IJEMR – October 2015 - Vol 5 Issue 10 - Online - ISSN 2249–2585 Print - ISSN 2249-8672

A Case Study on Conceptual Framework of Lending Technologies for Financing of Small and Medium Enterprises by Indian Overseas Bank

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Executive Summary

Quite an important issues involved in SME Finance have come across during the analysis made in the study which have direct bearing on financing from bankers' and entrepreneurs' perspectives. Most of the SMEs being driven as family business and first generation entrepreneurs do not have proper succession planning to take over business, which later on ends with family conflicts. They do not have strong capital base and also no adequate collaterals etc., which posed major problems for bankability of their firms. Lengthy and complex paper & processing system of loan appraisal observed impediment for SME sector while this sector considered to be lesser risky, high yielding, faster growing and sustainable for development. Indian SMEs do not face much competition from advanced & developing economies (ADEs) and emerging market economies (EMEs), but these firms are facing stiff competition from domestic large sized firms. The credit acceleration in the sector had significantly noticed absolute growth but proportion of MSE credit in net bank credit has been more or less at same level of 14%, which was way back in year 2000 despite widening the coverage of the MSE sector. This analysis has indicated that real growth in finance to MSE sector is not adequate in light of significant contribution of the sector in economy such as employment, manufacturing and export of the country. Low share of MSE credit does not only hamper equitable growth of economy but also fails the banks to fulfill their social commitment to the growing society.

Credit appraisal is a holistic exercise, which starts from the time a prospective borrower walks into the branch and culminates in credit delivery and monitoring with the objective of ensuring and maintaining the quality of lending and managing credit risk within acceptable limits. The main objective of this study is to understand the procedure of lending loans to Micro, Small and Medium Enterprises and to comprehend the complete procedure of lending loans to MSME, terms and conditions adopted by IOB. The availability of external finance for small and medium enterprises (SMEs) is a topic of significant research interest to academics and an important issue to policy makers around the globe. In this project, a conceptual framework for analysis of credit availability for small and medium enterprises (SMEs) has been studied. In this framework, lending technologies are the key conduit through which government policies and national financial structures affect credit availability. An emphasis should be there on the causal chain from policy to financial structures, which affect the feasibility and profitability of different lending technologies. These technologies, in turn, have important effects on SME credit availability.

The 12th Five Year Plan has a logical strategy for SME sector. Innovation is the *sine quo non-for* ambitious growth of the sector. SMEs need such financial product, which covers life cycle of their firms. Banking sector has therefore, huge opportunities of viable business from SMEs because this sector stands as strong pillar of inclusive growth in an economy. Banks now have challenge to customize their products to meet innovative needs of SMEs at competitive rates for the sector to grow. It is witnessed from the findings of study that growth rate of SME sector has always been much higher than the overall credit

growth of banking industry that coins the phrase *"…Small is mighty, profitable & good for sustainability …"*

In addition, the findings are open for further survey & research by scholars in academia.

Introduction

SME is a growth engine of economy for any nation across the world. The importance of this sector in India as compared to corporate giants with respect to its contribution towards Indian economy can be best understood that they contribute 8% in Gross Domestic Product (GDP), 45% of manufactured output, 40% of exports, manufacture over 6000 products and provide employment to around 60 million person through 26 million enterprises as per latest 4th all India census of MSMEs. Recognizing the significant contribution of this sector in economic growth and also in employment generation in our country, Government of India has taken good number of initiatives to develop the sector such as erstwhile definition of 'Small Scale Industries' was enlarged by increasing investment ceiling in plants & machineries from Rs. One crore and trading activities have taken in the ambit of MSMEs by enactment of Micro, Small & Medium Enterprises Development (MSMED) Act from 2nd October 2006. Generally, the credits facilities are extended against the security know as collateral. However, even though the loans are backed by the collateral, banks are normally interested in the actual loan amount to be repaid along with the interest.

There are a number of distinct transactions technologies used by financial institutions, including financial statement lending, small business credit scoring, asset-based lending, factoring, fixed-asset lending, and leasing. These financial structures, in turn, significantly affect the availability of funds to SMEs by determining the feasibility and profitability with which different lending technologies may be deployed. A common finding is that large institutions have a comparative advantage in transactions lending to SMEs based on hard information, while small institutions have a comparative advantage in relationship lending based on soft information.

Transactions lending technologies are primarily based on "hard" quantitative data that may be observed and verified at about the time of the credit origination. This hard information may include, as examples, financial ratios calculated from certified audited financial statements; credit scores assembled from data on the payments histories of the SME and its owner provided by credit bureaus; or information about accounts receivable from transparent, low-risk obligors that may pledged as collateral by the SME or sold to the financial institution. This information may be relatively easily observed, verified, and transmitted through the communications channels within the financial institution. The relationship lending technology, in contrast, is based significantly on "soft" qualitative information gathered through contact over time with the SME and often with its owner and members of the local community. The soft information may include the character and reliability of the SME's owner based on direct contact over time by the institution's loan officer; the payment and receipt history of the SME gathered from the past provision of loans, deposits, or other services to the SME by the institution; or the future prospects of the SME garnered from past communications with SME's suppliers, customers, or neighboring businesses. The soft information may often be proprietary to the loan officer and may not be easily observed by others, verified by others, or transmitted to others within the financial institution.

