

## **Problems of MSME Finance in India and Role of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)**

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**Abstract:** *The role of MSMEs in social and economic development are widely acknowledged. In spite of its significant contribution to Indian economy, this sector faces many hindrances and the main hindrance is finance. Access to timely and adequate credit at a reasonable cost is essential for growth of MSMEs.*

*Financial Institutions have limited their exposure to this sector because of small ticket size of the loan, higher cost of servicing the segment, and limited ability to provide immovable collateral. CGTMSE plays an important role by providing credit guarantee to MSMEs in India since its inception in the year 2000. Still due to many bottlenecks from both the side of Bankers and Entrepreneurs, this sector is not getting timely and adequate credit. This paper tries to highlight the way to get institutional finance by availing the benefit of Credit Guarantee Scheme.*

**Key Word:** *MSME Finance, Bank loan, Credit Guarantee, Collateral free loan, CGTMSE*

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### **I. Introduction**

Micro, Small and Medium Enterprises (MSMEs) represent a significant part of the Indian economy and are one of the strongest drivers of economic development, innovation and employment. Access to finance is frequently identified as a critical barrier to growth for MSMEs. Creating opportunities for MSMEs in emerging markets is a key way to advance economic development and reduce poverty.

With a sustained growth rate of over 10 percent in the past few years, the MSME sector has come to represent the ability of the Indian entrepreneur to innovate and create solutions despite the challenges. As the nation's largest employer, generating more than 111 million jobs through 63.38 million enterprises<sup>1</sup> and contributing over 28% of the nation's GDP and more than 40% of the country's overall exports, the relevance and role of the MSME sector as the central driving force behind India's assertive vision to be a dominant global economic power cannot be overemphasized.

In view of the fact that banks are the predominant source of finance in India and the Reserve Bank of India includes micro and small enterprises in the list of priority sectors lending. Banks have also been advised to achieve a year-on-year growth of 20% in credit to micro and small enterprises and an annual growth of 10% in the number of microenterprise accounts. The Government of India has been making new policies from time to time for support to this sector and particularly for smooth flow of credit to this sector.

### **II. Objective and Methodology**

#### **Objective of the Study:**

- i) To know the Source of MSME Finance
- ii) To know the Problem of MSME Finance
- iii) To Study the role of CGTMSE in facilitating MSME finance

#### **Research Methodology:**

Only secondary data is taken into consideration for purpose of the study. The relevant secondary data is collected from the publication of Ministry of Micro, Small and Medium Enterprises, Working Papers from International Finance Corporation (IFC), RBI Report on MSME, Report of SIDBI, related research papers, journals, and Publications from CGTMSE.

### **III. Literature Review**

Abraham and Schumkler (2017)<sup>2</sup> both supply and demand factors can explain the low observed use of banking services by SMEs. A supply-side problem occurs when SMEs have profitable investment projects but cannot get sufficient external funds to finance them. A demand-side problem exists when SMEs are not creditworthy. In this case, unless lending is subsidized, creditors will not extend credit because they would incur in losses. The macroeconomic environment can also hamper SME finance. For example, if the government runs

a fiscal deficit, banks might find it more profitable or less risky to fund the government instead of lending to the private sector. This could reduce the credit available to SMEs. Public credit guarantee schemes are particularly important in developing countries, where they are the main type of guarantee scheme. Movable assets (such as machinery, and accounts receivables) account for most of a firm's assets, particularly for SMEs. However, due to weak legal and regulatory environments, banks are often reluctant to accept these assets as collateral, especially in developing countries. In this context, banks prefer immovable assets, which are more difficult to hide and are less likely to be subject to ownership disputes, as collateral.

Singh and Wasdani (2016)<sup>3</sup> divides the life stages of an enterprise in to four stages viz. Startup stage, Survival stage, Growth Stage and Sustenance stage. Enterprises in the start-up stage use funds from personal savings, friends, and family, primarily for the purpose of working capital. They also use public sector banks for working capital and collateral financing. Enterprises in the survival stage would be looking to break even with regard to investments made and would therefore seek to meet their specific requirements through both informal and formal sources. In the growth stage they use public banks for working capital and collateral financing, and they use private banks for short-term loans. The move toward private banks is possibly due to greater financial need and an increase in the ability of enterprises at this stage to afford the higher cost of finance. Enterprises in the sustenance stage use personal funds, cooperative banks, public banks, and money borrowed from friends, again primarily for working capital. Cooperative banks were also used for short-term loans and collateral financing.

