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A Study on SME Financing in VUCA Environment in India

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ABSTRACT

Making changes happen is current trend in global business scenario. Indian Business has seen Paradigm shift in terms of opportunities and living in VUCA environment after refined social reforms and changing political environment.

Finance is ultimate requirement for each and every corporates, which may be Big or small, but inevitable for its growth and suitability. Though there is more challenges in operations of a business, finance become the basic requirement either to start up, expand or merge in order for the growth.

Over the period of years, Indian finance industry has imputed with more of opportunities to create new business, which has led to economic growth in SME sector.This paper will through insights of current situations of SME financing in India running in VUCA environments.

KEY WORDS: SME Finance, VUCA, GDP, MSME.

INTRODUCTION

In earlier scenario, there was more importance given to Small and medium sectors and government had made several valiant efforts to create a base in the industry, which is now developed into larger frame called SME /MSME.

SME finance is the funding of small and medium-sized enterprises, and represents a major function of the general business finance market – in which capital for different types of firms are supplied, acquired, and coasted or priced.

Capital is supplied through the business finance market in the form of bank loans and overdrafts; leasing and hire-purchase arrangements; equity/corporate bond issues; venture capital or private equity; and asset-based finance such as factoring and invoice discounting

The term 'MSME' is widely used to describe small businesses in the private sector. Regulators and financial institutions across the world use parameters such as employee strength, annual sales, value of fixed assets, and loan size proxies to define the sector in the context of finance. For instance, businesses with employee strength less than 500are considered MSMEs in Mexico. According to the World Bank definition, a Business is classified as MSME when it meets two of the three criteria – employee strength, size of assets, or annual sales.

MSME classified into two areas Manufacturing and service in business point of view. The units which are engaged in Manufacturing or producing and providing or rendering services has been pronounced as MSME, but based on the investment in Plant and machinery, equipment under.

Enterprises	Manufacturing	Service
Micro Enterprises	Up to 25 lakhs	Upto 10 lakhs
Small Enterprises	>25 lakhs to 500 lakhs	>10 lakhs to 200 Lakhs
Medium Enterprises	>500 lakhs to 1000 lakhs	>200 lakhs- 500 lakhs

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Review of Literature

The below are some of the study conducted by the authors and researchers in the topic which highlighted problems and current scenario of SME financing in India

B. NAGARAJU AND KAVITHAVANI S.D (2013) in PROBLEMS AND PROSPECTS IN BANK SME FINANCING IN INDIApublished in Indian Streams Research Journal concluded that in order to cater and develop SME finance by Indian commercial banks, they have to change the wayofbusiness, which exists and manage the risk according to the category of funding. Important point is to understand the SME market and how it differs from other segments. Banks has to develop their capacity to predict the risk without reliable financial information, adequate collaterals and by applying mass market approach, which can make Bank SME financing profitable opportunity.

A study on Strategiesto Strengthen Credit Flow to SSI Sector concluded that on the technological constraints and growing needs of the customer, there should be "Banker-Borrower" relationship, which has to be strengthen .In this process, if the banker have fulfilled his mission, the SMEs will prosper and the customers at large will benefit.

A study on the Bank financing of SMEs in India by ***Anirban Ghatak*** *published in* ***International Journal Research publication-(RESEARCH JOURNAL OF SOCIAL SCIENCE AND MANAGEMENT)***focussed that some of the factors that need to be considered in financing of SME's are - profit earning of SME, legal formation of the firm, stages of development of the firm. no of default firm made in previous loans, availability of collateral, payment history of firm, preparation of financial statements, feasibility of the proposed project and experience of management in business. The influence of these factors decides the risk associated with the SME lending.

Objectives of the paper

1. To portray the overall growth of SME finance in India.

2. To display the VUCA environment in the SME finance in India.

3. To know the changes and factors effecting SME business and their influence in current situation.

Methodology

This study is based on the secondary source of Data. These data were sourced from RBI website, Ministry of MSME website.

Books, articles and details from newspapers and journals were also formed as one of the data for the source.

Importance of SME and its Latest Contribution toward GDP

The SME financing has seen multifold growth in over the years, not only creating the employment, but creating growth in the Economy, over the period of years comparatively last 5 years, this sector has seen drastic improvement in Indian economy.

In FY11, 17 per cent is contribution to the nation's GDP and employed 60 million people, the second largest workforce in the country after the agricultural sector. The estimated contribution of Micro, Small and Medium Enterprises (MSME) sector, including service segment, to the country's GDP during 2012-13 was 37.54 per cent; while the total employment in the sector is 805.24 lakhand the share of MSMEs in India's total export for the year 2014-15 was 44.70 per cent, the Parliament was informed.