For small business credit scoring, large institutions use hard information on the SME and/or its owner obtained from credit bureaus to infer future loan performance; for asset-based lending, these institutions use valuations of the assets pledged as collateral to evaluate repayment prospects; for factoring, they focus on the quality of the accounts receivable purchased; for fixed-asset lending and leasing, large institutions look to the valuations of the fixed assets that are pledged as collateral (fixed-asset lending) or directly owned by the institution (leasing). Thus, when informative financial statements are not available, institutions are often able to use other types of hard information to assess repayment prospects. Similar arguments apply to potentially misleading conclusions based on the current framework about other dimensions of a nation's financial structures and the policies that affect these structures. The limited findings from studies that identify lending technologies suggest that significant variation in the deployment of these technologies exists across nations – an institutional fact that is not explained by the current conceptual framework.

Another area of concern regarding SME credit availability is the lending infrastructure of a nation, which defines the rights and flexibility of financial institutions to fund SMEs using the lending technology that best fits the institution and the borrower. This infrastructure includes the commercial and bankruptcy laws that affect creditor rights and their judicial enforcement; the regulation of financial institutions, including restrictions on lending, barriers to entry, and direct state ownership of financial institutions; the information infrastructure, including the accounting standards to which potential borrowers must comply as well as the organizations and rules for sharing information; the taxes that directly affect credit extension; and so forth that provide the economic environment in which financial institutions may lend in a given nation.

Statement of the Problem: -

To study current framework of lending technologies which are often categorized into two types: transactions lending that is based primarily on "hard" quantitative data and relationship lending, which is based significantly on "soft" qualitative information

The following steps that are to be analysed are as follows: -

1) To Study & Verify the Borrower's Papers, Documents & Necessary information required.

2) To Study the Financial Tools required for the Credit Appraisal of the Project:

   a) To Study & verify the Project Report of the Company

   b) To Study & analyse the Financial Statements of the Company

   c) To Verify the Statutory Approvals required for the Project

3) To Study & analyse the Working Capital Assessment of the Company

4) To study relationship lending Of IOB

Objectives of the Research: -

SME is *Gen-Next* engine of economic development and it is answer to realize 12th Plan with special reference to generate employment and export of the country. Also this sector has huge potential of banks' finance for sustainable growth, the instant research project "A Conceptual Framework Of Lending Technologies For Financing Of Small And Medium Enterprises By Indian Overseas Bank" hence aims –

a) To study the credit appraisal system for working capital finance to SME's

b) To understand the credit appraisal procedure followed to grant loans for MSME.

c) To examine & analyze the status of credit flow to SME

d) To take stock of extant policy frameworks and various provisions for financing to a SMEs and review them in the light of observations of the study.

e) To study the factors considered and focused on before sanctioning the loan amount.

f) To analyze primary and secondary data for observations and to offer recommendations to enhance accessibility of bank finance to SMEs.

Scope and Implication of the Study

Researcher mainly used secondary data for the study. It is mainly collected from the annual report prepared by the company itself. This policy covers credit facilities to micro and small enterprises. (Both manufacturing and services sector) and all related issues such as assessment of credit, margin norms, security requirements, coverage under Credit Guarantee Scheme etc. The present report is an attempt to understand the Framework of Lending Technologies by Indian Overseas Bank, Saheed Nagar Branch Bhubneswar to MSME Units.

Definition of Micro, Small & Medium Enterprises:-

The following chart indicates the threshold investment levels for both **Manufacturing Sector** (Investment in **Plant & Machinery**) and **Services Sector** (Investment in **Equipment**):-

	INVESTMENT IN PLANT & MACHINERY	**INVESTMENT IN EQUIPMENT**
ENTERPRISE	***Engaged in Manufacturing/Preservation of goods***	***Engaged in Providing/Rendering of Services***
MICRO ENTERPRISE	Not to Exceed Rs. 25 Lakhs	Not to Exceed Rs. 10 Lakhs
SMALL ENTERPRISE	More than Rs. 25 Lakhs but does not exceed Rs. 5 Crores.	More than Rs. 10 Lakhs but does not exceed Rs. 2 Crore.
MEDIUM ENTERPRISE	More than Rs. 5 Crores but does not exceed Rs. 10 Crores.	More than Rs. 2 Crores but does not exceed Rs. 5 Crores.

- **Targets for Lending to Micro & Small Enterprises (MSE) Sector by Domestic Commercial Banks:-**

Advances to Micro & Small Enterprises (MSE) sector shall be reckoned in computing achievement under the overall priority sector target of 40 percent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-Balance Sheet Exposure, whichever is higher. Bank loans above Rs. 5 Crore per borrower/unit to Micro & Small Enterprises engaged in providing or rendering of services, with investment in equipment as defined under MSMED Act, 2006 shall not be reckoned while computing achievement under the overall priority sector targets. In terms of the recommendations of the Prime Minister's Task Force on MSMEs, banks have to achieve a 20 percent Year-on-Year growth in credit to micro & small enterprises & a 10 percent Year-on-Year growth in the number of micro enterprise accounts.

In order to ensure that sufficient credit is available to Micro Enterprise within the MSE Sector, branches should ensure that :-

- 40 percent of the total advances to MSE sector should go to Micro (Manufacturing) enterprises having investment in plant & machinery up to Rs. 10 Lakhs & Micro (Service) enterprises having investment in equipment up to Rs. 4 Lakhs [say Micro-I] ;

▪ 20 percent of the total advances to MSE sector should go to Micro (Manufacturing) enterprises with investment in plant & machinery above Rs. 10 Lakhs & up to Rs. 25 Lakhs, and Micro (Service) enterprises with investment in equipment above Rs. 4 Lakhs & up to Rs. 10 Lakhs [say Micro-II].

Note: - ***Thus, 60 percent of MSE advances should go to the Micro Enterprises.***

▪ The target for lending to Micro Enterprises within the MSE Sector (i.e. 60% of total lending to MSE Sector should go to Micro enterprises) will be computed with reference to the outstanding credit to MSE Sector as on preceding March 31st.

