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Background

The Medium & Small Enterprises (MSE) sector has been a major contributor to the Indian Industrial Output, exports and employment in the country. One of the major challenges faced by the MSE sector is the availability of funds. Banks and other financial institutions were not easily providing loans to MSEs since they considered them as high risk. To address this situation and to help MSEs, the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) was set up by Govt. of India and SIDBI in the year of 2000-01 with a corpus of RS. 125 Crores. Annual additions were made continuously and the corpus balance for the year 2008-09 stands at Rs.1754.06 crores. The CGTMSE provided guarantees to banks and financial institutions to facilitate collateral free loans to MSE sector. This enabled better availability of credit facility and flow of funds within the MSE sector. Guarantee cover is given to collateral free loans disbursement by Member Lending Institutions (MLI).

Member Lending Institutions (MLI) are financial institutions that are registered with the trust and are covered under this scheme for the loans extended to eligible businesses. The MLI's constitute various categories of banks including PSU banks, private sector banks, regional rural banks, other lending institutions. One time guarantee fee and annual service fee at specified rate are collected.

Currently extent of guarantee is as follows:

Category	Maximum extent of Guarantee where credit facility is:		
	Upto Rs.5 lakh	**Above Rs.5 lakh upto Rs.50 lakh**	**Above Rs.50 lakh upto Rs.100 lakh**
Micro Enterprises	85% of the amount in default subject to a maximum of Rs.4.25 lakh	75% / Rs.37.50 lakh	Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh
Women entrepreneurs/ Units located in North East Region (incl. Sikkim)**other than credit facility upto Rs.5 lakh to micro enterprises**	80% of the amount in default subject to a maximum of Rs.40 lakh		Rs.40 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.65 lakh
All other category of borrowers	75% /Rs.37.50 lakh		Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh

All proposals for sanction of guarantee approvals for credit facilities above Rs. 50 lakh and up to Rs.100 lakh will have to be rated internally by the MLI and should be of investment grade. Proposals approved by the MLIs on or after December 8, 2008 will be eligible for the coverage up to Rs.100 lakh.

The Trust shall cover credit facilities (Fund based and/or Non fund based) extended by Member Lending Institution(s) to a single eligible borrower in the Micro and Small Enterprises sector for credit facility (i) not exceeding Rs. 50 lakh (Regional Rural Banks/Financial Institutions) and (ii) not exceeding Rs.100 lakh (Scheduled Commercial Banks and select Financial Institutions) by way of term loan and/or working capital facilities on or after entering into an agreement with the Trust, without any collateral security and\or third party guarantees or such amount as may be decided by the Trust from time to time.

How has the scheme performed

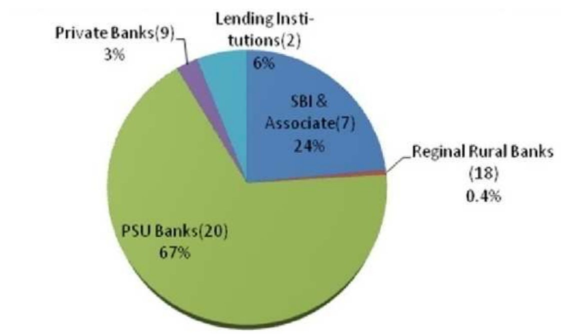

Figure 1 : source 9th Annual Report CGTMSE

How does one assess the performance of CGTMSE? World over, three parameters are used to evaluate the success of a credit guarantee scheme: financial additionality, economic additionality and sustainability of scheme. Financial additionality (FA) refers to availability of funds to SME that would not have been available in the absence of the scheme. Economic additionality (EA) refers to economic spillovers that accrue both at the beneficiary firm level and sector level because of the increased access and availability of capital.

The net cost of the administration of the scheme and the levels of EA & FA achieved indicate whether a credit guarantee scheme is economically sustainable. Some interesting insights emerged from our survey of lending institutions and beneficiaries of CGTMSE. Currently loans up to Rs. 1crore are covered under this scheme. The cumulative coverage for the year ending March, 2009 was Rs. 4824.34crores for over 150,034 proposals. The split of the loan disbursements against each of these lending categories are depicted in figure 1.

Out of the total 4 lending institutions, namely, National Small Industries Corporation Ltd., SIDBI, North Eastern Development Finance Corporation and The Tamil Nadu Industrial Investment Corporation, only the first two of them have disbursed loans under this scheme. Others haven't done any disbursements yet. The PSU Banks, as expected, have done extremely well. In fact, it is the State Bank of India & associates along with Canara Bank have disbursed around 30% of the total loan disbursements. RRB's have disbursed only 4.5% of the total disbursements.

The figure 2 below shows the slab wise loan disbursements. The maximum number of disbursements, that is, 90997 of them constitute about 60% of the total number of disbursements have been in the sub-1 Lakh category.

