# Effectiveness of Specialized MSME Branches: A Comparative Case Study

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***Abstract:***

MSME sector is seen as a huge potential for driving the growth story further in the Indian economy. It has been able to employ around 120 million people and contribute 45% of the exports of the country. Despite showing a robust growth rate of over 10% over the last 5 years, the MSME sector is beset with operational problems due to size and nature of business. RBI and government have taken various measures to improve the financing to the sector. One of such initiatives by the Reserve Bank of India is categorization of Specialized MSME Branches. Public sector banks have been advised to open at least one specialized branch in each district. Further, banks have been permitted to categorize their MSME general banking branches having 60% or more of their advances to MSME sector in order to encourage them to open more specialized MSME branches for providing better service to this sector as a whole. The specialized branches have been operational in the country for a long time, but how much they have been successful in fulfilling the government's mandate of increasing the flow of credit to MSME sector is yet to be tested. The paper is an attempt to test the extent to which these branches have justified their objective. The basic purpose is to throw light upon the effectiveness of the functioning of specialized MSME branches of the Public Sector Banks and perform a comparative analysis with MSME handling in private sector banks and to recommend the changes required in their working model to increase their efficiency.

***Index Terms:*** **MSME, Specialized Branches, SBI, HDFC, Small Enterprises**

## I. INTRODUCTION

The emerging Micro Small and Medium Enterprises (MSME) sector, has huge potential for economic and social development of the country. The development of the MSME sector creates spiraling effects for the large enterprises as well, as the MSMEs works as ancillary units to these enterprises. Moreover growth in MSME sector also indicates a more equitable Gini Coefficient. In the last five-year plan, this sector demonstrated an average growth of 12%, raising the share of the manufacturing sector in GDP to 16%. With the country moving towards a more inclusive growth agenda, a robust MSME sector can accelerate the growth rate, as they do not necessitate huge investments while simultaneously acting as ancillary units to larger industries. Hence, for the growth of the manufacturing sector in the country there is a need to focus on the MSME sector.

Before coming to what are the impediments for the MSME sector in the country, what specialized MSME branches are, and how they enhance the credit flow to the MSME, it is necessary to define which industries fall into the category of Micro, Small and Medium Enterprises.

Micro, Small and Medium Enterprise Development Act, 2006 defines Micro, Small and Medium enterprise based on:

(a) Investment in plant and machinery in respect of manufacturing enterprises and

(b) Cost of equipment in respect of service enterprise

| Classification | Manufacturing Enterprises*. (Investment limit in Plant & Machinery) | Service Enterprises** (Investment limit in equipment) |
|---|---|---|
| Micro | Rs. 2.5 million / Rs. 25 lakh | Rs. 1 million / Rs. 10 lakh |
| Small | Rs.50 million / Rs. 5 crore | Rs. 20 million / Rs 2 crore |
| Medium | Rs 100 million / Rs 10 crore | Rs. 50 million / Rs 5 crore |

MSME defined (Source: msme.gov.in)

MSME Contribution (2014-2015), Source: SIDBI


Despite showing a robust growth rate of over 10% over the last 5 years, the MSME sector is beset with operational problems due to size and nature of business (Ministry of MSME, 2014). In 2010, the Prime Minister of India appointed a task force set up under the chairmanship of the Principal Secretary, to consider various issues raised by MSME associations, discuss with the stakeholders and chalk out an action agenda. The key problems identified by the task force were finance related problems, legal and taxation problems, problems related to operations, and infrastructure and technology related problems.

The most challenging of these is the Finance related problem of MSMEs. MSMEs require timely and adequate capital infusion through term loans and working capital loans, particularly during the early and growth stages. Traditionally MSMEs have depended on internal sources of finance to meet their capital needs. The institutional financing scenario in the country has not been conducive to meet the finance needs of MSMEs in a timely and efficient manner. But the scenario is changing with changing times, and the government has taken various initiatives to empower the MSMEs.

One of such initiative by Reserve Bank of India is the categorization of Specialized MSME Branches. Public sector banks have been advised to open at least one specialized branch in each district. Further, banks have been permitted to categories their MSME general banking branches having 60% or more of their advances to MSME sector in order to encourage them to open more specialized MSME branches for providing better service to this sector as a whole. As per the policy package announced by the Government of India for stepping up credit to MSME sector, the public sector banks will ensure specialized MSME branches in identified clusters/centers with preponderance of small enterprises to enable the entrepreneurs to have easy access to the bank credit and to equip bank personnel to develop requisite expertise (RBI, MSME Guidelines). The existing specialized SSI branches may also be redesignated as MSME branches. Though their core competence will be utilized for extending finance and other services to MSME sector, they will have operational flexibility to extend finance/render other services to other sectors/borrowers. According to MSME Ministry, as on March 2013 there are 2032 specialized MSME branches.