Category	Sub-Targets
MICRO-1: **Mfg. Sector**: Units with Investment in Plant & Machinery up to Rs. 10 Lakhs, & **Service Sector:** Units with Investment in Equipment up to Rs. 4 Lakhs	40.00 %
MICRO-2: **Mfg. Sector**: Units with Investment in Plant & Machinery above Rs. 10 Lakhs & up to Rs. 25 Lakhs, & **Service Sector:** Units with Investment in Equipment above Rs. 4 Lakhs & up to Rs. 10 Lakhs	20.00 %
Total Finance to MICRO out of total Micro & Small Sector :-	60.00 %

➢ **Credit Appraisal:-**

Proper identification of the enterprises, verification of applicant(s) & his/her/their antecedent in accordance with KYC Norms/Guidelines, their experience in the proposed line of activity, educational & social background, technical/professional competence, integrity, initiatives, etc.

• Checking out for Willful Defaulter's List of RBI, Specific Approval List (SAL) of ECGC, CIBIL reports individuals as well as commercial etc.

• The acceptability of the product manufactured, its market demand/supply position, market competition, marketing arrangement, etc.

• Evaluation of State & Central Govt. Policies (enabling environment) with specific reference to the Enterprise in question, Environmental stipulations, availability of necessary infrastructure-roads, power, labour, raw material & markets.

• Techno-economic Appraisal of units to be carried out as per guidelines circulated by our TAD department from time to time. At present it is HOBC 107/46 dated 06.06.2013.

• Project Cost, the Proponent's own financial contribution, projections for following three years, & other important parameters which would include the BEP, Liquidity, Solvency & Profitability Ratios, etc.

- **Credit Tenure :-**

The Term Loan exposure to MSME Sector would generally be for a term of 7-10 year maturity, while working capital will be on demand.

- **Working Capital Assessment:-**

A. Turn-Over Method :-

For working capital limits requirement up to Rs.5 crores, turnover method would be applicable as per **"Nayak Committee Recommendations".** Under this Method, Working Capital is assessed at 25 % of the **Projected Turnover** based on the assumption of a three month operating cycle.**20% of the turnover is provided by way of bank finance & balance 5% or 1/5th of the working capital required should be brought in by the borrower by way of net working capital contribution.** It is abundantly clarified that this **20% is the minimum WC limit to be sanctioned even if the proponent's operating cycle is shorter than 3 months.**

MPBF (Maximum Permissible Bank Finance) Method:-

This is the Conventional Method of assessing working capital for units with Longer Operating Cycle and/or for units requiring working capital in excess of Rs. 5 crores. The assessment is based on the build-up of Current Assets & Current Liabilities. 25% of current assets should be brought in by the borrower/promoter by way of net working capital contribution. As a measure of incentives for exports, stipulation of providing margin on export receivables has been waived. As such the minimum margin required will be 25% of total current assets excluding export receivables.

B. Cash Budget Method:-

Here the working capital requirement is more than Rs. 5 crore assessments should be carried out under cash budget method especially where the borrower is engaged as contractor or revenue is recognized on progressive billing basis, etc. Under this method, the peak level cash deficit will be the level of total working capital finance to be extended to the borrower. The Peak Level Cash deficit will be ascertained from the projected Cash Budget Statement submitted by the borrower. The Cash Budget Statement would comprise of projected receipts & payments for the next 12 months on account of business operations including advance payment, mobilization advance, non-business operations, cash flow from capital accounts & other sundry items.

Branches should obtain & scrutinize latest audited financials of the constituent in all cases of WC limits request of **Rs. 10 Lakhs & above**. In case provisional balance sheets are submitted by the constituent, adverse variation between the provisional & audited financials should not exceed 5%. In the event of deviation beyond 5%, branches should have a discussion with the constituent to find out the reason for such variation & report to the sanctioning authority.

C. Benchmark Ratio for Credit Proposals:-

Following benchmark ratio shall be observed for credit proposals where WC is assessed on projected working capital method:-

SL. NO.	RATIO	Micro & Small Enterprises under manufacturing sector and Service Sector falling under regulatory guidelines	Medium Enterprises under manufacturing sector and Service Sector falling under regulatory guidelines
1	Current Ratio	1.17 & Above	1.25 & Above
2	Debt Equity Ratio (Total Term Liability/ Tangible Net Worth)	3:1	3:1
3	TOL/TNW	4.5:1	4:1
4	Average DSCR (Debt Service Coverage Ratio) for Term Loan	1.50:1	1.50:1

- **Collateral Security & CGTMSE:-**

Credit facilities extended to a single Micro & Small Enterprise, borrower (i.e. erstwhile SSI) either by way of **Term Loan** or **by way of Working Capital** or **both**, without any **Collateral Security** or **Third Party Guarantee**, will be covered, for eligible activity, under SIDBI's **Credit Guarantee Fund Trust for Micro & Small Enterprise (CGTMSE)**. A composite limit up to Rs. 100 Lakhs will be considered By branches to meet working capital & Term Loan requirements of Micro & Small Entrepreneurs.

As per the guidelines of RBI, Micro & Small Enterprises with limits up to Rs. 10 Lakhs may be sanctioned credit facilities without any Collateral Security. For customers with good record of accomplishment, this waiver of Collateral Security may be extended for limits up to Rs. 25 Lakhs with the approval of the Zonal Manager. **Credit limits up to Rs. 100 Lakhs for all eligible activity are to be mandatorily covered under CGTMSE & no Collateral Security or Third Party Guarantee to be obtained. However, obtaining Collateral Security, Third Party guarantee in lieu of CGTMSE cover may be considered with prior approval from GM-NBG.**

- **Rehabilitation of Sick Units & Debt Restructuring :-**

The Bank's extant instructions & RBI's guidelines on the Rehabilitation of Sick Units would be applicable for units in MSME Sector also. In addition, RBI revises these areas from time to time.

