

# INDEX

## Page No.

### I. Address of the President

17

### II. Articles :

- 1) Charting New Paths For Business Development Services To MSMEs 20
- 2) Risk Capital To Drive India's Entrepreneurial Engine 24
- 3) Private Equity Best Practices In Emerging Markets 26
- 4) Major Schemes Of National Small Industries Corporation Limited (NSIC) 29
- 5) IamSMEofIndia 31
- 6) Factoring - A New Perspective 35
- 7) Role of Incubators In Supporting Start Ups 38
- 8) New Business Model of SIDBI to Address Gaps in MSME Eco System 40
- 9) Need of The Hour Is For Social Entrepreneurs 43
- 10) Importance of The MSME Sector And The Role Of SFCs In Financing This Sector 47
- 11) SME Platforms : New Option For MSMEs To Raise Risk Capital 49
- 12) MSME Financing: Need For Innovation 53

### III. Outstanding Entrepreneurs" Financed By The State Level Financial Institutions (SLFIs)

- 1) M/s AMARA RAJA BATTERIES LTD. (APIDC, Hyderabad) 57
- 2) M/s PENNAR INDUSTRIES (APIDC, Hyderabad) 58
- 3) M/s NEOSPARK DRUGS & CHEMICALS PVT. LTD. (APSFC, Hyderabad) 59
- 4) M/s EQUIC DIES & MOULDS ENGINEERS PVT. LTD. (APSFC, Hyderabad) 60
- 5) M/s VALERY ENTERPRISE (AFC, Guwahati) 61
- 6) M/s AL KARMA (DFC, New Delhi) 62

7)	M/s SARK INDUSTRIES, (DFC, Chandigarh Branch)	63
8)	M/s SMARTLINK NETWORK SYSTEMS LIMITED (EDC Ltd., Goa)	64
9)	M/s GKB HI-TECH LENSES PVT. LTD. (EDC Ltd., Goa)	65
10)	M/s KASHMIR CABLE INDUSTRIES (J&K SFC, Srinagar)	66
11)	AMAR HOTEL (J&K SFC, Srinagar)	67
12)	M/s MAHINDRA REVA ELECTRIC VEHICLES PVT. LTD. (KSFC, Bangalore)	68
13)	M/s PATTABHI ENTERPRISES (KSFC, Bangalore)	69
14)	M/s CML BIO-TECH PVT. LTD. (KFC, Kerala)	70
15)	M/s SAGARA BEACH RESORT (KFC, Kerala)	71
16)	M/s ITL INDUSTRIES LTD. (MPFC, Indore)	72
17)	M/s PERMALI WALLACE PVT. LTD. (MPFC, Indore)	73
18)	M/s UTKAL GALVANIZERS LTD. (OSFC, Cuttack)	74
19)	M/s DUKE FASHIONS (INDIA) LTD. (PFC/PSIDC, Chandigarh)	75
20)	M/s RAUNAQ AUTOMOTIVE COMPONENTS LTD. (PICUP, Lucknow)	76
21)	M/s APPASAMY OCULAR DEVICES PVT. LTD. (PIPDIC, Pondicherry)	77
22)	M/s POLYCON INTERNATIONAL LTD. (RFC, Jaipur)	78
23)	M/s CHITTLANGIA COTTON GINNING & PRESSING FACTORY (RFC, Jaipur)	79
24)	M/s DIETECH INDIA PVT. LTD. (TIIC, Chennai)	80
25)	M/s KALPAKA CHEMICALS PVT. LTD. (TIIC, Chennai)	81
26)	M/s EKO DIAGNOSTIC PVT. LTD. (WBFC, Kolkata)	82
27)	M/s ATC LOGISTICS PVT. LTD. (WBFC, Kolkata)	83

**IV. List of Member Corporations of COSIDICI 84**

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## ADDRESS OF THE PRESIDENT

The Council of State Industrial Development and Investment Corporations of India (COSIDICI) is a national federation of state level financial and investment corporations comprising 18-State Financial Corporations (SFCs), 29-State Industrial Development Corporations (SIDCs) and 9-State Infrastructure Development Corporations (SIICs) engaged in promotion, development and financing of industry in small, medium and large sectors, besides developing industrial infrastructural facilities like industrial estates, industrial parks, industrial townships, etc. Established in 1976 the main objective of this national federation is to provide a platform to these SLFIs for addressing their common issues and influencing the policies having a bearing on the development of this sector. It also co-ordinates and integrates the activities of its member corporations and has been providing and arranging means and facilities for dissemination of knowledge and information relating to promotion and development of industries and for exchange of views and ideas on subjects of common interests. For accomplishment of these objectives and with a view to having a direct communication link with the corporations, COSIDICI has been publishing a bi-monthly journal titled 'COSIDICI COURIER' since 1978 which has achieved a wide readership among the government circles and financial institutions. COSIDICI has also been organising training programmes in collaboration with RBI, SIDBI and its Member Corporations to enhance the core skills of the officers of the SLFIs, so as to increase their level of preparedness to face the challenges thrown by the changing economic scenario.



**Shri Yaduvendra Mathura, IAS**

The State Level Financial Institutions (SLFIs) were created for fulfilling certain critical socio-economic obligations of the State like entrepreneurial development, employment generation, and balanced regional development resulting in inclusive growth and removal of poverty. They have played a pivotal role in the overall promotion and development of the MSME sector which has emerged as a highly vibrant and dynamic sector of the Indian economy. It contributes about 45 per cent of the manufacturing output and 40 per cent of total exports of the country and employs about 69 million persons in over 29 million units throughout the country. While SFCs have been concentrating on financing of small scale and medium scale industries in the states, SIDCs on the other hand have largely been responsible for creating and developing infrastructure facilities like industrial estates, industrial parks, housing complexes for industrial workers as also setting up of SEZs in certain states. The SFCs & SIDCs have helped to decentralize economic development and created employment opportunities by assisting and handholding first generation entrepreneurs, artisans, crafts persons, SSI units which are using simple to the most sophisticated technology. These units have contributed to the States' exchequer by way of sales tax, local duties etc. besides generating jobs. Thus they have been a strong vehicle of economic development in the States leading to balanced industrial development. Being state sponsored institutions they are well versed with local needs and aspirations. Their trained personnel and indepth knowledge of the State Government Policies, local conditions and opportunities allows them to manage and support resources effectively to achieve meaningful and sustainable results thus enabling the country to achieve its development objectives. It is a fact that some of the units financed by SFCs in the country have over-time become very big industrial groups viz. Infosys, Biocon, Dr. Reddy's Laboratories, Cremica Industries etc. The SFCs were performing very well but their fortunes declined after opening up of the economy in 1990s since the economic reforms did not embrace these DFIs. The SFCs suffered owing to indifference

on the part of stake-holders in providing cheap and adequate resources to SFCs and consequently, their inability to compete with commercial banks which have access to cheap public deposits. Keeping in view the strategic importance of SFCs the Government of India had provided a financial package through SIDBI in the year 2003. This package provided by SIDBI to these SFCs yielded positive results and has helped some of the SFCs turnaround and show better performance. However, the steps taken by the respective State Governments as also the SFCs have not been uniform and to the extent required. While some of the SFCs have implemented most of the improvement measures, others have partially implemented them. This has resulted in less than optimum improvement in the performance of these SFCs. Their viability is primarily dependent upon the cost of their funds. If SFCs have to function as viable units, they must get sufficient resources at affordable cost so that they can compete with the commercial banks and also continue to perform their developmental role.

In order to re-strengthen the State Financial Corporations and to enable them to play their role side-by-side with SIDCs for over all economic development with focus on the MSME sector, the following measures are proposed : -

1) Strengthening of the Equity base by Infusion of fresh capital :

The respective State governments and the Central Government are the main stake-holders of SFCs. The SFCs Act, 1951 being a Central Act was amended by the Central Government in the year 2000. The Gupta Committee set up by the Government of India in 2000 (under the Chairmanship of the then CMD, IDBI, Shri G.P. Gupta) opined that it was imperative to strengthen these institutions which provide assistance to the entrepreneurs in MSME sector who are overlooked by the commercial banking sector. One time recapitalisation of SFCs to make them positive networth with adequate share capital is, therefore, essential. The Central and the respective State Governments may, therefore, work out a formula for sharing their recapitalization cost. The Government of India has been providing liberal financial support to other growth drivers viz. Scheduled Commercial Banks (SCBs), Cooperative Banks and RRBs. The Central Government has already come forward with capital infusion of Rs.15,000 crore for strengthening cooperative banks in the country. With regard to the capitalization of commercial banks, the Central Government would need to infuse over Rs.90,000 crore, over the next 3-5 years.

2) Developing a Robust Business Model - wherein the SFCs alongwith SIDCs partner each other to meet all financial and non-financial needs viz. term lending, factoring services, venture funding, non-financial advisory services, industrial infrastructure including one window clearance of projects. This would require new skills, induction of professional manpower, continuity of top management, and running these organisations on purely professional and commercial terms to enable them to build up a strong and good portfolio which gives them adequate profitability to continue their activities over the years to come;

3) These Corporations do not have access to public deposits [as they are not a banks/NBFCs]. Therefore, they require assured sources of finance which could be as under : -

- a) Market funding through bonds which could initially be guaranteed by the respective State Governments so as to bring down the costs of funds.
- b) Refinance from All India Financial Institutions like SIDBI, NABARD, NHB etc.
- c) RBI may allow SFCs to raise funds through SLR bonds and also restore temporary borrowing

- facility against adhoc bonds. These facilities were available earlier prior to 2003-2004.
- d) RBI may allow Banks to treat loans sanctioned by them to SFCs for on-lending to Micro and Small Enterprises as eligible for priority sector status as was the case before the issue of its Master Circular dated July 05, 2011.
  - e) In the initial years, when the costs of funds is on the higher side, the respective State Governments may give interest subsidy of 1 - 2%, so that the final lending rates to SMEs by these corporations is both competitive as well affordable to the MSME sector. Once the SLFIs become strong institutions with high networth, the cost of funds raised from the market would come down and there would not be any need for industrial subsidy later on.

The Prime Minister has time and again stressed on the need for creating jobs and taking growth to all sections of the society and the SLFIs have excelled at this activity since their inception. The State Governments have also realised the importance of these SLFIs by making them the nodal agencies for their respective states for development of industrial infrastructure. They have developed a number of Industrial Model Townships/Industrial Estates at strategic locations in the States, set up International Airport through private investment; and also set up Industry-cum-Service Centres. Some of them successfully implemented resettlement programmes for the economically weaker sections. Many of them have set up Venture Capital Funds to support IT and other emerging sectors. To promote entrepreneurship, SIDCs are providing ready built up space on concessional rates. SEZs in the States have also been set up by these corporations to accelerate the pace of export of goods and services. The SIDCs provide complete and innovative support services to the MSMEs in the form of industrial infrastructure; finance; consultancy and other industry related assistance and thus play a major role in contributing towards the economic progress of the States.

However, the infrastructure work projects are getting delayed in States due to non-receipt of environment clearances consequently affecting the operations of SIDCs. It is, therefore, imperative that the Government of India may kindly help these corporations by expediting the process of environmental clearances.

The SLFIs as the Development Financial Institutions (DFIs) are the harbinger of change which has resulted in employment generation and economic activity. The revival of these Growth Engines would bring about the second round of development resulting in faster economic growth which is the need of the hour. Our Council, through its Member Corporations is dedicated towards servicing the building blocks of the economy viz. the MSME sector. Towards this end, COSIDICI today is poised to fulfill yet another one of its objectives viz. to institute Awards for outstanding and meritorious performance in the activities connected with development of industries. The aim of these awards is to honour entrepreneurs who have brought prosperity and laurels to our country by setting up successful enterprises. All these units have COSIDICI's Member Corporations viz. SLFIs as a common thread running in them i.e. they started their industries with a loan from the SLFIs in their respective States. These awards have a pan India presence in as much as the units being awarded have been chosen from all corners of the country. Though they started small they have become industry leaders today and are, therefore, a source of inspiration for many an entrepreneur. We hope to continue with our efforts to showcase the hard work of our entrepreneurs in future also so as to recognise their contribution to society and the Nation at large.



**Shri Yaduvendra Mathur, IAS, President, COSIDICI is at present Chairman & Managing Director, Rajasthan Financial Corporation (RFC), Jaipur**

# CHARTING NEW PATHS FOR BUSINESS DEVELOPMENT SERVICES TO MSMEs

V.S. Rathore & R K Singh\*

## MSME Sector in India

The Micro, Small and Medium Enterprises (MSME) sector is an important pillar of Indian economy as it contributes immensely to the growth of Indian economy with a vast network of around 30 million, creating employment for around 7 million manufacturing more than 8,000 products, contributing about 45% to manufacturing output and about 40% of exports, directly and indirectly. MSMEs are the driving force behind a large number of innovations and contribute to the inclusive growth. In India MSE sector attracts priority status. Considering the sector's significance, Government of India has been taking several measures to strengthen the MSME eco system.



Shri V.S. Rathore

## Paradigm shift in SME sector

There is a paradigm shift in Indian MSME domain which needs to be taken into account for evolving strategies to serve the sector. The MSME sector has been witnessing structural progression with paradigm shifts - from Protection to Promotion, Regulatory to enabling Environment; Subsidy Oriented Supports to Participative; Economic-Enterprise Growth to Sustainable-Inclusive Growth and Comparative to Competitive.

The various stakeholders of MSME sector are orienting and gearing themselves to attend to sectors' changed expectations.

SIDBI, the Principal Financial Institution for the promotion, financing and development of the Micro, Small and Medium Enterprise (MSME) sector and for co-ordination of the functions of the institutions engaged in similar activities. SIDBI attends to the entire value chain and supports initiative ranging from setting up to stepping up. In order to address diverse issues and problems of the MSME sector which are generally not attended to by banks and other institutions, SIDBI reoriented its business strategy towards filling up the financial and non-financial gaps in the MSME eco-system. The financial gaps which are being addressed by SIDBI are in the niche areas like risk capital/equity, sustainable finance (promoting energy efficiency and cleaner production technologies in the MSME sector), factoring & reverse factoring, service sector financing through tailor-made products, etc. This way, SIDBI would be complementing and supplementing the efforts of banks in meeting the diverse credit needs of MSMEs.

