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SMALL STEPS FORWARD

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

The committee set up to undertake a comprehensive review of the micro, small and medium enterprises (MSME) sector, which has submitted its report to the RBI, has examined issues such as access to finance and infrastructure bottlenecks that continue to plague the sector. Broadly, its suggestions are well-judged.

Lack of access to finance continues to be an impediment to the sector's growth. Bank lending continues to be disproportionately geared towards large entities, leaving a huge funding gap for MSMEs. The committee traces this skew to two factors — high level of non-performing assets (NPAs), and high cost to servicing. Typically, banks tend to restrict credit flow to MSMEs, discouraged by the high level of bad loans, which range between 8 to 11 per cent. A major reason for these bad loans is delay in buyer payments. MSMEs struggle to recover their dues from both the private and the public sector. To address this problem, the committee has suggested that public sector procurement from MSMEs be routed through the GeM portal to bring transparency in procurement and to quicken payments. This, if monitored closely, could help shorten the payment cycle considerably. There is also the suggestion that the MSME development act be amended to ensure that all MSMEs mandatorily upload their invoices to an information utility, which will display names of defaulting buyers. This, it hopes, could "act as a moral suasion on buyers", ensure timely payment, and thus minimise NPAs. But this is easier said than done. Big companies, with greater bargaining power, are likely to continue to stretch out the credit cycle. There is also the issue of documentation. Banks are wary of lending in the absence of detailed financial information as it makes assessing credit worthiness difficult. The problem is compounded by lack of collateral. To address this issue, the committee proposes a novel approach. Rather than relying on the traditional balance-sheet based funding route, it has proposed shifting to a cash flow based lending model. This not only provides greater clarity on the payment capacity of firms, but can also help in determining the repayment schedule.

The committee has also suggested doubling the collateral free loan limit to Rs 20 lakh, up from the current limit of Rs 10 lakh. While the move could address the sector's cash flow issues considerably, coming at a time when concerns are being voiced about the true extent of bad loans under Mudra, this could be a risky proposition.

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