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As per the Central statistical office & Ministry of Statistics and programme implementation, the estimated contribution of MSME sector towards GDP witnessed growth rate during 2010-11, 2011-12 & 2012-13 are 36.69 per cent, 37.97 per cent & 37.54 per cent respectively including service segment.

Indian SME Today's scenario

Indian SMEs today operates in a very challenging environment nevertheless growing economy in world. According to World Bank, India has slipped 3 ranks in its Ease of Doing Business Index –this raises deep concerns about the state of affairs in India. SMEsare said to be the backbone of India's economy, however not much is being done to promote their healthy growth and development in the past years. Though there is plenty of opportunities found, there is considerable challenges against these opportunities as follows

1. Poor Infrastructure

2. Inadequate market linkages

3. Lack of adequate and timely finance

4. Lack of Managerial competence

5. Obsolete technology

Source:Report of Working Group on Rehabilitation of Sick MSMEs, Reserve Bank of India

Presently SME in India demonstrates huge gap in SME financing to the tune of 2.93$ trillion in 2016- pointed out by CEO of Aditya Birla group- Rakesh Singh as per the IFC report According to the report, there are approximately 50 million SMEs in India, exercising frugal management skills and using local resources to create innovative products and services which cater to India's rowing needs. These SMEs contribute more than 45 per cent of India's industrial output, 40 per cent of the country's total exports and create 1.3 million jobs every year. SMEs currently witness high demand for finance, particularly, debt, to finance their growth. Most lenders prefer traditional-collateral based lending generally. Formal sources cater to less than one fourth of the total SME debt financing in present growing economy.

This formal financial sector comprises of scheduled commercial banks, NBFCs and smaller banks such as Regional Rural Banks (RRBs) and Urban Co-operative Banks (UCBs). Of the total financial requirement of SMEs, over three fourth is either self- financed or comes from informal sources. The informal sources can be segmented into two categories namely non institutional sources of funding which include family, friends and family business while institutional sources comprises of money lenders and chit funds.

The financing need depends upon size of operation, industry, customer segment and stage of development .In order to continue scaling up activity, timely and adequate access to financial services and credit is essential, and has been one of the biggest obstacles.

Many of these SME's depend only on the bank loans and credits from local and unorganised sectors, to run their business, which have huge rate of interest .A report by the International Finance Corporation (IFC) analysed that the total financing demand gap in the SME sector is of Rs 2.93 trillion. Most formal lenders prefer traditional-collateral based lending and

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look for at least three years of profitable track records.

Traditionally, private funds from friends and family form the single largest source of finance to SMEs in India. Such enterprises also rely heavily on private money lenders and the unorganized financial sector for their requirements, where the terms of financing are unclear and interest rates are high. Although banks are making efforts in bridging this gap, their approach to funding is somewhat restrictive.

It is quite evident that though there is traditional way of funding is in existence, there is also improved means like big Data Mining and data analysis to make lending decisions through CIBIL to judge the credit worthiness of borrowers and their repayments.

Newly developed credit system and technological improvement will however bridge the gap in coming years to get faster loans with reduced rate of interest against traditional system of credit raising and will surpass the Deficit space in SME funding in future.

Recent growth of SME Market in India

Working tandem with global growth, unlike other countries, India has proved its economy as emerging and growing among developing economies compared to china, Brazil,Pakistan and other developing nations across the countries in 2016.Major political reforms and new changes in policy has paved away growth in the development in opening new windows for the Indian economy in global arena. These include re-implementation of PublicProcurement Policy,“Pradhan Mantri MUDRA Yojana”, and “Make in India”, “Start-up India”, and “Skill India” as big boon to India.The new reforms and changes is aimed to increase growth inIndian economy in manufacturing sector by 12-14% and its share to increase 25% in GDP by 25% by upcoming years.

The announcement to implement GST Bill in 2017 is a prominent decision, which will help solve long existing challenges prevalent in the current taxation system. For SMEs, GST bill will help eradicate indirect taxes, have more transparency of tax process, draw projections of production cost and gain easy access to new geographies for business expansion. Hence the present steps taken by the ruling government has shown a sense of light in darkness with good rocket signs for further growth of the economy. After demonetisation in Nov-2016, Indian economy may deprived by negative growth in GDP of 6.6% against 7.6% estimated for this year as per IMF publications, but this measure is expected to ripe the desired fruits in long terms says government authorities.

SME trends in 2017 – Predicted

After technological advancement and rapid imputes of E-commerce, more opportunities are created not only to existing members of SME, but it has changed attitudes in new generation entrepreneurs to go business instead of employment. With Growth of SME’s touted to be 25.8$ billion market for emerging technologies by 2020, the raise of sme’s will gain momentum in 2017.

The year 2017 will experience a surge in NBFCs with special focus on offering customised loan solutions on online platforms. More inceptions of new banks /NBFC’s &payment banks remain an additional channels to tap the opportunities for financing in India.

