



# Activating SMEs for Acceleration

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## SMERA Analysis: The evolution of Indian MSMEs: 2006-2017

The evolution of MSME sector has been very much in line with the development of the Indian economy. Such has been sector's importance that India established the Small Industries Development Organization in the year 1954, during the first five year plan. Year 2000 onwards, the focus on the MSME sector became even more pronounced with the Government bringing about several packages and initiatives to solve the persistent problems relating to credit availability, technology upgradation, enabling infrastructure and other subsidies. The biggest change was however brought about by the passage of the Micro, Small, and Medium Enterprise Development Act (MSMEDA) in the year 2006. The Act seeks to "facilitate the development and enhancing the competitiveness of such enterprises." With this Act, the Government of India envisions the integration of the Micro, Small and Medium enterprises in order to effectively promote the sector at large. The very definition of an enterprise, incorporating both service and manufacturing units has also been put forward.

### Role of MSMEs in Indian economy:

- As of 2017, the country records nearly 40-50 million enterprises operating in the sector; creating employment opportunity for nearly 130 million people
- Since 94% of the sector is unorganized, until recently, no clear estimate was available regarding the sector's GDP contribution
- However, the Economic Survey 2015-16 has changed all that and has pegged the size of the MSME sector equivalent to 37.5% of the GDP
- The sector records a normalized growth of 4% over the last ten years and will likely remain the growth engine of the Indian economy's next growth phase

	Number of MSMEs (in Lakh)	Employment (in Million)
FY06	252.77	29.49
FY07	263.30	80.52
FY08	274.27	84.22
FY09	285.70	88.08
FY10	297.60	92.18
FY11	310.00	96.52
FY12	322.40	101.18
FY13	335.30	106.15
FY14	348.70	111.14
FY15	362.60	116.36
FY16	377.20	121.83
FY17	392.30	127.56

*Source: Planning Commission; Ministry of MSME; SMERA Research*

## Credit Offtake:

Planning Commission of India Estimate for demand of credit by MSME

	Total Credit demand by MSMEs	Working Capital demand of MSMEs	Term loan demand of MSMEs
FY06	12151	8506	3645
FY07	13547	9482	4064
FY08	15102	10571	4531
FY09	16836	11785	5051
FY10	18770	13138	5631
FY11	20925	14647	6278
FY12	23083	16159	6925
FY13	25416	17791	7625
FY14	28036	19625	8411
FY15	30898	21629	9269
FY16	34058	23841	10217
FY17	37577	26304	11273

**\*\*All figures in Billion Rupee; Source: Planning Commission of India**

- The Prime Minister Task Force Report on MSME has pointed out the criticality of credit to the sector's future growth and sustainability. There exists a credit gap of over 60% for small and medium enterprises and over 70% for unorganized micro enterprises. As per Government of India estimates, average per unit credit offtake for the sector is nearly Rs. 7.2 lakh and this number is expected to rise drastically in the coming years
- Since the year 2006, with the passage of the MSMDEA, Indian micro, small and medium enterprises have witnessed significant increases in their access to capital. Credit offtake has been expanding at 12.5% on average since 2007 and currently stands at around Rs. 9 lakh crore. While comparing these figures with those of 2006, MSME credit outstanding has expanded by over 200% and the sector maintains its weight of over 12% in total credit outstanding
- India's erstwhile Planning Commission had estimated that Indian MSME's current demand for credit is Rs. 37.5 lakh crore; pegging the working capital requirement at Rs. 26.3 lakh crore. Considering the credit gap of over 60%, there is an incremental credit demand for Rs. 28.5 lakh crore (working capital + term loans) in India. The overwhelming dependence of Indian MSMEs on commercial banks and promoter financing has now given way to other innovative funding avenues that are emerging at this time. NBFCs as well as private equity are such alternatives currently very popular among MSMEs. The gap however remains given entry barriers to the Bond market and the nascent equity markets for SMEs