Sinha (2012)<sup>4</sup> says that owing to their small size, the MSMEs often find it difficult to achieve economies of scale and fail to capture market opportunities which require large production facilities. Further, their small size hinders the internalisation of functions such as market research, technology innovation and market intelligence which impedes their productivity. However, it is not that their small size is always disadvantageous. MSMEs are agile and flexible and can leverage on these qualities to capitalise on their innovative ideas.

Yadav (2014)<sup>5</sup> emphasized on the leadership and talent management is required among bank officials for uninterrupted credit supply. Bank should come forward in counseling to entrepreneurs on both finance and non-finance related issues.

According to RBI Expert committee on MSMEs (2019)<sup>6</sup>, in the changed circumstances, it is imperative that the thrust of this important legislation should be focused more on market facilitation and promoting ease of doing business for MSMEs. SIDBI, as a nodal agency, should ideally play the role of a facilitator to create platforms wherein various Venture Capital Funds can participate and in turn create multiplier effect for providing equity support to MSMEs. A Government sponsored Fund of Funds (FoF) to support VC/PE firms investing in the MSME sector should be set up to encourage them to invest in the MSME segment. The Committee recommends for the creation of a Distressed Asset Fund, with a corpus of ₹ 5000 crore, structured to assist units in clusters where a change in the external environment, e.g. a ban on plastics or 'dumping' has led to a large number of MSMEs becoming NPA. Credit guarantee is an important risk mitigating tool which provides cushion to the lender for lending to MSEs. Currently, CGTMSE and NCGTC have devised credit guarantee schemes for MSE loans. However, these entities are currently outside the purview of regulation. It is, therefore, recommended that all Credit Guarantee Schemes should be subject to the regulation and supervision of RBI. While framing the regulatory and supervisory guidelines RBI can draw upon the well acknowledged principles for design implementation and evaluation of Public Credit Guarantee Schemes for SMEs, which has been evolved by the World Bank Group.

#### **IV. Discussions**

##### **Sources of MSME Finance:**

There are two types of source of MSME finance in India. One is non-institutional which includes loan from local money lenders, friends and relatives who charge a high rate of interest. And other is institutional. The institutional lending to MSMEs in India are regulated by Reserve Bank of India include Scheduled Commercial Banks (Public Sector Banks, Private Sector Banks including Small Finance Banks, Foreign Banks, Co-operative Banks and Regional Rural Banks) and Non-Banking Financial Companies including NBFC- MFIs. In addition to this, Securities and Exchange Board of India (SEBI) regulates the institutions engaged in providing or mediating capital to MSMEs such as SME Exchanges, Angel Investors, Venture Capital and Private Equity. Apex institutions such as SIDBI and MUDRA provide sectoral support and come within the purview of the Central Government. The MSMEs depend on both the sources as per their need from time to time.

As per the 4<sup>th</sup> census of MSME only 5.18% of the units (both registered and unregistered) had availed of finance through institutional sources, 2.05% from non-institutional sources and the majority of units i.e. 92.77% had no finance or depended on self-finance.

Despite increase in financing to MSMEs in recent years, the addressable credit gap in the MSME sector is estimated to be INR 25.8 trillion (USD 397 billion)<sup>7</sup>, which formal financial institutions can viably finance in the near term.