## II. OBJECTIVES OF THE STUDY

1. Defining four effectiveness parameters; Loan access and availability, Awareness, Credit Appraisal and NPA management. The parameters have been derived based on prior literature available on MSME finance.
2. An in depth case study of specialized branches of one public sector bank (State Bank of India) and one private sector bank (HDFC Pvt Ltd.)
3. 'Effectiveness' is a comparative parameter. The conclusions drawn out of similar data would lead to bias in the study. In order to gain the perspective from other side of the coin, we intend to conduct an extensive research of 'MSME Finance' in a private sector bank and make a comparative analysis with PSB.
4. To provide insightful recommendations based on our analysis.

## III. RESEARCH METHODOLOGY

The study adopted a descriptive Case Study method for an in-depth analysis of the Specialized MSME Branch. The objective of the research is to investigate the ground reality of the functioning of specialized MSME branches. Unstructured interviews were adopted to gain an in-depth knowledge about functioning of branches. A multiple case design was used to enable a comparative analysis. The use of multiple case design method increased the robustness of the study. The detailed qualitative accounts produced using case study method not only help to explore or describe the data in real life environment, but also helps to explain the complexities of real life situations. Two major banks were shortlisted for the study, one each from private and public sector.

## IV. LITERATURE REVIEW

The Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. It contributes significantly in the economic and social development of the country by fostering entrepreneurship and generating largest employment opportunities at comparatively lower capital cost, next only to agriculture (MSME, 2017-18).

1. **Asghar Afshar Jahanshahi, Khaled Nawaser, Seyed Mohammad Sadeq Khasksar, Amin Reza Kamalian (2011)** presented a historical view of the Government policies for the MSME sector in India dividing the era into three main time periods: 1948-1991, 1991-1999 and 1999 onwards.
    - **1948-1991:** In all the policy resolutions from 1948 to 1991, recognition was given to the micro and small enterprises, termed as an effective tool to expand employment opportunities, help ensure equitable distribution of the national income and facilitate effective mobilization of private sector resource of capital and skills. The micro, small and medium enterprises development organization [earlier known as small industries development organization (SIDO)] was set up in 1954 as an apex body for sustained and organized growth of micro, small and medium enterprises. MSME- Development Institutes [earlier known as Small Industries service Institute (SISI)] were set up all over India to train youth in skills/entrepreneurship and Tool Rooms were established with German and Danish assistance for providing technical services essential to MSEs as also for skill - training.
    - **1991-1999:** The new policy for small, tiny and village enterprise of august 1991 laid the framework for Government support in the context of Liberalization, which sought to replace protection with competitiveness to infuse more vitality and growth to MSEs in the face of foreign competition and open market. The small industries development bank of India (SIDBI) and a technology development and modernization fund were created to accelerate finance and technical services to the sector.
    - **1999 onwards**: The ministry of MSME came into being from 1999 to provide focused attention to the development and promotion of the sector. The new policy package announced in august 2000 sought to address the persisting problems relating to credit, infrastructure, technology and marketing more effectively.

    The study also talked about role and performance of Entrepreneurship on the MSMEs in India. Increased level of entrepreneurial activity contributes significantly towards job creation, economic growth, poverty alleviation, and creating new customers. Entrepreneurs are the driving force behind MSMEs, thus MSMEs play an important role in contributing to development of an economy.

2. **World Bank Working PaperMSME Finance Gap : Assessment of the Shortfalls and Opportunities in Financing Micro, Small, and Medium Enterprises in Emerging** Markets: In a series of Working paper, World Bank highlighted the role of Micro, Small and Medium Enterprises (MSMEs) in emerging markets as the engine of growth, and presented a new approach to estimation of the unmet demand for financing for MSMEs in developing countries. The study also described the potential implications for the public-sector bodies, private sector financial institutions, and technology providers, and also opened new opportunities for further investigation. The study for the first time estimated both supply and demand for MSME finance on global scale, which had never been done previously. The study tried to apply the model followed in developed countries to the developing countries. MSME equilibrium lending in developed countries was estimated according to industry, age, and size categories, and this benchmark was applied to MSMEs in developing countries. To find the finance gap, the difference between current supply and potential demand was estimated which could be potentially addressed by financial institutions.

