit limit in individual cases is up to Rs.2 crore [since raised to Rs.5 crore];

(iii) Prepare annual credit budget on the `bottom-up' basis to ensure that the legitimate requirements of SSI sector are met in full;

(iv) Extend 'Single Window Scheme' of SIDBI to all districts to meet the financial requirements (both working capital and term loan) of SSIs;

(v) Ensure that there should not be any delay in sanctioning and disbursal of credit. In case of rejection/curtailment of credit limit of the loan proposal, a reference to higher authorities should be made

(vi) Not to insist on compulsory deposit as a `quid pro-quo' for sanctioning the credit;

vii) Open specialized SSI bank branches or convert those branches which have fairly large number of SSI borrowable accounts, into specialized SSI branches;

viii) Identify sick SSI units and take urgent action to put them on nursing programs

(ix) Standardize loan application forms for SSI borrowers; and) Impart training to staff working at specialized branches to bring about attitudinal change in them.

9.2 Report of the High Level Committee on Credit to SSI

Kaptur Committee

Reserve Bank of India had appointed a one-man High Level Committee headed by Sheri S.L. Kaptur, (IAS, Red.), Former Secretary, Government of India, Ministry of Industry to suggest measures for improving the delivery system and simplification of procedures for credit to SSI sector. The Committee made 126 recommendations covering wide range of areas pertaining to financing of SSI sector. These recommendations have been examined by thereby and it has been decided to accept 88 recommendations which include the following important recommendations:

(i) Delegation of more powers to branch managers to grant ad-hoc limits;

(ii) Simplification of application forms;

(iii) Freedom to banks to decide their own norms for assessment of credit requirements;

(iv) Opening of more specialized SSI branches

(v) Enhancement in the limit for composite loans to Rs. 5 lakh. (Since enhanced to Rs.1 crore);

(vi) Strengthening the recovery mechanism;

9.3 Report of the Working Group on Flow of Credit to SSI Sector

Ganguly Committee

As per the announcement made by the Governor, Reserve Bank of India, in the med-Term Review of the Monetary and Credit Policy 2003-2004, a "Working Group on Flow of Credit to SSI sector" was constituted under the Chairmanship of Dr. A. S. Ganguly. The Committee made 31 recommendations covering wide range of areas pertaining to financing of SSI sector. The recommendations pertaining to RBI and banks have been examined and have accepted 8recommendations so far and commended to banks for implementation which areas under:

(i) Adoption of cluster based approach for financing SME sectorial) Sponsoring specific projects as well as widely publicizing successful working models of NGOs by Lead Banks which service small and tiny industries and individual entrepreneurship)

(ii) Sanctioning of higher working capital limits by banks operating in the Northeast region to SSIs, based on their commercial judgment due to the peculiar situation of hilly terrain and frequent floods causing hindrance in the transportation system

(iii) Exploring new instruments by banks for promoting rural industry and to improve the flow of credit to rural artisans, rural industries and rural entrepreneurs (v) Revision of tenure as also interest rate structure of deposits kept by foreign banks with SIDBI for their shortfall in priority sector lending.

9.4 Internal Group to Review Guidelines on Credit Flow to SME Sector

An Internal Group was constituted under the Chairmanship of Shri C.S. Murthy, CGM-in-Charge, Central Office, Reserve Bank of India, to inter-alia review all circulars and guidelines issued by Reserve Bank in the past regarding financing of SSIs, to suggest appropriate terms for restructuring of the borrower accounts of SSI/Medium Enterprises and also to examine the guidelines issued by Reserve Bank for nursing sick SSIs and suggest suitable relaxation and liberalization of these norms. The Group has submitted its report on June 6, 2005The internal group has recommended:

(i) Constitution of empowered committees at the regional office of Reserve Bank to periodically review the progress in SSI and Medium Enterprises financing and also to coordinate with other banks/financial institutions and the state government in removing bottlenecks, if any, to ensure smooth flow of credit to the sector.

(ii) Opening of specialized SME branches in identified clusters/centers with preponderance of SSI and ME units to enable the entrepreneurs to have easy access to the bank credit and to equip bank personnel to develop the requisite expertise.

(iii) The group has proposed to empower the boards of banks to formulate policies relating to restructuring of accounts of SME units subject to certain guidelines.

(iv) While recommending continuation of the extant guidelines on definition of a sick SSI unit, the group has recommended that all other instructions relating to viability and parameters for relief and concessions to be provided to sick Subunit's, as prescribed by the Reserve Bank be withdrawn and banks be given freedom to lay down their own guidelines with the approval of their Board of Directors.

2.8 Micro, Small & Medium Enterprises Development (MSMED) Act, 2006

The Government of India has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 on June 16, 2006 which was notified on October 2, 2006. The definition of micro, small and medium enterprises engaged in manufacturing or production and providing or rendering of services has been modified and is required to be implemented by the banks along with other policy measures. The following type of credit facilities will be extended to MSE units.

1. Term Loans
2. Project Finance
3. Working Capital Finance
4. Purchase and discounting of Bills
5. Negotiation of Bills
6. Non fund based facilities such as LC and LG

7. Pre shipment/Post shipment finance

8. Credit facilities under Bank's special credit schemes such as Sanjeevani, Easy Trade Finance, Commercial Cash Credit against Jewellery etc.,

9. Any other type of credit depending on specific need.

2.9 Assessment of credit for SME units

1. Simplified procedures will be adopted for sanction of working capital limits. 20% of the projected and accepted annual turnover will be extended as working capital limit to MSE units requiring aggregate fund based working capital limits up to Rs.7.5 crore. Borrower has to bring in5% of the accepted turnover as margin. Current Ratio of 1.25 will be acceptable in such cases.

2. For MSE units requiring working capital limits above Rs.7.5 crore and up to Rs.10 crore, the Maximum Permissible Bank Finance (MPBF) method based on Credit Monitoring Arrangement (CMA) data will be followed c.

3. For MSE units requiring working capital limits over Rs.10 crore, Cash budget system or MPBF method, at the option of the borrower, will continue to be followed.

4. A combined working capital limit will be allowed against the stock and receivables without any sub limit for CC against receivables. However, different margins will be fixed for stock and receivables'.

5. Lending will be based on scoring model for advances up to Rs.2 crores. Information required for scoring model will be incorporated in the application form itself. No individual risk rating is required in such cases'.

6. If the bank sanction term loan solely or jointly with one or more Banks, working capital limit will also be sanctioned solely or jointly (in the ratio of term loan) to avoid delay in commencement of commercial production.

