

Helping MSMEs is not just about credit availability; And it mustn't deteriorate into a loan mela, resulting in high NPAs

By: [The Financial Express](#) | Published: November 3, 2018 1:25 AM

PM's MSME plan welcome, but boosting credit mustn't deteriorate into a loan mela, with high NPAs resulting



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Given the post-IL&FS NBFC crisis—IL&FS represents 16% of all bank lending to NBFCs—and the slowing of bank credit to MSMEs, it is not surprising prime minister [Narendra Modi](#)'s MSME package pays special attention to credit access. The package has several welcome features that include an extra 2%

interest subvention for GST-registered MSMEs, bringing in more trade receivables on to an e-discounting platform so as to ensure 24×7 credit availability, simpler filing of the mandatory labour returns and an increase in the compulsory PSU procurement to 25% of total purchases from 20% right now. What is worrying, though, is whether the package will end up with greater pressure on bankers to lend more to MSMEs, especially since NBFC credit has dried up to a large extent. An online loan portal where loans up to Rs 1 crore are to be granted in just 59 minutes suggests that this might well be the case.

Since outstanding bank credit to MSMEs was Rs 4.69 lakh crore at the end of September 2018 as compared to Rs 4.73 lakh crore in September 2016, many argue the shrinkage in credit is reason enough for the government to intervene to get credit supplies growing. That is missing the point. For one, bank credit to industry as a whole—including large firms—is hardly growing since there is very little capacity creation; and since other sectors are growing faster, it has even shrunk as a share of the total lending. While outstanding credit to all industry was `27.02 lakh crore in September 2018, this is not much higher than the Rs 26.29 lakh crore in

September 2015. As a result, industrial credit as a share of total non-food credit fell to 33.9% in September 2018 from 43.1% in September 2015. As a share of total industrial credit, in fact, the share of MSME has fallen less sharply, to 17.4% in September 2018 from 18.3% in September 2015.

The reason for MSME lending from banks remaining flat, or even contracting a bit, is that banks are not best equipped to lend to this sector. The amount of management time required to service an MSME loan is the same as for a larger loan, so banks prefer to focus on larger clients; a very large chunk of MSMEs

don't have enough collateral or well established sales trails to justify loans, especially when the sales are primarily in cash. Also, given the nature of the market varies from industry to industry, NBFCs and MFIs are better suited for such loans since they are, by their very nature, much closer to their customers. In such a situation, the government needs to be careful to ensure that, while it encourages banks to lend more to MSMEs, this must not deteriorate into a loan mela, where loans are handed out irrespective of the ability to repay.

While RBI doesn't put out data on the NPAs of SMEs, in the case of a large bank like SBI, its FY18 annual report puts the NPAs for SMEs at 16.1%, up from 14.8% in FY17—the bank doesn't give data for SMEs, but since this appears under priority sector lending, it is clear it refers to SMEs.

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And while credit is very important, this is just one of the constraints faced by MSMEs; others include very poor infrastructure and access to markets. A study by urban-development-solutions firm MetroValley found, for instance, that while firms in Bangalore pay rents of over \$5 per square metre, industrial rents in Hanoi are less than a fifteenth of that; it takes 21 days to deliver goods from JNPT to the US east coast versus 14 from China ... While increased PSU procurement from MSMEs is welcome, at Rs 30,000 crore, the hike is not enough to solve the access to markets which is a big problem for MSMEs. Indeed, thanks to Chinese imports flooding the market, large domestic markets are getting shut down for MSMEs; inherent disadvantages have meant export markets aren't growing well either. Fixing this is not going to be easy as it requires lots of action on various fronts including serious labour reform, cutting

red tape and fixing broken infrastructure. There is a danger that, since granting bank loans is more visible, government action may remain primarily focused on just that.

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