**Table-1 Credit Flow to the MSME Sector by Banks**

*(No. of A/cs in lakh) (Amount ₹ in crore)*

Year ended	Public Sector Banks		Private Sector Banks		Foreign Banks		All Scheduled Commercial banks	
	No. of A/cs	Amt. O/s	No. of A/cs	Amt. O/s	No. of A/cs	Amt O/s	No. of A/cs	Amt O/s
March 2015	86.08 (1.37%)	852689.27 (12.44%)	50.23 (30.15%)	281548.83 (13.93%)	2.84 (-3.14%)	36787.95 (6.85%)	139.15 (10.05%)	1171026.05 (12.61%)
March 2016	106.82 (24.10%)	820548.0 (-3.77%)	96.42 (91.95%)	359085.34 (27.54%)	1.86 (-34.40%)	36373.76 (-1.13%)	205.10 (47.40%)	1216007.11 (3.84%)
March 2017	111.97 (4.82%)	828933.42 (1.02%)	119.59 (24.04%)	430962.70 (20.02%)	2.07 (11.10%)	36502.70 (0.35%)	233.63 (13.91%)	1296398.82 (6.61%)
March 2018	111.01 (-0.85%)	864597.79 (4.30%)	148.33 (24.03%)	410760.21 (-4.69%)	2.20 (6.21%)	48881.34 (33.91%)	261.54 (11.95%)	1324239.35 (2.15%)
March 2019	<b>112.97</b> <b>(1.76%)</b>	<b>880032.90</b> <b>(1.76%)</b>	<b>205.31</b> <b>(38.41%)</b>	<b>563678.47</b> <b>(37.23%)</b>	<b>2.40</b> <b>(9.30%)</b>	<b>66939.14</b> <b>(36.94%)</b>	<b>320.68</b> <b>(22.61%)</b>	<b>1510650.52</b> <b>(14.08%)</b>

Source: Report on 24<sup>th</sup> Standing Advisory Committee on MSME, FIDD, RBI, September 17, 2019

Note: Figures in parenthesis indicate Y-o-Y % growth/decline

From the above table it is seen that the outstanding credit growth of all scheduled Commercial Banks as on March 2019 vis-à-vis March 2018, is 14.08%, and private sector banks are also playing an active role in granting loans to the MSME sector.

Despite growth in credit, a large number of MSMEs are not depending on bank credit due to lack of timely credit, information asymmetry, issue of collateral and procedural delays. Therefore, there is a need for alternative sources of finance. On the recommendation of Prime Minister's Task Force Committee, Bombay Stock Exchange (BSE) launched the SME Platform in which listing of MSMEs is paving the way for a new source of finance by attracting investors from diversified fields.

The role of Risk-Capital and Angel funding can play an important role for the modern technology and innovation oriented start-ups. Unlike developed countries, these are not popular in India. But Indian MSMEs are in need of external equity financing through Private Equity (PE) and Venture Capital (VC) Funds. Keeping in view its importance Government of India has announced the creation of a scheme named Fund of Funds for MSMEs, set up with a corpus of Rs. 10,000 crore<sup>8</sup> which will help the growth potential and viable MSMEs who face shortage of equity.

Factoring is also a source of finance for MSMEs. It is a financial transaction between a business owner and a third party that provides instant cash to the former in exchange for the account receivables of the business, at a discounted price. The enactment of Factoring Regulation Act, 2011 is helping this sector in accessing working capital finance.

To address the problem of delayed payment related issues faced by MSMEs in India, RBI introduced the concept of Trade Receivables Discounting System (TReDS) in 2014, which is a mechanism of trade receivables financing for MSMEs in a secure digital platform.

### **Constraints in MSME finance:**

Out of all sources of finance, besides the timely credit from non-institutional sources at an exorbitant rate of interest, bank loans are becoming popular due to spread of bank branches across the country. But despite many policy initiatives and regulations there are many constraints to MSME finance, as Indian Banking System is still small relative to the increasing debt demand in this sector.

From the Banks' perspective, MSMEs are high risk borrowers due to insufficient assets and low capital. This sector is highly vulnerable to market and economic fluctuation. There is also fear of sickness of units in this sector. As per RBI provisional data of September, 2016, there are 480280 numbers<sup>9</sup> of sick Micro & Small enterprises with Rs. 326.74 billion outstanding credit.

MSMEs typically are more opaque than large firms because they have less publicly available information. Consequently, it becomes difficult for banks to assess the creditworthiness of MSMEs, which can discourage lending and the lenders can substitute the lack of information with higher requirement of collaterals. Indian MSMEs are also lacking collaterals, due to which they are unable to get timely and adequate finance.