3. **Eneh, Onyenekenwa Cyprian (2007),** conducted an international study to establish that promotion of growth and development of micro, small and medium enterprises sector is a veritable factor for poverty reduction in developing countries. According to the study, growth and development of sustainable MSMEs leads to industrialization, which is synonymous with national development, hence industrialized nations are developed nations. Productive and technological base of country are the prime movers of activities. These need to be developed to foster industrialization, national development, and eradication of absolute poverty and reduction of poverties of money, access and power in developing countries. The growth and development of sustainable MSMEs is the key to

growth, equity and security, which are pivotal pillars for creation of and sustenance of sustainable livelihoods and meaningful strides in poverty reduction in developing countries.

4. **Masato abe, Michael Troilo, Orgil batsaikhan (2012),** through their study, proposed policy suggestions for financing of small and medium enterprises (SMEs) in the Asia pacific region. They concluded that since the lack of external finance constraint the survival and growth of SMEs, thus enabling policymakers to assist SMEs in their search for financing will boost economic growth. World bank data on strength of various financial institutions in select Asian countries was analysed to discover areas of improvement. On the basis of analysis policy changes were recommended.

5. **Yuko Nikaido, Jesim Pais Mandira Sarma (2015),** tried to investigate enterprise level factors affecting access to formal credit for small enterprises in India. The study was based on an empirical analysis of enterprises with and without credit limit to find out the factors that affect the access of MSMEs to formal sources of external finance. The results of the study indicated that enterprise size, owners' education level, being registered under an agency and being involved in diversified activities are positively associated with access to formal credit. However, the ownership of land that can be used as collateral is negatively associated with the likelihood of receiving formal credit. This may be due to an obsolete land administration system resulting in high transaction costs of land as collateral. These results provide some insights into the factors to improve credit constraints for small enterprises in India.

6. **Vishal Vyas, Sonika Raitani, Ankur Roy, Priyaka Jain (2015),** in their paper 'Analysing critical success factors in small and medium enterprises banking', conducted a confirmatory factor analysis to find out the critical factors that contribute of profitability in SME banking in India. A total of 22 individual critical factors were examined in the study. On the basis of the factor analysis the most and the least critical factors were identified. 'Fast and responsive services' were considered as the most responsive factor. The study aimed at making recommendations to the bankers for dealing with the SME sector. The research suggested that it is crucial for the bank managers to take a holistic view of all the factors while developing appropriate strategies for SME banking and channeling resources towards more critical aspects of SME business management. The study also tried to identified why the Indian banking scenario has changed in terms of lending to the MSME sector, i.e. the reasons for a shift from avoiding serving to SMEs due to the risk associated with it to targeting SMEs for higher profits.

7. **MSME finance gap: Assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets, IFC**: In recognition of the need to quantify the extent of the MSME finance gap, the International Finance Corporation (IFC) partnered with McKinsey & Company in 2010 to produce an estimate of the gap. As the first study of its kind, the aim of the study was to produce approximate figures that could, at an aggregate level, highlight this critical issue and the scale of the challenge. However, the assumption and methodology of the study raised concerns about its use at a more granular level. For example, cross-country comparisons, crucial for strategic policy decisions by international organizations and others, were not possible. In the developing economies studied, the potential demand for MSME finance is estimated at US $ 8.9 trillion, compared to the current credit supply of $3.7 trillion. The finance gap from formal MSMEs in these developing countries is valued at $5.2 trillion, which is equivalent to 19 percent of the gross domestic product (GDP) of countries covered in this analysis. This in turn amounts to 1.4 times the current level of MSME lending in these countries. The study concluded that access to finance for MSMEs continues to be an issue of critical importance, but at the same time there is an ongoing need to improve data collection efforts for MSME financing in developing countries.

## V. Case 1: STATE BANK OF INDIA

About the bank:

State Bank of India is the largest bank by in India with a 23% market share, besides a share of one-fourth of the total loan and deposits market. SBI is the third largest bank in India by Market Capitalization. The company is ranked 217th on the Fortune Global 500 list of the world's biggest corporations as of 2017. SBI is the biggest financial services conglomerate in India.