- **Structured Mechanism for Monitoring Credit Growth to the MSME Sector :-**

In view of the concerns emerging from the declaration in credit growth to the MSE Sector, an **INDIAN BANK'S ASSOCIATION (IBA)** led Sub-Committee (**Chairman: Shri K.R. Kamath**) was set up to suggest a structured mechanism to be put in place by banks to monitor the entire gamut of credit related issues pertaining to the sector. Based on the recommendations of the committee, banks have been advised to:-

✓ Strengthen their existing systems of monitoring credit growth to the sector & put in place a system-driven comprehensive performance "**Management Information System (MIS)**" at every supervisory level (branch, region, zone, head office) which should be critically evaluated on a regular basis.

✓ Put in Place a system of e-tracking of MSE Loan applications & monitor the loan application disposal process in banks, giving branch-wise, region-wise, zone-wise & state-wise positions. The position in this regard is to be displayed by banks on their websites. In this connection, a web-based system of Centralized Branches are required to fill in the necessary details in the register online, on receipt of the application under MSME. On clicking the submit button "**Acknowledgement Slip**" would be generated with a running serial number. A print out of the application should be handed over to the applicant & simultaneously the running serial number should be recorded on the hard copy of application for future reference (HOBC 107/6 dated 08.04.2013). The Package is being developed by HO-IT team further to take care of all other requirements as mandated by RBI.

IOB Guidelines on MSME

Advances to MSE sector will be assessed like any other advance (except for the specific relaxations and concessions given in this policy) and credit decisions will be taken based on viability, merits and commercial judgment in each case as per general norms of lending. The credit appraisal will be made in a transparent and non-discriminatory manner. All genuine and just requirements of the MSE units will be considered and adequate amount of credit will be sanctioned to ensure that the unit does not suffer for want of funds at a later date.

Necessary credit support will be extended to MSE units for business restructuring, modernization, expansion, and diversification and technological up gradation as may be required from time to time.

The following type of credit facilities will be extended to MSE units.

1. Term Loans
2. Project Finance
3. Working Capital Finance
4. Purchase and discounting of Bills
5. Negotiation of Bills
6. Non fund based facilities such as LC and LG
7. Pre shipment/Post shipment finance
8. Credit facilities under Bank's special credit schemes such as Sanjeevani, Easy Trade Finance, Commercial Cash Credit against Jewellery, etc.,
9. Any other type of credit depending on specific need

Strategies:

To improve the flow of credit to MSE sector and to achieve the various targets and commitment for the MSE sector, the bank will adopt the following strategies:

• Branch Managers and other officials handling MSE credit will be imparted training to enable them to properly understand the nuances of MSE finance and opportunities in the sector.

• MSE credit processing centres will be set up at key locations to ensure prompt and efficient processing for all MSE credit applications for credit limits of more than Rs.10 lakhs.

• Simplified loan application forms in bilingual formats will be made available for loans to Micro Enterprises.
• Region wise and branch wise targets will be fixed for lending to MSE sector and monthly review notes on Region wise performance will be placed to Top Management.
• A separate target will be fixed to branches for sanction of loans under CGTMSE cover in order to increase the coverage under Credit Guarantee Scheme of CGTMSE.
• Thrust will be given to cluster based financing.
• SME branches and specialized SME branches will be opened at potential centres, identified clusters and industrial estates to enhance the flow of credit to MSE sector.
• At corporate level, bank will enter into MOU/tie up arrangement with the corporate and other agencies to formulate specific schemes for delivery of credit to MSE sector.
• Latest technology will be adopted for on line submission of MSE credit applications, tracking of applications and for MIS requirements.
• New credit products will be developed for MSE sector to meet the emerging requirements of the sector from time to time.
• Bank will implement all Government of India/State Government sponsored schemes for MSE sector and disburse credit under such schemes.
• Bank will avail refinance from SIDBI to augment the resources for lending to MSE sector, whenever considered necessary.

Concluding Remarks

The loan policy for MSE sector will operate within the overall loan policy of the Bank and subject to guidelines/instructions of Regulatory Authorities/RBI/Government of India. Therefore, the policy will be amended with the approval of the Board whenever revised guidelines are received from the Regulatory Authorities. This policy will be in force until a review is made by the Board of Directors for accommodating the emerging requirements.

Review of Literature

Kristin Hallberg, (2000) Governments in both industrialized and developing countries provide a wide variety of programs to assist small- and medium-scale enterprises (SMEs). Despite the success of SME strategies in a few countries, the majority of developing countries have found that the impact of their SME development programs on enterprise performance has been less than satisfactory? This paper investigates the economic rationale for intervention in support of small- and medium-scale enterprises, on both theoretical and empirical grounds.

Krishna Kumar (2003) He views that In India foreign collaborations have generally been to have the technological transfer, which involves high cost. It is important to understand the MSME's single handedly cannot afford this cost, however if a group of MSME's of similar nature of work come together the burden of the foreign collaborations can be shared effectively.

Y.Srinivas (2005) MSMEs play a very significant role in the economy in terms of balanced and sustainable growth, employment generation, development of entrepreneurial skills and contribution to export earnings. However, despite their importance to the economy, most SMEs are not able to stand up to the challenges of globalisation, mainly because of difficulties in the area of financing.

