

# Financing a Fractured Enterprise System: Search for New Strategies

*ISED Policy Briefs*

by  
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**ISED Small Enterprise Observatory**  
*Jointly with*  
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**About ISED Policy Briefs**

ISED Policy Briefs are a key tool to present research and recommendations to a non-specialized audience. By providing up-to-date reports on issues and activities for decision-makers, planners, managers, practitioners, researchers and academics, they seek to stimulate discussion and application where appropriate. They serve as a vehicle for providing evidence-based policy advice to help readers make informed decisions.

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## Preface

Setting a right balance between epidemiological compulsions and keeping the development process going, is the challenge of Pandemic Economics. Sustaining the health, growth and sustainability of the MSMEs, a sector that really matter in India's development agenda, in terms of output, employment, and opportunities, is critical today. While sustaining agriculture is vital to ensuring food security during the Pandemic and beyond, the health of the MSMEs is critical to the dynamics of the local economy. Financing such a fractured enterprise system is a challenge as well as an opportunity for the financial system.

Under the India MSME Communication Programme(IMCP), the Observatory, in co operation with the various Knowledge Centres of the Institute, makes a rigorous analysis of the latest currents in the MSME constituency, leading to a unique 'Development Report'. This study is a spill-over of this exercise of Development Reporting on micro, small and medium enterprises (MSMEs) at the ISED.

While the team of the Observatory did a meticulous job under the guidance and support of the Project Leaders, individual members of the Team, including the editors and the Associates, have made their special contribution in specific thematic areas. While this title is significant in the present context of the Indian economy , and of the MSME developments in specific, I hope it will contribute to wider discussions in the subject area.

As this title come out as a joint output of the Observatory and the ISED Centre for Financial Education & Research, the Institute wishes to thank, without fail, the pains and efforts of the authors, and all who have supported it through inputs and suggestions. ISED has taken best efforts to ensure the quality and reliability of this paper. However, for the findings and views, the authors alone are responsible.



P.M.Mathew

Director, ISED Cochin

December 10,2020



# Financing a Fractured Enterprise System: Search for New Strategies

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## Abstract

*Setting a right balance between epidemiological compulsions and keeping the development process going, is the challenge of Pandemic Economics. Sustaining the health, growth and sustainability of the MSMEs, a sector that really matter in India's development agenda, in terms of output, employment, and opportunities, is critical today. While sustaining agriculture is vital to ensuring food security during the Pandemic and beyond, the health of the MSMEs is critical to the dynamics of the local economy. Financing such a fractured enterprise system is a challenge as well as an opportunity for the financial system.*

*Key Words: Finance, SME, Covid 19, enterprise system.*

## 1.0. Introduction

The priority of public policy, during a pandemic situation, is to understand its dimensions and magnitude, and to evolve containment strategies. Unlike many other countries, the Government of India, with the active support of the States, has made timely interventions in this area. It is important to understand that, apart from political will, the policy choices are dependent on the epidemiological compulsions, on the one hand, and the budgetary implications, on the other. Having a reasonably realistic understanding of the situation, the next challenge is to keep such initiatives going, without hampering the interests of the economy and of the welfare of the people. Keeping a right balance between the two, is the challenge of Pandemic Economics, and public policy in general. India is now on a vigorous search for sustaining the health, growth and sustainability of the MSMEs, a sector that really matter in its development agenda, in terms of output, employment, and opportunities. While sustaining agriculture is vital to ensuring food security during the Pandemic and beyond, the health of the MSMEs is critical to sustain the dynamics of the local economy. It is also important to ensure that, the Indian economy does not get derailed into second-order problems emerging out of the Pandemic.

## 2.0. MSME Finance in 2019

The recent developments relating to credit delivery has been a matter of concern, both for the RBI, and for the financial system as a whole. This relates to two things: a) overall credit flow position; and b) the volume of non-performing assets with the banking system. An understanding of the picture as in 2019 is important as a backgrounder.

### 2.1. Credit Delivery

The RBI figures on sectoral deployment of credit released during the last week of June, 2019, showed

an increase in non-food bank credit by 11.4 per cent in May 2019 as compared with an increase of 11.1 per cent in May 2018. Credit to industry rose by 6.4 per cent in May 2019 as compared with an increase of 1.4 per cent in May 2018. Credit growth to 'infrastructure', 'chemical & chemical products', 'vehicles, vehicle parts & transport equipment' and 'all engineering', accelerated. However, credit growth to 'basic metal & metal products', 'textiles', 'food processing' and 'petroleum, coal products & nuclear fuels' decelerated/contracted. Credit growth to the services sector decelerated to 14.8 per cent in May 2019 as compared with 21.9 per cent in May 2018.