Role of the Bank in the MSME Sector:

The MSME segment of SBI is picking up fast, the bank reported a sequential growth of Rs. 15,224 crore (6.03% increase quarter on quarter basis) for the quarter ending 31st December 2017. SBI is a pioneer in SME financing in India. As a bank it has been playing a critical role in the overall growth and development of the SME sector. The bank has developed a wide array of products and services in order to cater to the evolving needs of the SME sector. It has over 1.3 million SME loan accounts. Apart from a wide network of branches across the country, 579 specialized SME branches across the country have been kept under special focus to develop an effective platform for SME lending. Single point contact through dedicated relationship managers have been put in place for medium as well as small enterprises. Centralized Processing Cells have been created for quick turnaround time in sanction and disbursal for loans upto Rs.

1 crore. For inclusive growth, a special scheme called 'SME Collateral Free Loan' for Micro and Small enterprises segment has been designed for lending under CGTMSE guarantee coverage with liberalized terms upto a credit limit of Rs. 1 crore.

Branch under Study:

Loan Processing Centre

Criterion for selection of Branch:

All the MSME Branches came under the purview of the Loan processing center, hence it was selected for the study.

STUDY**:**

1. NATURE OF BUSINESS OF CUSTOMERS AVAILING SMALL LOANS:

SBI being the largest bank of the country lends to all the sectors including Manufacturing, Trading, Services/Self Employed/Professional. There was a surge in Auto loans when the Cab aggregation business was at a rise. The products offered to MSME includes SBI asset backed loan, SBI e-smart SME e-Commerce Loans, SME Credit card, SBI Fleet finance Scheme for transport operators etc. The bank extends both term loan and Working capital finance. The bank has a separate portal for its MSME customers 'SBIforSME'. The loans are offered for a maximum tenure of 8 years.

2. LOAN APPLICATIONS AND SANCTIONS:

SBI has loan processing centers for processing the loan applications of MSME enterprises, which deal with all loan applications upto Rs. 50 lakh. The bank has a list of 'Minimum required documents', which is made available to the customer who wishes to apply for a loan. The documents vary depending upon whether the loan is collateral based or not. The documents include KYC documents, Proof of business, Statement of profits, property documents (if the loan is collateral based) etc. Once the loan is sanctioned, further security documents have to be submitted by the customer. The major problem faced by the bank in lending to the MSME borrowers is regarding the proof of business of small enterprises. As these enterprises often operate on a very small scale, by renting the premises, it is difficult for them to produce a proof of business especially in case of unregistered rent agreements. The loans are finally approved at the concerned branch or the loan processing center depending upon the amount of the loan.

The Central Processing Tracking System (CPTS), which is an online system for processing of loan applications, was not operative in the branch, meaning that the applications are made and processed manually, which leads to delay in processing of applications and further delay in sanctions and approvals.

3. PRE SANCTION CREDIT APPRAISAL:

The Pre Sanction credit appraisal is typically based on the documents submitted by the customers. The documents are scrutinized carefully before approving a loan application. Apart from document verification, inspections are also carried out to verify that the business, machinery and stock actually exist.

4. POST SANCTION CREDIT APPRAISAL

Post sanction credit appraisal generally starts with inspection and visits to the place of business of the customer to get an idea of the actual facts. The post sanction Inspection visit is carried on in all the cases, whether small or large accounts (As reported by the Bank officials).

Although all the loans irrespective of the size and amount are subject to the post sanction credit appraisal, but a delay of 15-20 days is normal in case of small loans due to huge quantum of loans.

5. NPA MANAGEMENT:

There is a classification of NPA accounts as SMA0, SMA1 and SMA2 according to RBI guidelines and specified actions are taken as and when an account shows any signs of stress. There are different stressed account committees for dealing with stressed accounts below and above Rs. 10 lakh. The committees recommend specific actions to be taken in case of different accounts, which differ on the basis of the facts of the case.

SBI is contributing to a major chunk of the overall NPAs in Indian banks; the reasons as mentioned by the concerned bank officials for an account turning into NPA are as follows:

a. Cab aggregators like Ola, Uber, Meru, are creating a lot of problems as far as NPAs are concerned. The income levels are decreasing due to increased competition, as a result the repaying capacities of the borrowers are reducing, leading to stress in accounts.
b. The introduction of Goods and Service Tax is also one of the reasons of accounts turning into NPA. The introduction of GST lead to a huge turmoil in the MSME sector due to lack of knowledge about the various returns. All these reasons lead to a number of small accounts going bad.
c. Demonetization of Indian currency notes has also majorly contributed in fuelling the NPA problem. The small and medium enterprises generally operate on cash basis, and the survival of their business is dependent upon timely receipts from customers and payment to suppliers. Due to the cash crunch created by Demonetization created survival issues for the MSME borrowers, leading to failure of their businesses and their accounts turning into NPA.
d. Another major problem is lack of awareness among MSME borrowers. Many borrowers are not aware of various schemes and regulations of MSME ministry and RBI. Due to this information gap, many eligible and credit worthy borrowers are not able to choose the right credit products, leading to NPAs
e. Another important factor is the 'risk taking nature' of the MSME borrowers. The MSME borrowers are generally start-up based firms, where the risk involved is substantially high. Moreover young entrepreneurs are prone to taking more risk. According to a study conducted by Forbes, the failure rate of start-ups in India is around 90%, most of these are MSMEs. Due to this the NPA ratio of MSME Accounts increases.
f. MSME borrowers are small borrowers who are not in the habit of maintaining proper books of accounts (Balance sheet, Cash Flow statement, Funds Flow statement etc.). As a result it becomes difficult for the bank to analyse the success potential of the borrower correctly. Due to this loans are even extended to 'default prone' borrowers which further raise the NPAs.
g. The MSME borrowers have a behavioral tendency of trusting their Chartered Accountants more than their bankers. This creates hurdles in developing fruitful long term relationships between bank and the MSME Borrower, which further makes the credit appraisal process difficult.

RECTIFICATION, RESTRUCTURING AND RECOVERY:

When an account turns NPA, or shows signs of stress, several measures are taken to revive the account. A number of notices are issued, telephonic communications are established, Emails are written, and even bank officials visit the site to ensure a recovery.

No restructuring is carried out in case of small accounts as the cost involved exceeds the amount that can be recovered.

## 6. PROBLEMS FACED BY THE BANK IN LENDING TO MSMEs

Following problems are generally faced by the Bank in lending to the MSME sector:

1. There is a lack of awareness on part of MSME Borrowers regarding government schemes, RBI guidelines, the documentation process, and other formalities.
2. Another problem is lack of proper business planning. MSME borrowers have high aspirational levels, but they lack proper planning to meet those aspirations, which makes it difficult for them to access proper credit.
3. Misuse of Pradhan Mantri MUDRA Yozana by well-established people creates problems. The benefit of the scheme is not reaped by the actual target groups.
4. Collateral free loans under CGTMSE scheme create huge problems. The bankers feel that collateral free loans are more prone to NPA as the borrowers become complacent when they don't have anything to lose.
5. Diversion of funds
6. A large number of guidelines are issued by RBI on a regular basis, which makes it difficult for the bank to keep track of each and every guideline. The bankers feel that there is lack of proper implementations of schemes on part of regulators. (As reported by bank officials)

## VI. Case 2: HDFC BANK

About the bank:

HDFC Bank Ltd is one of the India's premier new generation private sector institution providing wide range of banking services serving key segments including large corporate houses, governments/PSU's, Agriculture, Small and Medium enterprises, emerging corporates, agriculture, etc. The second largest private sector lender reported a 20% year on year rise in its net profit as on 31 March 2018 with a stable loan growth of 18.7%. Gross NPA's stood comparatively low at 1.30% of its total loans. However, it edged up from an year ago period of 0.33%. The Bank has a network of 1165 branches across 831 cities. ("HDFC Bank looks to double SME Loan Portfolio Rs. 1.4 Lakh Cr in 4 years", Dhru, A, 2016)

Role of Bank in the MSME sector:

As of March 2016, The Bank's SME book stood at Rs 70,000 crore, which accounts for 7% of the market share when it comes to financing small businesses. The bank targets to double the MSME exposure by 2020, using digital technology and penetrating non metro areas. SME's constituted 18% of the overall book of the Bank. As per 2016 data, the Bank is reported to be serving close to 100,000 of 3.6 crore SME units in the country (HDFC Bank, Investor Presentation).

The Bank caters to MSE customers requirement from every branch through two different verticals, one of which EEG focusses on the Micro sector and the other one, BBG on the Small Scale Sector. The verticals have been created to bring about sharper and specialized focus in serving the needs of micro, small and medium enterprises. They concentrate on specific areas with a Pan-India footprint to ensure increased level of productivity and hence higher dispensation of credit.