Sickness and Rehabilitation of MSMEs in India (2005): The author feels that the SMEs will fail in a sector for a variety of reasons. There are a multitude of reasons for failure, however, not all of them related to competition. Lack of knowledge, available capital, qualified workers or even motivation on the part of the owner are all viable reasons for business failure. Whatever the reason for failure, the business must have some sort of recourse to 'declare' its sickness

Keshab DAS (2007) Despite an elaborate and dynamic policy framework, the progress of Indian MSMEs continues to be hindered by some of the basic constraints as poor credit availability, low levels of technology (hence, low product quality and limited exportability) and inadequate or no basic infrastructure, both physical and economic. The MSMED ACT attaches importance to networking with stakeholders both upstream and downstream in the entire global value chain, from raw material procurement to processing / manufacturing to marketing to customer services.

Bhatendra Kumar Gupta (2008) In India, the MSME sector is the second largest employer after agriculture. With the growth in the Indian Economy, it is of need for the MSME to raise capital is becoming increasingly critical. He says that there is a need for the dedicated STOCK Exchange for the MSME sector to cater to their needs better which are different from the large industries.

RBI's Report of Working Group on Rehabilitation of Sick SME's (2008) A Working Group was constituted under the chairmanship of Dr. K. C. Chakrabarty, Chairman and Managing Director, Punjab National Bank to suggest measures for improving credit flow to the SME sector as well as measures for early implementation of rehabilitation/nursing of sick SME units by examining feasibility of bringing in additional capital through alternative routes, such as, equity participation, venture financing, etc. Support schemes like Credit Linked Capital Subsidy Scheme in case of units in other (than rural) areas, KVIC Margin Money Scheme (for units in rural areas) may be extended for rehabilitation packages also. Many other recommendations have also been given.

Shamika Ravi (2009) The MSME sector has often been termed the 'engine of growth' for developing economies. The MSME Development Act of 2006 is perhaps the most crucial of these recent policy changes.

Sankar De (2009): This article pot rays the enormity of the challenge and outlines a possible partial remedy. SME's in India face may challenges, but perhaps none are as difficult as the challenge of financing, both short term and long term.

Ramesh V Penumaka (2009) It reflects that while the government can be a facilitator of growth and promoter of equity , the role of the large enterprises is also critical, The MSME could be the steroid the Indian economy needs at this juncture. The SME provides not only the much needed boost for growth, employment and exports but also more significantly, contributes to geographical and social equity.

Raja, SME Times (2010): The challenges that the SMEs face today seem to be primarily in the area of ICT and to quote specifically, ERP. The SMEs lament that whenever they approached the usual ERP firms, the first question they were faced with was that of their turnover as they are quoted based on their turnover.

Seema Sharma & Milind Sharma (2010): The purpose of this paper is to examine the relative production efficiency of state-wise clusters in the registered small-scale sector in India. The author says that, most of the states are found to be operating at decreasing returns to scale, which signifies the scope for investment and further employment generation.

Report of the Task Force on MSME (2010) The MSME sector in India is highly heterogeneous in terms of the size of the enterprises, variety of products and services produced and the levels of technology employed. While one end of the MSME spectrum contains highly innovative and high growth enterprises, more than 94 per cent of MSMEs are unregistered, with a large number established in the informal or unorganized sector. Besides the growth potential of the sector and its critical role in the manufacturing and value chains, the heterogeneity and the un-organised nature of the Indian MSMEs are important aspects that need to be factored into policy making and programme implementation.

Risk and Capital Management in MSME's- by SIDBI (2010) The advent of globalization offers both challenges and opportunity to MSMEs. The challenge for them is to remain competitive and consistently deliver value to customers. Risk Capital is an important instrument for not only start-ups and innovative / fast growing companies but is also critical to those looking at growth. However, the sources of risk capital are limited in developing countries. It is encouraging to note that with global integration of economy, emerging markets like India are sought after destinations for successful Private Equity (PE) funds. Majority of the MSMEs are owner driven with lesser inclination towards formal organizational structures. The non-corporate structure and small size of the majority of MSMEs in India makes the venture capitalists and other risk capital providers reluctant to investing in them due to higher transaction costs and difficulties in exits out of such investments. Thus, it is critical to have appropriate risk capital products and focused funds for MSMEs of different size and constitution.

Sangeeta Baksi (2010) TIFAC is of the opinion that, there are few programs, which are of utmost importance in the MSME- led technology development efforts, which promote the public private partnership. More so, the technological development has never been a straight forwards process. Technological innovations have been the key to the survival of the MSMEs.

C.B. Bhave(2010) In this opinion the MSME's are a catalyst in most of the economies and constitute a major part of the industrial activity. He foresees that the SME Stock Exchange will be a great boon to this sector, as it will provide a wide pool of capital, increased status and credibility and other benefits.

Roopa Kudva (2011) The Managing Director of CRISIL says it is not easy to attract MSME's to do a credit rating, however it is important to have the credit rating done if the MSME's wants to position itself in the international market as well as there is a rebate from the bankers in the lending terms. Unfortunately, the 75% subsidy is available only for the first time /year the MSME gets its rating done subsequently they have to bear the entire cost next year, which is a strain on the purse strings.

Tarak Shah (2011) The major problem of inadequate financing to SMEs needs an urgent attention amongst the others such as adequate credit delivery to SMEs, better risk management, technological up gradation of Banks esp. Public Sector Banks, attitudinal change in Bankers. A number of issues and business practices of global players and markets can be observed, learnt and adapted for ensuring competitiveness of Indian SMEs

SME Chamber of India (2011) SMEs are now exposed to greater opportunities than ever for expansion and diversification across the sectors.

Vijay Kumar (2011) Talking about a few basic issues being faced by the MSMEs sector is lack of awareness, investment and resource, "Zero wastage and continuous design improvement hold the key to survival and growth of MSMEs."