## Developmental Initiatives :

In the overarching framework of MSME eco-system, capacity building of MSME sector is an important component which includes technology development, marketing infrastructure, cluster development, skill development, entrepreneurship development etc. while a lot has been written on financial services to MSMEs and general capacity building measures,

## **Business Development Services (BDS)**

This article focuses on a very important initiative of market driven Business Development Series (BDS) under a unique project – the “MSME Financing and Development Project [MSME – FDP]” implemented by SIDBI with support/cooperation from the World Bank, DFID (UK) and KFW & GIZ (Germany) as partners.

### **BDS – Market development in Clusters**

Business Development Services are wide range of services used by entrepreneurs to help them operate efficiently and grow their businesses. It includes training, consultancy and advisory services, marketing assistance, information, technology development and transfer and business link promotion as also financial services. The BDS field focuses on promoting access to and use of these services by MSMEs. The BDS market development believes in the theory that once BDS are capacitated and are successful in satisfying the needs of MSMEs, the market rejuvenates. By using services, MSMEs get growth impetus and subsequent profit. They seek more services of BDS and as profitability of service provider goes up it attracts other players.

BDS as we have seen above are critical services (transactional, strategic, and embedded) for survival and growth of MSMEs. Project successfully carried forward the mandate of market development of Business Development Services (BDS) so that these continue or are replicated later on sustainable basis. The project endeavoured to match the demand and supply of BDS (both institutional and individual) and thus trigger functionality in market forces so that services are available on sustainable basis.

Under the project, SIDBI has supported soft infrastructure creation in around 25 clusters by fostering market oriented Business Development Services (BDS). Each adopted cluster was mapped through diagnostic study and action plan to attend to the thematic issues were implemented in consultation with stakeholders. Under the programme, viability gap funding to developmental institutions, voucher support to MSMEs/BDS, etc. was provided. The adopted clusters were in sub sectors of Leather, Floor covering, Engineering, Fruit & vegetable Processing, Textile, Chemical & Pharma. The project contributed to systemic change by developing sustainable and technically competent - locally relevant experts (410 BDS -both individual/ Institutional) & enabling national/ international compliances by over 1950 MSMEs in these clusters. These have been achieved through 960 activities (cumulatively since 2006-07), over 1453 transactions (voucher supported, which were found to be replicated later on without project support, indicating functionality of market for BDS). The thrust has been on micro enterprises for inclusive growth ( with social impact) and instilling competitiveness through market driven initiatives.

### **Few important support areas under BDS intervention included :-**

- National Level Mentoring to MSMEs – An online portal [www.msmentor.in](http://www.msmentor.in) for availability of right Professionals / service providers has been supported.
- Rural entrepreneurship- Taking the agenda of rural enterprise forward, the project has supported BDS aligned Rural Industrialisation Programme (RIP) in 2 pilot locations in underserved states of Rajasthan and Orissa.
- Micro Enterprises Business Information Counselors (MEBIC) - In order to foster entrepreneurship within micro enterprises of underserved regions, the Project took an initiative for developing a cadre of BDS providers for counseling, initial handholding and development of micro enterprises in North-Eastern region as Micro Enterprise Business Information Counselors (MEBIC). More than 1200 prospective entrepreneurs were provided counseling services till June 2012.

**A brief write up of the successful BDS intervention and transformation of Allepey Coir Cluster carried out by Shri Jagat Shah of Cluster Pulse under the project is presented here :**

### **Transformation of Allepey Coir Cluster**

Allepey, also known as Alappuzha is the largest coir (natural fiber extracted from the husk of coconut) cluster in Kerala. The cluster has 45,000 yarn manufacturers, 25 large firms, 9,700 MSE manufacturers and 250 SME finishers. The turnover of the cluster was around Rs.2000 crores. Looking to the size of the cluster, the Alappuzha Business Development Services (BDS) project was taken up with a noble cause of improving productivity and lives of workers involved in this coir industry cluster.

**An Ahmedabad-based international non-profit NGO, Cluster Pulse's efforts to introduce mechanization in coir rope industry has changed the lives of thousands of people, especially women, connected with coir rope industry, in Alapuzha.**

#### **Problems before Project intervention:**

- Despite having around Rs.2000 crores turnover, the coir cluster was functioning traditionally, not knowing its potential.
- The manufacturing process of spooling and weaving was a manual process and was physically very strenuous. The workers, mostly women used to stand, tie the raw material around their waist and walk for hours in the shed (almost 10 to 12 km) to produce about 8-10 kg of coir per day. The traditional spinning ratt, they were using required two to three women to operate it.
- No serious efforts were made to enhance productivity and quality of trial products. Introduction of new technology and marketing skills were never on agenda.
- Many weavers were of the opinion that they need small technology changes in looms which would improve production and work environment.
- Nothing was done till the beginning of the year 2007.

#### **The Allapuzha BDS was implemented from Feb 2007 to Nov 2011.**

The project started with diagnostic study to understand need of MSMEs and workers. Within a month, it was found that

- ❖ low productivity was due to inefficient technology.
- ❖ There was limited access to modern management techniques including IT enabled services.
- ❖ Enhancement of quality to tap newer market was never on agenda.
- ❖ There was complete lack of focus on marketing.

An important outcome which came during the study was that in order to run a traditional unit, at the minimum, a 50 feet shed worth Rs 85000 was required. Besides, younger generation was shying away from the cumbersome coir industry. There was urgent need for increased mechanization to enhance production and reduce physical work.

The project started with few seminars and workshops on coir design and IT awareness. First B2B portal was also launched from the cluster. First time ever, branding strategies were devised.

#### **Spinning Ratt mechanization :**

Simultaneously technical experts were also given assignments to develop user-friendly Spinning Ratt. Following

frequent visits to various MSEs and a detailed study, the experts suggested development of a semi-mechanized Spinning Ratt.

The first version of Spinning Ratt introduced by Cluster Pulse did not require workers to walk, they could simply stand and operate the spinning ratt. Unlike traditional one where three workers were required, only one worker was needed to operate it. With this, shed was not at all necessary. However, the issue of quality was not addressed, as it remained the same.

After three months, second version of Spinning Ratt was introduced, which was more comfortable as workers would sit and operate on it, space saving was achieved but productivity did not improve. Raw material input was manual just like previous one.

When third version was introduced, MSEs experienced double output compared to the traditional one. Quality also improved, but it was not enough. Cluster Pulse experts wanted to introduce a Spinning Ratt which can produce world class products that would be acceptable in the international market.

Finally fourth version with important alterations was given to the units. The Spinning Ratt was designed in such a way that it was occupying lesser space and one person could easily handle two Ratts at a time. Unlike prior versions, raw material input was semi-automated. This version addressed both the issues of quality and productivity. The quality of yarn was extremely high with little variation. Productivity almost doubled compared to traditional method of making coir products.

#### **Achievement :**

When the project completed in 2011 end, lives of thousands of weavers transformed remarkably. Their family income increased. Instead of walking around whole day in scorching heat, the environment was comfortable and pleasant.

The transformation was not limited to workers and weavers only. Owners of MSMEs have different thought process now. Just 5-6 years back, they used to target domestic markets only, mostly nearby places. Now, the SMEs are seeing global opportunities. Some of them have already started exporting coir products and many are preparing themselves to plunge into international trade. The turnover has increased to Rs.2900 crore.

Founder of Cluster Pulse, Jagat Shah says, "The revolutionary change in Allepey through the project has touched the lives of more than 200,000 people. Apart from the weavers and owners of looms, lives of their family members have also changed for better. Technology intervention put the cluster on world map as they started producing world class products. Another achievement of the intervention - One unit in the cluster joined hands with the project to make World's largest Coir Mat....."

## **Conclusion**

Making Market Work for MSMEs (through BDS market development Indian clusters), initiating innovative concepts, such as, Public Private Partnership, Voucher support, Business Counselor in Northeast, creation of National Level database of BDS providers, BDS clinic, BDS Bazaars, BDS on wheels Cluster level websites linked with mother website. Critically, it is estimated that the funded SMEs have improved their competitiveness, compliances and capacity to deliver better and as attuned / oriented themselves to market expectations. The project results have established that, in clusters, where soft infrastructure ( in form of sustainable and locally available BDS) supplements hard infrastructure (physical facilities such as common facility centres) , the growth pattern is significant.

MSMEFDP has been a trend setter project which continues to contribute to change the way financial and non financial services for MSMEs are attended to in a sustainable way. The international partners have

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# RISK CAPITAL TO DRIVE INDIA'S ENTREPRENEURIAL ENGINE

Padmaja Ruparel\*

India needs to create 10-15 million jobs per year for the next decade and entrepreneurship is crucial for such large-scale employment generation. Entrepreneurship converts job seekers to job creators, is innovation-driven, will also help generate solutions to India's myriad social problems including high-quality education, affordable health care, clean energy and waste management, and financial inclusion. Entrepreneurship-led economic growth. India has the potential to build about 2,500 highly scalable businesses in the next 10 years, which will require at least 10,000 start-ups to be bred, generating revenues of \$200 billion.

## Risk Capital is critical to drive this entrepreneurial engine

1. Angel Investors : This is very high quality investment where high net worth investors invest in high quality startups. But angel investing is very nascent in India with only about 500 investors and US\$22mn of investment in 2011. In 2007, Angels in the US invested about US\$30bn.
2. Venture Capital : Over the last 5 years, early stage Venture Capitalists have invested about US\$1bn in early stage companies in India. This is miniscule. In the same period, US early stage VCs invested over US\$26 bn
3. Debts : Banks and Financial institutions are very wary of investing in startups in the absence of collaterals and low credit ratings are a huge disincentive for providing seed / early stage financing

The most critical investment is from Angels as they not only provide capital but also act as great scouts of emerging ideas, helping them scale at a stage where institutional seed and venture funds would typically not invest. They breed companies and nurture them for the next round investors - Venture Capitalists and Debt providers. For instance in the US angels invested close US\$30bn in close to 60,000 companies in 2007; in the same year, Venture Capital Funds invested a little under US\$25bn in close to 4,000 companies. This is the pyramid which is critical for breeding entrepreneurship and innovation.

The first time the concept of "Angel Investors", was referred to individuals who helped funding Broadway Entertainment several decades ago. In today's world, Angel Investors continue to play a similar role. Leading companies in the world like Google, HP, Amazon received initial investment from Angel Investors. Individual angels or In fact, the fabled Silicon Valley entrepreneurial eco system's major contributor are Angel Investors, they seeded the companies which Venture Capitalists then funded and help create leading ventures.

In India, Angel investing was brought to India by the Indian Angel Network, in 2006. Indian Angel Network, India's first and Asia's largest angel network, with over 200 investors, brings together successful entrepreneurs and CEOs who share a passion to enable more early stage businesses to create scale and value. By focusing on start-ups, the Network addresses the current acute lack of funds available to early stage companies. The Network believes that early stage businesses require more than just money to succeed. They require close mentoring and inputs on strategy as well as execution. These investors share a passion for entrepreneurship which creates value and wealth.

Angel Investing is the highest risk and highest gain asset class in an investor's portfolio. Investors invests in a promise - what the entrepreneurs project that can be achieved. The only thing that a venture is likely

to have is the entrepreneurial team - the only tangible on which the investor can lay his bet on. More often than not, there will be none or very few customers, no cash flows or assets, and an idea that may just be taking a tangible shape. Therefore the investors look for not the best of the best, but best of the next. And then explore ways of mitigating / reducing their risks. And this can be best done by investing through Angel Groups or investors coming together to choose their investments from a much larger deal flow, invest over a larger number of ventures across sectors, leverage fellow investors domain expertise, networks and mentoring and reduce the cost of investing using the services of a good Angel Network Secretariat. This is far better than individual investing as the risk just increases manifold.

For this private investment class of risk capital to grow, it is imperative that this new class of investment be recognized. Angel Investor Groups need to be encouraged as they can drive high quality money to genuine investment. Some critical steps could spawn many more networks :

- a. Accreditation of Angel Investor Groups so that genuine investors money can be leveraged for unlisted start ups / early stage companies with investors investing upto Rs. 5 crores per venture / Rs. 10 crores collectively per venture
- b. Angel Investor Groups be allowed to create Limited Liability Partnerships to be used as intermediate investment vehicles with a tax pass through effect.
- c. Angel Investors invest tax paid money and their investments should be given tax exemption like 100% tax exemption upto Rs. 1 crore. Many countries like Singapore, US etc. provide these incentives to angels to encourage investment in startups.

The author an Angel Investor, is today the President of Indian Angel Network (IAN). This "For Entrepreneurs, By Entrepreneurs" platform now has over 200 investors with a portfolio of 36 companies across multiple sectors and geographies; operating across 5 cities. She has established a unique model of an incubator, based on domain expertise and mentoring portfolio, which now has a portfolio of 26 incubatee companies, growing quickly to attract seed funding within 6 months of incubation.

# PRIVATE EQUITY BEST PRACTICES IN EMERGING MARKETS

Bert van der Vaart\*

Over the past decade, the private equity and venture capital landscape has changed considerably, especially in the so-called emerging and frontier markets (EM). Investors must not only be well-informed about the local markets in which they are investing, but must also understand how changes in other markets (developed and emerging) will affect their investments. For example, an investment in a single super phosphate fertilizer processing company in India turned out to depend for its returns on: 1) a change in the Indian fertilizer subsidy scheme; 2) the Arab Spring, which reduced access to phosphatic rock to the Indian market; 3) demand for food increasing not only in India but in China and the EM more generally; and 4) higher oil prices. Technology means that local markets are increasingly global, as mobile telephony's success in India and Africa has demonstrated. Gone are the days when investing in the best printer in an area with a radius of 100 km or in "appropriate technology" was sufficient.