7. The interest payable up to six months after commercial production will be included as part of the project cost for assessment of credit requirements

When the sanctioning authority decides to reject a MSE credit application, the same will be conveyed to the applicant only after obtaining approval from the next higher authority. MARGIN NORMS No margin is required for loans up to Rs.50000/-II. Minimum margin requirements for loans/credit facilities above Rs.50000/-are as under:

1. For loans above Rs.50000/- and up to Rs.5 Lac -10%

2. For loans above Rs 5 Lac -15%3. In case of Term Loans for acquiring second hand machineries, higher margin may be stipulated on case-to-case basis Working Capital Finance1. Working Capital against hypothecation of raw materials, work in Process, finished goods etc. Above Rs.50000/- and up to Rs.5 Lac -15%Above Rs.5 Lac -20%
3. Working Capital against Book Debts/Receivables Margin to be taken as per our Bank's general loan policy document, without any concession. Minimum cash margin of 10% will be prescribed in respect of non-fund based limits such as LG and LC. For loans under Government sponsored schemes and Bank's special credit schemes; margin will be obtained as stipulated in the scheme even if it is different from the levels indicated above. In exceptional cases, margins lesser than indicated above can be prescribed with the approval of the appropriate authority as per powers delegated in bank's concession policy.

2.10 Security Norms

No collateral security or third party guarantee is required for loans to micro and small enterprises up to Rs.5 lacs. Such loans will invariably be covered under Credit Guarantee Scheme of CGTMSE Loans above Rs.5 lac and up to Rs.100 lacs to micro and small enterprises will also be sanctioned without collateral security or third party guarantee subject to following conditions: i. the unit should be eligible to be covered under Credit Guarantee Scheme of CGTMSE ii. The bank is fully satisfied with regard to viability of project and track record of the promoter/units'. In all other cases of credit facilities to micro and small enterprises (other thane and b) suitable collateral security and or third party guarantee will be obtained based on risk perception and judgment of sanctioning authority.3. As per General Loan Policy Document secured advances can be sanctioned by Branch Managers up to the level of Scale IV only by taking collateral securities to a minimum extent of 75% of the credit limits sanctioned. This will be relaxed in respect of MSE advance and Branch Managers up to the level of Scale IV will be allowed to sanction secured advances to MSE sector by taking collateral securities to a minimum extent of 60% of the credit limits sanctioned. Such sanctions should be supported by sound reasoning. CLUSTER BASED APPROACH Clusters are defined as sectorial and geographical concentration of MSME units sharing common opportunities and threat. Thrust will be given to cluster based finance wherever recognized clusters are existing. Following benefits of cluster based approach to lending will be taken advantage of:

• Dealing with well-defined groups• Availability of appropriate information for risk assessment and

• Easy monitoring of borrowable units.

2.11 Pricing and Credit Rating of SME advances

As per Risk Management Policy of the Bank, all borrowable accounts with credit limits of Rs.1 crore and above to Large Corporates, Traders, SME and Infrastructure (Road and Power) must be rated under Risk Assessment Model(RAM) before sanction. Pricing of all loan facilities of Rs.1 crore and above is to be made based on the rating obtained. A relaxation will be made for MSE borrowable accounts in this regard names accounts for credit facilities up to Rs.2 cores need not be rated under RAM. Pricing of MSE credit facility up to Rs. 2 cores will be based on internal scoring model. Bank will continue to prescribe separate and favorable interest rates forms credit in order to encourage the MSE sector.

CHAPTER 3 – RESEARCH METHODOLOGY

It is a process used to collect information and data for the purpose of making better and efficient business decisions & therefore, acquiring the desired targets. The research methodology is a method of understanding that how the basic research process is to be carried out. Mainly, the process by which the people associated with the research move about describing their work and how they explain.

This methodology can also be described as the ways by which knowledge and relevant information is obtained and studying it. While working on the Research Methodology, it is important to focus on the reasons/logics behind choosing a particular method in the context of research study apart from listing down the research methods only.

The research should always answer the following important questions:

- That why a specific research has to be studied?
- And how exactly a particular research problem is described by the researcher?
- Why a particular hypothesis has been formulated and how it has been chosen?
- Why a particular technique of data analysis is used? How the data is collected?
- How the collected data were interpreted?
- What was the conclusion? Finally what was the solution for the Research problem?

3.1 Research Problem

Scope of this study:

The SME sector is a very vast area and contributing nearly 7% of GDP. This study is useful for the SME organizations as it contains RBI guidelines for raising funds for SME sector, eligibility criteria and norms. It helps new entrepreneurs to know whether they will get the credit from the banks or not according to their business plan and how much they can get according to their financial structure. The wide range of information regarding the lending norms and conditions will help the business man to take decision about funding of long term, working capital and other requirements of the organization.

3.2 Sampling

Sample is a small part of a the area which actually we need to perform our analysis on. In other words, the exact process of sampling mainly identify and select certain specific elements which are tend to represent all the population of which the study has to be performed.

The actual need for the sampling is to represent the similarity characteristics which the whole population is expected to perform. In other words, the exact idea is to be undertaken of whole population. It is required to make a general thumb rule for the road ahead in the research. It actually is quite important that sampling is performed well in advance so that the proper information and knowledge about the basic characteristics of population can be generalized.

Now, the determination of sample size is the process of obtaining the exact number of observations to be included in a statistical sample for the research from the population. The sample size for this study is 8. I have chosen eight different Banks in India to study their business banking patterns. The names of the banks are given below.

1. The State Bank of India
2. Allahabad Bank
3. Corporation Bank
4. Indian Bank
5. Syndicate Bank
6. City Union Bank
7. Karnataka Bank
8. Yes Bank

CHAPTER 4 – ANALYSIS, DISCUSSIONS & RECOMMENDATIONS

4.1 Introduction to the Case

Every bank has to follow the guidelines of the regulatory authority i.e. RBI. Special provisons are also presnet. The norms of the credit lending of the specified banks according to RBI guidelines are as follows:

Application

"The banks will. Make available, free of cost, simple standardized, easy to understand, and application form for loans'. They will provide a checklist (compliant with legal and regulatory requirements) along with the loan application form to enable you to submit the application complete in all respects. At the time of making available application form, the banks will also provide information about the interest rates applicable, and the fees/charges, if any, payable for processing, pre-payment options and charges, if any, and any other matter which affects customer's interest, so that a meaningful comparison with those of other banks can be made. Acknowledge in writing the receipt of your loan application. Collect all particulars required for processing the application for credit facility at the time of application. In case they need any additional information, they will contact customers within seven working days from receipt of applications. Endeavour to enable customers to know online the status of their applications. Not charge any processing fee for loans up to Rs.5 lakh if the loan is not sanctioned."