## Asset Quality and Accounts:

### MSME Accounts with Commercial Banks

	Domestic		Foreign		Total	
	Number of Accounts	Outstanding Amount	Number of Accounts	Outstanding Amount	Number of Accounts	Outstanding Amount
2008	47.86	1980.49	0.65	154.89	48.51	2135.38
2009	47.93	2380.65	0.58	180.63	48.51	2561.28
2010	83.48	3411.43	1.57	211.47	85.05	3622.9
2011	91.69	4644.82	1.91	214.60	93.6	4859.42
	Domestic		Foreign		Total	
	Growth (%)	Growth (%)	Growth (%)	Growth (%)	Growth (%)	Growth (%)
2009	0.15	20.21	-10.77	16.62	0.00	19.94
2010	74.17	43.30	170.69	17.07	75.32	41.45
2011	9.83	36.15	21.66	1.48	10.05	34.13

*Note: Accounts in Lakhs; Amount in Billion*

*Source: Planning Commission; SMERA Research*

### Sector Key Takeaways

- **The number MSME accounts more than doubled between 2008 and 2011 when credit offtake to the sector averaged 20%.** Even though credit offtake has since then slowed down, MSME accounts can safely be assumed to be over 20 million in the year 2016. As compared to that of the year 2008, growth in MSME accounts is recorded at over 300%. This is commensurate with the growth in credit offtake as well as the incremental MSME units coming online. The largest contributor in this growth have been the public-sector banks which are also responsible for over 95% of the entire credit outstanding to the sector
- **The Prime Minister's Task Force Report on MSME envisages a 20% YoY growth in credit offtake for the sector.** If this growth is achieved, the supply of credit to the sector might go up to over Rs. 20 lakh crore, almost double of current levels
- **However with the current slowdown playing havoc with industry, not only has demand for credit fallen but also supply side constraints have restricted offtake.** As of now, public sector GNPA levels are hovering at over 9%, with overall PSB stressed advances crossing the 16% mark. Under pressure from the Finance Ministry and the RBI, banking sector in India might strengthen their due diligence mandates (lending operations) and make it more difficult for the already vulnerable MSME sector to access much needed finances. Expansion and R&D goals will be incidentally held for ransom with stricter credit policies

While considering the results of RBI's Sustainability Report, credit to MSME sector is however safest and presents a contrarian view to the prevailing situation. As on December 2015, percent slippages of overall

loans to NPA category was recorded at 3.2%. Loans less than Rs. 5 crore were the least vulnerable with a slippage percentage maintained at just 2.3%. Modern Indian MSMEs that access such small denomination loans are therefore less susceptible to defaults on loans despite being under severe negative pressures. According to SMERA's understanding, the following remain the most challenging factors, which inhibit MSME growth in the next phase;

- Non-availability of information, which in turn leads to an information gap does not allow a conducive environment for MSMEs to prosper. Banks, policy makers and other financial institutions must strive to mend this shortfall to unlock unprecedented value in the sector
- Due to their smaller size, MSMEs are rated lower and generally carry a higher risk weight. Smaller entities are perceived to have a lower resilience as compared to their larger counterparts; the belief is more pronounced in the current volatile scenario. Therefore, lending rate is higher for this category by at least 200-300 bps as compared to larger entities
- Compliance and other tax obligations arising due to the implementation of the GST
- Forging alliances and fueling R&D to enter global supply chains