Bert van der Vaart

The consumers embrace and discard new sectors, resulting in both greater winners and greater losers than before. Why were grocery stores a failure in 2008 India, but Flip Card and Domino's Pizza a huge success?

Furthermore, in the wake of the 2008 Financial Crisis, raising funds has proven to be an arduous task, especially for early / growth stage Companies, as financial markets across the globe continue to struggle with risk and collateral continues to be unreliable. So too is the path to exiting an investment a growing challenge, as trade sales, secondaries and management buyouts far outpace the former Holy Grail: the IPO exit.

SEAF has been investing globally in more than 25 EM countries, having made more than 380 investments at an average per investment size of roughly \$1.5 million by the end of 2012. What have we learned that could be of help to investors in SMEs in India in 2013?

## **It's All about the People**

First, no matter how trendy market or hot the sector, the most important aspect of an investment remains the owners and management of an enterprise. The strength, vision, willingness to adapt to dynamic business environment and persistence of the entrepreneur are paramount to success. Transparency is also a vital to build a culture of openness within the management team, and with the investors/ Fund managers. This will reduce the chance of surprises and misunderstandings down the road, and in the end save time.

## **Be Opportunistic**

Quality management may not be interested or available in exactly the sector an investor has identified as being interesting. However, often we find an excellent entrepreneur in a sector we had not really considered to be that interesting. A corollary of the "people first" rule is the need to stay opportunistic as to sector.

## **Know the Market(s)**

The Fund Manager MUST understand the culture and business practices of the market(s) in which he

invests. Proper research must be done on the regulatory framework relevant to industry/ sector/ geography. Some questions to consider include: Who are the other competitors? What are the active sectors? What role does which government entity play? What are the taxes, regulations, and rules that will affect business? Nor can we take for granted that one part of say Maharashtra will be exactly the same as another part of Maharashtra. Exports are even more difficult.

Despite its challenges, India continues to offer globally significant growth opportunities that can be leveraged in terms of investments as well as evolving new business models. India has a truly significant domestic market (or markets), with technological creativity that is potentially applicable in a great deal of (especially other EM) countries. Too often SMEs in India seek to offer their products or services to the UK or the USA. Indian companies may well compete there, but they could dominate markets in countries like Kenya or Vietnam.

Further, succeeding first in its domestic market will enable a company to succeed in other markets, with a secure base of business, as export markets are far more volatile (forex, changing laws and hidden rules). Further, the more similar the potential other markets are to the home market, in terms of success factors and competitive conditions, the likelier the success. While BPOs and certain high end export companies may be an exception, sustainable success normally requires a strong domestic base of business.

### **Value Proposition and Competitive Advantage**

SMEs are price-takers, that is, they cannot affect the market but must produce and sell their goods and services to customers on a voluntary basis. Therefore, neither our SMEs nor we as their shareholder can rest but must constantly test their respective value proposition, and their competitive advantages. What does the company bring to the table that its competitors do not? Is it replicable? How sustainable are these barriers to entry? Is the Company engaged in providing goods or services which the market "has to have" or merely something that is "nice to have"? "Have to have" companies are much more interesting in slower economic times.

"Nice to have" companies are much more dangerous over a long term. Further, how will the company innovate in order to maintain its value proposition? Will it need a great deal of capital or can it grow without requiring a great deal more equity?

### **Value Addition**

Entrepreneurs should perceive investors as "partners" and increasingly expect them to conduct them accordingly. In other words, fund managers need to provide "smart money" and continuously strive to "add value." What does this mean? In terms of private equity, this includes developing and executing growth strategy, building HR and MIS systems, ensuring effective corporate governance, providing a network to build scale, sharing experience and access to potential markets, complementing the skills of the entrepreneur and being a reliable partner in good times or bad. In our experience, fund managers may add a great deal of value; however, they may also destroy value, by for example not understanding the business of the company or not understanding or communicating well with the promoter. SEAF has found its more than 30 nationalities within its system, and its high quality local team coupled with experienced international officers to be the best way to hold each other accountable, and to be helpful to our invested companies.

### **Transparent Exit Paths**

Successful exits (mode as well as timing) remain a most critical issue for the Fund Manager. It is a misconception that the IPO (initial public offering) is the easy or "best" exit route within a limited investment horizon, especially for early/growth stage investments in Emerging Markets. As the national stock markets in most emerging countries are yet to be fully developed, there is often uneven appetite/ liquidity in the market for a small though growing business. Experience has shown that having the option to choose

over time between trade sales, sales to financial investors and management buyouts, provide an investor with the necessary flexibility to exit its investment. It is also critically important to discuss "early and often" with the promoter and management team the different kinds of exits available, both to set mutual expectations as well as to work together to achieve the best joint result.

### **Indian Specific Factors**

India presents an enormous opportunity with a generation of young, educated and ambitious workforce that is expanding the entrepreneurial landscape while also forming a large consumer base. However, this market also faces similar challenges to its other emerging markets peers, although to different degrees.

Certainly the Government of India is a mixed blessing. Though Government often intends to do the best for the people, it often cannot see the unintended consequences of its actions.

With major reforms measures in the offing, the investment climate and sentiment are expected to improve. Implementation of Direct Tax Code, IFRS, GST, greater clarity on Taxation (GAAR) and policy reforms (FDI etc) should provide another boost in economic prospects.

### **India Specific Considerations**

Although SEAF has been active in India for almost 10 years and is blessed with an excellent local team and top partners like SIDBI and TDB, we take great care NEVER to believe that we understand India. Constant vigilance with respect to the understanding and alignment of mutual interests is vital, with both India's rich and varied culture and the importance of understanding what is important for its consumers complex and quickly (but not too quickly) changing. SEAF has sought to develop mezzanine and venture debt-like instruments, to complement its straight equity products, and it will continue to develop such products in accordance with the laws and the understanding of the entrepreneurs.

*SEAF is proud to be investing in one of the most dynamic and creative countries of the world. We look forward to working with Indian SMEs to grow their businesses not only in India, but when appropriate in other countries around the world.*

SEAF established in 1989 is an investment management group that provides growth capital and business assistance to small and medium enterprises (SMEs) in emerging and transition markets underserved by traditional sources of capital. A healthy SME sector is considered vital to both provide for the needs of consumers, as well as to generate a robust boost in employment. SEAF, therefore, invests in entrepreneurs to seek to build successful businesses, hoping to realize both attractive returns for its investors and a measurable development impact in local communities.

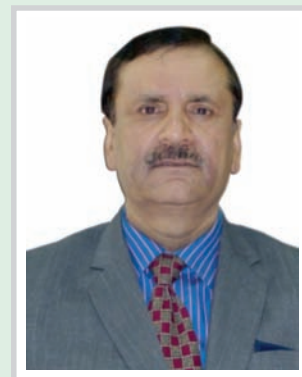
**Bert van der Vaart** is one of two co-founders of SEAF ([www.seaf.com](http://www.seaf.com)) in 1989, and served as Director-General of its first fund in Poland. Becoming its CEO in 1997, Mr. van der Vaart led the growth of SEAF to more than \$740 million in assets, 32 investment funds (20 currently active), with operations throughout Central and Eastern Europe, Latin America, Asia and recently Africa. He lived in New Delhi from August 2010 through February 2012, in leading SEAF's India Agribusiness Fund, and has served on the investment committee of the Kotak India Growth Fund since 2004. He holds degrees from Yale Law School, Oxford University, and the University of North Carolina.

# MAJOR SCHEMES OF NATIONAL SMALL INDUSTRIES CORPORATION LIMITED (NSIC)

Dr. H. P. Kumar'

National Small Industries Corporation Limited (NSIC), an ISO 9001 certified company established in 1955, is engaged in providing support for the growth and development of micro, small and medium enterprises (MSMEs) in the country. NSIC provides integrated support services encompassing marketing, technology, credit facilitation and other services to enhance the competitiveness of MSMEs through its large network of 150 offices spread across the country.

The major schemes / programs of the Corporation are briefly explained here below : -



Dr. H. P. Kumar

## I. Marketing Support:

### (i) Government Purchase Program:

NSIC operates a Single Point Registration Scheme under Government Purchase Programme, wherein the registered Micro & Small enterprises get various facilities like tender set free of cost, exemption from payment of Earnest Money Deposit, Price matching option to the MSEs quoting price band of L-1 plus 15%, Advance intimation of tenders issued by DGS&D and Issue of competency certificate in case the value of an order exceeds the monetary limit, after due verification.

### (ii) Raw Material Distribution

NSIC has made arrangements with bulk manufacturers for facilitating MSME sector in getting the raw materials. NSIC procures the raw materials in bulk by pooling the requirements of the micro, small & medium enterprises and distributes the same enabling them to avail the economies of scale. These arrangements help the micro & small enterprises to get the material with ease, bring down their inventory cost and also arranging to provide them closer to their works. In case they need any credit support, NSIC facilitates procurement of raw materials on credit.

### (iii) Consortia and Tender Marketing

Micro & Small Enterprises in their individual capacity face problems to procure & execute large orders, which inhibit and restrict their growth. NSIC, accordingly adopts Consortia approach and forms consortia of units manufacturing the same products, thereby easing out marketing problems of micro & small enterprises. The Corporation explores the market and secures orders for bulk quantities. These orders are then distributed to micro & small units in tune with their production capacity.

### (iv) Exhibitions/Technology Fairs/Buyer Seller Meets/ Marketing Campaigns/ Seminar

To showcase the competencies of Indian MSMEs and to capture market opportunities, NSIC participates in select International and National Exhibitions and Trade Fairs every year. Participation in these events at concessional rates exposes micro & small enterprises to international practices and enhances their business prowess. NSIC also organizes buyer-seller meets to enrich micro and small enterprises' knowledge regarding terms and conditions, quality standards etc required by the buyers. Bulk and Departmental buyers such as Railways, Defense, and large companies are invited to such meets. In addition various marketing campaigns and

seminars are conducted to spread the information regarding the various schemes available for the benefit of micro and small enterprises.

## **II. Credit Support:**

### **(i) Finance through syndication with Banks**

In order to ensure smooth credit flow to micro, small & medium enterprises, NSIC has entered into strategic alliances with commercial banks to facilitate long term / working capital financing of the small enterprises across the country. The arrangement envisages forwarding of loan applications of the interested micro, small & medium enterprises by NSIC to the banks and sharing the processing fee.

### **(ii) Performance and Credit Rating Scheme**

NSIC, in consultation with Rating Agencies and Indian Banks' Association, has formulated 'Performance & Credit Rating Scheme' for micro & small enterprises. This scheme was launched by the then Hon'ble Union Finance Minister and Hon'ble Union Minister of SSI & ARI in April, 2005 in New Delhi. NSIC has been appointed as implementing agency to carry out this scheme on behalf of the Government.

Performance & Credit Rating Scheme is aimed to create awareness amongst micro & small enterprises about the strengths and weakness of their existing operations and to provide them an opportunity to enhance their organizational strengths and credit worthiness. The rating under the scheme serves as a trusted third party opinion on the capabilities and creditworthiness of the small enterprises. An independent rating by an accredited rating agency has a good acceptance from the Banks/Financial Institutions, Customers/Buyers and Vendors. Under this Scheme, rating fee to be paid by the small enterprises is subsidized for the first year only and that is subject to maximum of 75% of the fee or Rs. 40000/-, whichever is less,

## **III. Technology Support**

NSIC offers micro and small enterprises the following support services through its Technical Services Centres by way of Material testing facilities through accredited laboratories, Product design including CAD, Common facility support in machining, EDM, CNC, etc., Energy and environment services at selected centres, Classroom and practical training for skill upgradation

## **IV. Other Support Services**

### **(i) B2B & B2C Portal**

MSME Global Mart ([www.msmemart.com](http://www.msmemart.com)) is a new endeavor to facilitate marketing services across the country and connect MSMEs with the buyers and suppliers all over the world. It provides online platform for B2B & B2C marketing. Major features of [www.msmemart.com](http://www.msmemart.com) are Interactive & sector specific large database of MSMEs, Online global & national tender notices and alerts, Self web development tool and other B2B facilities, Payment gateway for membership subscription, Global Trade leads from trusted international sources, Online buying / selling.

### **(ii) Training-cum-Incubation**

NSIC has been setting up Training cum Incubation Centres all over the country. The aspiring entrepreneurs are provided integrated services in the areas of skill upgradation training, preparation of project reports, identification of plant and machinery, imparting technical training and credit facilitation in order to boost the development of micro & small enterprises and create employment opportunities.

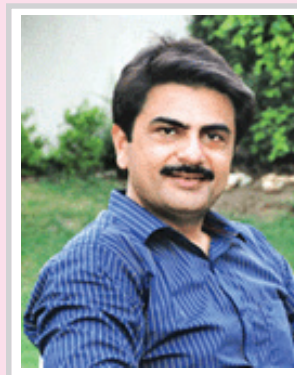
*\* The author is a Chairman & Managing Director, NSIC.*

# IamSMEofIndia

Rajive Chawla\*

**F**aridabad Small Industries Association (FSIA) started in the industrial hub Faridabad in 1977, and worked like many other regional SME Association. The association was formed with great aspirations by the most enterprising individuals representing enterprises of national prominence. Due to their intense participation and engagement, within a few years it has become one of the largest and most vibrant associations in India being recognized all over the world for its continuous contribution and efforts.

As they grew in numbers and experience, it was realized that they must transform themselves to an organization that not only raises and highlights the problems & issues concerning the MSME sector, but also becomes a Center wherein growth & development of MSMEs is facilitated as well as stimulated through regular brainstorming sessions, seminars, workshops, training programmes etc.