Credit Assessment

a. The banks will "(i) Verify those details mentioned by customers in their application by contacting them through the bank's staff / agencies appointed by the banks for this purpose at the customer's business address/ residence. (ii) Before lending any money, or increasing overdraft or borrowing limit/sasses whether the customers will be able to repay it. They shall carry out proper assessment of the loan application by carrying out detailed due diligence and appraisal. (iii) Satisfy themselves about the reasonableness of the projections made by customers."

b. “This assessment may include looking at the following) Information that customers give them, including the purpose of borrowing. (ii) Customer’s business plan.iii) Their business’s cash flow, profitability and existing financial commitments supplemented, if necessary, by account statements. (iv) Their personal financial commitments’) How they have handled their finances in the past.vi) Information the banks get from credit reference agencies (vii) Ratings assigned by reputed credit rating agencies, if any (viii) Information from others, such as other lenders /creditors. (ix) Market reports’)” Any security provided.

c. “The banks will i) Not insist on collateral for credit limits up to Rs 5 lakh (ii) Consider providing collateral free credit limits up to Rs 25 lakh if banks are satisfied about customer’s track record and financial position being good and sound (iii) Provide micro and small enterprises (manufacturing) working capital limits computed on the basis of a minimum of 20 per cent of your projected annual turnover(iv) Consider customer’s request for suitable enhancement in the working capital limits in cases where the output exceeds the projections or where the initial assessment of working capital is found inadequate and they have provided necessary evidence.”

d. Guarantees

If the “customers want banks to accept a guarantee or other security from someone else for their liabilities, the banks will ask customers for their permission to give confidential information about their finances to them or to their legal adviser. They will also) Encourage them to take independent legal advice to make sure that they understand their commitment and the possible consequences of their decision (ii)Tell them that by giving the guarantee or other security they may become liable as well as customers.”

Sanction/Rejection

The “banks will not insist on compulsory deposit as ‘quid pro-quo’ for sanctioning credit facility/i.e. While offering an overdraft, or an increase in the existing overdraft limit tell the customers if their overdraft is repayable on demand or otherwise. Put down in writing terms and conditions and other caveats governing credit facilities agreed to and duly certify the same and give customers a copy thereof. Supply authenticated copies of all the loan documents executed with a copy each of all enclosures quoted in the loan document and the list therefore. Convey in writing the reasons for not acceding to customer’s request for a loan or credit facility. Follow a rating system, the parameters of which will be shared with the customers. e.g. Permit pre-payment of loans up to Rs.5 lakh without levying any prepayment penalty h. Ensure disbursal of the loan sanctioned within two working days from the date of compliance with all terms and conditions governing such sanction."

4.2 Data Collection

Every bank has their own process and scheme. The special schemes by some of the banks are as follows:

Bank 1 State Bank of India (SBI)

The "State Bank of India has been playing a vital role in the development of small scale industries since 1956.The Bank has financed over 8 lakhs SSI units in the country. It has 55 specialized SSI branches, 99 branches in industrial estates and more than 400 branches with SIB divisions. The bank is providing loan facility to SME sector under various schemes." They are:

Eligibility:

Any commodity trading dealer

Eligible Amount of Finance:

"Demand Loan: 75 % of the value of the warehouse receipt, valued at the market value OR 80% of the minimum support price declared by State/Central Government Whichever is lower. Cash Credit: 70 % of the value of the warehouse receipt, valued at the market value OR 75% of the minimum support price declared by State/Central Government, whichever is lower."

Margin:

"Demand Loan: 25% (minimum) of the value of the warehouse receipt, valued at the market value OR 20% (minimum) of the minimum support price declared by State/Central Government, whichever is higher Cash Credit: 30% (minimum) of the value of the warehouse receipt, valued at the market value OR 25% (minimum) of the minimum support price declared by State/Central Government, whichever is higher"

Insurance:

Insurance is to be done by owner of the particular warehouse.

<u>Traders easy loan scheme</u>

"This scheme is launched by SBI to provide hassle free loan to traders. Any business man/ entrepreneur/ Professional and self-employed person can avail this loan. Loan under the scheme can be availed to meet normal business requirements and is sanctioned against equitable mortgage of property. Agriculture property or property outside urban limits is not accepted. The advance can be availed by way of Loan or Cash Credit limit. It can also be availed for Non Fund Based requirements (for issuance of Bank guarantees or LCs). Cash Credit limit or non-fund based limit is renewable every 12 months. Loan can be repaid in monthly or quarterly, even half yearly installments - as may be suitable to the borrower – in a period up to 5 years. Minimum and maximum amount of loan is Rs 25,000/- and Rs 5.00Crore. Margin is 35%. i.e., loan can be up to 65% of the realizable value of the property or the business requirement- whichever less is. Business requirement is assessed on the basis of projected business turnover. Interest at floating rate is charged at monthly intervals on daily reducing balance." No Third party guarantee is required to avail the loan.

General purpose term loans

"State Bank of India grants term loans to small scale industries for meeting general commercial purposes like substitution of high cost debt research and development, shoring up net worth and funding business expansion. And the pricing is fine-tuned to suit the risk profile of the borrower. The repayment is structured in monthly or quarterly Installments, according to the cash generation cycle."

Liberalized credit for SSI

"State Bank of India extends production-linked credit facilities to small-scale industries, ancillary industrial units, village and cottage industrial unison liberal terms and conditions. Under this scheme, the quantum of advances is not linked to the security furnished, but the genuine requirements of the unit. The pricing of the loan is based on credit assessment, and the units with strong ratings may be given finer rates. No collateral security is required for loans up to Rs 5 lakh. Composite term loans can be sanctioned up to Rs 25 lakh combining term loan and working capital. The Liberalized scheme offers a range of financial products including the following:

1. Term loans for acquisition of fixed assets
2. Working capital loans financing current assets
3. Letter of credit for acquisition of machinery and purchase of raw materials
4. Bank guarantee in lieu of security deposits to be made with government department/other departments for execution of orders.

5. Deferred payment guarantees for purchase of machinery on deferred payment basis.

6. Bill facility for purchase of raw materials and for sale of finished goods.

7. Composite loans (term loans plus working capital) up to Rs 25 lakh."

Equity fund scheme

Under the "Equity Fund scheme, the SBI grants financial assistance to entrepreneurs who are not able to meet their share of equity fully, by way of interest-free loans repayable over a long period. This type of assistance fills in the gap between the margin requirements in the project and the capital contributed by the promoter. The Equity Fund assistance can be normally re paid over 5 to 7 years after the moratorium period."