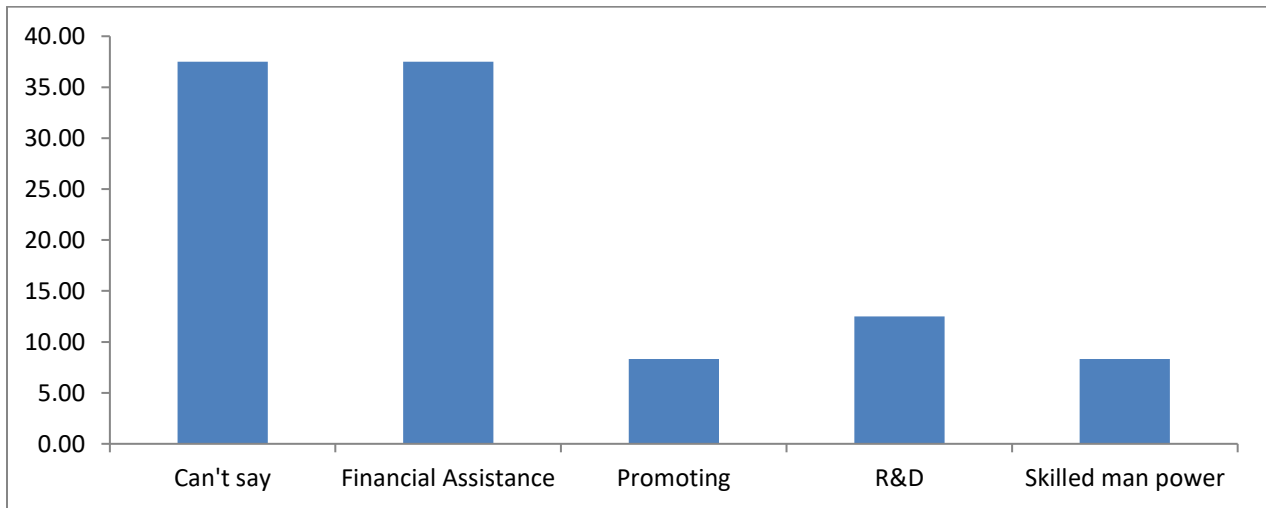
Ultimately, bankers must evolve a new methodology to identify the right MSMEs to lend to. The high potential MSMEs must be segregated and incubated. SMERA Ratings Limited can play a critical role in creation of this methodology. The evolution of the sector is important at this time, given the fact that it is the very backbone of our economy. It is also the Government and RBI's role to make the MSME sector an attractive segment for disbursement since there is a lot riding on its performance, from both the employment as well as economic growth's perspective.

**Polling Results (compiled from the responses of delegates of SME Activator, 2017)**

**Percentage distribution of sample size in various category:**

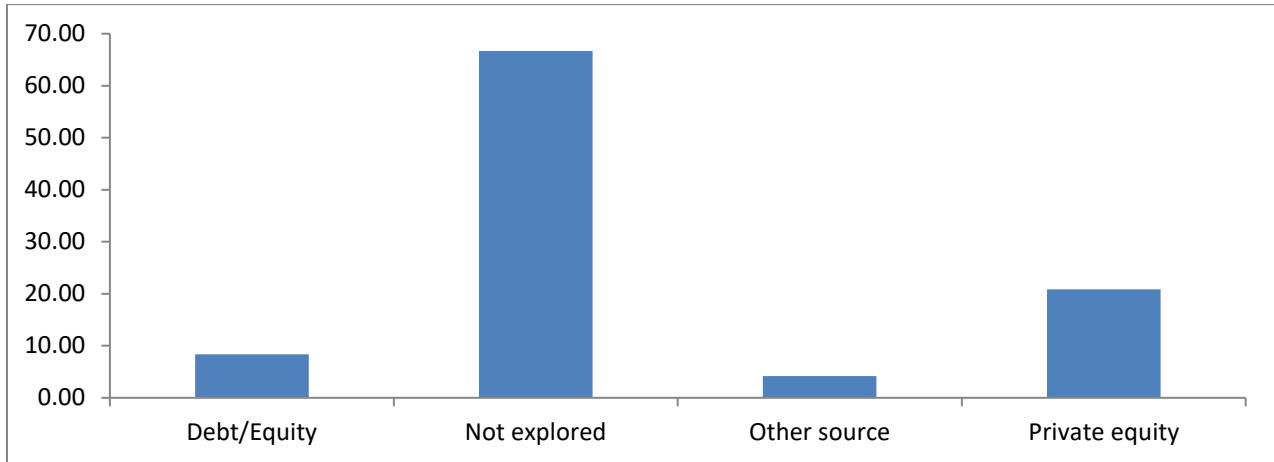
**Which services are required to scale up your business?**

Surprisingly, over 35% of the participants currently cannot assess the scalability of their business. In line with the current slowdown, it is clear from the responses that capex cycle is subdued along with low capacity utilization levels. In light of these circumstances, businesses have not assessed their expansion plans in the near term. Financing however was seen equally important for scaling of operations but the emphasis will be lower borrowing cost. R&D and Skill remains a low focus area for the respondents.