**Shri Rajive Chawla**

It was observed through these interactions wherein questions were asked about maintaining relevance in ever changing times, that most of the entrepreneurs start lonely, work singularly, act separately. They face their situations, challenges, problems individually. Often they fail. Sometimes they overcome. Is it necessary that each one find their own solution? Can there be learning from others' experiences? Can there be a one-stop MSME Station where these solutions, standard or customized, are available readily?

Through these most burning and challenging questions and problems, they started identifying common problems and tried to find their solutions. It was quite evident for all to see that for every individual problem, there is a collective solution.

In light of these eye opening revelations and insights, they successfully created alliances in PPP (Public - Private Partnership) mode with various institutions and introduced innovative and path breaking services for MSMEs which directly benefit them in terms of bringing down their costs and help them save their time, energy and money by streamlining business essentials.

To share these benefits with more and more MSME and to reach out to others beyond the borders of city & region, an institution was created called Integrated Association of Micro Small & Medium Enterprises of India popularly known as, IamSMEofIndia.

It is an Institution created and run by progressive entrepreneurs to facilitate growth of present and future entrepreneurs and businesses.

Some of the activities and services of IamSMEofIndia are highlighted below. It is their continuous wish to form strong long-term alliances with MSMEs, strengthen network, build the capacity of MSMEs and facilitate their growth.

## **HIGHLIGHTS - KEY SERVICES AND DIRECT BENEFITS**

**DIRECT** Benefits through present Services and MoUs:

1. IamSMEofIndia keeps members **updated on the latest relevant information** through regular updates on Facebook, Circulars and News Letters.
2. **Collateral Free Credit upto Rs 75 Lacs for IamSMEofIndia members:**

IamSMEofIndia has signed MoU with Small Industries Development Bank of India (SIDBI) introducing a very special scheme of Collateral-free Equipment Finance upto Rs.75 lacs for Entrepreneurs, businesses and startups at low interest rates of 12.25%. To avail the benefit after applying, IamSMEofIndia helps in filling up of the Application Form, complete documentation etc. Their professionals evaluate and recommend limit upto Rs.75 lacs to SIDBI. This limit can be used in parts through the year for machines and approved assets.

Therefore, the applicants' present working capital limits are not misused for purchasing fixed assets. After 6 months, whatever one has used from this limit, is converted to easy instalments from 1 to 5 years. There is 15% capital subsidy on eligible items and many more features are inbuilt making the arrangement one of the most unique and beneficial financial solution available to MSMEs.

In fact, every existing and running unit, MUST ensure to avail this limit for emergency purchase of Machinery etc. and not misuse CC limits for purchase of fixed assets.

**3. Collective Bargains** for products and services entrepreneurs, enterprises and businesses use in common. This helps greatly in savings. *"Anything we buy, together we buy cheaper, better, easier".*

**a. Special Discounts for Members from L&T Insurance & Sivana Insurance:**

Through a very special arrangement of IamSMEofIndia with L&T General Insurance and Sivana. This service not only assures member entrepreneurs low tariffs on Insurance but also brings in the expertise of L&T General Insurance in assessing the risks involved.

**Highlights of the MoU is:**

- ❖ Upto 70% discount on Motor/Vehicle Insurance,
- ❖ Upto 90% discount on Fire Insurance,
- ❖ Other risks such as Cash (in transit/in hand/at counter), Marine, Burglary, Stock etc are also covered.

Scientific Risk-assessment is also provided based on Insurance premium through this arrangement. This facility is for IamSMEofIndia members located anywhere in India.

It is requested to all to take a quotation on your existing Policies and compare the same with the quote from this arrangement. Their members have saved lacs of rupees annually because of this MoU. In case of any query or help, please free to write to: [insurance@iamsmeofindia.co.in](mailto:insurance@iamsmeofindia.co.in) , [info@iamsmeofindia.co.in](mailto:info@iamsmeofindia.co.in)  
\*Insurance is the subject matter of solicitation

**b. MoU with Axis Bank**

IamSMEofIndia has signed an MoU with Axis Bank to provide credit facility to members at very low interest rates. Under the arrangement, all types of Loans are available for the members located anywhere in India. For any kind of query or support, one can reach out to IamSMEofIndia at [credit@iamsmeofindia.co.in](mailto:credit@iamsmeofindia.co.in) or [info@iamsmeofindia.co.in](mailto:info@iamsmeofindia.co.in)

**c. One-stop arrangement for Solar Energy generation, Finance and Subsidy:**

IAMSME of India has signed a very special MoU with Bosch (Germany) for Supply and Installation of Solar Generating Systems for its members at Very Special Terms, Conditions and Pricing under the Cluster Pricing. 30% Subsidy from MNRE is inbuilt in the Final Price ensuring great benefits. They have also tied up to arrange finance of up to 70% for the eligible members. The above scheme is for all the members located anywhere in India.

**d. MoU with Matrix Cellular**

With growth in Globalisation and world becoming a business place, IamSMEofIndia realised that one of the biggest concerns of Entrepreneurs while travelling abroad is their mobile and data costs. In view of these concerns, they have signed MoU with Matrix Cellular to guide members when they travel abroad and further provide discounts to our members under the "Collective Sourcing". These discounts are for our members located anywhere in India for International SIM Cards and Data Cards. All International Travellers & SMEs engaged in Exports-Imports are being provided this facility of SIM Cards and Data Cards to enable huge savings. All members located anywhere in India can avail this facility.

By opting for this service, business travellers or vacationers can save on huge bills on Cell Phone Services from Domestic Cellular Service Providers, while travelling abroad. Today, incidents of very high bills are increasing as Data is continuously downloaded by E-mail, Facebook and various other applications in the background including many other software updates that happen in 'smart phones' that are widely used. There have been instances of Bills crossing more than Rs.50,000/- in just 3 days. Infact, many a times mobile and data usage charges exceed even the cost of travelling to such destinations. It also further leads to legal disputes and litigations between the users and service providers as travellers feel cheated.

To avail the facility and know more about the same, please feel free to contact Mr. Tara Dutt Sharma of Matrix Cellular at +91-9811432856 or email him at tara.datt@matrix.in or info@iamsmeofindia.co.in

e. **Assistance for Small businesses & entrepreneurs** to help protect their Consumer Rights. Often businesses face issues where promised product or service delivered is not up to the mark as promised. Entrepreneurs even do not have time to write complaints, follow-up and resolve. For the same reason, IamSMEofIndia has engaged the services of a Professional group which takes up the complaints and follows up on behalf of its members to resolve and bring the dispute to a solution.

f. IamSMEofIndia is presently working with a **Private Power Distribution Company** to make arrangements for **24X7 supply of electricity** to few clusters under the Open Access Scheme. After the feasibility exercise is complete, it will be applying for necessary permissions. This could be the first of its kind arrangement, and if successful, can be replicated across India.

4. IamSMEofIndia is implementing **Energy Efficiency & SME Financing Programme** in Faridabad Cluster, supported by SIDBI & Bureau of Energy Efficiency (BEE) and funded by The World Bank.

Already Walk Through Audits in 400 MSMEs, Detailed Energy Audits and Project Reports in 250 pSMEs has been done. This unique programme requires only commitment, **No FEE or Charges**.

5. IamSMEofIndia helps its MSME members get **70% to 95% Financial Assistance** (subsidy) on Consultancy Fee to hire and engage specialised services of Professional consultants in ANY area. There is **No Upper Limit**. And this facility can be availed by all the members located anywhere in India.

6. IamSME implements **Cluster Development Programmes for MSMEs**. It is presently running Lean Manufacturing Clusters for Light Engg & Auto-component Manufacturing MSMEs which is supported & subsidized upto 80% by the Ministry of MSME, Govt. of India.

7. **Credit Facilitation Centre** at IamSMEofIndia helps in arranging all types of credit facilities from various Partner Financial Institutions and Banks. They also help in take over of high interest rate loans and provide lower interest rate solutions from partner Financial Institutions and Banks.

## 8. Export-Import Help Centre:

IamSMEofIndia provides information, advice and support on export-import procedures, custom duty, clearances, logistics, documentation, LC, Export Incentives, duty drawbacks, etc to its members. Anyone interested to know more on this can write at [info@iamsmeofindia.co.in](mailto:info@iamsmeofindia.co.in)

## 9. Entrepreneur Information and Facilitation Centre:

IamSMEofIndia provides information, advice and support to any issues, challenges, problems faced by entrepreneurs and start-ups. It encourages students, managers for development self employment opportunities.

## 10. Mentoring & Advisory Services:

IamSMEofIndia provides **FREE** consultation to New Entrepreneurs for the first 2 years in Filing of Income Tax Returns, Preparation of Balance Sheet, VAT Consultation, Allotment of PAN, TAN & TDS Procedures.

11. IamSMEofIndia organizes many **Training Programmes for Small Business Development**
12. **Credit Counseling Cell** of IamSMEofIndia helps its members get their loan-portfolios assessed by leading experts, swap high interest loans with alternate sources, re-negotiate interest rates if possible and advice on financial statements to make the business credit-worthy.
13. IamSMEofIndia has **All Women Entrepreneur's Cell** to enable women entrepreneurs acquire modern business and management skills and to enable better business growth & future for women.
14. **i-TREE** (Institute for Training in Employment and Entrepreneurship). This center provides Vocational Training in various areas and has started a unique **Entrepreneurship Development Programme** (EDP) with Manav Rachna College of Engineering,
15. IamSME helps its members find skilled personnel through **Placement Cell**.
16. Through its continuing efforts and perseverance in reaching out to the industries of Faridabad consistently over a period of time, today IamSMEofIndia is the largest MSME association in North India. IamSMEofIndia has been instrumental in bringing about changes in various local and administrative policies insuring better facilities, facilitation, redressal etc to fellow industries. Taking cue from IamSMEofIndia, many associations across the country have started to follow the Best Practices.
17. Through these constant passionate efforts, IamSMEofIndia stands to be recognised as a premier association for MSMEs internationally.

*\* The author is Chairman IamSMEofIndia and President, Faridabad Small Industries Association (FSIA),*

# FACTORING - A NEW PERSPECTIVE

K.I. Mani\*

**W**orking Capital is lifeline of any SME. One of the principal instruments of working capital is Trade Finance including bill discounting and factoring. Factoring is nothing but, the business of acquisition of receivables through assignment with or without recourse to the assignor and basically a form of financing against assignment of receivables.

Factoring is nothing but Receivable Management service wherein the seller cash against his credit sales. Factor makes pre payment to the seller after deducting some margin, against production of sales invoices, collects the money from the purchaser on the due dates and pays balance amount to the seller after deduction of some charges. The principal distinctive feature here is Factoring provides funds based on the strength **of the transaction** between the **client and its debtor** rather than on collaterals and strong financials of the borrower under normal working capital arrangement thus proving ideal for **SMEs in growth phase** dealing with larger entities in capacity of supplier or customer. Besides MSMEs generally being a single man show normally find it difficult to manage their books and receivables which is taken care



Shri K. I. Mani

## II CURRENT SCENARIO

Worldwide factoring volume is around Euro 2015 billion (appx. `140 lakh cr.) Asia's factoring volume accounts for approx.25% at Euro 503 billion (appx ` 30.18 lakh cr.)and India's share (Euro 2.8 billion) in Asia is less than <0.6%. For the year ended FY 2012, the three major factoring organizations recorded a combined factoring turnover of around `18000 cr with an outstanding of around ` 5100 cr.

Some of the reasons for low penetration in India were -

- ❖ High stamp duty on assignment of debts (differs from State to State) .
- ❖ Inadequate legal framework
- ❖ Conflict of interest with working capital lenders
- ❖ Operating in the fringe of the market

Presently only 5 standalone factoring companies in India of which 4 are in public sector (SBI Global, Canbank, IFCI Factors, ECGC) and 1 in private sector (India Factors Ltd.), besides a few foreign banks like Citibank, DBS and HSBC

## III NEW DEVELOPMENTS

Keeping in view the need for extending factoring services for MSMEs and to provide enabling legislative framework for development of this activity, Govt. has taken a bold initiative and passed Factoring Regulation Act 2011 (12 of 2012) in parliament. The passing of the Act is expected to change the way Factoring Business is being done as most of the legal limitations on growth of factoring business has been addressed through the Act.

- ❖ This legislation has become effective from April 02, 2012.  
The act now clears and defines what is factor and factoring business.

- ❖ Framework has now been provided for regulation of assignment of receivables in favour of Factor.
- ❖ Includes provisions for registration and obligations of parties to contract for assignment of receivables.
- ❖ First time enabling legislative framework has been brought in.
- ❖ This is set to change the way Factoring business is done.

#### IV. IMPORTANT PROVISIONS OF THE ACT

Registration of Factors with RBI has been made compulsory

- ❖ Assignment of receivables has got legal recognition, which was absent so far.
- ❖ Notice of assignment is now must for enforcement of rights.
- ❖ Registration with Central Registry made compulsory, thereby eliminating the scope for double financing.
- ❖ Assignment transactions are now exempt from Stamp duty, one of the major impediments for growth in factoring services, so far.
- ❖ Access to Credit Information like CIBIL provided to factoring companies, so that information asymmetry avoided.