Stree Shakti package

The "Street Shakti Package is a unique scheme run by the SBI, aimed at supporting entrepreneurship among women by providing certain concessions. An enterprise should have more than 50% of its share capital owned by women to qualify for the scheme. The Concessions offered Under the Street Shakti Package are:

1. The margin will be lowered by 5% as applicable to separate categories.2.
2. The interest rate will be lowered by 0.5% in case the loan exceeds Rs 2lakh.3.
3. No security is required for loans up to Rs 5 lakh in case of tiny sector units."

Open term loan

The "easy and hassle-free way to get finance for hassle free pre-approved line of credit. Max Loan Amount: Rs. 250 lacs (for Manufacturing), Rs.100 lacs (for Trade and Services). Validity of sanction is 12 months. Freedom to avail the facility at your own convenience, within the validity of sanction.. Multiple disbursements allowed. No penalty on the unutilized amount (even if completely unutilized). The loan can be utilized for any genuine commercial purposes in line with the regular business activity of the customer. These would include term loans for

a. Expansion and modernizations.

b. Substitution of high cost debts / high cost term debts of other banks/FIs

c. Design and introduction of new layouts in the factory to enhance productivity

d. Up gradation of technology& energy conservation schemes/ machinery's. Acquisition of software, hardware, consumable tools, jigs, fixtures, Acquisitions of ISO & other similar certifications' are included as well. Visits abroad for acquiring technology, finalizing business deals, participating in exhibitions/ fairs for market promotion etc."

Bank 2 Allahabad Bank

Bank's Policy Processing of Applications.

1. "Loan Application - Revised Simplified application form will be used for Micro and Small Enterprise. The existing Common loan Application form applicable to all loans irrespective of limit will be applicable for Medium Enterprises sector."

2. "Issue of Acknowledgement of Loan Applications - Each branch will issue an acknowledgement for loan applications received from the borrowers towards financing under this sector and maintain the record of the same."

3. Photographs of Borrowers

"While there is no objection to take photographs of the borrowers, for the purpose of identification, branches themselves should make arrangements for the photographs and also bear the cost of photographs of borrowers falling in the category of Weaker Sections."

Types of Loans

"The Bank may provide all types of funded and non-funded facilities to the borrower under this sector via, Term Loan, Cash Credit, Letter of Credit, Bank guarantee, etc."

Margin

Loan Size	Minimum Margin
• Up to Rs.25000.00	Nil
• Above Rs.25000.00	As per lending policy of the Bank

Security

No collateral or “Third party guarantee for advances up to Rs.5.00 Lacs. In case of good track record of the borrower Collateral Security and or third party guarantee may be waived beyond Rs. 5.00 Lac but up to Rs.100.00Lacs, Where guarantee cover of 62.50% of the amount of default is available from CGTMSE, in respect of term loan and/or working capital facilities extended to new and existing Entrepreneur. It has also been stipulated by CGTMSE that all proposals of sanction of Guarantee approvals for credit facilities above Rs.50.00 Lacs and up to Rs. 100.00 Lacs will have to berate internally by MLIs and should be of investment grade. Accordingly, all proposals above Rs. 50 Lacs are to be rated on Credit Risk Grading (CRG 2) as per applicable internal rating modules prescribed under Bank’s Credit Risk Management Policy and proposals rated as AB-1 to AB-7 would only be considered as investment grade subjected to other stipulated norms in relevant policies / guidelines. The commission of CGTMSE will be borne by the borrower. In case of Loan up to Rs.25000.00, Minimum Asset Coverage Ratio (Primary Security /Loan amount) would be 1:1. However, in case of schematic lending/specified scheme, the guidelines as applicable will be complied with. In case of Loan above Rs.25000/- and up to Rs.10.00 Lacs, a minimum asset coverage ratio must be 1.25:1

In case a loan is not covered under CGTMSE scheme for valid reasons, the Security coverage Ratio for such loan above Rs.10.00 Lac will be based on the Risk Rating status of the borrower”

Rating Grade (As per our Rating module)	**Minimum Security Coverage Ratio****
AB-1	1.25:1
AB-2	1.5:1
AB-3	1.75:1
Other rated accounts	2.00:1
** In each of the above case, **Primary + collateral Security /Loan amount** should not be less than 1.25:1 so as to ensure the minimum stipulated margin.	

1. "Nevertheless, availability of collateral security shall not be the mere criterion for arriving at credit decision.
2. In case of loan accounts not covered under CGTMSE scheme, it may be explored as far as practicable that the credit facilities/loans extended, are supported by collaterals in the form of liquid securities or fixed assets, immovable properties, based on the Credit Risks perception.
3. Collateral security shall not be insisted upon in those cases where the RBI directives specifically advised the banks not to insist on obtaining Collateral security /third party guarantee, in certain priority sector credit or Government sponsored schemes.
4. The other guidelines/amendments as per lending policy of the Banks should be closely observed

<u>Risk Rating, Pricing & Other Service Charges</u>

Risk Rating - The RBI has directed to Banks to take steps to rationalize the cost of loans tome sector by adopting a transparent rating system". The rating of account may be done under:

A. In House Rating Module: The credit exposure-wise is applicable as under: -

Sl. No.	Credit Exposure	Rating Module
1	Upto Rs.10.00Lac	As per CRG-01
2	Above Rs.10.00 Lac up to Rs.1.00 Cr	As per Credit Risk Management Policy of the Bank.
3	Above Rs.1.00 Cr to less than Rs.5.00 Cr	1.Credit Rating Grading-7(CRG-7A)-Existing Unit 2.Credit Rating Grading-7(CRG-7B)- New Unit
4	Rs.5.00 Cr & above	**Risk Assessment Module (RAM)-CRISIL** where if the RAM module is not operationalized, the following modules will be applicable:- **Credit Rating Grading-7 (CRG-7A): Existing unit.** **Credit Rating Grading-7 (CRG-7B) : New unit.**

B. Rating from outside rating Agencies:

I. "Our Bank has entered into MOU with CRISIL, ONICRA and SMERA, forgetting the SME borrowers rated by them.

II. The National Small and Industries Corporation (NSIC) have been appointed as nodal agency which provides subsidy to the units obtaining Credit rating from any of the empanelled agencies with them. NSIC reimburse 75% of the rating fee of the empanelled agencies to the Micro and Small Enterprises {Manufacturing sector i.e. earlier SSI units}.