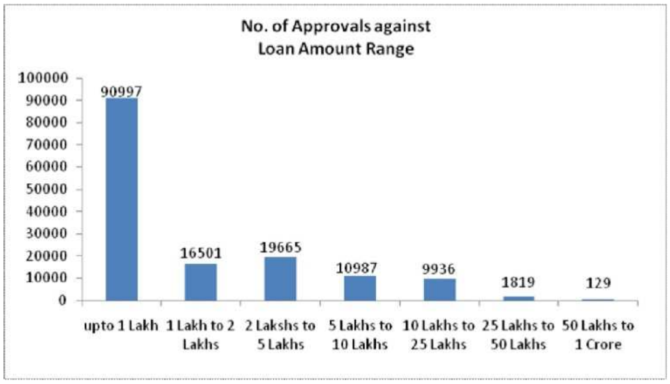

Figure 2 : source 9th Annual Report CGTMSE

While the number of beneficiaries may look high, comparatively small amount of loan (<1 lakh) may not be sufficient enough to significantly contribute to economic benefits. It could be postulated as one of the reasons for claims settled being very negligible when compared to the coverage given. In sunrise industries such as Solar, Biotech, IT, Healthcare, the loan amount at best may be just enough to meet 20 days working capital requirement.

It may be construed to reflect the “risk averse” nature of the intermediaries wherein they have spread their loans to a large number of beneficiaries with low exposure per client.

The trust itself can have separate wing to deal with capital intensive projects. Korea has two corporate credit guarantee institutions namely Korea Credit Guarantee Fund (KCGF) and Korea Technology Credit Guarantee Fund (KOTEC). KCGF provides guarantees mostly for SME loans, while KOTEC covers mainly technology-oriented SMEs. This would enable better loan disbursements to the technology sector. Some other Asian countries which have couple or more of credit guarantee corporations are Indonesia and Japan. There are various models of schemes which are used around the world. Few of them are discussed below.

Further, he state wise analysis of loan approvals (figure 3) gives us lots of insights about the awareness levels and success of the scheme throughout our country. Southern states of Tamilnadu, Kerala and Karnataka are among the top 7 states which has utilized the scheme effectively. Around 34% of the coverage are given to these states. Andhra Pradesh seems to lag behind with only 3.72% share of the distribution of CGTMSE coverage. It would be interesting to investigate the same. Within western zone, Maharashtra and Gujarat have the lion’s share of coverage of 17% of the loans distributed. North & East both have 1 representatives each, namely, Uttar Pradesh & West Bengal.

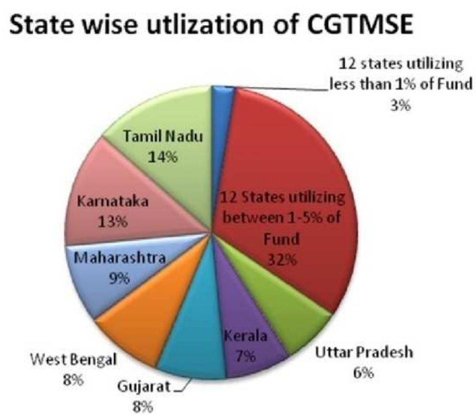

Figure 3 : source 9th Annual Report CGTMSE

Most of the eastern states like Sikkim, Nagaland and Manipur have availed coverage around less than 0.7%. Investigations into this disparity and promoting the awareness in this zone are needed. It is interesting to note that advertisement and publicity expenses constitutes about 11% of the total expenditure of the trust. Allocation of more funding towards advertisement and publicity expenses will enhance the coverage and the success of the scheme. Training Institutes, colleges and other student bodies should be approached for conducting workshops on credit facilities and publicity through mass media would help raise the awareness among the public.

State wise and/or sector claims settled data would give more insights on the performance of the scheme. The table below shows the top 7 states which has utilized the coverage under CGTMSE scheme.

Top 7 States to utilize CGTMSE fund				
State/Union Territory	**GDP 2007-08(Cr)**	**GDP 2008-09(Cr)**	**CGTMSE (Cr)**	**CGTMSE %**
Uttar Pradesh	344,346	398,732	312.07	6.54
Kerala	162,415	162,415	354.27	7.42
Gujarat	306,813	0	376.77	7.89
West Bengal	303,705	0	404.97	8.49
Maharashtra	590,995	NA	418.79	8.78
Karnataka	238,348	271,902	615.26	12.89
Tamil Nadu	304,989	339,212	646.99	13.56
Sum total			**3129.12 cr**	**65.57 %**

Top 7 states that have utilized the funds better than others in line with the expectation – these are also the top 7 industrially sound states. The awareness of the MLI functionaries need to be increased in the lower rung states so these can benefit from the scheme as well.

