LENDING TO MSE SECTOR UNDER CGTMSE SCHEME - EMERGING THREAT AND CHALLENGES FOR THE BANKERS

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ABSTRACT

MSEs or Micro and Small Enterprises form the backbone of an economy. In India, MSEs have been picking up pace for past few years now. Though while acknowledging the significance of small businesses, banks do hesitate in extending loans to the first generation entrepreneurs. Owing to the inability of providing adequate collateral security against loans, micro and small enterprise owners face hurdles in having access to bank credit. Taking this into account, the government introduced the Credit Guarantee Fund Scheme for MSEs in August, 2000, wherein an Entrepreneur can avail loan without offering any collateral security and third party guarantee. It also targeted at lowering the hindrances to credit flow to Micro and Small Enterprises. The objective of this scheme was to reduce the problem of collateral security. Further, CGTMSE in the current year has proposed to go for many changes including temporary suspension of CGTMSE scheme coverage to some banks due to very high level of NPAs under CGTMSE scheme accounts, reported by some of the Banks. This paper attempts to study and discuss the various changes proposed by CGTMSE and its impact on MSE sector’s lending and future challenges for the Bankers to extend credit under the said scheme.

Keywords: Micro and Small Enterprises; Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE); Non-Performing Asset (NPA); Member Lending Institutions (MLI); Credit Guarantee scheme (CGS); Guarantee fee (GF); Interest Rate Cap; Base Rate (BR); Annual Service Fee (ASF)

INTRODUCTION

While Micro and Small enterprises drive economic growth with their ability to innovate and employ in large numbers, the biggest challenge faced by them is access to finance. As MSEs have been the green-field for nurturing entrepreneurial talent, first generation entrepreneurs should be facilitated in accessing desired finance through Banks/Financial Institutions (FIs).

One of the major reasons for banks/financial institutions (FIs) being unable to meet the financial requirements is the perceived credit risk involved in financing to these sectors. This is primarily on account of non-availability of valid bills, proper accounting systems and lack of known buyers etc. To mitigate such credit risk and banks typically look for enhanced collateral or traditional equity, both of which cannot be brought in by most entrepreneurs.

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 realise their dream of setting up a unit of their own Micro and Small Enterprise (MSE). Keeping this objective in view, Ministry of Micro, Small & 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 operationalise the scheme, Government of India and Small Industries Development Bank of India set up the Credit Guarantee Fund Scheme (CGTMSE) in August, 2000.
Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in August 2000. The objectives of the scheme is to provide guarantees to MLIs a substantial extent in respect of credit facilities extended to borrowers in Micro and Small Enterprises.

The scheme is operated through Banks/lending institutions registered as Member Lending Institution (MLI) with CGTMSE. Scheduled Commercial Banks/Select Regional Rural Banks (RRBs)/other lending institutions eligible to register as MLIs.

The main objective is that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. The lender availing guarantee facility should endeavor to give composite credit to the borrowers so that the borrowers obtain both term loan and working capital facilities from a single agency. Under the scheme, MSE Business unit can avail both term loan and working capital up to Rs. 100 lakh. The loan amount can be extended without any third party guarantee or collateral security.

OBJECTIVES

1. To study the importance of CGTMSE scheme in lending to MSE sector
2. To study the various changes proposed by CGTMSE in the scheme in view of increasing level of NPA accounts sanctioned under the scheme
3. To study the challenges posed by the bank in extending credit facilities to MSE sector due to the changes proposed by CGTMSE and suggest steps to meet the challenges.

Definition of Micro, Small Enterprises

Enterprises engaged in the manufacture or production, processing or preservation of goods as specified below:

i. A micro enterprise is an enterprise where investment in plant and machinery does not exceed Rs. 25 lakh;

ii. A small enterprise is an enterprise where the investment in plant and machinery is more than Rs. 25 lakh but does not exceed Rs. 5 crore; and

In case of the above enterprises, investment in plant and machinery is the original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification.

Enterprises engaged in providing or rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act, 2006) are specified below:

i. A micro enterprise is an enterprise where the investment in equipment does not exceed Rs. 10 lakh;

ii. A small enterprise is an enterprise where the investment in equipment is more than Rs. 10 lakh but does not exceed Rs. 2 crore; and

While the scheme is under operation during the last 15 years, CGTMSE in the current year has proposed to go for many changes in the scheme as it is witnessing very high level of NPAs reported by some of the Banks going up to more than 40%. The high levels of claim due to NPAs, coupled with a highly leveraged CGTMSE Corpus – has led to take many steps including temporary suspension of CGTMSE scheme coverage by the Credit Guarantee Fund Trust to some banks.