Information asymmetry in this sector results in inadequate bank finance. Due to heavy dependency on cash transactions the reported data is different from actual figures of sales and profitability. This difference arises due to lack of documentation of large volume of small ticket cash transactions. As a result of which, the MSMEs qualifies for less amount of loan than what is required.

Besides this, due to high transaction cost and lower margins, lack of product innovation by the enterprises and low-risk appetite of Financial Institutions, MSMEs are unable to get timely and adequate credit.

NPA is another factor in this segment which creates fear among the bankers in providing loans. The year on year growth NPA data from June-2018 to June-2019 is 12% in the MSMEs as compared to 10.8% in large enterprises<sup>10</sup>.

### **Role of Credit Guarantee Fund Trust for Micro & Small Enterprises (CGTMSE) in facilitating Institutional loans:**

CGTMSE has been set up jointly by Ministry of MSME and SIDBI in August 2000 to facilitate access to finance for un-served / under-served borrower segments, making availability of financial assistance from lenders to first generation entrepreneurs and underprivileged section of society who lack collateral security and/or third-party guarantee for supporting their ventures. During last 18 years of operations, CGTMSE has approved over 34 lakh guarantees<sup>11</sup> covering loans amounting to over Rs. 1.75 lakh crore on cumulative basis.

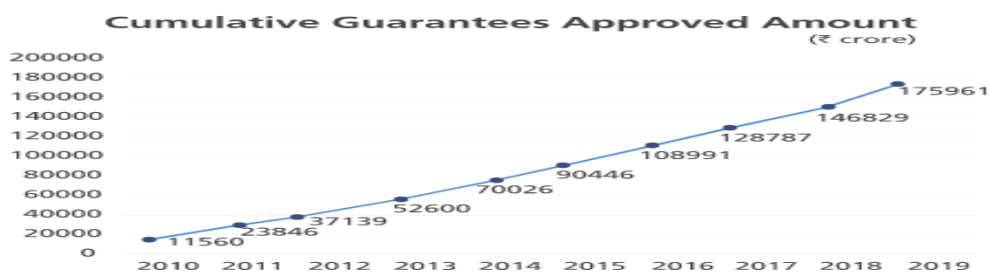
Any collateral / third party guarantee free credit facility (both fund as well as non fund based) extended by eligible institutions, to new as well as existing Micro and Small Enterprise, including Service Enterprises, with a maximum credit cap of Rs. 200 lakh (Rupees Two Hundred lakh only) are eligible to be covered. Recently, guarantee coverage made eligible to select NBFCs and Small Finance banks.

The guarantee cover available under the scheme is to the extent of 50%/ 75% / 80% & 85% of the sanctioned amount of the credit facility. The extent of guarantee cover is 85% for micro enterprises for credit up to Rs. 5 lakh. The extent of guarantee cover is 50% of the sanctioned amount of the credit facility for credit from Rs. 10 lakh to Rs. 100 lakh per MSE borrower for retail trade activity.

The extent of guarantee cover is 80%(i) Micro and Small Enterprises operated and/or owned by women; and (ii) all credits/loans in the North East Region (NER) for credit facilities upto Rs. 50 lakh. In case of default, Trust settles the claim up to 75% of the amount in default of the credit facility extended by the lending institution for credit facilities upto Rs. 200 lakh.

Credit Guarantee Scheme has over the years emerged as a successful tool in facilitating MSEs access to formal credit sources. The Scheme attempts to reorient the lenders perspective from collateral based lending to project liability. CGTMSE has been able to instill confidence and encourage MLIs to enhance credit flow to MSEs, backed by the comfort of guarantee cover. Considering that the Scheme is exclusively focused on the MSE sector which is the backbone of the Indian economy, the positive externalities in terms of contribution to GDP and employment generation is immense. CGTMSE has always been responsive and proactive in ensuring sustainable growth of the trust and meeting the needs of the MSME sector.

**Fig-1**



Source: Annual Progress Report 2018-19, CGTMSE, Mumbai

The impact of enhancements to the credit guarantee products with changing needs of the sector is evident from the upswing in the credit guarantee flow shown by CGTMSE in the above graph. MSEs have been continuously getting benefitted from this scheme.