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Creating a disruption in the industry and for good, these alternative lending companies analyse credit worthiness of the sellers using analytics and other scanning metrics like their sales and fulfilment records and can disburse loans in less than 48 hours. As a matter of fact, some of the banks like Bank of Baroda is also partnering with new age Fintechs to expand their reach especially in the SME sector.

There is huge expectation from MSME sectors from government in this Union Budget 2017, this rise in expectation has been satisfied with some announcement which are as follows

1. Budget has increased the period of profit-linked deductions available to the start-ups to seven years from the current five years
2. New Budget has allowed to carry forward MAT (Minimum Alternative tax from 5 years to 15 years
3. The latest announcement in Union Budget 2017 has cheered Indian SME sector, through announcement of a Cut in income tax 5% that would benefit 96% of Indian corporates, which is facing hard hit due to demonetisation.
4. For MSMEs having revenues less than Rs 50 crore have been given a cut in corporate tax rate to 25 %, from 30% earlier. Also, for the businesses that have turnover up to Rs 2 crore, under section 44AD of the Income Tax Act, income would be presumed to be 6% of the total turnover of the assesse, instead of 8% only if gross receipts are received through digital means. Hence this important announcement will lead the sector turning into cashless and good transparency and reduce tax burden
5. Adding to the above announcement there is also further increase in allocations towards schemes like Modified Special Incentive Package Scheme (M-SIPS) and Electronic Development Fund (EDF) to Rs745 crore in 2017-18. , This will be making India a global manufacturing hub, and encourage the existing electronic players and also make the space lucrative for new players

This announcement will give benefit to 96% of companies almost (6.67 lakhs) at the expense of the government forgoing Rs 7,200 crore of revenue

SOURCE: Union Budget 2017

VUCA in SME financing in India

In India,Existence of VUCA resides in its basic structure , the common business structure in the MSME sector is segregated into Proprietorship with 95%, Partnership, Cooperatives 1.2%, ,Private Limited, Public Limited is 0.8%, others 3.5%. The ownership of the capital comes from own sources/savings, friends and relatives and private borrowings. Hence VUCA remains a basic nature in Indian business.

Proprietorship and partnership enterprises cannot accept any form of external equity other than owner contributions. This can significantly impact growth potential both at start-up stage as well as whenthe enterprise is in need of growth capital.

General Conditions of VUCA prevails as a threat to Indian economy and curtails its growth to scale its level to remarkable

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heights. Some of the VUCA elements in SME funding are as follows.

1. Dearth of easy finance and credit instruments

2. Limiting regulatory polices

3. Unavailability of modern, affordable technology

4. Lack of basic infrastructure facilities

5. Absence of exclusive marketing platforms and distribution networks

6. Inflexible labour laws and availability of affordable skilled labours

Apart from traditional funding, Collateral based lending offered by traditional banks and finance companies is usually made up of a combination of asset-based finance, contribution based finance, and factoring based finance, using reliable debtors or contracts. Hence there is mismatch in requirements and availability of the data between borrowers and lenders to assess and meet the timely finance requirements. However, Information based lending usually incorporates financial statement lending, credit scoring, and relationship lendingmay reduce the gap in future for increased demand for funds in these sector.

Major Reasons for Huge Gap in SME Financing

The major reasons for this financing gap include information asymmetries, higher risks, sizeable transaction costs and lack of adequate collateral. It is important for the enterprise to introspect the obstacles of financing and accordingly address these ingredients toovercome the gaps .One of the preferred modes of financing options could be trade credit or supply chain financing. This addresses the need of collateral and also mitigates the risk to a large extent by making it transaction backed lending wherein the origination to end of cash flows can be easily sighted and tracked by the lender. Other alternative finance options such as securitisation of SME credit, factoring, accessing equity capital from SME Exchange, Venture Capital, and cash flow based financing, etc. can also be looked at and evaluated from a feasibility perspective.

Some of the Suggestion to Overcome VUCA in SME financing

Some of the Measures which may be incorporated towards SME financing in VUCA environment prevailing in India as follows

1. Building Capacities of Small Finance institutions through training and financial investments
2. Promote /form institutions that Support MSME under Private of Government setup
3. Encourage Factoring and securitisation of trade by introduction of special set of acts
4. Formation of MSME specific venture funds by private and government participation
5. Special Rehabilitation and Creditor protection laws for MSME sectors
6. To Provide IT enabled Technological flat forms to track receivables that facilitate factoring and securitisation of trade receivables
7. Undertake special research activities to analyse the Financing patterns & investments in services of SME by government and private companies
8. To Strengthen MSME credit information bureau and expand the

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scope to collate information and data dissemination to process critical data for receivables and trade.

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