### Other source of investments to foray in public markets?

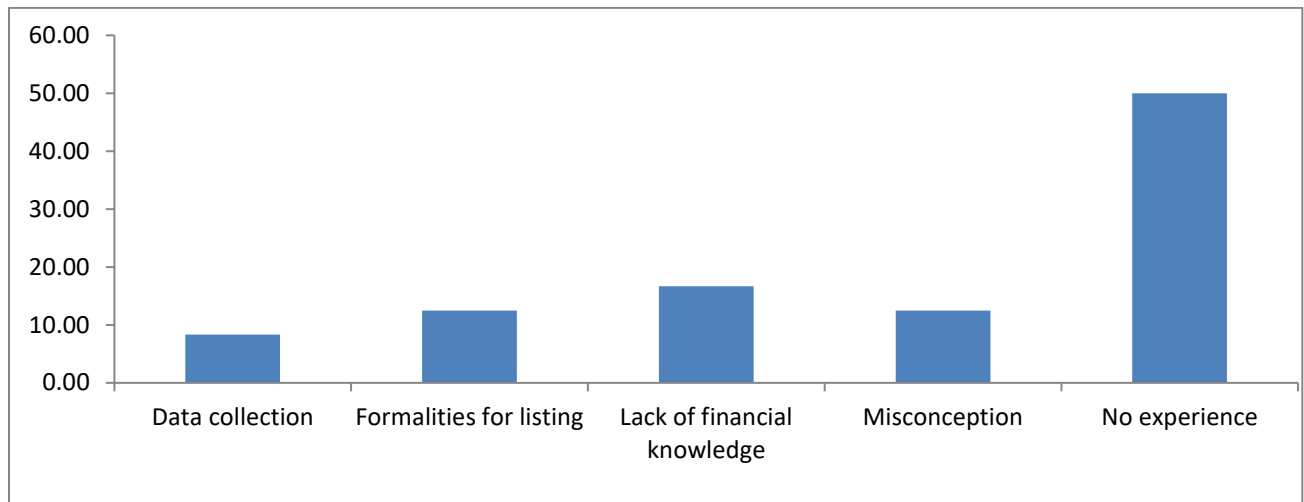
Again, majority of the respondents are not looking for any finances and the demand for other sources of financing remains low. Nearly 20% of the respondents indicated some interest in Private Equity while less than 10% showed some interest in Debt and Equity. A higher preference for PE is probably because of the perceived higher entry barriers in the Debt/ Equity markets.





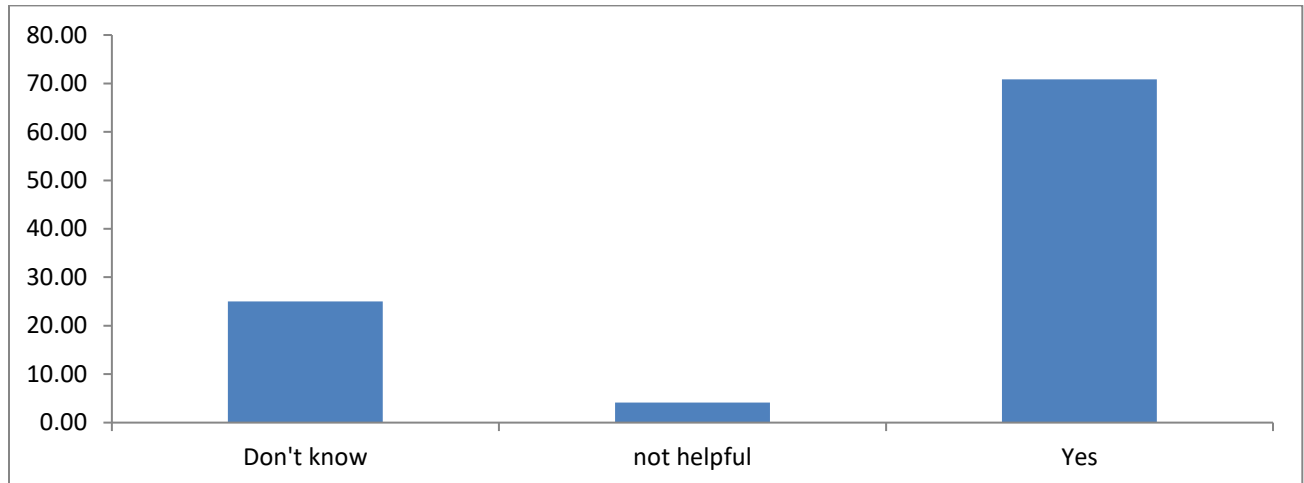
### What are the hurdles in listing in BSE?