III. Validation of the rating will be done as per extant guidelines of the Credit Risk Management"

<u>Methodology for calculation of Bank Finance</u>

Working Capital Loan:

(I) "Working capital credit limits to Micro, Small and Medium Enterprises in individual cases Up to Rs.5.00Crore (Manufacturing sector) and Up toRs.2.00 Crore (Service sector) will be computed as per existing guidelines on the basis of minimum 20% of their projected annual turnover

(turnover method). However in case of borrower applying for working capital limit higher or lower than the working capital computed on the basis of turnover method shall be assessed as per actual requirement."

(II) For the "assessment of the working capital requirement for borrowers falling within the band of Above Rs.5.00crores and below Rs.10.00Crore (Manufacturing sector) and above Rs.2.00 Crore and below Rs.10.00 Crore (service sector)The Traditional method of computing MPBF."

(III) For "borrowers having working capital limit of Rs.10.00 crore and above, Cash Budget system will be applicable. However, if a borrower is desirous to continue with the existing MPBF system the Bank may accept the request. If any of the borrowers falling in this band intends to shift to cash budget system, the same may be accepted".

Bank 3 Corporation bank

Acknowledgments for "receipt of loan application by branch by affixing date stamp. time Norms for disposal of loan applications: a] Upton Rs. 25,000 - Within 2 weeks*b] Over Rs. 25000 & up to Rs. 5 lacs - Within 4 weeks*c] Over Rs. 5 lacs - Within 8-9 weeks** from the date of receipt of duly completed loan application and check list3. No collateral security for advances up to Rs. 5 lacs and for Advances over Rs.5 lac up to Rs. 25 lakh based on good track record and financial position.4. Composite loan up to Rs. 100 lakh is sanctioned to SSI units.

<u>Loan quantum</u>

Minimum 20% of projected annual sales turnover (Kayak committee norms) for working capital requirement.6. Margin Money Requirement (Contribution by the Borrower): Loans up to Rs. 25,000/- NIL Loans above Rs. 25,000/- 15% to 25%7. Rate of Interest with effect from 1.1.2009Corporation Bank reduces its Bench Mark Prime Lending Rate (BPLR) by 50basis points to 12.00% from 12.50% from April 1", 2009.

Sl. No.	Credit Exposure	Rating Module
1	Upto Rs.10.00Lac	As per CRG-01
2	Above Rs.10.00 Lac up to Rs.1.00 Cr	As per Credit Risk Management Policy of the Bank.
3	Above Rs.1.00 Cr to less than Rs.5.00 Cr	1.Credit Rating Grading-7(CRG-7A)-Existing Unit
		2.Credit Rating Grading-7(CRG-7B)-New Unit
4	Rs.5.00 Cr & above	**Risk Assessment Module (RAM)-CRISIL**
		where if the RAM module is not operationalized, the following modules will be applicable:-
		Credit Rating Grading-7 (CRG-7A): Existing unit.
		Credit Rating Grading-7 (CRG-7B) : New unit.

Bank 4 Indian Bank

Salient Features	Financing the SMEs based on collateral security coverage
Eligibility	All SME accounts (Fresh and Existing)
Quantum of Loan	Above Rs.25 lakhs and upto Rs.5.00 crores. Group exposure to be restricted to Rs.10.00 crores.
Margin	25% on Stocks, BDs and P&M. 10% cash margin on NFB and 30% on building.
Interest Rates	Please see the Interest Rate link on home page
Repayment Period	Upto 7 years for TL
Security	Minimum collateral Requirement: 75% of the limits
* BPLR = 12.00 %	

Bank 5 Syndicate Bank

The "Syndicate bank is providing various types of loans for SME units. They are as follows:

1. <u>SyndUdyog</u>

Loans for Entrepreneurs Purpose: Scheme for financing small and medium entrepreneurs

Target Group: Manufacturing Units, Trading Units & Service Entities

Eligibility:

• Credit requirement of the applicant party/unit shall not be more than Rs.50 lacs.

• The annual sales/revenue turnover of the applicant party / unit shall not be more than Rs. 250 lacs

Nature of facility:

Overdraft/Loans, Bill Limit, LCs/BGs offered in one package at competitive rates within a predetermined overall limit"(not exceeding's. 50 lac)

2. SyndVyapar

Purpose: "To meet the credit needs of traders

Eligibility: All Traders

Quantum: Maximum Rs. 25 lakhs in the form of overdraft

Repayment: To be renewed once in 2 years

Rate of interest: Up to Rs.2 lakhs: PLR; Above 2 lakhs: Depending on credit rating of the borrower

Security: Mortgage of property / Pledge of NSC / KVP / LIC / RBI Relief bond and hypothecation of stock in trade

Margin: 40% on immovable property, 15% on other securities

Requirements: Financial statements for limits of over Rs. 10 lakhs"

3. Synd small credit

Highlights of the scheme: "The scheme aims at Entrepreneurs of small means such as manufacturers, retail traders, professional & self-employed persons, artisans and those engaged in making handicrafts, village / cottage industries & other non-farm income generating activities.

Facility available At all the branches where "Pigmy" scheme is in operation, in clusters of not less than 20 accounts in an area. Need based credit of above Rs.25, 000/- subject to a maximum of

Rs.2.00lac Per borrower. A component Up to 30% of the total limit Is Included for necessities like consumption/ contingencies and repayment of high cost private debt,No collateral security. Only hypothecation of assets created out of bank loan, lien on 'Pigmy' account and credit worthy third party guarantee. No third party guarantee in respect of loans extended to Micro and Small Enterprises. Easy repayment at the convenience of the borrowers. The repayment is linked to day to-day contributions towards "Pigmy" account, at the doorsteps of the customer.
Contributions towards pigmy can be at the convenience of the customer. It's not fixed.

Ballooning of Equated Monthly Installments (EMIs) facilitating the customer
To repay smaller installments in the beginning when the income level is low and gradually higher installments by the time the income level get improved.
Repayment period spread over 60 months.
First 3 months is the repayment holiday.

Excepting for execution of documents at branch level, Doorstep-banking Facility is extended to the customer through Pigmy Agents.

The rate of interest is at PLR-0.50%.