Illustratively, the environment post and pre legislation is captured hereunder:

Features	Pre legislation	Post legislation
Assignment of Receivables	Lack of encumbrance/assignment of receivables led to fraudulent transactions hence slow growth	Act requires every assignment to be registered with Central Registry (set up under SARFAESI Act)- <b>No double financing</b>
Stamp duty payable on assignment of receivables	High rate of stamp duty payable (rate differs from State to State) makes the scheme unattractive	Assignment exempted from Stamp Duty by insertion of Section 8D in Indian Stamp Act.- <b>Easy assignment for MSMEs.- lower transaction costs</b>
Information on the Debtor	Lack of information about debtor's credit worthiness and track record with other vendors	Access to data with Credit Information Companies like CIBIL provided to factoring companies through the Act.- <b>No information asymmetry</b>
Debtors agreement	Debtors may not agree to pay amount directly to the factors	Debtor receiving notice of assignment should pay only to factor for discharge of debt - <b>Clarity in responsibility</b>
Charge on receivables	In spite of funding receivables, due to lack of demarcation, Factors' charge on receivables was subordinate to that of existing Working Capital Banker	Where receivables constitute security for repayment of a loan advanced by a bank are assigned, the Factor shall pay the consideration directly to such bank - <b>No conflict of interest with working capital banker</b>
Without Recourse	No legal framework on rights and responsibilities besides other points listed above	Clear legal frame work for growth of Factoring without Recourse.
Registration	NBFCs undertaking factoring organisations were <b>regulated as any other NBFCs in general</b> by RBI	No factor can conduct business without certificate of registration from RBI- <b>Direct regulation from RBI as a factoring company</b> brings in transparency, discipline and better corporate governance amongst factoring organizations - <b>Better service to MSMEs.</b>

The enabling environment is likely to change the way MSMEs do business as shown below :

		<b>Old Way</b>	<b>New Way</b>
1.	Improved business focus	Focus on collections or business comes to a halt.	Now they can focus on business expansions as collection is managed by the factoring organizations.
2.	Increase WC automatically	Run after banks to increase working capital.	Cash flow in sync..with the business growth. No running around necessary
3.	Simplify business process	Administration task increase as business grows.	Receivable management/Book keeping task held by the factors. All information available as needed.

- ❖ Factoring companies also can have Summary suits, now like Banks thus providing for faster exit options.

It is thus expected that MSMEs will stand benefited using factoring services

Factoring organizations will bring in new products including Factoring without Recourse through the enabling legal framework.

New NBFCs may come forward to register with RBI for undertaking factoring activities in view of potential business opportunity.

RBI has come out with regulations recently. It has been stipulated that a minimum of 75% of income or turnover should come from factoring activities as defined under Factoring Act to qualify for registration as NBFC Factor. Factoring organizations see this is as a major limitation for the following reasons:

- a. Factoring as per Factoring Act only includes seller wise factoring of receivables and LC discounting/ reverse factoring (purchaser wise factoring) etc. has been kept outside the ambit of the Act.
- b. Practically, for factoring to be successful, it has to be on a wholeturnover basis and selective factoring of seller wise receivables alone may pose operational difficulties.
- c. In addition, unless seller wise factoring is complimented with other activities like LC Discounting/ reverse factoring etc., the business model may not prove viable.
- d. Since MSMEs look at factoring as an alternate financing mechanism, unless factoring NBFCs have access to resources at competitive rates, it may not be a preferred choice for MSMEs.
- e. Corporates continue to resist accepting notice of assignment, as it tantamount to taking up additional responsibility with obligations attached to it under the Act.

Unless all the stake holders, viz. Factors, MSMEs, regulators come together and address the remaining issues, it may take some more time for this activity to witness large scale growth as seen in developed countries.

*\* The author is a General Manager, SIDBI*

# ROLE OF INCUBATORS IN SUPPORTING START UPS

Gagan Aggarwal, Indian Angel Network\*

## Overview

India is rated high in the Entrepreneurial index in the world. Entrepreneurship in India is very high in micro, small enterprises who with their limited resources, infrastructure, manpower are able to compete. India has also seen the growth of knowledge based industries. Many successful entrepreneurs have spawned in the recent years and they are now the biggest brand ambassadors of the country. Professionals, technocrats with industrial or professional experience are willing to take the risk to become entrepreneurs. However these kinds of enterprises require a different kind of funding which combines risk financing with strong hand holding. Such enterprises ideally should invest a minimum amount on infrastructure and focus on investment which generates returns to make optimum use of capital. In a country like India we need mechanisms to convert job seekers to job creators'. One of the things is the ability for entrepreneurs to find a market otherwise, entrepreneurship won't happen. Second, for entrepreneurs to grow, they need the right resources. Then there is infrastructure, which includes incubators and mentoring. The role of Incubators becomes important in developing countries like India to promote Entrepreneurship.

## Role of Incubators

For entrepreneurs, start-ups, technocrats with project at idea/seed stage who have limited resources, equipment, infrastructure facilities; incubators should be first choice. Besides reducing the time to start their project the additional advantage would be the expert advice available from the Academic staff (in case the incubator is attached to an Educational Institution) or the Mentors with stand-alone Incubators. This reduces the failure rate which generally is high in early stage, innovative projects. The Incubator linkage with Angel funds, Venture Funds also addresses the major concern of fund raising.

The Incubator supports entrepreneurs in their entire journey from idea to enterprise and beyond. The Incubator facilities business mentoring by varied experts, help in business planning, help in developing the product, assistance in identifying and creating fruitful partnerships and strategic alliances, early customer validation, assistance in getting seed funds, connecting with the industry, introduction to business support service providers like web developers, IPR agencies, social media marketing agencies, HR agency etc. puts the entrepreneur on a fast track path to become operational. The Incubator program also embeds a rich training and development schedule.

Most incubators have witnessed a huge upsurge in this trend with increasing nos. of student plans coming in for funding and incubation. The trend is getting stronger by the day and is here to stay. This is validated by the increasing no. of e-cells in b-schools and engineering colleges, no. of b-plan competitions and increasing participation in entrepreneurial competitions (like Power of Ideas and Think Big Challenge) receive responses in big numbers. This trend has gone up recently with the emergence of the knowledge economy which does not require high capital investment in the initial stages of the venture. In the recent days incubators & Angel Investors have been invited as angel partner for student contests of various academic institutions like by IIT Bombay, IIM Lucknow, and IMT Ghaziabad. This shows the seriousness of students for their entrepreneurial aspirations.

Incubators are typically set up with the support of Department of Science & Technology (DST), Government of India to foster entrepreneurship. Most Incubators focus on a wide range of areas including IT, ITeS,

Internet/Web, Mobile VAS, Telecom, Retail, Education, Media & Entertainment, Manufacturing, Clean Technologies, etc. During the course of Incubation, the incubatee companies get Seed Capital and other Business assistance like - IP Strategy & Protection, Support in Business Planning; early connect to the market for obtaining customer validations, refining prototypes and running pilots, Visibility & Promotion of the venture, Training & Development to improve entrepreneur's skills, Business support services at negotiated rates for Legal, HR, IT, etc.

### **Role of Nodal Departments & Ministries**

Globally Government/Government Agencies play a key role in supporting Incubation activities. In India Department of Science & Technology (DST) Government of India has played a pioneering role in promoting incubators.

A large numbers of interdisciplinary multi-sector project(s) are supported by the Government leading to technological empowerment and capacity building for sustainable livelihood. DST also has programmes to help S&T (Science & Technology) personnel towards self-employment and entrepreneurship. Programmes like Science and Technology Entrepreneurs Park (STEP) and Technology Business Incubator (TBI's) help the students & others in their start-up by providing necessary support in the form of infrastructure, technical input and academic linkages. DST supports such initiatives by not only assisting the host institution to set up the Incubator but also assists the selected start-up(s) by providing seed support to them via the Incubator. Typically these schemes for start-up come via TDB and NSTEDB (both under DST) where relevant seed support is offered to S&T Start-Up.

Similar to DST, also MSME offers support to start-up through its approved incubators. The only key difference being that MSME does not offer support purely for R&D purpose.

Under both the schemes MSME as well as DST the support can come only to a registered incubatee at the approved incubator of the respective Nodal Department & Ministry. Both the schemes have different conditions of offering the seed support.

### **About IAN Incubator**

Indian Angel Network Incubator is equity based incubator and has a unique model of an incubator-leveraging relevant business & domain expertise for entrepreneurs & moving away from geographical boundaries. IAN incubator has been set up as a Public Private Partnership with Department of Science & Technology (DST), Government of India.

The IAN Incubator traverses the entire journey from 'concept to value' with the entrepreneur. The incubator's concentric mentoring model provides desk to desk multi-dimensional mentoring to Incubatee by its experts. It has the unique ability to provide Incubatee companies with an early connect to the market, operational guidance, strategic thinking on building scalable ventures, high quality teams, obtaining customer validations, refining prototypes, pilot testing products and services etc. and raising the first round of seed funding. Several IAN incubates have raised seed funding within 6 months of incubation and some have grown to build scalable businesses across multiple cities. This approach of IAN incubator and mentoring by Industry icons makes IAN Incubator unique and stand ahead of many other prominent Incubators in India. The IAN has a strong mentoring network of successful entrepreneurs with strong domain knowledge and Angel Investors.

*\* The author, is an International Business expert and has over 15 years of experience in consulting services in sectors such as Education, Infrastructure, and IT& Telecom Services. As IAN Incubator Manager, he has been focusing to help budding entrepreneurs in every possible way to build businesses*

# NEW BUSINESS MODEL OF SIDBI TO ADDRESS GAPS IN MSME ECO SYSTEM

R.K. Das\*

## Introduction

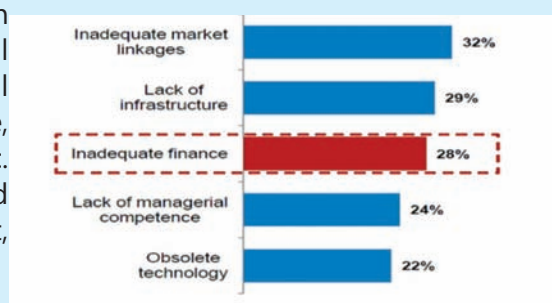
Micro, Small and Medium enterprises (MSMEs) across the world, including India are the vehicles for faster, sustainable and overall inclusive growth; hence, help in building a better socio-economic environment in any nation. This sector acts as the nursery bed for ideas, innovation and contributes to reducing regional imbalances. With more than 30 Million enterprises, comprising 94% as micro enterprises (MEs) in the unorganized sector, this sector generates more than 70 million jobs - the second largest next to agriculture.



Shri R.K. Das

## Gaps in the Sector

Notwithstanding the same, recent evidence shows the results of a diagnostic research into the key constraints facing MSMEs in India shown in Figure (1). The sector is beset with a number of financial and non-financial / developmental gaps. Various financial gaps are like risk capital/equity assistance, sustainable finance, factoring and reverse factoring, services sector financing, etc. Similarly, the non-financial or developmental gaps are found in the areas of marketing, technology, skill development, infrastructure, etc.



As the Principal Financial Institution for the Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector and for co-ordination of the functions of the institutions engaged in similar activities. SIDBI has to address these financial and non-financial gaps in the MSME sector. Accordingly, SIDBI's business model has been reoriented to cater to various needs of MSMEs both directly and indirectly through banks / FIs. In that sense, SIDBI is supplementing and complementing the efforts of the banks/FIs to promote and develop the MSME sector.

The business strategy of SIDBI has recently been reoriented towards filling up the financial and developmental gaps in the MSME eco-system.

## Finance

Direct credit is provided to address financial gaps in niche areas like risk capital/equity, sustainable finance to promote energy efficiency, clean production technologies in MSME sector, receivable finance, services sector financing, etc. Such assistance is provided to complement and supplement the efforts of Banks / Financial Institutions in channelizing credit to MSME sector to meet their felt needs. SIDBI is also now laying greater thrust on providing re-finance assistance to smaller banks and Non-Banking Finance Companies (NBFCs).

## Risk Capital

Realising the increasing demand of MSMEs for equity assistance, SIDBI provides risk capital assistance to

growing as also innovative MSMEs. The risk capital assistance is offered to such units on the backing of future cash flows, rather than asset coverage / collaterals unlike conventional loans. In order to extend pure equity type investment support to support worthy growth stage MSMEs, SIDBI also invests in SEBI approved MSME dedicated funds of reputed Venture Capital funds under the bank's fund of fund operations. SIDBI's such investments are limited upto 15% of the corpus of the concerned MSME dedicated funds.

### **Receivable Finance**

In order to help the MSMEs for quicker realization of their receivables, SIDBI has a special reverse factoring scheme called receivable finance scheme under which SIDBI fixes limits to well-performing purchaser companies and discounts usance bills of MSMEs / eligible service sector units supplying components, parts, sub-assemblies, services, etc. So that the MSME / service sector units realise their sale proceeds quickly. SIDBI also offers invoice discounting facilities to the MSME suppliers of purchaser companies. SIDBI has also taken a lead in promoting factoring services for MSMEs.

SIDBI, along with National Stock Exchange (NSE), took an initiative in 2009 for setting up an electronic platform for discounting of MSME receivables named as NSE Trade Receivables Engine for E-discounting in association with SIDBI (NTREES). Operations on the platform are done under real time gross settlement and as a result the delivery time period is reduced from 4 days to 2 hours.

### **Promoting Energy Efficiency**

In order to promote sustainability in the MSME eco-system, SIDBI has devised special schemes for providing assistance for investment in energy efficiency projects and cleaner production options to MSMEs. Under the scheme, assistance is provided at concessional terms. In order to enhance the environment and social (E&S) standards in MSME sector, the bank has started a specialised refinance scheme under world bank loc in this direction which incentivises other financial intermediaries also to follow these standards.

SIDBI has developed an unique model called credit appraisal and rating tool (CART), for loans upto ` 2 crore, which helped in reduction of turn-around-time (TAT) by 3 to 4 days resulting in faster credit appraisal and sanctions. SIDBI has shared the tool with banks and MoU SFCs (State Financial Corporations) free of cost and has also been giving training to the officials of Banks / FIs to facilitate its smooth implementation.

### **Missing Middle**

SIDBI also addressed the credit issues of 'Missing Middle' (MM) segment (loans ranging from ` 50,000 to `10 lakh) by way of developing various credit dispensation / risk measurement tools like downscaling (i.e. developing new risk assessment tool for the MM segment), upscaling (i.e. developing the credit appraisal and risk assessment capacity of micro finance institutions to give loans beyond micro finance and Non-Banking Financial Companies to give loans to higher segment of Micro and Small Enterprises). SIDBI is channelising a special line of credit from Asian Development Bank to provide credit and for capacity development of the MM segment. SIDBI is in the process of sharing this tool with RRBs/UCBs to build their capacities to meet the needs of this segment.