Most respondents believe that they currently have no experience in raising money through the equity markets. Also, a significant 15% believe that they do not have the requisite knowledge to list themselves on the exchange as they are not sure about the repercussions. Availability of data was cited as the least important concern for considering a listing.



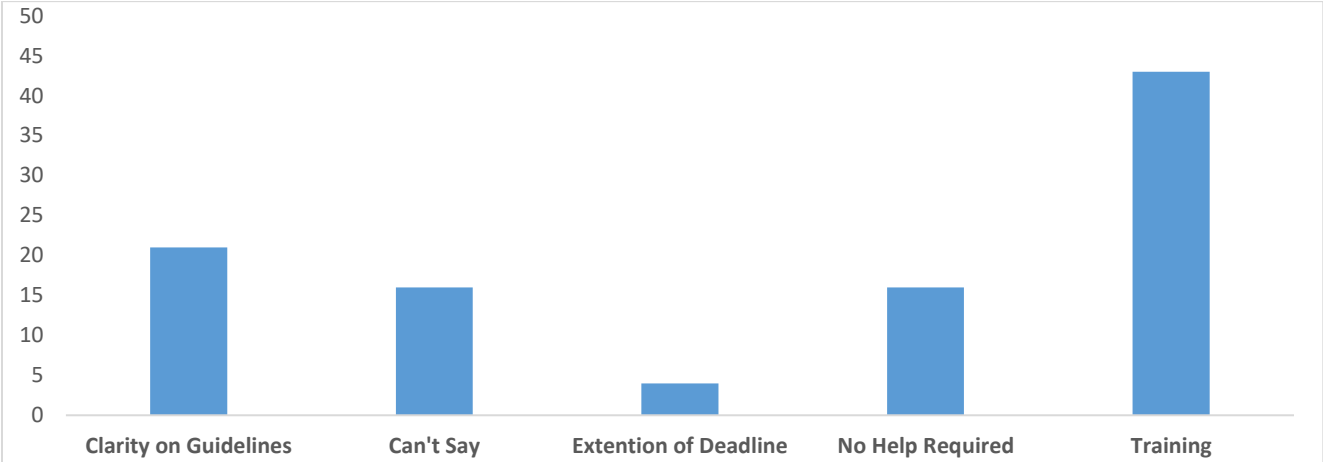
## Whether listing on BSE will help to grow?

Despite citing lack of knowledge and experience, a majority of the respondents believe that a listing will help their cause. Even among the naysayers, the majority was limited by knowledge rather than actually negating a future listing completely.