Branch/Branches under study:

1. HDFC Bank, ITO Branch, Indian Express Building, Bahadur Shah Zafar Marg, Delhi 110002.
2. HDFC Bank, Chandni Chowk, Delhi 110006

Criteria for selection of Branch/Branches:

According to data provided by HDFC Bank, the aforementioned branches constitute more than 60% of the credit extended to the MSME sector in Delhi. The selection of the branches for study would enable us to fulfill twin objectives of:

a. Studying, interpreting and analyzing the performance of the Bank in the MSME sector by inclusion of major MSE serving branches under the purview of the project.
b. Conduct of a comparative analysis with Specialized MSME branches in the public sector which are categorized as such for generating 60% or greater credit for the MSME sector.

STUDY**:**

1. NATURE OF BUSINESS OF CUSTOMERS AVAILING SMALL LOANS:

The Bank's lending to the SME segment occurs within the turnover range of 60 lakhs to 2 crore. Trading, manufacturing, partially trading partially service and service enterprises constitute major customers under the segment. The Bank deals in a wide range of loan products. Short term loan products include cash credit, overdraft, letter of credit, export credit, supplier credit, bill discounting, etc. Bank offers term loans and letter of credit for capital goods on a long term basis. Primary sectors availing loans under this segment include Pharma, automobiles, food and beverages, education and retail business.

2. LOAN APPLICATIONS AND SANCTIONS

The Bank has adopted 'vertical model' for extending MSME credit in an effective and efficient manner. A relationship manager is deployed for client handling and management. The customer's first contact with the Bank takes place through a relationship manager. When a SME business customer approaches the Bank to avail a loan, he is asked to fill a general questionnaire. He is also asked to submit an application form along with minimum primary documents such as KYC (preferably digital) and business financials (annual reports, profitability statement, bank statements, etc.). The documents are entered digitally and sent to Central Processing Unit for undertaking a process of approvals and sanctions. The service is outsourced to McKinsey and Company for faster, efficient and analysis based processing of applications taking into consideration proper risk and business assessment of the customer.

The application is processed within 3 hours of the time of submission based on the initial documents submitted by the customer. Software named 'Perfios' is used for the entire process of financial checks, verification and extraction of financial data. The customer is intimated about the approval within the stipulated time, subject to due submission of other necessary documents within specified time.

The Bank also reported that a prior customer account with the Bank is a prerequisite for availing a loan under this segment. This implies that the person should either be a HDFC Bank account holder or agree to pursue his banking with HDFC Bank to be able to obtain credit for his business. Moreover, it is mandatory for the customer to do his entire business banking with HDFC. In fact, he is encouraged to conduct all his personal banking transactions via HDFC Bank account too. The reasons cited for restricting customer account to HDFC Bank only include:

a. A long term relationship developed with a customer enables a Bank to gauge and analyze his 'banking behavior'. Bank can keep a track record of all his transactions, past and current, relating to the business.
b. As the customer owns a sole account for conduct of all his business transactions, Bank can easily identify early signs of diversion of funds, problems in business and any likelihood of account coming under stress.
c. This also enables the Bank in building long and loyal customer relationships, which is the key to banking success.

3. PRE-SANCTION CREDIT APPRAISAL

A. Role of Business team:

The business team conducts appraisal of business performance prior to final sanction of loan. The documents studied and analyzed for pre sanction appraisal include past years profitability statements, balance sheets, bank statements, digital analysis conducted in Perfios, CIBIL score, etc.

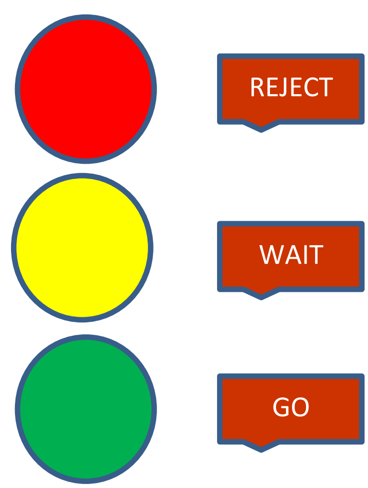
Customer is also asked to submit personal and business details of ten references, which includes 5 suppliers and 5 buyers. Details of all transactions with the suppliers and buyers during the past year are provided to the banker. This enables the Bank to study the performance of business and ensure the credit worthiness of the customer availing the loan.

The customers who are not able to provide minimum primary documents or are not able to fulfill appraisal conditions due to incomplete records or poor financials are denied extension of credit.