Mehul Kapadia (2011): Every bit of capital investment is crucial for an SME. Seasonal peaks are one of the greatest reasons for companies under-provisioning or over-provisioning. This can later result in a heavy loss and idle resources. Large enterprises have the capability and the resources to execute such transformations smoothly, but SMEs face a significant challenge in doing so, given their limited resources and capital.

Annual Report of MSME 2011-2012 gives the overall view of MSMEs with respect to its performance and growth in production, employment, export, number of industries, detail view of various schemes and of various departments of MSMEs.

Annual Report of MSME 2012-2013 gives the overall view of MSMEs with respect to its performance and growth in production, employment, export, number of industries, detail view of various schemes and of various departments of MSMEs.

Final Report of Fourth All India Census of MSME gives a sound, accurate and comprehensive database of MSMEs for sound policy formation.

Garg, Ishu and Walia, Suraj. (2012) confirms that the significant growth of MSMEs have been taken place over a period of time and this sector is the major donor to gross domestic

Methodology

The methodology adopted to carry out study is described below:

a) Use of primary and secondary data relating to SME finance
b) Secondary data has been collected from published reports and other data source from various sites such as Reserve Bank of India, SIDBI, GOI and banks in their various committee reports, speeches and periodical reports.
c) Statistical techniques viz. ratio analysis used to draw inference

Type of Research

The study conducted is a descriptive, analytical and conclusive type of research. The study is descriptive because it is in the descriptive study, that the data is collected for a definite purpose and here the purpose is definite i.e. the data is collected, to find out the lending procedures of Micro, Small and Medium Enterprises (M.S.M.E).It deals with the MSME policy and guidelines of Indian Overseas Bank and assessing the balance sheet and working capital of a particular enterprise. It is analytical as because the study is been conducted with the calculation of current ratio, debt equity ratio, debt service coverage ratio, holding period , working capital assessment, credit rating and finally overall analysis of different ratios. The study is conclusive because after doing the study the researcher comes to a conclusion regarding the Credit Rating of the Account on the basis of which the Credit will be appraised by the bank for providing the Working Capital Finance to Micro, Small and Medium Enterprises (M.S.M.E)

Source of Data Collection

The data was collected from the Company's Loan Policy Document 2013-2014. It includes:-

Report on SME Units

Financial Data of the Company

Internet Data

Books on Financial Institution

Type of Data

Primary Data:-

The primary data was collected directly from the bank manager as whenever required for making the project report more appropriate.

Secondary Data:-

The secondary data collected from the already sanctioned loan files

Collection of secondary data from Management journals

Bank and Borrower's Annual Report

Project proposal

Respective Banks Web Sites other sites

Reference from Management Books

The software used during the analysis is MS Excel 2013 and MS Word 2013.

After Scrutinization of all the Documents, the Bank decides whether to Approve the loan to the respective Company or not. If No, then the subject matter ends up there. In addition, if Yes, then the Bank goes for the Project Report of the Company, Financial Statements of the Company, & finally for the Statutory Approvals & their Scrutinization.

The Financial Tools Required for Credit Appraisal of A Company:-

A. Project Report Of The Company :-

The Project Report of the Company comprises of the following:-

a) Cost of Project (C.O.P), b) Means of Finance (M.O.F), c) Utility Details of the Project,
d) Capacity Utilisation of the Project, e) Project's Implementation & Drawdown Schedule, &
f) Repayment Schedule

B. Financial Statements of the Company: -

In the Financial Statements, the Bank goes for the following: - Estimation of Sales, Estimation of Profit, Calculation of various types of Ratios such as: - the Current Ratio, the Debt-Equity Ratio (D.E.R), the Debt Service Coverage Ratio (D.S.C.R), the Interest Service Coverage Ratio (I.S.C.R) & the Break-Even Point (B.E.P).

➢ **Working Capital Assessment:**

The Working Capital Assessment refers to the day-to-day expenses required for the proper functioning of an organisation. Here, the Bank goes for the assessment of Working Capital of the Company in order to know whether the Loan amount proposed by the respective Company is Acceptable or not. The following tools required for the Assessment of the Working Capital are the **Holding Period** (otherwise known as the **Operating Cycle Time-period**) & the various methods of Working Capital Assessment are **Turnover Method** & **Second Method of Lending** (otherwise known as the **Maximum Permissible Bank Finance Method** (**M.P.B.F**)).

• **Holding Period: -** It refers to the time between an Assets Purchase & its Sales. It is otherwise known as "Operating Cycle Time-period".