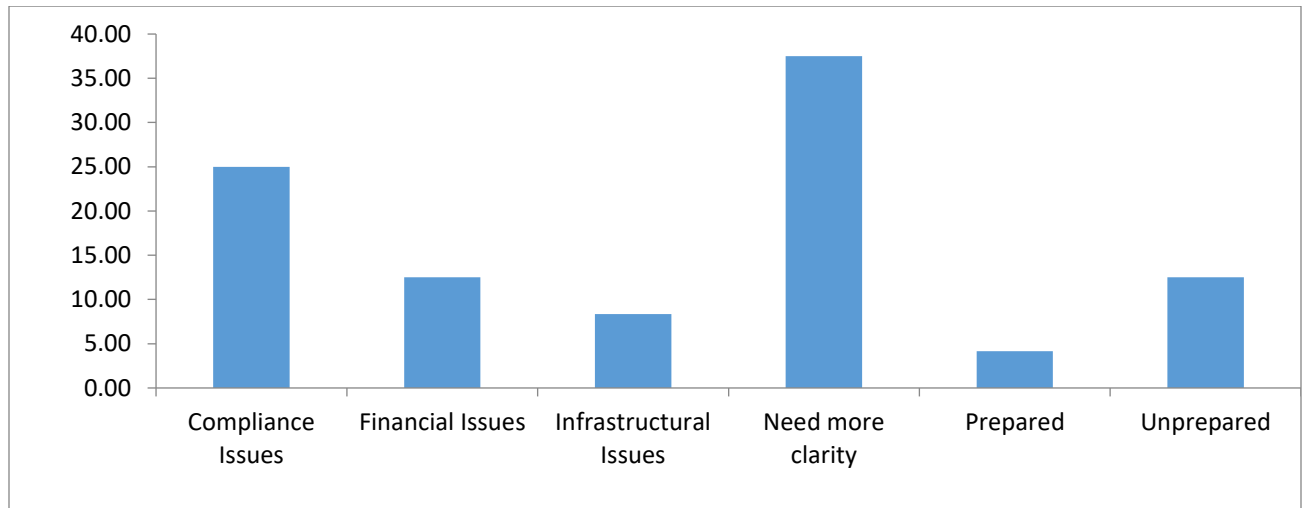
### What is the support expected by SMEs with regards to GST?

As much as 43% respondents believe that training will help them deal with the new tax regime effectively. Further, 20% wanted more clarity on the guidelines and compliance costs involved. Less than 5% wanted a deadline extension while 18% sought no help in this regard.



### Specific concerns pertaining to the levels of preparedness for GST implementation

Less than 5% respondents indicated that they are fully prepared to meet the GST obligations while nearly 13% out rightly suggested that they are not prepared at all. 35% and 25% of the respondents believe that Clarity on the processes and Compliance respectively are their chief concerns. Infrastructure issues were surprisingly the least concern for the respondents, when it comes to GST and its implementation.



## Event Takeaways

Archana Tiwari Nayudu, Content Head, ET Edge set the tone of the event by talking about the ROI quotient. She said, “The day will be packed with ROI.” She also pointed out the reason behind the recent fall in events dedicated to the SME space by citing data, “Number of SME events went down because current events on SMEs are superficial and engagement levels are low.” She also talked about the external and internal elements, which chiefly included financing and mind blocks. She finished her introductory speech with the following comment: “All elements will come alive through this event.”

The first session, Spotlight Talks (Shades of Success) included life lessons

- The importance of resilience in life and business
- Many challenges faced are not because of personal failures but due to adverse circumstances, macro-economic conditions and failures in the system
- The most important aspect to survive in the business is to be in the innovation cycle.
- Emphasis on the importance of globalization and out of the box thinking
- Business environment demands innovative thinking and global lessons
- An entrepreneur should understand customer’s requirements and thereafter work on improving the product
- Collaboration can help SMEs achieve organic growth
- The importance of ‘focus’ in business success: It was pointed out that one of the most important factors that every SME entrepreneur should keep in mind is consistency and a focused business. There will be many ups and downs in a business - irrespective of that one should maintain consistency in business

## Important attributes of entrepreneurs

- Innovation and branding: Guest Speakers suggested that innovation is the key factor to position oneself in the market. If one is clear and confident then it will help growth. Second aspect is building a brand. Innovation does not mean launching a new product – a business needs to improve the existing product and make it more user friendly and better
- Customer Satisfaction: The key factor that will distinguish a business from others is customer satisfaction. Businesses must go back to their customers and ask them what more be done for them
- Money and Finance: There were deliberations on the importance of money and financing as well as the panelists discussed about the importance of project viability and strength. It was suggested that “the entrepreneurs should not think that raising money for innovation or for operations is the bigger task.” In fact, according to panelists, financing is widely available – it’s all about the entrepreneur’s vision and the strength of his business. The onset of other sources of financing, including equity and debt was also a major discussion point

## The session on GST

GST as anticipated was a major discussion point in the and a panel of distinguished individuals provided substantial advice and insights to SME participants. With a prelude by Additional Commissioner of Service Tax, Central Board of Excise and Customs, Dr. Raju Sakthivel, the panel deliberated on several facets of the new tax structure.