However, if we analyse the guarantee fees charged under this scheme, we can see from the following table that the guarantee fees are high for prospective and even existing MSEs.

**Table-2** Annual Guarantee fee charged by CGTMSE

Credit Facility	Annual Guarantee Fee (AGF) [% p.a.]*	
	Women, Micro Enterprises and Units covered in NER	Others
Up to Rs.5 Lakhs	1.00+ RP	
Above Rs.5 Lakhs and up to Rs.50 Lakhs	1.35+RP	1.50+RP
Above Rs.50 Lakhs and up to Rs.200 Lakhs	1.80+ RP	
Retail Trade (Rs.10 lakh to Rs. 100 lakh)	2.00+ RP	

Source: Website of CGTMSE, Mumbai

RP- Risk Premium as per extant guidelines of the Trust

\*AGF will be charged on the guaranteed amount for the first year and on the outstanding amount for the remaining tenure of the credit facility.

Indian MSEs are hesitant to bear high extra fees in addition to high rate of interest already charged by the Financial Institutions. Moreover the inability of MSEs for promoters contribution of margin money also results in non-sanction of credit.

### V. Suggestions

- Medium Enterprises should also be included as beneficiary under CGTMSE, as it will resolve the issue of units becoming ineligible on its upgradation to Medium category from Small category on account of investment in plant and machinery/equipment.
- The rate of Annual guarantee fee under CGTMSE, should be lower from the existing rate for the benefit of MSMEs.
- The extent of guarantee coverage should be uniform for all categories of MSMEs and it should be increased upto 90% of the project, as it will enable the entrepreneurs to contribute lower amount of margin money.
- There should be motivation/incentive / award or reward programme for the Credit Sanctioning Officers by each bank and region wise to encourage more lending to MSME sector.
- Government should make elaborate provisions to make all the bankers, and prospective and existing entrepreneurs aware of loan procedures and all government support schemes. Keeping in view the significant contribution of this sector to the Indian Economy, emphasize should be given on entrepreneurship and this should be included in the higher secondary curriculum, so that our young generation choose entrepreneurship as their career and the knowledge and procedure of getting loan from banks will enable them to equip with all required information for timely credit.
- There should be single window system for MSMEs, so that they can get all benefits at one place.
- Provisions should be made for MSME borrowers to directly apply to CGTMSE for credit guarantee and on the basis of eligibility certificate issued by CGTMSE, they should approach to the MLIs and get loan at a competitive rate.

### VI. Conclusion

In spite of plethora of policy and schemes from the Government and RBI this sector is struggling to get timely and adequate finance. This problem persists from the side of both entrepreneurs and bankers. In the era of Digital India and Atmanirbhar Bharat, India is witnessing many small but innovative start-ups in the service sector which need assistance in the form risk capital and timely credit. MSMEs are also making partnership with larger firms and bringing out competitive products in market. In spite of the fact that large number of enterprises are becoming sick, we cannot deny that the rate of NPA is less than the large enterprises and the Banks should consider this fact.

There is also a need to ensure access of banking facilities in the remote unbanked/under-banked areas. Banks have an important role to play in addressing several problems faced by MSMEs in India. Banks have to view themselves not mere as a credit provider but as partners in the growth of these enterprises, through a process of hand holding support of first generation entrepreneurs and startups, while they find their feet in the business. Banks should therefore, provide financial consultancy/financial management services to their MSE borrowers to give them holistic guidance and support and nurturing them. Banks could set up special industrial and management consultancy departments to address functional inadequacies and market gaps

There might be a higher failure rate for start-up MSMEs, but despite the risk, the financing of these enterprises is a must for ensuring inclusive growth and here Credit Guarantee Scheme can play a major role. Credit guarantee is not the sole criterion for facilitating MSME credit but we cannot deny the fact that lack of collateral is the major cause of rejection of good projects by Banks. Financial Institutions are also safe while

granting loans under Credit Guarantee Scheme. Therefore, this scheme should be popularized among bankers and entrepreneurs.

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