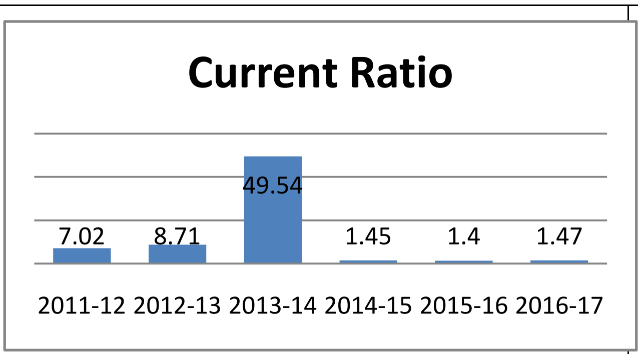
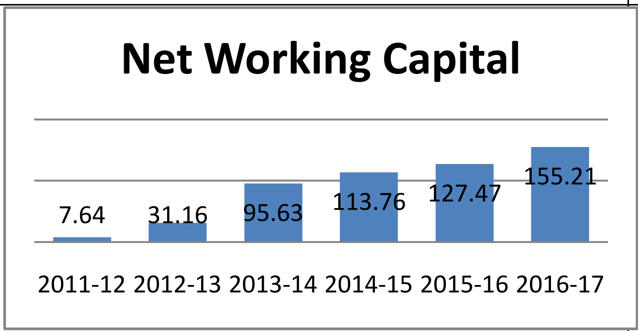
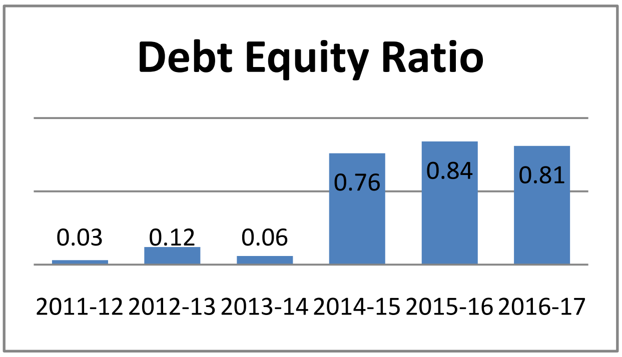
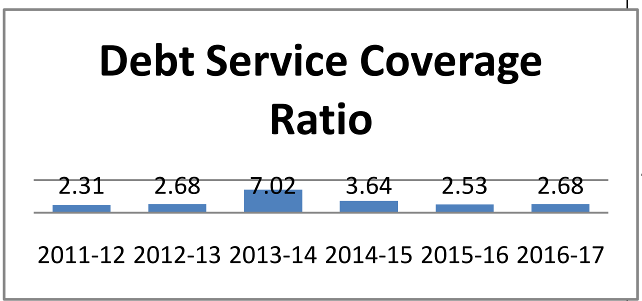
Case Analysis:

XYZ Enterprises is a partnership firm managed by three partners including one female member among them. MRX, MS Y and MR Z. The company is managed by professionally qualified managers and skilled staff. The organization culture reverberates the general understanding and protocol of doing business ethically. The management team that leads the company today, forms the integral part of the pedigree of successful experience in the business of PROJECTS CONSTRUCTION /EPC/PMC/MFG. OPERATIONs and Execution capabilities deeply involving BASIC & DETAILED ENGINEERING, PLANNING, PROJ. MGT., CIVIL, MECHANICAL, ELECTRICAL, INSTRUMENTATION, UTILITIES AND MISC. FACILITIES UPTO COMMISSIONING AND START UP OF PROJECTS/ OPERATIONS.

Data Presentation:

Calculation of Various Items: -

Amount in Rs. Lakhs

Calculation of Current Ratio (C. R.) Current Ratio = Current Assets / Current Liabilities		Analysis As the ideal current ratio is 1.25:1. The position of the company is quite stable to meet all the requirements. Current liability was much more in the year 2013-14 because of less demand in the market. The CR is more than the ideal ratio so it is acceptable.
Calculation of Net Working Capital (N. W. C.) Net Working Capital = Current assets-Current liabilities		Analysis The net working capital of the firm is increasing day by day, which gives a good signal to meet the short-term funds easily
Calculation of Debt Equity Ratio (D. E. R.) Debt-Equity Ratio = Total Outsider's Liabilities (T.O.L) / Tangible Net Worth (T.N.W)		Analysis The ideal debt equity ratio is 2:1 and in case of this firm it less than the ideal ratio so it in decreasing form. This shows the Company is doing well enough in all of its business operations
Calculation of Debt Service Coverage Ratio (D. S. C. R.) D.S.C.R= Profit After Tax + Depreciation + Interest for the current year / Installment + Interest		Analysis From the Debt Service Coverage Ratio Analysis, it is found that the Debt Service Coverage Ratio (D.S.C.R) is increasing in a positive manner year by year. Therefore, the Company is able to repay the debt including the interest to the bank within the respective time frame. The ideal ratio is 1.5:1 so it more than the ideal ratio.

Calculation of Working Capital Assessment: -

Comparative statement of Current assets and Current liabilities

Current Assets	**Projection 31.03.2016 (**) (in Lakhs)**	**Projection 31.03.2017 (in Lakhs)**
Raw Materials including stores, spares, consumables & other items included in the process of manufacturing (Rs. in Lakhs)	48.42	54.13
Raw Material Consumed (Rs. in Lakhs)	442.09	515.78
Raw Material Holding Period (in months)	**1.31**	**1.26**
Stock in Process (Rs. in Lakhs)	23.56	26.74
Cost of Production (Rs. in Lakhs)	679.44	794.71
Stock in Process Holding Period (in months)	**0.42**	**0.40**
Finished Goods (Rs. in Lakhs)	0.60	0.70
Cost of Sales (Rs. in Lakhs)	679.34	794.61
Finished Goods Holding Period (in months)	**0.01**	**0.01**
Receivables other than export & deferred receivables (Rs. in Lakhs)	278.63	299.44
Domestic Sales: excluding Deferred Payment Sales (Rs. in Lakhs)	679.34	794.61
Receivables Holding Period (in months)	**4.00**	**3.67**
CURRENT LIABILITIES		
Creditors for purchase of raw materials, stores & consumable spares (Rs. in Lakhs)	36.34	42.39
Purchase of Raw Materials, Stores & Consumable Spares	171.65	182.72
Creditor's Holding Period (in months)	2.54	2.78
Operating Cycle in months	4.11	3.4
(**) for 9 months of operations		

1st METHOD OF LENDING		Projection 31.03.2016 (in Lakhs)	Projection 31.03.2017 (in Lakhs)
a.	Total Current Assets (C.A.)	449.12	487.93
b.	Total Current Liabilities excluding Bank Borrowings(C.L.)	171.65	182.72
c.	Working Capital Gap (a-b)	277.47	305.21
d.	Minimum Stipulated Net Working Capital (25% of "c")	69.3675	76.3025
e.	Actual/Projected Net Working Capital	127.47	155.21
f.	Bank Finance (c-d)	208.10	228.91
g.	(c-e)	150.00	150.00
h.	**M.P.B.F (Lower of "f" & "g")**	**150.00**	**150.00**
i.	**Limit Proposed**	**150.00**	**150.00**

Assessment of Working Capital is done under Nayak Committee Method

Projected Turnover for the year 2015-16: Rs 835.89 Lac

Adjusted Turnover: Rs.835.00 Lac

25% accepted turnover: Rs.208.75 Lac

Less 5% margin: Rs.41.75 Lac

Or Actual NWC available: Rs.95.63 Lac

PBF: Rs.113.12 Lac

Requested by the party Rs. 150.00 Lac. The excess margin available in the system will be utilized for the machinery to be purchased for the proposed unit.