Differential Rates of Annual Service Fee/Annual Guarantee Fee Linked To NPA Level

The Trust presently adopts non-discretionary approach in levying Guarantee Fee (GF)/Annual Service Fee (ASF)/Annual Guarantee Fee (AGF) without reference to the level of NPAs reported by the Member Lending Institutions (MLIs) on the CGTMSE portal vis-à-vis the guarantees issued to them. Considering the high level of NPAs reported by some of the MLIs vis-a-vis the guarantees issued to
them, it has now been decided to charge differential rates of ASF/AGF, depending upon the NPA levels reported by the MLIs. The existing provision of the Scheme and the revised rate structure is as follows.

<table>
<thead>
<tr>
<th>Credit Guarantee</th>
<th>Annual Guarantee Fee [% p.a.]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Women, Micro Enterprises and units in North East Region (including Sikkim)</td>
<td>Others</td>
</tr>
<tr>
<td>Up to Rs. 5 lakh</td>
<td>0.75</td>
</tr>
<tr>
<td>Above Rs. 5 lakh up to Rs. 100 lakh</td>
<td>0.85</td>
</tr>
</tbody>
</table>

The differential rates of ASF/AGF depending upon NPA levels of MLIs of the Trust are as follows:

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Annual Service Fee (ASF)/Annual Guarantee Fee (AGF)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NPA level of the MLI (%)</td>
</tr>
<tr>
<td>1</td>
<td>Above 20%</td>
</tr>
<tr>
<td>2</td>
<td>15% - 20%</td>
</tr>
<tr>
<td>3</td>
<td>12% - 15%</td>
</tr>
<tr>
<td>4</td>
<td>12% and below</td>
</tr>
<tr>
<td>5</td>
<td>Below 6%</td>
</tr>
</tbody>
</table>

SR=Standard Rate (Existing ASF/AGF prescribed rate).

Charged rates are not applicable for credit facility up to Rs 5 lakh.

NPA level of the MLI shall be computed as a % of guarantees issued on and up to March 31 every year.

@ Provided MLI has been obtaining guarantee cover from the Trust for at least 5 complete years.

i. The proposed revision shall be w.e.f. Guarantees approved by the Trust on or after October 01, 2015

ii. Further, the Trust shall levy ASF/AGF as per the rate structure obtaining on all Guarantees live as on March 31, 2016 while issuing Demand Notices for ASF/AGF for FY 2016-17.

iii. The Trust has planned to gradually move towards a risk based premia.

Non Issuance Of Guarantee To MLIs Having NPA Level 10 % And More

The Trust has communicated that no guarantees (includes fresh, renewals and enhancements) will be issued to MLIs which have marked cumulative NPAs (in terms of amount) of 10% or more vis-à-vis the cumulative amount of guarantees issued by the Trust to it. Such MLIs would be advised by the Trust separately giving them reasonable time to submit its eligible pending sanctions for guarantee approval. Further, if this NPA level crosses has crossed the 12% mark, the claims of such MLIs will be settled after giving notice and after thorough scrutiny of each claim.

Reduction of Interest Rate Cap

The trust has communicated that they have decided to further reduce the cap on Interest Rate which could be charged by MLIs for CGTMSE covered proposals from up to 4% above base rate, as applicable presently, to up to 2% and 3% above Base Rate for loans up to Rs 50 lakh and loans above Rs 50 lakh respectively considering overall exposure of the borrower. The trust has also clarified that in case of any enhancements of credit facility sanctioned under the revised guidelines of Base Rate plus 2% crosses Rs 50 lakh, the cap of interest rate could be enhanced to 3% for the entire loans sanctioned and covered under CGS. The revised guidelines shall be applicable for the credit facilities sanctioned by MLIs on or after September 01, 2015, including additional term loans for existing credit facilities covered under CGS. The revised guidelines shall, however, not be applicable for existing working capital cases already covered under CGS where enhancement and / or renewal takes place subsequent to September 01, 2015.

Based on the MLIs plea that the interest rate charged by the MLIs for MSE loans are normally within the range of 12.5% to 14.5% based on its internal rating model which would not be in compliance with the revised guidelines on interest rate cap, the Trust has modified the date of applicability of revised
interest cap from September 1, 2015 to December 1, 2015 and finally, however, the reduction interest rate cap was withdrawn in November 2015.

Challenges

1. The present challenge for the banks is to contain the NPA level in MSE accounts covered under CGTMSE to continue to get guarantee cover from CGTMSE. Not only to get guarantee cover for new accounts, but to continue the guarantee cover for existing accounts covered under CGTMSE. Banks are required to take immediate steps to reduce the NPA level. Banks can not adopt the route of increasing MSE advances with CGTMSE cover and reduce the % of NPA level, but necessarily have to upgrade the existing NPA account and/or to recover the dues of existing NPA account by preferring claim with CGTMSE. Unless the present NPA level is reduced, banks may not be able to go for further lending to MSE sector under CGTMSE which may pose great challenge for the bankers. Further in case of existing accounts already covered under CGTMSE, if the guarantee cover is discontinued by CGTMSE and in case of such accounts turned as NPA, banks can not make any recovery in such accounts and the reduce the % of NPA, to immediately fall in line with Trust’s requirements to avail guarantee cover subsequently. Further banks have to keep provisions for such accounts and maintain Capital, which are otherwise not required in case of guarantee cover accounts. Further, due to poorly documented financial information and non-availability of accurate information from the MSE borrowers, particularly small enterprises, which is a critical input for decision making, controlling the NPA and to fall in line with the Trust’s requirements is the biggest challenge for the bankers.

