

Factsheet: Financing the Missing Middle: Policies, Channels and Products

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There are an estimated 488.46 lakh working enterprises in the Micro, Small and Medium Enterprises (MSME) sector, employing 1,114 Lakh people. The MSME sector contributes to roughly 37.54% of the total manufacturing GDP of India. The recent e-commerce boom in India, has provided a much needed boost to MSMEs in India. Further, the Union government's 'Make in India' initiative is expected to generate the interests of global and local investors in the segment.

Understanding the MSME Finance and other Gaps

- A 2012 study estimated the finance demand of MSMEs to be Rs. 32.5 Trillion, of which 74% came from SMEs.
- 17% of the debt supply from formal institutions is jointly received by low-income states and northern eastern states.
- 0.3-0.4 million is the average financial requirement from micro firms.
- 4.5 million is the average financial requirement from small firms.
- Only 22% of this demand is met by banks and the remaining is catered to by informal sources and self-financing, placing the total finance gap at Rs. 20.9 Trillion.

Availability of adequate and timely credit and equity capital	High cost of credit and collateral requirements imposed by banks due to limited credit history of applicants	MSME policies and budgets lump together medium, small and micro firms despite their distinctive natures
Poor infrastructure and inadequate market linkages	Inability of SMEs to optimally market their products	Convolutd and inconsistent taxation system
Lack of information, awareness and utilization of available government schemes and benefits	Poor Availability of Skilled Labor and frequent employee turnover	Highly affected by small scale corruption from bureaucrats

Source: IFC (2012), CCS report on regulatory barriers to Indian MSMEs, UNIDO (2007)

Policy Initiatives Targeting SME Constraints

Constraints	Policy Initiative
Access to Finance	<ul style="list-style-type: none"> RBI mandates that banks direct 7% of their total annual lending to microenterprises as a part of priority sector lending norms. Government provision of schemes providing collateral free loans, subsidies for technology up gradation and debt and equity funds MUDRA has been set up to fund last mile financiers for 5.8 Crores SMEs
Improving Transparency	<ul style="list-style-type: none"> Credit ratings from agencies like SMERA, CARE, CRISIL and ICRA allow finance providers to speed up the process to suit the working capital cycles of SMEs and additionally attract banking institutions to high potential SMEs The MSME ministry has simplified registration processes by reducing it to a single page portal that asks for basic details and does not require documents, and has so far received applications from 10,300 units.
Providing Skilled Labour	<ul style="list-style-type: none"> The National Skill Development Mission aims to bridge gaps in skills by providing skill-based training to over 5 million people in addition to improving the skill training infrastructure in underserved geographies and sectors. The MSME Ministry has set up a free employment portal to bring together skilled labour for the manufacturing industry in June 2015.

Learning from the Global Experience of Strengthening MSMEs: Possible Future Steps

Constraints	Global Experience ¹
Improving Physical Infrastructure	<ul style="list-style-type: none"> US and Canada lower tax rates for physical assets used by small businesses Italy provides grants (starting from EUR 100,000) to MSMEs for purchase of hardware/software/ICT tools and EUR20, 000 of tax credit is provided for improving network speed (of mobile and fixed line) to more than 30 Mbps. UK provided SMEs shared office spaces in prime locations
Improving Knowledge Infrastructure	<ul style="list-style-type: none"> USA and Canada provide MSMEs knowledge capital at ground level by connecting them to existing educational institutions through the HUBZone program and the Business Innovation Access Program
Simplifying Documentation and Taxation Processes	<ul style="list-style-type: none"> Canada launched a 'Right from the Start Program' to ensure tax compliance by MSMEs, for which it offered services such as compliance support initiatives, books and review of records, and small business support visits In the USA, to simplify the process for start-ups, the SBA has created a tool 'Permit Me' that is a guide on the licenses/permits required for a business type, along with links on the process of application.

¹ .Source: The New Wave Indian MSME, KPMG