The cumulative loan coverage for different sectors by CGTMSE for the year ending 2009 is shown below (figure 4). Manufacturing industries enjoy the major chunk of coverage while service sectors are still considered risky and the loan disbursement to this sector is fairly low.

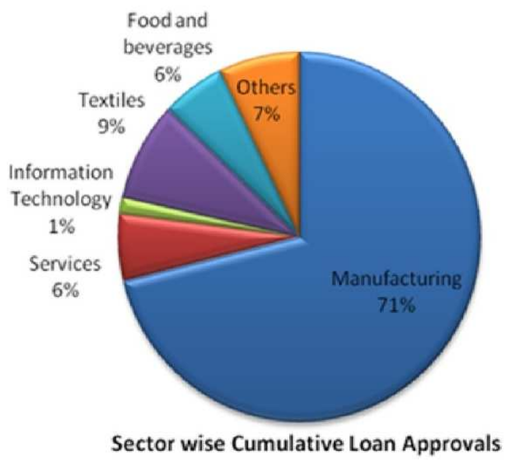

Figure 4: source 9th Annual Report CGTMSE

Interviews with lending institutions and beneficiaries in FY 2010 revealed further insights. Lending patterns across banks revealed some useful data. Only 5% of the loans were disbursed to start-ups (less than 2 years) and majority of the disbursements were for primarily existing clients whose risk profiles were very well known. Most beneficiaries would have obtained the credit as a term loan too, hence raise questions on intended risk-behavior changes in the lending institutions. From a principal-agent perspective, the major weakness was the principal (CGFTMSE) not asking the financial institutions (agents) to use a different scoring model for start-ups and established firms or even across various industrial sectors. The result, many a needy entrepreneurs could not access the credit as on several parameters such as DSCR, leverage, etc, their business plans fell short of the traditional lending norms. Most significantly affected were high technology and capital intensive sectors such as alternative energy projects. CGFTMSE has to bring out new norms favorable to start-ups to improve financial availability.

Conclusions:

What changes should be brought about to improve financial availability. The current coverage of credit guarantee must be raised from Rs 100 lakhs to Rs.300 lakhs for certain capital intensive industries and accordingly the norms for project appraisal should be revised industry-wise. Another omission in the existing scheme is support to SHG's. While limited and partnership firms are eligible for CGSTME funds, SHG's (with their memberships limited to 20) are not covered. Financial institutions feel SHG's with their peer-pressure norms and excellent history of repayments could increase the reach of the scheme. Currently, trading, training institutes and educational organizations are excluded under CGSTME scheme. With a growing need for private institutions in the training and educational arena and a burgeoning population, these enterprises are less likely to fail. From a gender perspective, women-led enterprises accessing the scheme were few and far. To ensure more women-led enterprise inclusion, CGSTME can reduce the upfront fee by 1% and annual service fee to 0.5%.

One major weakness that needs to be addressed is the awareness of the program. Many in the industry perceive this to be “subsidy” or a government-scheme (with all its unintended message of get and shove). Awareness at industrial incubation centres, even at institutes of higher learning such as National Institutes of Technology, and other autonomous institutions is pretty low. Industrial associations have been the primary channel used till now to inform and educate the SME about the credit fund. Many members of these associations would otherwise be the target for other schemes and hence training Institutes, colleges and other student bodies should be targeted to raise the awareness among the public. It is desirable that CGTMSE evolves into to a more comprehensive, financially self sustaining credit guarantee mechanisms with improved feedback mechanism in place.

Yet another area that may need consideration is the operating model CGSTME may have to pursue to increase financial and economic availability. Guarantee agencies adopt a portfolio model or a closed model to enhance the performance of the scheme. In a “portfolio model”, the guarantor does not approve single loans, but a criterion is set for guaranteeing loans. The criterion may vary according to the target group. For example, the criterion for capital intensive sector will be different from a sector which has high working capital requirement. In a “closed model”, a specific target group is identified for guarantee cover. For example, in India, north eastern region or women entrepreneurs can be a target group. Falling under this category qualifies them for a guarantee subject to meeting of the criterions. Different kinds of assistance can also be given to the entrepreneurs who avail guarantee under this scheme. Not being part of the specific target group will exclude that borrower automatically from the fund. First generation entrepreneurs who generally do not have a credit rating on the business are still unable to get loans under this scheme.

The benefit of the CGSTME scheme is clearly visible with the number of proposals and the amount of loans that has been disbursed under this scheme. Further improvements would only increase an inclusive growth and economic development. There are however many fine tuning improvements that needs to be done to the scheme to make it more successful in attaining its vision. Awareness creation is a very important aspect and this needs to be done in many states which have not used this scheme effectively. Educating about this scheme both within the MLI functionary community and as well as to the business community is very crucial.

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