SIDBI, as on march 31, 2012, has made cumulative disbursements of over ` 2,442 billion benefitting more than 32.5 million persons. Thus, facilitating access to finance and enterprise creation with their capacity building, have been the corner stones of SIDBI's operations over the last 2 decades.

### **Developmental**

As regard the developmental gaps in MSME sector, SIDBI provides various types of non-credit assistance which include technology development, marketing infrastructure, cluster development, skill development,

entrepreneurship development, information and communication technologies, etc. Further, the bank would also be providing technical assistance for capacity development of Regional Rural Banks (RRBs) / Urban Cooperative Banks / District Cooperative Banks (DCBs).

#### **(a) Credit Plus**

SIDBI shall continue to adopt a 'credit plus' approach wherein, besides credit, the bank shall extend support for the promotion and development of the sector to make it strong, vibrant and competitive in the international markets. The Promotional & Developmental (P&D) activities of SIDBI are designed to achieve the twin objectives of national importance, viz. (a) promotional - enterprise promotion resulting in setting up new units and creation of additional employment through its select programmes, and (b) developmental - enterprise strengthening to enable MSMEs to face the emerging challenges of globalisation and growing competition through select interventions, SIDBI has benefitted the MSME sector through its P&D activities, i.e. setting up of over 1 lakh enterprises, which generated employment of around 3 lakh and benefitting around 4 lakh persons in the MSME sector.

#### **(b) Credit Facilitation Centre**

In order to further facilitate more credit delivery to MSME sector, SIDBI has initiated the process of setting up Credit Facilitation Centres (CFCs) at various industrial clusters in partnership with cluster level industry associations. This will provide a proper / adequate guidance and support system for smoother credit flow to new as well as existing entrepreneurs.

#### **(c) Loan Syndication**

SIDBI has initiated loan syndication activity which will involve accredited MSME project consultants / Technical Consultancy Organisations (TCOs) and rating agencies to bring in more credibility in the evaluation process of loan application by banks and FIs.

#### **(d) Small B.In**

Smallb.in, a proactive website, is SIDBI's attempt to inspire enterprising individuals to look at the business opportunities all around. It tries to demystify and simplify the process of establishing a business in the country. Smallb.in creates an awareness of the business opportunities that exist. It helps understand how to go about identification of business opportunities, stimulates generation of ideas and learning's from some of the most successful startups in the world. It also helps in preparation of a business plan as well as preparation of a detailed project report for availing financial facilities from the Banks in India. It assists in how to incorporate new business in India and understand various requirements of Banks / Financial Institutions and how to deal with them. The website uses contemporary style of communication designed to engage the young educated audience of today's India.

#### **Associates/Subsidiaries**

SIDBI, has brought in institutional solution and strengthened the eco-system for addressing thematic requirements of MSMEs. SIDBI's subsidiaries and associates include SIDBI Venture Capital Ltd. (for venture capital), credit guarantee fund trust for micro and small enterprises (for credit guarantee), SME rating agency of India Ltd. (for credit rating), India SME technology services Ltd. (for technology transfer) and India SME asset reconstruction Ltd. (for asset reconstruction).

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# NEED OF THE HOUR IS FOR SOCIAL ENTREPRENEURS

Dr. A. Jagan Mohan Reddy\*

## Introduction:

Economic development of any country depends on the development of agriculture and its industrial sector. Of course, of late, the importance of service sector too, has increased. Nevertheless, for providing a solid foundation to the process of development the development of agriculture and industry is interlinked. Government of India, after achieving independence, has recognized the need to give a big push to the economic development of the country. Further, at the same time it has also realized the importance of promoting small scale and medium scale industries. Among these two special importances was given to the promotion of small scale enterprises as they are less capital intensive in nature and have a great potential to create the much *needed employment opportunities*.



**Dr. A. Jagan Mohan Reddy**

In addition to the above the need for entrepreneurial development too was felt. Because it was considered essential to motivate and assist prospective and potential entrepreneurs to set up their own ventures to contribute in production, employment and tapping of unutilized resources.

## Who is an Entrepreneur?

Bob Reiss, entrepreneur and author of "Low Risk, High-Reward: Starting And Growing Your Small Business With Minimal Risk", says:

*"Entrepreneurship is the recognition and pursuit of opportunity without regard to the resources you currently control, with confidence that you can succeed, with the flexibility to change course as necessary, and with the will to rebound from set backs:"*

A key factor in Reiss's definition is that entrepreneurs undertake opportunities regardless of the resources they currently control. As we all know, many who say they would love to start a business, but they just don't have the money to get started. Neither did many of history's greatest entrepreneurs like Michael Dell, who started his computer company in his college class room or Lillian Vernon, who started her mail-order business when she was a housewife look for extra income. These successful entrepreneurs didn't start rich and successful. They ended rich and successful. Entrepreneurs find ways to acquire the resources they need to achieve their goals.

***Let's take a closer look at what entrepreneurs do differently and the lessons youngsters could draw from them.:***

### **1. Entrepreneurs see clues everywhere:**

Entrepreneurs look at reality differently. They are hungry for fresh ideas, and see opportunities even in the most mundane daily activities. For instance, a city dweller's occasional need for a car led to the car-sharing concept of Zipcar.

### **2. Entrepreneurs don't fall in love with an idea too soon:**

Few ideas remain unchanged in the development process. Usually, as product prototypes are created

and the first consumers share their reactions, the original idea goes through much alterations. It's important not to get hung up on the idea's original version but to allow it to evolve naturally. That's the reason late Sri CK Prahlad used to say "Keep innovating' if you wish to survive.

### **3. Entrepreneurs are scrappy.**

One thing entrepreneurs often taste is rejection. Most, if not all, startups have been refused funding multiple times before someone finally said "yes."

### **4. Entrepreneurs obsess over execution:**

Both entrepreneurs and innovators spend a lot of time talking about ideas : inspiring, hunting for, sharing and championing ideas. Without a doubt, fresh ideas are the fuel of innovation. However, truly unique ideas are extremely rare. Entrepreneurs know that, when it comes down to it, what differentiates a winning idea is its excellent execution. Colorado-based venture capitalist Brad Feld says, "Great entrepreneurs quickly move past the idea to the execution of the idea."

### **What is the issue?**

India is gripped by a strange case of Tragedy of the commons—a situation where individual rational users over utilize or exploit resources in such a way that they create a complete system breakdown at a larger level. They are not bothered about factory shutdowns, environmental degradation, corruption etc., as long as they are meeting their selfish ends. Our current glory would be short lived if we are not able to prioritize between individual and social needs.

In other words, today what we need is social entrepreneurs who know a thing or two about starting businesses that do well for the planet and the bottom line.

### **What is a Social Entrepreneur?**

Social entrepreneurs are individuals with innovative solutions to society's most pressing social problems. They are ambitious and persistent, tackling major social issues and offering new ideas for wide-scale change. Rather than leaving societal needs to the government or business sectors, social entrepreneurs find what is not working and solve the problem by changing the system, spreading the solution, and persuading entire societies to take new leaps.

### **But a question may arise as to why Social Entrepreneurship?**

Over the past two decades, the citizen sector has discovered what the business sector learned long ago: There is nothing as powerful as a new idea in the hands of a first-class entrepreneur. Social entrepreneurs drive social innovation and transformation in various fields including education, health, environment and enterprise development. They pursue poverty alleviation goals with entrepreneurial zeal, business methods and the courage to innovate and overcome traditional practices. A social entrepreneur, similar to a business entrepreneur, builds strong and sustainable organizations, which are either set up as not-for-profits or companies.

A social entrepreneur is a leader or pragmatic visionary who achieves large scale, systemic and sustainable social change through a new invention, a different approach, a more rigorous application of known technologies or strategies, or a combination of these. Focuses first and foremost on the social and/or ecological value creation and tries to optimize the financial value creation. Innovates by finding a new product, a new service, or a new approach to a social problem. Social entrepreneurs believe in the innate capacity of all people to contribute meaningfully to economic and social development.

### **Need of the Hour?**

What we need today are enlightened business leaders who transcend personal limitations to serve not only the basic needs of business and shareholders but shift more towards better distribution of wealth,

making their businesses a force for good. Infact, the basic issue was never about the creative power of business. It is about distributive justice based on integrity towards a fair share to shareholders and all stakeholders where no one is exploited to satisfy the other. Generating revenues and profits are taken for granted - they are 'just means'. Recognizing this power of business, people have growing concerns and new aspirations related to environment and society.

So, it is high time business leader's start believing that 'beyond profits are more profits'. Further, business leaders must realize that an enterprise is not created; it is actually co-created by all making their respective forms of contribution. In total it is 'co-creating sustainable value'. So, ownership and governance of business have to be such that: wealth generated is not for few but used for the betterment of society in general. In this regard it is worth noting that 66% profits of Tata group go to charity i.e., to help the needy.

### **Let's look at Few such cases in our country:**

#### **1. SELCO Solar light-A Case of Social Business**

SELCO solar light, a Bangalore social enterprise that specializes in solar lighting solutions, started a project/social business that provides Karnataka rural children solar-powered lamps to do their homework. While 20% of the cost being borne by the school, SELCO arranges the balance through donations or soft funding.

The light for education project consists of a centralized solar charging system, pocket-sized batteries and LED study lamps. The solar charging system is installed in school and student is given a lamp and detachable battery. The lamp remains at home, where children study at night, while batteries have to be taken to school daily to charge them. The effort results in high attendance at schools. Because, if a child skips school, the LED lamp battery remains uncharged and it means darkness at home that night. What an excellent way of doing a meaningful and purposeful business

#### **2. Serum Institute of India Ltd-Concern for the Suppressed/Oppressed**

As we all know Serum Institute is committed to improving access to and affordability of vaccines for children throughout the world. It is estimated that one out of every two children immunized in the world is vaccinated by a vaccine manufactured by Serum Institute .The institute which exports to 130 nations is also developing affordable rotavirus and pneumococcal vaccines for Global Alliance for Vaccines and Immunization. The clinical trials are being funded by the Bill and Melinda Gates Foundation.

#### **3. The inspiring rags-to-riches tale of Sarathbabu**

Most of us are aware that when 27-year old Shri Sarathbabu graduated from the Indian Institute of Management, Ahmedabad created quite a stir by refusing a job that offered him a huge salary and instead preferred to start his own enterprise -- Foodking Catering Service -- in Ahmedabad i.e., instead preferred to create jobs for his young countrymen rather than seeking a one.

He was inspired by his mother who once sold idlis on the pavements of Chennai, to educate him and his siblings. It was a dream come true, when Infosys co-founder Shri N R Narayana Murthy lit the traditional lamp and inaugurated Shri Sarathbabu's enterprise. Shri Sarathbabu was born and brought up in a slum in Madipakkam in Chennai. He had two elder sisters and two younger brothers and his mother was the sole breadwinner of the family. It was really tough for her to bring up five kids on her meagre salary. As she had studied till the tenth standard, she got a job under the mid-day meal scheme of the Tamil Nadu Government in a school at a salary of Rs 30 a month. She made just one rupee a day for six people. So, she sold idlis in the mornings and would then work for the mid-day meal at the school during daytime. In the evenings, she taught at the adult education programme of the Indian government.

Thus, she did three different jobs to bring them and educate. He got very good marks in the 10th

standard exam and it was the most critical moment of his life. Because, till the 10th, there was no special fee but for his 11th and the 12th, the fees were Rs 2,000-3,000. So he did book-binding work during the summer vacation and accumulated money for his school fees. When he got plenty of work, he employed 20 other children and (right from the beginning had that zeal to help others) and all of them did the work together. That was his first real job as an entrepreneur. Once he saw the opportunity, he continued with the work.

A question may arise as to How he got Inspired to be an entrepreneur. It was while preparing for the Common Admission Test that he read in the papers that 30 per cent of India's population does not get two meals a day. And he knows how it feels to be hungry. He also read about Infosys and Narayana Murthy, Reliance and Ambani. Reliance employed 20,000-25,000 people at that time, and Infosys, around 15,000. When a single entrepreneur like Ambani employed 25,000 people, he was supporting the family, of four or five, of each employee. So he was taking care of 100,000 people indirectly. So he felt that he too should become an entrepreneur. Initially he worked for 30 months at Polaris to pay off all the debts.

### **Becoming an Entrepreneur:**

By the end of the second year, there were many lucrative job offers coming his way, but in his mind he was determined to start something on his own. His mother was his first inspiration to start a food business. His friends helped him in registering the company with a capital of Rs 100,000. The first order was from a software company in Ahmedabad to supply tea, coffee and snacks.

His ambition is to employ as many people as he can, and improve their quality of life. It would be great if some more youngsters could follow the footsteps of Babar Ali and Saratbabu thereby making a difference to the society they are living in, by enabling their young friends to stand on their own.

### **Conclusion**

Entrepreneurs form the backbone of development activity of any nation. While addressing a group of engineering students in Chennai on December, 18th 2003, the former President APJ Abdul Kalam, narrated success stories of high profile Indian entrepreneurs both in India and abroad. He wanted the young to be innovative and enterprising so that they could be job providers instead of job seekers. But what we require today not simply entrepreneurs but Social entrepreneurs.

As we all know there are 55 billionaires from India in the latest Forbes rich list of 2011. But what is shocking is the growing disparity between the wealth of the few [whether in India or abroad] and the position of the rest of the humanity.

What is the use of so much of wealth when it is not used for the development of needy citizens and for human beings? Business has a larger responsibility towards society. This is not what passes these days for 'Corporate Social Responsibility'. It is much loftier than that. What is good for the country must become good for the enterprise and business must make this rule 'the lodestar of its conduct'. Needless to say, when we make people our priority rather than personal success and then success will make us its priority. Lets hope that this sort of spirit will guide our youngsters in their future endeavors.