Recommendations

SME sector is perceived as a profitable endeavor for banking business despite significant differences in lending practices, business models, drivers and obstacles in SME finance. Numerous issues relating to SME finance have been analyzed in the study based on first hand impressions of entrepreneurs and banks officials and observations have made by using industry level statistics on selected data. The following measures are recommended from bankers' as well as entrepreneurs' perspective based on the empirical observations of the study which probably would help bankers in making their SME loan book strong for sustainable development of banking industry and inclusive growth of Indian economy.

a) Human capital is the key driver of finance in banking. It is a sort of special breed of capital, which needs skills to handle loan proposals of entrepreneurs who have dream projects and thus involves behavioral appraisal of promoters and financial viability of ambitious project to be undertaken by firms. The covenant of ***"one size fits to all"*** does not make much sense in the present competitive environment. Therefore, there is a need to differentiate finance officer and general banking officers in terms of their service conditions, postings, grooming, attitude, promotions, creativity and many more.

b) First generation entrepreneurs and family business being unique peculiarity of SMEs; have either no credit rating or poor credit rating for want of its awareness, it is therefore recommended that a need of handholding approach to be experienced by both entrepreneurs and bank officials. Banks in consultation with SMEs association at all levels such as Chamber of Commerce, Industry Associations etc. should conduct Entrepreneurs Development Programme (EDP) for incubation and entrepreneurship to set up industries, which will realize theme of 12th Plan of generating 30 Million employments, and 25% increase in manufacturing production.

c) Technology backwardness and lack of innovation have been causes of failure of SMEs. Further, the promoters do not have not fund for technology up gradation. Banks should therefore, mandatorily consider loan for capex investment in technology up gradation and innovation of SMEs; otherwise it may lead to diversion of funds from working capital to capital expenditure or increase in private borrowings. . This loan for technology up gradation should be subsidized from government fund by way of capital subsidy or interest subvention etc.

d) Since credit requirement of SMEs to the largest extent are small, which qualify for guarantee under CGTMSE, it is liquid security as compared to any other tangible collaterals. It is, therefore, recommended that banks should encourage collateral free & activity oriented lending which are of self-liquidating in nature.

e) State Governments should have provision of preferential and green channel treatment to SMEs in respect to clearance & approvals to be given for setting up business, providing uninterrupted power supply or back end capital subsidy on loans for purchase of power back up investment like DG sets, provide land & common facilities in industrial estates at acquisition cost for making them competitive with large firms indigenously and globally

f) Huge amount of expenses are to be incurred towards market making movement and such type of expenses are of capital nature, which should be amortized in due course of time. It is therefore, recommended that investment for market development activities illustrated here in the report should be considered as permissible cost of project for finance at par with capex in plant & machinery, else without taking this aspect into account, the assessment of loan limit would be *ab-initio* incomplete. A scheme of clean overdraft for marketing development may be worked out.

g) Government procuring policy regarding buying at least 20% of annual purchase from SMEs has been put in place but not being adhered to in its letter and spirit by big giants. Since MSEs do not have expertise/skills for approaching to the large corporate, DIC or Directors, MSME establishments at regional level should own responsibility of providing details of products of these MSEs to the Government/PSU buyers reinforcing mandatory guidelines and also verifying their compliance from time to time. In addition, banks should mark lien in total working capital limit as sub-limit reserved for purchasing from SMEs while sanctioning credit facilities to large corporate.

Conclusion from Analysis: -

Sales

The firm is constituted during Dec 2010 with three partners. The gross receipt was Rs 40.11 lakhs during 2011-12 and it was increased to Rs 90.35 lakhs as on 31.3.2013. Due to global recession, it was increased to Rs 92.18 lakhs as on 31.3.2014. However, the firm has estimated Rs 261.53 lakhs during the current financial year. As there are substantial, work orders on hand, the firm projects around Rs 835.89 lakhs as of 31.3.2016.

NPAT

The firm has earned profit Rs 0.20 lakhs during 2012-13 and it was increased to Rs 0.84 lakhs as on 31.3.2014.

However, it expects Rs 6.10 lakhs during the current financial year. The firm projects Rs 20.33 lakhs NPAT as of 31.3.2016. The profitability of the firm seems too achievable as per projections, which comes within 2.33% of net sales.

TNW

The TNW of the firm is quite satisfactory due to unsecured loans from the partners. However, the firm has projected each year to plough back of profits in the business.

TOL/TNW

The captioned ratio is projected within one, which reveals there is less outside liabilities in comparison to Net Worth of the firm.

CR/NWC

The current Ratio is very high due to own capital invested in the business. However, it will be 1.45:1 as on 31.3.2015 due to proposed borrowing from banks. As per projections the liquidity position of the firm quite healthy. However, the financial indicators of the company are satisfactory.

However, the relationship of the customer with the bank based on the financial transactions and other parameters play a very important role while deciding the lending of fund.

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