- The importance of the unification of the multiple statutes was pointed out; this became important given the overlapping of jurisdiction between center and states.
- It was pointed out that “in the longer scheme of things” GST is an opportunity as it will lead to ease of doing business and aid in ‘Make in India’ vision. It was also suggested that the most critical aspect will be the correlation of inventory to excise structures
- Panelists were of the view that even though the chartered accountants are trying to understand the implications now - what is clear is the fact that once a company is compliant, both its vendors and customers should become compliant as well
- The importance of technology was emphasized in the GST’s successful implementation as it will help in dispute settlement
- The panelists were unanimous with the fact that the GST is a super idea, which is adopted by many developed countries and that the GST will bring inclusive growth to the Indian economy

*“GST will force unorganized businesses to turn organized”*

- The importance of SMEs was also discussed in detail as they will play a major role in the new tax system
- Pertaining to trade it was deliberated that direct port delivery system will make exports easy. After implementation of GST, goods will move with a single invoice, which will majorly help in logistics/mobility part of businesses
- A few panelists suggested that, “post the GST implementation, we need to bring sell side efficiency to reduce inventory stock”
- Tax claim or ITC were the following concern, with panelists commenting, “Delay in claiming tax will cause penalties”

Further, it was stated that in the procurement side, there will be different categories of vendors. Category ‘A’ type vendors will be completely GST complainer. In case of Category ‘B’, some vendors will be GST complaint while some will be not. In Category ‘C’, the vendors will not be GST complaint and therefore anything that is bought from this category will not lead to an ITC claim and costs will have to be absorbed. Concluding, the panelists sated that GST will be the gateway to a secure information transfer and significantly boost big data analytics, which will be useful in effective policy making.

The next panel discussion dealt with the issue of financing and importance of listing on the BSE.

Ajay Thakur, Head, BSE SME used parallels from the Mahabharata while explaining the perils of raising money from the market, alone. He said that “BSE listing acts as a *Sarathi*, who leads a company into a *Chakravyuh*.”

- It was opined that with a listing, one can improve his/her corporate visibility in the market and this helps growth and expansion
- Panelists were in consensus when asked about the benefits of the BSE as a guide and mentor to an SME as it forays into the financial markets
- It was deliberated that one's talent and performance can be showcased through a listing and a corporate can easily distribute finances to several 'small pockets (equity investors)'
- Also, the panelists were unanimous, while they discussed about BSEs role in making their businesses more credible and competitive

The profound impact on the 'mindset of an entrepreneur' was reflected as well. It was suggested that the following increase in responsibility and the knowledge about oneself and the eco-system ultimately leads to a life changing experience.

*"Many SMEs assume that listing their company will take away their liberty. Their control over company will go away. This is a completely wrong notion. This mind set needs to change"*

## **SME Spring Board: The Highlight of SME Activator**

After a scintillating session by Harshbeena Zaveri of NRB Bearings, the event concluded with the SME Spring board session. Eight SMEs who were selected through a nomination process presented their business cases to a distinguished jury comprising of senior representatives of SME finance and strategy of various SME organisations.