*The author is Associate Professor (HR) in Institute of Public Enterprises, Hyderabad*

# IMPORTANCE OF THE MSME SECTOR AND THE ROLE OF SFCs IN FINANCING THIS SECTOR

Sh. V.S. Rathore\*

World over, the Micro Small and Medium Enterprises or MSMEs have been recognized as engines of economic growth. Over the years, the MSME sector has performed well and enabled our country to achieve balanced industrial growth with diversification. By its less capital intensive and high labour absorption nature, MSME sector has made significant contribution towards employment generation and rural industrialisation. MSME sector in India creates largest employment opportunities for the Indian populace, next only to agriculture.

On the one side, the capability of Indian SME products to compete in international markets is reflected in its share of about 34% in national exports. In case of items like readymade garments, leather goods, processed foods, engineering items, the performance has been commendable both in terms of value as well as their share in national exports; while in some items like sports goods they account for almost 100% share of the total exports of the sector. On the other, this sector is also ideally suited to build on the strengths of the traditional skills and knowledge, by infusion of technologies, capital and innovative marketing practices. The diversity in production systems and demand structures in India ensure long term co-existence of many layers of demand for consumer products / technologies / processes. There will be flourishing and well grounded markets for the same product/process, differentiated by quality, value addition and sophistication. This characteristic of the Indian economy will allow complementary existence for various diverse types of units spanning from micro & small to large/very large units.

However, if we compare the growth of MSMEs in India with those in the neighbouring countries in South East Asia like South Korea, Thailand, Malaysia, China, Japan etc. it is found that we lag far behind. The major hurdles/bottlenecks faced by the sector which do not allow this sector to flourish well have been - inadequacies of finance, capital, technology and marketing.

## **Role of State Financial Corporations (SFCs)**

SFCs, which are basically Development Financial Institutions (DFIs), were set up under the SFCs Act, 1951 with the prime objective of financing and promoting small and medium enterprises for achieving balanced regional growth, catalyzing investment, generating employment and widening the ownership base of industry by fostering entrepreneurship. The SFCs have helped decentralise economic development and created employment opportunities by assisting artisans, crafts persons, SSI units and most important the first generation entrepreneurs. The units assisted by the SFCs have also contributed to the States' exchequer by way of sales tax, local duties etc. A recent study conducted by KSFC has found that for every crore of loan assistance by the corporation, there was a yield of VAT and ST revenue of Rs.18.49 lakhs per annum. When extrapolated, the annual tax revenue to the Karnataka State exchequer from units financed by KSFC during the Financial Year was around Rs.100 crore, besides generation of 13,500 skilled jobs and 1500 indirect jobs annually. The SFCs are, therefore, instrumental in fulfilling the socio-economic objectives of the government by bringing 'inclusive growth'.

The Gupta Committee (set up by the Government of India in 2000 under the Chairmanship of the then CMD, IDBI, Shri G.P. Gupta) opined that no other financial institution has the wherewithal and outreach to penetrate into the far-flung areas of the States for promotion and financing of first generation entrepreneurs - an activity which no other financial institutions in the country has ever undertaken. The credit deposit ratio of Commercial Banks in rural and semi-urban areas of the States has been much below the stipulated ratio of 60% and, further the loans extended to SSI and tiny units by commercial banks in such areas was almost negligible. This was despite the fact that nearly 70% of the total number of branches of Commercial Banks were located in rural and semi-urban areas of the States. It is, therefore, imperative to have such institutions to provide assistance and support to the micro, small and medium entrepreneurs who more often than not are overlooked by the commercial banking sector. The closure of SFCs could impact adversely on a dynamic segment of the India economy and undermine industrial growth.

The SFCs were performing very well in the first 3-4 decades, but their fortunes declined after opening up of the economy in 1990s since the economic reforms did not embrace these DFIs. The SFCs suffered owing to indifference on the part of stake-holders in providing affordable and adequate resources to SFCs leading to their inability to compete with commercial banks which have access to cheap public deposits. Keeping in view the strategic importance and relevance of SFCs, SIDBI alongwith the Government of India provided a financial package for revitalizing SFCs in 2003. The package was availed by thirteen out of eighteen SFCs which entered into tripartite agreement with SIDBI in which the State Governments concerned were also a party. The above relief provided by SIDBI to these SFCs yielded positive results and have helped SFCs turnaround and show a better performance. A number of these SFCs have recorded increase in their sanctions and disbursements over the years and have also brought down their NPAs. Eight out of these thirteen SFCs have been showing operational/net profits and consequently their cumulative losses are steadily coming down, while two SFCs i.e. APSFC & KSFC have completely written off their losses.

With a view to putting these corporations on sound footing, a number of State Governments namely Andhra Pradesh, Rajasthan, West Bengal, Madhya Pradesh, Kerala, Odisha, Haryana, Tamilnadu, Karnataka and Assam have come forward to provide some equity support during the last couple of years and have also extended other reliefs in the form of interest free loans, pass through arrangements etc. However, the steps taken by the respective State Governments as also the SFCs have not been uniform and to the extent required. While some of the SFCs have implemented most of the improvement measures, others have partially implemented them. This has resulted in less than optimum improvement in the performance of a number of these SFCs.

The need of the hour is for various State Governments to provide a comprehensive financial package in strengthening the equity base of the respective SFCs and also to strengthen the HR by necessary training and professionalization. Once this has been accomplished the continued viability of the SFCs would then depend up the cost of their resources / funds. If SFCs have to function as viable entities, they must get sufficient resources at affordable rates of interest so that they can compete with the commercial banks and also continue to perform their development role. It is, therefore, suggested that following measures be under taken to help the SFCs raise necessary resources : -

Strengthening of the equity base by infusion of fresh capital by the State Govts./other stake-holders and also raising fresh capital from institutions and general public by floating IPOs.

Once the financial position and network of SFCs is strong, SIDBI could be requested to continue/resume refinance to the well-performing SFCs.

The Reserve Bank of India may be requested to consider restoring the facilities hitherto being enjoyed by SFCs such as ad-hoc borrowing limit, allocation of SLR Bonds quota and soft terms for raising fixed deposits. The withdrawal of these facilities by RBI had aggravated the financial crisis facing SFCs as the average cost of their funds had gone up forcing them to curtail their lending programmes and consequent losses.

The SFCs also provide finance to agro industries in the rural, semi urban, backward regions of the state which fall under the ambit of NABARD. Refinance may be provided by NABARD to SFCs for financing village, forest/agro based industries.

The National Housing Bank may also be requested to provide refinance of SFCs against their lending to construction activities such as industrial housing, EWS housing as also group housing undertaken by State agencies.

The objective of Government of India / RBI in augmenting the flow of institutional credit to MSME sector in the country would be accomplished to a considerable extent if the SFCs in all the States are strengthened. SFCs are undoubtedly the most suitable institutions at the grass-roots level to dispense credit to the decentralized sector in the rural, semi-urban and backward regions of the States and have immense potentialities for accomplishing the national objective of decentralized economic development and ensuring inclusive growth.

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# SME PLATFORMS : NEW OPTION FOR MSMES TO RAISE RISK CAPITAL

Ravi Tyagi\*

Indian Capital markets took a big leap with the launch of two New SME platforms, by both BSE and NSE. It was a major landmark for the SME sector to have a new avenue for raising capital in an efficient manner. NSE's SME platform, 'Emerge' which was launched in September 2012, symbolizes the aspirations of a large number of growing enterprises having potential to unlock value and emerge on a bigger stage. Operations at EMERGE are gaining momentum with the exchange having approved public offerings of 4 companies out of which 2 SMEs have listed on Emerge with a capital raising of Rs.45 crore and several other transactions being in pipeline.



Shri Ravi Tyagi

## Indian SMEs : A new asset class for Investors

India has high entrepreneurial potential and the SME sector has been a key engine of economic growth, job creation, wealth distribution and effective mobilization of resources (capital and skills). Due to their small size and entrepreneurial spirit, they are able to adapt to changes quickly, use innovation as a key competitive strategy and have high growth prospects. Indian SMEs today stand ready to exploit unprecedented opportunities, driven by a fast-growing domestic economy and the increased credibility of Indian SMEs in the global markets. Over the last decade, a paradigm shift has taken place in the profile of Indian SMEs. Today, they present a very diversified profile in terms of sectors, stage and geographic locations. Indian SMEs operate in sectors which are very traditional to the most modern and cutting edge industries competing with the best in the world. SMEs in new economy sectors like IT, IT enabled, organized retailing, education, entertainment, media, etc. represent the new and modern face of Indian SMEs. In recent years, several Indian companies scaled up their businesses rapidly providing high returns to the early stage investors. They have also demonstrated impressive management bandwidth by successfully managing high growth, cross border operations, and complex inorganic transactions.

This aspirational section of MSMEs forms the new asset class on SME platforms for investors who are looking to invest in and participate in their growth journey. SME platforms will offer capital raising opportunity to a large spectrum of companies as under :



The availability of adequate capital for growth is one of the key factors required to encourage the SMEs to exploit opportunities and grow exponentially. The Indian capital landscape has also changed—the Indian markets have matured substantially over the past decade and are now ready for a product such as an SME Exchange. SMEs need risk capital for growth and expansion, working capital, innovation & intangible financing, acquisitions, R&D, marketing etc.

## SME platforms: Role in the Ecosystem

India has always had a strong tradition of small and medium enterprise (SME) listings. Compared to the

situation in other markets, the Indian exchanges have kept their minimum capital requirements comparatively low, and this has encouraged relatively small companies to tap the public equity market. At the same time, small IPOs have presented challenges to issuers as well as investors. Smaller firms find it hard to bear the cost of the IPO and the recurring costs associated with being a publicly listed company. Dedicated SME platforms will lead to evolving of customized processes for smaller companies which bring down the cost, time and effort for raising capital for them.

Emerge is envisaged to be a platform offering an efficient capital raising avenue to growing companies on one hand and attract informed and institutional investors to a new asset class, on the other. The platform is positioned as a Public Venture Platform, where venture-like investment opportunities are available at an early stage to a wider investor base. Currently, the early stage investors in the companies including Angel and Venture Capital investors have limited avenues for exit from the SME investments; with a special exchange for SMEs, the exit will be made easier. With an exit route visible, there will be higher incentive for VCs to invest in start-ups and small businesses, promoting entrepreneurship. The very nascent angel industry in India will have an opportunity to grow as more of their investments get funded by VCs and who in turn get exits at the SME exchange.

### SME Platform: Regulatory Framework

The SME platform is a regulated platform under the purview of SEBI. A new chapter (XB) was added to the ICDR to define the regulations applicable to the SME platforms. EmERGE is a segment within NSE and

PARTICULARS	EMERGE	MAIN BOARD
<b>IPO</b>		
Post-issue paid-up Capital (Face value)	Less than Rs.25 crore	Not less than Rs.10 crore
Track record	Track record of atleast three years, positive cash accruals (EBDT) from operations for atleast 2 financial years and positive network *	Three years track record of profitability
IPO Grading	Not mandatory	Mandatory
Min number of allottees in the IPO	50	1000
Observations on DRHP	By the Exchange	By SEBI
IPO Underwriting	100% underwritten (15% on the books of the merchant banker	Mandatory (Not reqd where 50% of issue offered for compulsory subscription by QIBs)
Market capitalization / Issue size	No restriction	No restriction
IPO Application size	Not less than Rs.1 lakh	Rs.5,000 - Rs.7,000
<b>POST-ISSUE</b>		
Reporting requirements (Audited a/c)	Half-yearly	Quarterly
Market making	Mandatory	Not mandatory
Corporate governance requirements	Same as main board	Clause 49

\*NSE requirements

enjoys the benefits of a well established exchange. The trading terminals of the main exchange, its risk management and surveillance systems, the existing infrastructure are all available to the SME platform also. The members and other intermediaries continue to be the same as the main board too.

Some of the key differences between the SME Platform and the Main Board are as under:

### **Benefits of an Exclusive SME Platform**

An exclusive stock exchange for SMEs will enable SMEs to consider approaching capital markets as a new and viable option for raising capital in an efficient manner and scale up their businesses to compete globally. A large spectrum of SMEs would be eligible to list on the SME platform and the amount of capital raised could also be significant as long as the companies meet the eligibility criterion of post listing paid up capital of Rs 25 crore.

Given the smaller number of minimum allottees and smaller fund raisings, a more focused approach to selling can be adopted by the issuers making the process more cost and time efficient.

Once listed, they will enjoy a higher profile and greater visibility, which will in turn improve their credibility with various stakeholders like customers, vendors, employees, etc. ESOPs become a powerful tool and being listed will help the SMEs to attract better quality talent and improve retention by incentivizing the employees. SME Exchange will have reduced compliances vis a vis the main exchange, while ensuring product innovation and without compromising on risk management.

Listing unlocks value for the shareholders and early investors by providing them exits and liquidity. Further, stock can be used as currency for acquisitions and enable companies to complete transactions in a timely manner. An SME Platform provides a new source of capital to SMEs and reduces their dependence on debt financing. As is well known, every company, whether large, medium or small, should have an appropriate debt-equity ratio to enable maintaining an ideal capital structure and avoid over-leveraging. Further, because they are subject to higher scrutiny and higher governance requirements, listed companies will also usually be able to get better rates when they approach their banks for debt financing. Additionally, capital infusion improves the leveraging capacity to attract more funds for growth.

Companies can use the SME platform as a stepping stone to the main board and avoid reaching there too early where they struggle to get trading interest and sustain value. Getting listed on the SME Platform with informed investors with long term interest in the company will allow companies to grow to a serious size, conserve value and migrate to the main board with a more broad based offering. The regulations provide for a seamless migration to the main Board once the company meets the eligibility criterion.

### **NSE's Initiatives for Developing SME Market**

NSE has a transparent admission process which ensures that issuers walk through a planned route to listing while the investors are assured of credibility and governance of the issuers. The process will also ensure faster and more efficient IPOs resulting in lower Turnaround Time and costs for the participants.