2. To have the guarantee cover from Trust, Banks are required to pay Annual service fee/Guarantee fee/Annual guarantee fee to them. Banks pay the fees by debiting their expenditure account and/or debiting the borrower’s account and also on sharing basis by banks and borrower. The trust has now decided to reduce the lending interest rate cap from BR+4 % to BR+2 % for loans up to Rs 50 lacs and BR+3 % for loans above Rs 50 lacs. Now the lending interest rate is linked to credit rating and it is risk associated. By reducing the interest rate cap for eligibility, the trust prefers to extend guarantee cover to small borrowers say up to Rs 25.00 lacs, in such advances banks have fixed lower interest rate and not linked to credit rating. For high ticket advances up to Rs 100 lacs, the interest rate is linked to rating and to meet the interest rate cap for such advances, banks have to necessarily go for lower risk advances with good rating and thus helps the Trust to reduce/avoid lodging of claims by banks. Getting lower risk advances in MSE sector is highly competitive and a challenge for the bankers to get eligibility for guarantee cover. Further, Banks are compelled to refuse loans to high ticket acceptable risk customers under the scheme as interest rate for such customers will be more than the interest rate cap prescribed by the Trust, which will pose big challenge for the bankers to face such customers. Further the revised interest rate cap guidelines shall be applicable for the credit facilities sanctioned by MLIs on or after December 01, 2015, including additional term loans for existing credit facilities covered under CGS. Banks have to face the existing borrowers as it may not be able to lend additional term loan for the existing accounts which are already covered above the revised interest rate cap.

3. Further, Taking in to account the guarantee fee of 0.75 % to 1.00 % and incase of absorbing the entire guarantee fee by the Banks, the banks get only 1% to 1.25 % over and above Base Rate and thus Banks will be under pressure with less interest income at one side and maintaining the asset quality of such advances on the other side.

4. Therefore, many Member Lending Institutions (Banks) represented the above issues and expressed that reducing the interest rate Cap would exclude many of the MSE accounts from the guarantee cover and would affect the growth of MSE Sector badly, the above guideline was totally withdrawn in November 2015. However, in some of the MLIs, the interest rate Cap for Small enterprises exceeds the prescribed Cap of BR+4 % even at the initial lending.
stage itself and also the interest rate Cap increases further when the account’s credit rating slipped in subsequent renewal. It is a challenge for the Bank to maintain the above interest rate Cap throughout the Loan life period to fulfill the Claim requirements.

5. The Trust presently adopts non-discretionary approach in levying Guarantee Fee (GF)/Annual Service Fee (ASF)/Annual Guarantee Fee (AGF) without reference to the level of NPAs and has now decided to charge differential rates of ASF/AGF, depending upon the NPA levels reported by the MLIs. Depending upon the NPAs level mentioned above, the additional fees will be charged ranging from 0.25 % to 1.00 % for all accounts, over and above the regular guarantee fees. It is again a challenge for the Banks to absorb the additional fees at their end because it reduces the income for the bank. It case if the banks decide to recover the additional fees from the borrower, it is a challenge for the banks to recover the additional fees from standard account borrowers arising out of default of other borrowers particularly, when the fees are being paid based on the limit and not on reduced outstanding amount in case of Term loan.

CONCLUSION
MSE sector, being the backbone of Indian economy assumes lot of importance in providing employment opportunities and in contributing towards export and GDP. To reduce the hindrances towards credit flow to MSE sector and give comfort to Bankers and entrepreneurs, Government of India launched Credit Guarantee Scheme (CGS) so as to strengthen credit delivery system and facilitate flow of credit to the MSE sector. The main objective is that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. However, as the Trust is witnessing very high level of NPA accounts sanctioned under the scheme as reported by some of the Banks and in turn high levels of claim due to NPAs, coupled with a highly leveraged CGTMSE Corpus – has led to take many steps including temporary suspension of CGTMSE scheme coverage to some banks. Therefore, Bankers have to take immediate steps to reduce the present level of NPA of loan sanctioned under the scheme in order to continue the guarantee cover scheme for the existing and new accounts with the Trust. Further, since the guarantee fee is linked to NPA level, Bankers have to contain the NPA level to reduce the guarantee fee to be paid. The due diligence on MSE borrowers and credit appraisal system in the Banks are to be further strengthened so as to reduce the slippages of account to NPA category, to take advantage of this scheme.

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