1.0% rebate in interest for prompt repayment
To be provided at the closure of the account.
The Bank collects nominal out of pocket expenses @ 3% of amount set for transferring from "Pigmy" to the loan account, which includes payment of 2% commission to pigmy agents? Various interest rates chargeable"

Size of Credit limit	Micro Enterprises		Small Enterprises	
	(Mfg.Sector)	Service	(Mfg.Sector)	Service
Upto Rs.50000/-	PLR -3.50	PLR - 2.00	PLR -3.00	PLR – 1.50
Above Rs.50000/- up to Rs.2.00 lakhs	PLR -2.00	PLR -2.00	PLR -1.50	PLR – 1.50

Above Rs.2.00 lakhs:

A) MICRO ENTERPRISES	Spread to be added to PLR							
Credit Rating of Borrower	S YND1	SYND 2	SYN D3	SYND4	SYN D5	SYND6	SYND7 & below	NPA
Above Rs.2 lacs	-1.00	-0.75	-0.50	0.00	0.50	1.00	1.50	2.00

B) SMALL ENTERPRISES	Spread to be added to PLR							
Credit Rating of Borrower	SYND 1	SYN D2	SYN D3	SYN D4	SYN D 5	SYND 6	SYND 7 & below	NPA
Above Rs.2 lacs	-0.50	-0.25	0.00	0.50	1.00	1.50	1.75	2.00

3. Medium Enterprises: (Working Capital/Short term advances/term loans)

Size of the credit limit	**Interest Rate**							
Upto Rs.2 Lakhs	PLR – 0.50							
	Spread to be added to PLR							
Credit Rating of Borrower	SYND1	SYND 2	SYND 3	SYND 4	SYND 5	SYND 6	SYND 7 & below	NPA
Above Rs.2 lacs	0.00	0.25	0.75	1.25	1.75	2.50	2.75	3.00

Bank 6 City Union Bank

Eligible Borrowers	i) All trading entities who have regular business ii) Micro and small enterprises [Manufacturing]
Constitution	Proprietary/Partnership/Limited Companies
Eligibility	The firm should be in business at least during the last two years and audited financial statements at least for one year should be available VAT Registration Certificate / Firm's Registration Certificate should be available. The credit facility should be considered only on sole banking basis. The business entity should be properly identified and KYC rules should be followed
Quantum of Advance	Minimum Rs.15 lakhs & Maximum Rs.75 lakhs
Facility	Can be considered as OLCC/ Demand Loan/ Term Loan/ Bills Financing
Purpose	For Working capital / Acquisition of fixed

	assets
Repayment in case of Demand/Term Loan	Ranging from 24 months to 60 months [in case of Demand Loan/ Term Loan, actual PBDIT should not be less than 1.10 times of proposed annual EMI.]
Application and collection of Interest	On monthly basis
Renewal	OLCC accounts are renewable every year
Security	Primary – Stock and/or Book Debts Collateral – Non-agri immovable property or any other liquid security having value equivalent to atleast 80% of the sanctioned credit facilities
Primary Security Margin	Minimum 20%
Rate of Interest	In the range of PLR-0.75% to PLR based on the quality of advance
Processing fee	0.20 % of the credit limit subject to minimum of Rs.7500/-. In case of OLCC facility, processing fee is payable every year on due date of renewal.
Assessment	Turnover method
Applicability of the Scheme	Only for New Clients
Authority of Sanction	All proposals should be submitted to Central Office and no discretionary power is allowed to the branches for sanction of this facility.

Bank 7 Karnataka Bank

Eligibility criteria: "The Debt restructuring guidelines shall be applicable for MSMEs to the following entities, which are viable or potentially viable:

1. All non-corporate MSMEs irrespective of the total exposure to the banking sector.
2. All corporate MSMEs solely banking with us.
3. All corporate MSMEs, which have funded and non-funded outstanding up toRs.10 crore under multiple/ consortium banking arrangement".

Viability Criteria for MSME

The following viability criteria are prescribed

PARTICULARS	VIABILITY NORMS FOR MSME-DRS
Minimum Average DSCR	1.25
Maximum Period within which the unit should become viable	7 years
Maximum Repayment period of the restructured debt	12 years
Minimum Promoters' Contribution (of which at least 50% must come upfront and balance within 6 months)	**Micro sector -**10% **All other sectors -** 20%

"It shall also be ensured that the ceiling of 30% of term loans for loans with residual maturity of more than 7 years prescribed in the Loan Policy is complied with. The relief and concessions may be decided as per the cash flow anticipated in the techno-economic viability report."

Procedure

"The borrowers intending to avail the benefits of restructuring under DRM for MSMEs shall approach the branch with the following papers:

a) Request for restructuring of debts.

b) Copies of the audited balance sheet and profit and loss account of the borrower for the last three years.

c) Unaudited data for the current year.

d) For projects under implementation, details of sources and uses of funds since inception.

e) Projected Profitability statement covering the period of repayment proposed for the restructured debt along with the calculation of DSCR.

f) Projected Balance sheet and Profit and Loss account covering the period of repayment proposed for the restructured debt.

g) Techno-economic viability study report to be obtained for exposure of Rs.10.00 crore and above.

h) Statement showing identification of the sources of margin money

i) Statement showing the annual working capital requirement."

Legal Basis

"While considering restructuring of accounts under MSME sector exchange letters duly signed by borrower/s, co-obligant/s, surety/ies shall be obtained in the cases where there is only simple change in repayment schedule. If the restructuring involves modification of terms of original loan documents beyond simple change in repayment schedule, then revised documents shall be obtained in addition to exchange letters."

Bank 8 Yes Bank

Process for lending to MSMEs Application process

• "Application forms are provided free of cost, along with a checklist. Information pertaining to fees/prepayment charges and rates would be provided to the customers at the time of application".

• "The branches would give acknowledgement with date of receipt on the duplicate of the application received."

• Zero processing fee for 5 lakhs if the loan is not sanctioned.

Appraisal Process

• "The loan appraisal consists of evaluating customer profile, business viability, past credit history of the borrower and the end use of the fund."

• "The borrower is visited by the officers of the bank at residence /office / factory premise. The officer understands the management, business requirement, future potential of the business and exact credit requirement of the borrower."

• "Detailed ratio/balance sheet analysis to also carry out to grade the financial health of the borrower entity. All loan applications for Micro and Small Enterprise up to Rs. 2 lakhs would be processed within 2 weeks and up to Rs. 5 lakhs would be processed within 4 weeks provided the loan applications are complete in all respects and accompanied by a 'check list'. YES Bank has dedicated specific bank officers who are part of the Small Business Banking/Business Banking loan sanction and disbursement process team dedicated to assist the borrower infilling the application form as also completing the loan sanction and disbursement process."

Pricing

• "Interest rate and other charges would be as per the sanction terms as detailed in the loan agreement and copy of the same is also given to the borrower at the time of executing the agreement• Loan can be fixed/ floating. Floating rate will be linked to the BPLR of the bank"

• "Increase in the Fees/Charges would be notified through our website/Account statements/email/sms/notice at the branches 30 days prior to the revised charges becoming effective."