B. Role of Risk team:

Risk team also plays a pertinent role in the appraisal process. It is entrusted with the task of giving a risk indication w.r.t the loan application. The risk classification provided by the Bank is as follows:

a. Green segment: The loan applications under this segment are reported to expose the Bank to minimal risk and given a 'go' signal immediately. This usually includes customers with proper records, good financials and duly submitted documents.
b. Amber segment: The loan applications under this segment expose the bank to some amount of risk and are not given an immediate go signal. They are under a 'wait' process. The applications are studied and analyzed under due diligence and supervision of senior management to minimize the chance of account coming under stress in future.
c. Red segment: The applications under this segment expose the Bank to high risk. The Bank avoids extension of credit to such applicants.




To mitigate risk, the Bank avoids lending to high risk volatile sectors such as real estate, religious organizations, contractor profiles, etc. The Bank does not extend credit to Wine and Tobacco businesses on moral grounds.

4. POST SANCTION CREDIT APPRAISAL:

1. Site Visit report: Relationship manager:

The relationship manager conducts a site visit as a part of post sanction credit appraisal. A visit report is prepared and submitted to the Bank based on the same.

2. Property Valuation:

A property valuation is conducted by a specialized official to ensure viability of mortgage.

3. Banker visits under specific conditions:

Specific banker visit is conducted in cases where loan amount exceeds 2 crore or property value exceeds 5 crore.

5. NPA MANAGEMENT:

The accounts are classifies as SMA-O, SMA-1 AND SMA-2 as per RBI guidelines.
Any signs of account showing signs of incipient stress is dealt with arranging a meeting between the customer and a relationship manager. There is a special counselling team assigned for this purpose. According to the Bank, customer counselling has proved to be effective in dealing with stressed accounts. Moreover, accounts under SMA-2 are referred to SPT (Special Project Team).

Although the percentage of NPA's stand low w.r.t the branches under study, major reasons for NPA's in accounts are hereunder:

a. Wilful default
b. Diversion of funds
c. Genuine default i.e. Problems in businesses lead to stress in accounts.

RECTIFICATION, RESTRUCTURING AND RECOVERY:

Rectification process is initiated as the accounts start showing signs of stress. Restructuring of accounts is rarely undertaken.

6. PROBLEMS FACED BY THE BANK IN LENDING TO THE MSME'S:

Following problems are generally faced by the Bank in lending to the MSME sector:

1. Incomplete accounting records: Small businesses don't maintain proper accounting records. Hence, they are not able to provide complete, correct and reliable financials to the Bank.
2. Fund diversion: Diversion is cited as one of the major problems leading to stress in MSME accounts. The bank has adopted 'sole banking with HDFC' model to mitigate the risk of diversion of funds. In most cases, business funds are used to pay for personal transactions.
3. Lack of awareness: There is a general lack of awareness on the customer's part about government schemes, RBI guidelines, documents, Bank requirements, etc.

## VII. RECOMMENDATIONS AND KEY TAKEAWAYS

- **Specially trained staff and Infrastructure for Specialized branches:** The current functioning of specialized MSME branches is similar to a driving a car on a busy road by a person who does not know driving. The term 'Specialized branches' should be adopted in its truest sense, and not just for the name sake. The banks should ensure that the specialized branches are also equipped with specialized staff and proper infrastructure in terms of technologically updated software so that these branches can work to the best of their capacity. Public banks need to learn from their private counterparts in terms of technological up gradation. The banks should organize proper training to make the staff of specialized MSME branches aware about the problems of the MSME sector, and also about the technical aspects of their business. In this direction, the banks should follow a cluster based approach. The staff of a particular branch should be well versed with the business model, nature of business and working of the industries that carry on business in the cluster in which the branch is located. This will serve the twin purpose of faster loan disbursals for the MSMEs and better and enhanced credit appraisal for the branch.