### 2.2. Economic Governance

Economic governance consists of the processes that support and facilitate economic activity and economic transactions by protecting property rights, enforcing contracts, and taking collective action to provide appropriate physical and organizational infrastructure. Even the best of policy can have significant positive effects, only when the economic governance system is proactive and efficient. Major reforms in governance, and spill over effects of reforms during recent years, had their impact on the economy. These reforms included, bank recapitalisation, tax reforms, and some welfare schemes.

Under Indradhanush roadmap, the Government had announced infusion of Rs 70,000 crores in state-run banks over four years. The Union Budget 2019, as a major step, announced Rs.70'000 crores capital infusion for public sector banks.

The introduction of GST is one of the major economic reform measures of recent times. The revenue collection has progressively gone up. The GST collection in July 2019 was 5.8% more, than that of July 2018. For August this year, it was 4.5 per cent higher than the Rs 93,960 crore collected in the same month last year. Following the major crisis in the farm sector, especially in relation to a fall in agricultural prices and farmer suicides,

### Need for Monitoring Enterprise Vulnerability and Insecurity

As a cross-cutting area of concern, enterprise security needs close monitoring. Enterprises have vulnerability at three levels: a) internal; b) external.; and c) mixed. These three sets of factors are largely perception-related, rather than objective. For example, some entrepreneurs consider a government policy as “manageable’, but others take it blindly, as they do not have the clout or resources to manage such a situation in a strategic manner. Attitudes and bargaining power matter in shaping such perceptions. Therefore, capturing such perceptions in a realistic manner is a major imperative.

some welfare measures were announced. Similarly, a pension scheme was announced in the Union Budget 2019 for petty traders. The impact of these measures has been widely debated.

In order to improve the credit flow situation in MSMEs, Rs 350 crore was allocated for FY 2019-20 under the Interest Subvention Scheme. An External Benchmark Based Lending was announced by the RBI in September 2019. As a step in that direction, it was announced that all new floating rate personal or retail loans and floating rate loans to Micro and Small Enterprises extended by banks from April 1, 2019 shall be linked to external benchmarks. Subsequently, it was announced in the first bi-monthly Monetary Policy Statement for 2019-20, to hold further consultations with stakeholders and work out an effective mechanism for transmission of rates. Based on the consultations with stakeholders, it was decided to link all new floating rate personal or retail loans (housing, auto, etc.) and floating rate loans to MSMEs extended by banks with effect from October 01, 2019 to external benchmarks.

To ease the liquidity crisis in NBFCs, the Government has taken some important steps. The Budget announced that, fundamentally sound NBFCs should continue to get funding from banks and mutual funds without being unduly risk averse. For purchase of high-rated pooled assets of financially sound NBFCs, amounting to a total of Rs 1 lakh crore during the current financial year, Government will provide one time six months’ partial credit guarantee to Public Sector Banks for first loss of up to 10%.

Against the range of disruptions in the economy since the demonetisation decision in 2016, and the implementation of the GST in 2017, the RBI appointed a committee under the chairmanship of U.K.Sinha, to study the problems faced by MSMEs, in January 2019.

#### 2.3. Broad basing Credit Guarantee

The Union Budget 2019-20 has issued a scheme regarding partial credit guarantee on 10.8.2019, which sought to deal with temporary asset- liability mismatches of otherwise solvent NBFCs/HFCs without having to resort to distress sale of assets for meeting their commitments. The Union Budget

2019 also proposed a Credit Guarantee Enhancement Corporation, in order to deepen the long-term bond market.

#### 2.4. Morbidity and Wellness

A major pointer regarding MSME health status is their asset quality. MSME sickness is defined as the ability of a firm to repay the loans, within a specified period of time, as per norms laid down by the Reserve Bank of India. Since the banking system in the country does not bring out such data on MSMEs, it is difficult to make a macro level assessment of the situation. However, the findings of several specialized studies indicate the prevalence of sickness among MSMEs. For example, ISED(2018) has brought out the case of the state of Tamil Nadu, where a significantly large number of units were found to be sick.

Enterprise morbidity is a cross-cutting area of concern, both for financing and development practice in general. Enterprises have vulnerability at three levels: a) internal; b) external.; and c) mixed. These three sets of factors are largely perception-related, rather than objective. For example, some entrepreneurs consider a government policy as “manageable’, but others take it blindly, as they do not have the clout or resources to manage such a situation in a strategic manner. Attitudes and bargaining power matter in shaping such perceptions. Therefore, capturing such perceptions in a realistic manner need to be the key to MSME credit policy and strategies.

### 3.0. Macro and Credit Policies

The COVID 19 pandemic involves an unavoidable temporary economic paralysis, and its consequences will likely amount to a severe contraction of the global economy and a global financial crisis. In this context, the efficacy of the various policy measures at the macro level has been widely discussed.

#### 3.1. Policy Instruments

One of the key issues raised in this context has been the effectiveness of standard macro and credit policies in dealing with the pandemic. The arguments relating to the so called ‘SME relief packages’ vary from, one-