• "The PLR would be available on the website for reference and would be updated within seven days of change"

• "The interest rates on loans up to Rs 2 Lacs will not exceed BPLR. The penal interest will be charged for all loans as per the Bank guidelines for the relevant product portfolio and not be decided on a case to case basis. Also there will not be any prepayment charge of working capital loans up to 5 lacs"

Security

"The facilities offered by banks would be secured by primary security and collateral security, wherever applicable. The evaluation and acceptability would be as per the credit policy decided by the Bank from time to time. All assets given as security should be insured to the fullest. Collateral Free loans for limits less than Rs. 5 lacks: The bank has in place retail lending programmers, which cater to small ticket advances on collateral free basis up to Rs. 5 lacs"

Post disbursement

a. “Change in interest rates: The bank would intimate the customer regarding interest rate change through any or all of the following modes”:

i. A letter

ii. Branch Notice

iii. Website notification

b. Servicing of existing accounts:

i. “Convey our consent or otherwise within two weeks of receipt of a request for transfer of the borrower account, either from the customer or from the bank / financial institution that proposes to take over the account.”

ii. “Release all securities on receiving repayment of loan immediately and in any case not later than 25 working days subject to any legitimate right or lien for any other claim we may have against you.”

iii. “Grant the customer increase in the drawing power within 96 hours of lodgment of stock and book debt statement.”

iv. “Bank would provide authenticated copies of all loan documents with a copy of enclosures, as quoted in the loan document”

v. “All working capital accounts would be sent a regular bank statement. Customers can also request for Interest statements, wherever applicable, preferably within a period of 2 months.”

4. 3 Data Analysis

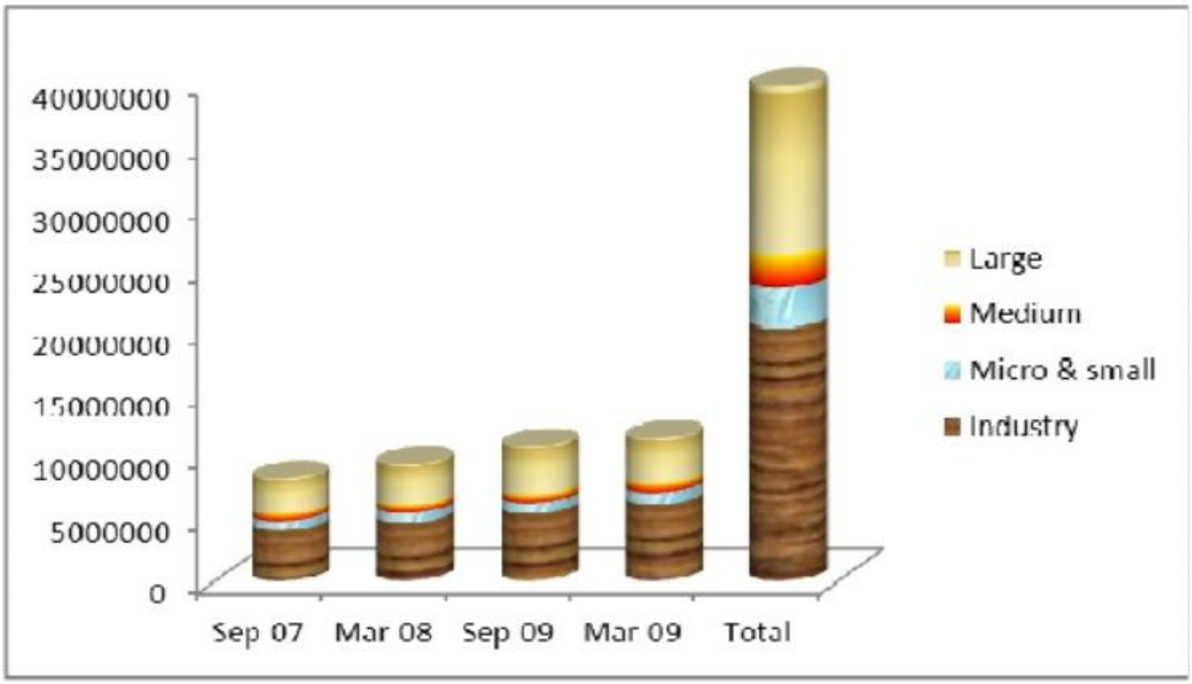
1. Comparison of lending norms of different Banks

The table compares the different criteria of different banks. Each bank will follow different norms for lending. The SMEs have to choose among the alternatives. Normally they will be having multiple accounts.

2. Disbursement of credit to SME sector

		Sep-07	Mar-08	Sep-09	Mar-09	Total
Industry		4105408	4677918	5402018	6134802	20320146
Micro & small		697316	774902	839824	947503	3259545
Medium		571398	627616	684090	731737	2614841
Large		2836693	3275400	3878104	3647261	13637458

Source: Statistical tables relating to Banks in India



The above graph shows the steady increase in the flow of bank credit for small, medium and large scale industries.

3. Calculation of maximum permissible Bank finance

Method	Calculation M P B F
I	0.75 (CA – CL)
II	0.75 CA – CL
III	0.75 (CA – CCA) – CL

As per Tondon Committee report there are three methods of lending. Let us consider that bank will permit level of holding as per broad indicators suggested by Reserve Bank of India and work out the requirements of the borrower. Let us further take that unit as an engineering unit manufacturing consumer durables. The broad indicators for such units are given below Raw materials 2 months Stocks-in-Process 0.75 months Finished goods and receivables 2.50 months On this basis the permitted level of inventory will be calculated as under:2 months requirement of raw materials= 2 x 290.58 = Rs. 581, 16 lacs0.75 months of stock-in-process = 0.75 x 4326.1/12= Rs. 270.38 lacs. But the unit is working with average stocks-in-process of 2.68 weeks and will be permitted to hold the inventory level up to that value only. Thus stocks in process = Rs. 222.96 lacs.2.50 months finished goods and receivables = Rs. 2.5 x 5315.82 /12= Rs. 1107.46 Lacs We may also permit stores and spares up to Rs. 10.00 lacs. The total working capital will now be worked out as under:

Particulars	On average basis	After application of broad indicators
Raw materials	610.22	581.16
Stock - in progress	222.96	222.96
Finished goods	478.05	1107.46
Bills receivables/debtors	812.56	0
Stores	10	10
Total	**2133.79**	**1921.581**