- **Implementation:** As they say, Plans are only good intentions unless they immediately degenerate into hard work. There is no dearth of exceptionally good policies and regulations which have the potential to completely revolutionize the Indian Banking scenario; all it needs to change things is the proper implementation of these regulations. RBI, as the central bank of the country can undertake this task to ensure implementation of different schemes at various levels. Changing everything at one go is not possible, but starting small can have huge benefits in the long run. The strategy to ensure proper implementation of various schemes and regulations should be to have small but attainable targets. By moving forward in this direction with the effort of each and every individual, RBI can bring about a huge change in the Indian Banking landscape; this can even help India overcome various problems to a maximum extent (e.g. NPA resolution, Speedy Processing of Application etc.)
- **Simplifying the documentation:** The number of documents that MSME borrowers need to submit before they can actually get the amount transferred in their account is enormous. This reduces the attractiveness of institutional financing for MSMEs. There is a need to deduce models which can reduce the cumbersome documentation process for MSME borrowers. A possible solution can be accessing data through the GSTN no. of the customer. After the rollout of Goods and Services Tax, nearly all the entities are registered on the GST Portal. Information regarding customers can be accessed through the portal including the KYC, business information etc. This requires integration of data of all the departments. But once implemented it can substantially reduce the documentation requirement for MSME loans, and increase the access of MSMEs to Institutional Finance.
- **Innovation and Digitization:** Another major area which creates hindrance for the MSME sector in accessing adequate credit is backwardness in technology. Even today, all the applications in the Public sector banks are processed offline. This creates a lot of problems for MSMEs as they have to submit the same document again and again as the records are physically kept. It even increases the workload of bank staff as they have to maintain, organize and store a large number of files and documents, which wastes a lot of their time which could have been invested somewhere else more productively. Private sector banks have moved a step forward in this direction, and it is visible in their efficiency. There is a need for ensuring that proper software are operative in banks for online processing of applications, which will not only fasten the loan application process but also make it less prone to errors.
- **Alternate Financing Instruments for MSME:** Alternative Financing techniques should be promoted by the central bank to ensure smooth flow of credit to MSMEs during different stages of their life cycle. Some measures are taken in this regard, like the introduction of Trade Receivables Discounting System (TReDS), which enables financing of both invoices as well as bills of exchange there by fuelling the flow of funds to the MSMEs. More such measures should be encouraged, according to a report published by OECD (New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments), these instruments can be classified as Asset based finance, Alternative Debt, Hybrid Instruments, and Equity instruments.

Alternative Financing Instruments for MSMEs, Source: OECD


- **Use of Big Data analytics:** In the changing times of globalization, where there is free movement of people and capital, traditional banking techniques, which once used to work effectively, cannot be of much use for long. Here comes the role of big data in serving customers better and improving the efficiency of banks. Big data refers to extremely large data sets that may be analysed computationally to reveal patterns, trends, and associations, especially relating to human behavior and interactions. The data from consumer transactions create an electronic paper trail for ongoing discovery and analysis. Historical data about customers such as payment records, credit history, interactions with bank call Centre creates a digitized knowledge base. Then comes behavioral analytics, putting all the data to work to find useful insights. Big data can be used in several ways from boosting cyber security to cultivating customer loyalty through innovative and personalized offerings that can make banking a highly individualized experience. In case of MSMEs, big data analytics can be used to create a national repository of all the data regarding MSMEs and linking it with all the departments of the government and sharing that data with the trusted banks, so that the process of MSME dealing with banks can be simplified. This will have several implications, from reducing the time taken to process loan applications of MSMEs to reducing the number of documents required for application. It will create a win-win situation for both the MSMEs and the Banks. This requires proper utilization of the data which is already created.

- **Customer Relationship Management (CRM):** Today in the banking and financial services industry, the customer is empowered with choice. Brand loyalty is rare. Many customers maintain financial services relationships with more than one bank of financial service company. In this scenario of changing customer loyalty, it is important for banks to take initiatives that drive customer retention. This calls for maintaining long term and fruitful relationships with customers through customer relationship management. Customer relationship management (CRM) refers to the principles, practices and guidelines that an organization follows when interacting with its customers. CRM, although is much more of a human function, but technology can be used to enable the human aspect to function more effectively. The process starts with building comprehensive view of the customer, by putting in place Analytic CRM framework that automates data capture across human channels and during every contact with the customer. The system's ability to integrate data from multiple contacts made with a single customer for various products and services decides its efficiency. The next is to use this information about the customer to find the best way to reach a particular customer. After analyzing demographics, purchase history and other significant data, the system creates profiles of common customer behavior patterns basis. This will allow a bank to identify specific segments within its customer base and design marketing strategies customized for these segments. This is additionally important for the MSME customers as they have huge potential for growth, and with their growth the business of the bank will grow. Thus maintaining good customer relationships through use of analytical frameworks is really important for long term success of banks.
- **Reducing the burden of work on a single person:** During the study it was observed that in most of the public sector banks, all the functions are carried out by one or two people only. The same person receives the application from the applicant, the same person processes the application and undertakes the credit appraisal process, the same person analyses the risk in the proposal, and that very same person also acts as relationship manager to the customer. This not only delays the process of application but also create certain biases, as the person might get prejudiced at one stage or the other. Therefore there is a need to designate separate teams to carry out different functions, so that the efficiency of the staff can be increased and the process can be made speedier and error free.

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