Prospective issuers on EMERGE can benefit from several customized programs and modules which will enable them to take a decision for a prospective listing in a confident and assured manner. NSE has introduced a CFO Certification program which will help them understand the nuances of capital markets and also appreciate how to assess and prepare themselves for a prospective listing.

SMEs are not conversant with Capital Market processes and need a lot of handholding in their journey to listing. NSE provides support in terms of educating the SMEs on IPO processes, connecting them to various intermediaries, and supporting the companies in meeting various post-listing compliances. NSE has introduced voluntary adoptions which help in increasing investor confidence by building credibility. CRISIL has introduced a special SME Fundamental Grading scale for SME IPOs; although IPO Grading is

not mandatory on the SME Platform, NSE encourages the issuers to get the companies graded to instil confidence in the investors.

Most investors have the grievance that once a company raises funds, the investors do not get any information on the utilization of the funds nor on the performance of the company following infusion of new capital. Further, research agencies tend to focus on the top tier of listed companies. This gap in information availability leads to many small company scrips languishing despite good performance of the business. Facilitating extensive research coverage for the listed SME scrips is also critical for investor interest. NSE has tied up with CRISIL to provide research coverage on the companies listed on its main board as well as the SME platform, improving access to information for investors and to provide visibility to the listed companies.

### **Role of Key Stakeholders**

The SME platforms have begun operations and the initial response has been encouraging. However, to develop the SME platform into a vibrant market, it is important for institutional investors to take interest on the platform. Long term Institutional investors can invest in the initial IPOs and help build market integrity and investor confidence for this market. Major stakeholders including Banks, FIs and VCs therefore can play an important role to position the market as an attractive place for long term investors with potential of handsome gains.

There are various industry bodies and associations representing SME in the country. These bodies should engage with the SMEs to spread awareness about the an alternate option for raising funds and at the same time educate them on the importance of corporate governance, good management teams, clear plans and other aspects which are viewed critically by sophisticated investors.

SMEs comprise a large section of Banks' asset base. This is an opportunity for banks to take equity exposure in companies where they already have a debt exposure, thereby strengthening the relationship and improving the leverage position of the company. Banks can also engage actively in handholding their SME customers to prepare for the capital market.

Venture capital and Angel investors invest in growing companies in the private space. The industry has huge investments in the SME sector and can benefit by using the SME Platform as an exit route. An offer for sale on the platform will not attract capital gains tax (only Securities Transaction Tax) which will have a substantial impact on the overall returns of the investors. Participation by VCs on the platform will play an important role in creating a credible platform for good quality growing companies. Moreover, these investors invest after detailed diligence and therefore help in attracting other investors.

It is important for the government to incentivise institutional investors to participate on this platform to make it a serious market place for channelizing risk capital to emerging companies. With timely support and positive steps by the key stakeholders the platform has the potential to revolutionise the way in which companies get access to public equity at the early stages of their development.

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Shri Ravi Tyagi looks after EMERGE, the exclusive SME platform of NSE, the leading stock exchange of the country. EMERGE has been operationalised in September, 2012 with two SMEs having raised Rs.45 crore through the platform and several others being in pipeline. NSE has made efforts to position the NSE SME platform as an alternative and credible platform offering informed investors opportunity to invest early in India's best emerging businesses. The SME platform is also expected to provide liquidity to early stage risk investors in SME companies.

*\* The author has more than 20 years industry experience including 15 years with SIDBI. He was instrumental in establishing of Rs.2000 crore risk capital fund for MSMEs in SIDBI. The risk capital fund has rolled out several mezzanine risk and equity products in the country for SMEs in addition to running the fund operations.*

## MSME FINANCING: NEED FOR INNOVATION

Mukesh Gulati & Gaurav Paliwal\*

**M**SMES worldwide play a leading role in propelling economic growth, sustaining livelihood and in promoting equitable regional development. Significance of MSMEs can widely be observed in the developing economies where this sector constitutes over 90% of total enterprises and substantially to industrial production, exports and employment generation. In India also MSMEs play pivotal role in overall industrial economy of the country. A unique feature of Indian MSMEs is that a very large proportion of them are concentrated around an estimated 6600 clusters including 1157 traditional industrial clusters, 3091 handicrafts clusters and 563 handloom clusters. ([www.clusterobservatory.in](http://www.clusterobservatory.in))



**Shri Mukesh Gulati**

With the opening up of Indian economy in 1990s, MSMEs are no more insulated in the controlled economy; the competitive pressure of free market economy is catching up. MSMEs are transitioning into a new business environment characterized by the emergence of national and global supply chains where they share symbiotic relationship with large corporations. Yet a large number of MSMEs cater only to regional domestic markets through local supply chains. With the advent of foreign direct investment in organized retail sector and opening up of government market for MSMEs through a new bill that will ensure procurement of products and services from this sector, the opportunities will increase for many of the MSMEs who will need to upgrade their production, quality and supply systems according to the buyers' upgraded requirements. This will therefore also require increased credit requirements among MSMEs. Credit flows to the sector will also be needed for plugging infrastructure bottlenecks more particularly power generation and other common facilities.

Without adequate and timely flow of credit, sickness among MSMEs and NPAs for the banks will only increase. The major reasons identified by the Economic Survey of India 2009-2010 behind the increasing sickness among Indian MSMEs are the lack of market demand and lack of working capital. The survey for 4th All India Census of MSMEs identified 48% units among the sick units are suffering due to the lack of working capital. The major reason suggested by experts in the field of MSME development for lower access to credit among MSMEs is the high risk perception among the banks about this sector and high transaction cost for loans appraisal that restricts access of MSMEs to institutional credit mechanism.

While developing mechanisms for enhancing flow of credit to MSMEs, it needs to be recognized that the MSMEs access credit not only from the formal institutions but also informal sources. The effectiveness of any channel for credit delivery depends on transaction cost, ease of access and turnaround time for delivery. In India, according to the 4th All India Census of MSMEs, a mere 5.2% of total MSMEs have access to institutional finance, most of which are registered formal enterprises. It is therefore very important to provide a thrust to financing through informal channels as well.

The Government of India while realizing the potential of MSMEs with respect to job creation and industrial and economic growth has taken various measures to facilitate MSME development including enacting Micro, Small, Medium Enterprises Development (MSMED) Act, 2006, implementing various promotional initiatives including National Manufacturing Competitiveness Program. The Prime Minister's Task Force on MSMEs Report 2010 advised banks to achieve 20% annual growth in outstanding credit to micro and

small enterprises. Government of India launched Credit Guarantee Fund Trust for Micro, Small and Medium enterprises (CGTMSE) with SIDBI for creating an institutional mechanism to support banks and financial institutions to ensure availability of credit facility and easy access to institutional funds to MSME sector. The slew of measures taken by the government has certainly resulted in increased credit flow to MSME sector by 5.5 times from Rs 746 billion as at end 2004-05 to Rs 4079 billion on November 19, 2010. A significant amount of increase is due to change in the definition of MSMEs with inclusion of service enterprises in the year 2006-07 and manufacturing enterprises with higher investment limits upto Rs. 10 crores instead of Rs. 1 crore earlier as applicable to the then small scale industries. However despite the increase most of the micro and small enterprises still remain uncovered through institutional finance.



**Shri Gaurav Paliwal**

SIDBI during a study undertaken in the year 2011 identified several constraints that hinder MSMEs access to credit and acknowledged in its report the need for financial innovation by adoption of several international best banking practices for MSMEs sector. Many of these measures indicated the need to adopt revenue based financing instead of collateral based financing that is currently in vogue in most of the institutional financing. There is also need to come up with new institutional mechanisms that can address the smaller loan requirements of the MSME segment ranging from Rs. 50,000 to Rs. 10 lacs that is most starved of formal credit. This is also classically called the missing middle between the extremes of micro finance and larger institutional credit beyond Rs. 10 lacs requirements where banks are more comfortable to lend.

Sarkar et.al (2011), studied around 100 MSME clusters and found accessing finance as the major concern in 43 clusters. The study found that most of the units in these clusters stay away from institutional finance either due to perceived high rate of interest, non availability of institutional finance mechanism or because of improper documentation, inability to provide physical collateral and tedious and/or lengthy documentation process of the banks. All these resulted in problems like inability of enterprises to stock raw materials and finished products to meet the peak season demand, securing domestic supplies and leaning towards informal markets for credit at higher rate of interest thus increasing the production cost and reducing the viability of businesses. Very little work has been done to study and find ways to strengthen alternate institutional mechanisms to plug missing middle financing and improve efficiency of the informal financing markets. This paper therefore advocates the need for designing, piloting and scaling up of various innovative methods for improving access to credit for MSMEs through various alternate routes.

These models must aim at reducing transaction costs particularly for smaller credit requirements and yet help banks provide loans with mutually win-win synergy. Several Innovative models for facilitating MSMEs access to finance are developed around the world some of which have also been tried in India. The ones that have been successful must be taken up for piloting at bigger scale and then replicating at still higher levels by designing them to suit local context. Some of these models are illustrated here in this paper.

Customised financing systems among banks: Strengthening internal knowledge systems in banks can help them customize credit facility suiting common local needs of enterprises, often in the same or similar sector. There is a lot of scope for customisation of financial products with respect to the business needs in terms of their seasonality, production cycles and cash flows of the businesses through flexibility to meet differential need of the groups of enterprises. Over the last two decades several banks including State Bank of India, SIDBI, Punjab National Bank and ICICI Bank have claimed to set up cluster based branches to capitalise on building an understanding of common needs of cluster based MSMEs. There is however a great deal of improvement required in the methodologies adopted for capitalising on this opportunity. Sarkar et.al (2011) emphasized the fact that credit needs vary with the level of maturity of

the cluster. It was found that clusters where units are value chain linked with large enterprises need credit for technology, expansion, creation of sheds and building etc. Other enterprises demand credit for basic working capital requirement. The paper identified huge difference between felt credit needs and the credit accessed by banks in 90% cases. The process includes involving local industry associations (also called Business Membership Organisations or BMOs) to facilitate better communication between MSMEs and the Banks. Faridabad Small Industries Association (FSIA) and SIDBI have developed a successful model where the BMO provides further value added services to help screen applications thus giving further comfort level to SIDBI.

**Order based financing:** It is often observed with micro and small enterprises that they do not have adequate working capital due to which they are unable to fulfil the orders. Order based finance could be a well suited model in such a situation and is well practiced in South Korea. Under this model purchase order can be used as collateral for the loan. The accounts receivable is transferred to the lending institutions and becomes the source of loan repayments. The financial institution may then collect full interest, fee and part payment for the loans. The model reduces the risk for the financial institutions by creating an accounts-receivable mechanism of lending based on buyers demand.

**Purchase based lending:** Where there is less surety of orders in the short term or where MSMEs are involved in their own marketing, purchasing raw material at appropriate time and price becomes a major issue. Under such circumstances, raw material need of the MSMEs can be fulfilled by giving vouchers to bank approved raw material suppliers (RMS). RMS in this case would just be a facilitating agent. Here the liability will not be on the RMS but the relationship of enterprise as gauged by regular transactions and history of buying selling with RMS could act as a comfort. Similar mechanisms can be applied to meet technology needs of the enterprises where credit is required to buy equipment from pre-approved higher end technology provider. The order based financing and purchase based financing are transaction based models.

Mutual credit guarantee system that provide collective guarantee to member firm is another way of improving MSMEs' access to credit. Joint liability groups like these reduce the need of intermediaries between the banks or other financial institutions and MSMEs. It is a well practiced model with its genesis in Italy and several other European countries. However, for this the banks need to recognize the consortia of MSMEs organizing themselves into a Mutual credit guarantee group. There are well documented institutional mechanisms that enable enterprises to become members of such organisations that can have thousands of members and in house established systems of screening applications for credit and sharing of profit evolved from good functioning of such institutions.

**Finance plus services:** Credit delivery needs to be often supplemented with credit advisory services that can help MSMEs make effective use of credit and also provide improved monitoring system for the banks. These services can be charged for either upfront or subsequent to credit delivery. In other cases provision of linkages with differential value added service providers in the cluster for providing technical guidance and hand-holding support can be provided thus mitigating the risk associated with financing. There is in fact a wide gap between the existing and potential productivity levels that such services can help to reduce thus giving synergic advantages to all stakeholders involved. The State Bank of India's Uptech programme implemented since 1989 is one such model that has immense potential for scaling up.

**Strengthening capacities of other intermediary institutions:** The missing middle financing can also be taken care of by bringing in micro finance institutions, non banking financial institutions and regional rural banks to start financing micro & small enterprises. This will require building their capacities to identify the needs of local MSMEs and help build systems to effectively meet the requirements. This will ensure bringing in new supply institutions that are not traditionally involved with MSMEs. Moreover

NBFCs and MFIs can develop or use their own systems of appraisal and risk financing suiting the requirements of this heterogeneous sector across diverse economic geographies.

Risk participation in financing innovative MSMEs: Banks traditionally provide lending using safe norms and securities. Risk participation by banks among a basket of innovative enterprises particularly at small levels of financing practically does not exist. The appraisal and recovery systems for financing currently in vogue do not provide for risk based financing of innovative enterprises. This does not necessarily allow start up entrepreneurs access credit as their business plans fall short on parameters like DSCR, leverage etc. (Aruna Balamurgan, SME World, 2010). There is need to build new windows for such financing.

SIDBI has undertaken to undertake trials through certain developmental projects financed by international agencies such as JICA, KFW, GIZ, World Bank, DFID and more recently European Union in the areas of energy efficiency, green financing, sustainability financing and innovative financing. An intervention aimed at improving energy efficiency of 500 enterprises under an EU Switch Asia project initiated in 2012 has targeted to reach out to at least 100 enterprises through different means, thus providing lessons for future replication. Similar trials are also being undertaken by other banks, a repository of which must be built to share learnings among the institutions and help scale up successful pilot interventions.

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