The excess level of inventory and receivables projected by the unit is thus Rs. 2133.79 - Rs. 1921.58 = Rs. 212.21 lacs. As per the broad indicators the unit should be allowed to hold inventory and receivables up to Rs. 1921.58 lacs only and the unit must make efforts to reduce its holding. Let us now consider the following example to illustrate the application of all the above three methods:

Current Liabilities	**Amt**	**Current assets**	**Amt**
creditors for purchase	200	Raw materials	300
Other current liabilities	80	Stock in process	100
Bank borrowings	400	Finished goods	150
		Receivables & book debts	100
		Other current assets	50
Total	**680**	**Total**	**700**

In this example Total Current Assets (TCA) = Rs. 700 lacs. Other current liabilities (OCL) = Rs. 280 lacs (Excluding bank borrowings)

Lending under Method I

Total current assets	700
Less: other Current liabilities	280
Working capital gap	420
25% of above margin	105
Maximum Permissible Bank Borrowing	315
(MPBF)	
Excess borrowings	85

Method II

Total current assets	700
Less: 25% of above margin	175
from long term sources	
	525
Less: other current liabilities	280
Maximum Permissible Bank	245
Borrowings(MPBF)	
Excess borrowings	155

Method III

Total current assets	700
Less: Core current assets(assumed	160
figure) from long term sources	
Balance current assets	540
Less: 25% of above for long term sources	135
	405
Less: other current liabilities	280
Maximum Permissible Bank Borrowings	125
(MPBF)	
Excess borrowings	275

It would be noticed from above that contribution from long-term sources is to be progressively increased as we move from 1st method of lending to the 3rd Method of lending and the ideal set up the group was to bring all the borrowers to 3rd method in a phased manner. All the existing and new borrowers were to conform to 1st method to start with. Due to various difficulties in assessing the core assets, the 3rd method of lending had been discarded and as per recommendations of 'Chore Committee' all the borrowers have now to conform to 2nd method of tending. It would also be noticed that 1stmethod corresponds to a minimum current ratio of 1. 17:1 while the 2nd method ensures a minimum current ratio of 1.33:1

4. Assessment of risk, profitability and efficiency

Above tables shows how Banks assess the risk, profitability and efficiency. In order to award loan to the business entity banks has to look in to the risk, return and efficiency by using the past and present information available about the company. Bank will consider the following factors to assess the risk.

Industry Risk

Here the banks will look in to the all risk factors that related to an industry. Include the production stage risk and post production risk. Production stage risk assessed by considering the factors like raw materials, technology, infrastructure etc. and post production risk involves demand, competition and marketing challenges.

Management Risk.

Promoters experience, management proficiency, employed executives are the factors which comes here

Operational risk.

Here banks look in to the past records of the customer's transactions. Supply of information to the bank, record of the irregularities and compliance of sanctions and stipulation are considered here.

Collateral security

The collateral cover offered by the customer review here,

Financial Liquidity, profitability and interest coverage ratios are assessed here to determine short term and long term solvency of the company

4.4 Recommendations

Major concern of the SME sector is the adequate availability. The timely credit lending to the SMEs is also quite a concern.

A declining trend is observed in the credit proportion to the SMEs among the whole total of the bank credit.. So it is about half. Hence obviously it is showing a declining graph. 11.85 million SSI units are present in India, from which, about 1.63 million are registered with the government and about more than 10 million are unregistered. Only 14.16% of SSI units in the registered strata have access to institutional finance whereas around 3 percent has access in unregistered sector .

Hence we can say that institutional finance has not been in reach for the market. clearly stated from the above data, that despite having the quite clear and positive intentions of the Government in expansion of the credit to the SMEs, the results are not quite a satisfaction. There are following suggestions which I would recommend:

1. Firstly I can say that a quite important thing to understand is the structure of the Indian Smes and their actual needs to operate.SSI survey clearly depicts that, out of around 12 million SSI units operational in India, almost all of units are in the catergory of "tiny" that means their investment in machinery and other need is less than even 25 lakhs. And in this "tiny" industry of SSIs, major portion consists of artisans and the cotton. About 3-4 million from all of them can be termed

as actual modern form of SSI which has investment in the range of 25 lakhs to 1 crore. The money and lending needs of a tiny SSI and a big SSI is quite different from each other.

These Normal units having more the 25 lakh investement in SSI sector will require these funds for the basic diversification process. The improvement of technology and upgrading the current process is also needed. Hence it is quite important for this sector to get investments and credit lendings.

2. Now secondly, the position of the Indian banks has to be clearly understood. Banks have quite a famous concern I.e. the presence of NPAs in their system. That also concerns them about the major incidents of the SSI sickness which is quite a concern. We can't deny that the credit lending to the banks will be a profitable business for all sorts of banks and they would want to lend the credits to gain more and more. It is also seen that big firms often have some alternate sources of funding as the market rate of funding is quite less, the banks also desire high profits from their credit lending to SMEs. But, this need is to be balanced by correct mix of the both, policies and risks.

3. Third, the RBI and SIDBI policies gives a different level of understandings to the financial institutions and the respected functioning bodies.The proper training has to be provided to the officials in this regard.

4. Fourth, "a number of private banks are venturing in the field of SME financing with innovative schemes. But there is a lack of understanding of these schemes on the part of banks and other financial institutions as well as SME entrepreneurs. SME associations should come forward in this regard and organize programmers in which all the stakeholders could be invited and the schemes could be popularized"

5. Fifth, "the SME associations and NGOs should come forward and accept more responsibilities. Their role should not be limited to only lobbying for their members. The associations and NGOs can play a crucial role in micro financing".

6. Sixth, "a few changes and improvements in the policies could help infuse credit to this sector. Equity participation ceiling of large companies in small-scale sector should be raised from 24 % to 49

%. It would certainly motivate large enterprises to invest in small enterprises and thereby expansion of these units".

7. Seventh, "over the period, it has been observed that small units that are linked to large corporates as suppliers, service providers, etc. are usually successful. It is relatively easier for the banks and financial institutions to finance various requirements including working capital, technology up gradation, etc. of these units. Promotions of clusters linked to large units, thus, could help expansion of credits to small units".

8. Finally, "it has been observed that one of the major reasons for delays in sanction and disbursal of loans is the lengthy documentation and legal procedures involved in the process. It will greatly help SMEs if facilitation services are provided by various promotional agencies like SISIs, DICs, SIDCs, industry associations, banks, etc".

4.5 Limitations of the study

- Cost and time are major concern.
- Banks does not provide their internal policies and data.
- Also, internal guidelines of RBI is not available.
- The study is basically conducted for only of the partial fulfillment of the MBA programme.

CHAPTER 5 - BIBLIOGRAPHY

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