- When the jury was asked about what it looks for in a strong SME, it was suggested that, “technological steadiness is very important as it shows how the SMEs are evolving over a period”
- Mohit Jain of SMERA Ratings Limited opined that “mindset of an SME is most important as it gives a clear understanding of the business, integrity and openness of the promoters”
- Other suggestions for assessing SMEs included business ideas, clarity in thought process, management, business potential in terms of product positioning as well as growth

### **SMEs Nominated for the Spring Board session**

Schiller Healthcare India Private Limited

HD Fire Protect Private Limited

Shiv Shakti Oxalate Private Limited

Majestic Research Services & Solutions (India) Limited

Saan Engineers Private Limited

Sahajanand Laser Technology Limited

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### **Jury members of SME Springboard**

Amitabh Verma, Executive Director & Head, Small and Medium Enterprises, DBS Bank, India
Arun Kumar Nayyar, CEO, SME Lending, Edelweiss Retail Finance Limited
Anurag Bansal, Whole Time Director, SMC Global Securities Ltd
Rajesh Undaviya, Director - General Business Sales, Salesforce India
R Narayan, Founder & Chief Executive Officer, Power2SME
Mohit Jain, Vice President (Knowledge Centre), SMERA Ratings Limited
Vineet Chadha, Partner, Tata Capital Innovation Fund



## **Key highlights of SME Springboard**

- **Corporate Dilemma, “How much growth is necessary and for how long?”**
- **No funding required due to sufficient funds and a viable business model; future expansion may require expert mentoring nonetheless**
- **Retailer financing and replacement service sought due to inherent quick obsolescence and slow turn over time**
- **Requirement of Private Equity to infuse expertise at the board level and help direct expansion**
- **Hand holding for vendor and customer support and database management required since the industry is unorganized**
- **International foray, mentoring and financing sought are required**
- **Listing of business on the BSE impeded by a lack of knowledge and experience**
- **Passion’ was highlighted several times and the panel believed that, “a business’s success is directly proportionate to an entrepreneur’s passion”**
- **Commitment towards one’s cause was also noted as prime criteria for an entrepreneur’s success**

## About ET Edge

ET Edge, an initiative of The Economic Times, has been founded to empower multiple sectors, industries and segments through the dispersion of critical business knowledge through strategically developed conferences and summits. Foreseeing the tremendous potential which India has in store, ET Edge strives to bring together visionaries and key global leaders through its enriched knowledge platforms to aid the symbiotic relationship societies and businesses share.

We aim to channelize global business intelligence vide summits and conferences through fortifying lectures, workshops, panel discussions, roundtables and case studies. The forums would ensure that the senior decision makers are equipped with information to respond to challenges being faced from a global perspective. We have substantial expedients for the business & visualize it taking mammoth proportions while developing into a one stop destination for the stalwarts of the industry.

The plan is to formulate a focused holistic solution for key sectors which contribute largely towards the GDP of the nation. Extensive market research with core practitioners, experts, leading trend setters and policy makers is conducted to ensure that these platforms are unparalleled in the vertical they cater to. Visionaries and industry leaders contributing as speakers will only ensure that these platforms set themselves apart. Our delegates are key management personnel and decision makers who can further enrich the gatherings with their crucial insights and vast experience.

Retail, e-Governance, Real Estate, Infrastructure, Healthcare, Education, Technology, Rural & BFSI are some of the key sectors around which ET Edge aims to develop knowledge destinations.

## **About SMERA**

SMERA Ratings Limited is a full-service rating agency providing bond ratings, bank loan ratings, SME ratings, MFI gradings & COCA, and solar gradings. SMERA's pioneering work is globally recognized. SIDBI was awarded 'Outstanding Development Project Award' in SME Development Category for setting up SMERA by The Association of Development Financing Institutions in Asia and the Pacific (ADFIAP). As of 15th June, 2017 SMERA has assigned 45,640 ratings to bank borrowers, bond issuers, and SMEs. SMERA has permanent registration as a CRA from SEBI to rate a wide range of capital market instruments. RBI has approved SMERA as an eligible External Credit Assessment Institution (ECAI) under the New Capital Adequacy Framework (Basel II). NSIC has empaneled SMERA under the Performance & Credit Rating Scheme to award independent and reliable opinions on capabilities and creditworthiness of MSMEs. SMERA partnered with the RBI think tank, to develop SMEs' Sentiment Index. SMERA was sanctioned a Technical Assistance grant of Rs.10.54 crores by DFID, UK under the World Bank 'Project on SME Financing & Development'.