POLICY ON MICRO & SMALL ENTERPRISES (MSE)

1. Preamble

Micro& Small Enterprises (MSE) sector constitute the growth engine of the economy with significant contribution to GDP, exports, and employment opportunities. Besides providing depth to industrial base of the economy, the MSEs also lead to entrepreneurial development and diversification of the industrial sector. With the Services sector dominating the MSE, and MNCs outsourcing their various requirements to Indian service providers, the scope for MSE finance has increased even further. As per the Priority Sector guidelines issued by RBI, only **Micro & Small Enterprises Segment will qualify for inclusion under priority sector**.

1.2. Govt. of India have taken various policy initiatives to promote MSE sector through infrastructure development, skill set development /entrepreneurship development, technology up-gradation etc. There is an immediate need for the banks generally to focus on credit and finance requirements of MSEs. Credit risk in the MSE sector is widely dispersed and Banks get better yield from MSE advances as against the traditional advances where the spread is getting gradually reduced.

1.3. The MSMED Act 2006, which came into effect from 02/10/2006, aims to remove the several bottlenecks faced by the MSE sector, particularly the tiny segment of the small enterprises.

1.4. The role of Banks, in general, has become very important in the above context. The MSE sector's demands can be addressed through initiatives such as:

- Setting up of MSE cells

(xxiv) Quick decision with least Turnaround Time through specially constituted MSE Cells &

(xxv) Better service.

2. The following chart indicates the **threshold investment levels** for both Manufacturing sector (**INVESTMENT IN PLANT & MACHINERY)** and Services sector (**INVESTMENT IN EQUIPMENT)** to be eligible for inclusion under MSE segment:

Enterprise	**Engaged in Manufacturing / Preservation of Goods (incl. Processing units)**	**Engaged In Providing/ Rendering of Services**
(1)	(2)	(3)
Micro Enterprise	Investment in plant & Machinery not exceeding Rs. 25 lakhs.	Investment in equipment not exceeding Rs. 10 Lakhs.
Small Enterprise	Investment in plant & Machinery exceeding Rs.25 lakhs exceeding Rs.5 Crores.	Investment in equipment exceeding Rs.10 lakhs but not exceeding Rs. 2 Crores

While calculating the investment in plant and machinery/equipment referred to above, the **original price** thereof shall be taken into account, irrespective of whether the plant and machinery/equipment are new or second hand. There are certain specified costs/ charges not to be included in calculating the value, which are not elaborated here for brevity.

- Micro Enterprises would include Tiny Industries also.
- Small Enterprises (Manufacturing) would mean Small Scale Industries (SSIs).

Thus, **MSE advances** would be categorised as under:

- All advances to segments viz. Micro & Small Enterprises (refer to table above) in the **Manufacturing sector** irrespective of sanctioned limits, (including advances against TDRs/Govt. Securities etc for business purposes to these categories of Borrowers),

And

- Advances to **Services Sectors** (refer to table above)such as Professional & Self-Employed, Small Business Enterprises, Small Road/Water Transport Operators and other enterprises,
  - o engaged in providing/rendering of services,
  - o conforming to the above investment criteria and
  - o enjoying borrowing/non-borrowing facilities with the Bank (including advances against TDRs/Govt. Securities etc for business purposes to these categories of Borrowers).
- Those enterprises **exceeding the investment ceilings** would be categorized as Medium and Large Enterprises and be **outside the purview of MSE**.

- The **sanctioned limits would no longer be the criteria** determining the status as micro or small enterprise in these cases.

(xxvi) MSE Thrust Centers

- The following centers have good potential for MSE advances. We may instruct branches in these centers to exploit the potential available.

  Hyderabad, Delhi, Ahmedabad, Surat, Baroda, Goa,Gurgaon, Bangalore, Kochi/Ernakulam, Mumbai, nagpur, Pune, Bhopal, Indore, Ludhiana, Jaipur Chennai, Coimbatore, Tirupur, Noida, Ghaziabad.

(xxvii) **MSE Counseling Centres:**

- We have already started a MSE counseling centre at Ernakulam. We may in due course open more counseling centers at other places.

3. While dealing with MSE segment borrowers we may prioritise the following, in particular:

- ✓ Provision of timely and adequate credit to the MSEs,
- ✓ Encouraging Technology Upgradation, for better quality and competitiveness of their product(s), and
- ✓ Financing of Clusters with adequate and concessional Bank finance on liberal terms in several pockets for specified activities concentrated in these pockets, which would result in reducing transaction cost and greater economies of scale.

The Bank's credit-related exposures (both Fund-Based and Non-Fund Based) and the policy guidelines relating to Credit Risk Management, Credit Delivery, Credit Monitoring and Recovery are to be treated as uniformly applicable to the MSE Policy as well to the extent these have not been modified under the Bank's MSE Policy. In case of modifications, the modified provisions of the MSE Policy would prevail over the other Policy Guidelines of the Bank. With changes in any of these other policy
guidelines, at appropriate levels, the MSE Policy would also automatically stand amended.

4. Cluster-Based Lending Approach

Cluster based approach for financing MSEs is expected to result in less transaction costs, and risk mitigation. It can also contribute for improvement in infrastructure.

The MSE Thrust branches would also have adequate operational flexibility to extend finance/render other services to other sectors/borrowers.

SIDBI has already initiated the process of establishing Small Enterprises Financial Centres (SEFCs) in select clusters. Risk profiles of each cluster will be studied by a professional credit rating agency and such risk profile reports when made available to Bank(s) would enable us to consider adoption of the cluster for comprehensive credit saturation.

5. Credit Tenure

The Bank's Term Loan exposure to MSE sector would generally have a 5-7 year maturity.

6. Minimum rating for entry level / enhancements, continuance etc

The acceptable minimum rating for entry level / enhancements, continuance etc shall be as mentioned in the Credit Risk Management Policy which is currently as follows:

Sector	Entry / Enhancements	Continuance
Micro& Small Enterprises (MSE)	SIB BBB	SIB BB

Exceptions: Relaxation in rating by one notch can be considered by functionaries not below the rank of CGM depending on merits for entry / enhancements.

7. Credit Acquisition and Take-over

Apart from direct /primary credit acquisition, we may also consider take-over of advance accounts from other Banks/FIs following the **minimum** financial parameters and conditions as prescribed below:

For *take-over*, accounts should be eligible for a credit rating of minimum **BBB** as per our credit rating model treating the account as a new one. The powers of Regional Offices for takeover will be as per the extant guidelines applicable for general loans.

- ✓ The accounts to be taken over should be standard accounts with the existing Bank.
- ✓ The firm/company continuously registering increasing trend in sales volume and making **cash** profit for at least last three years.
- ✓ Though our general norm is Maximum Debt Equity Ratio (DER) of 2 :1 for limits of Rs. one crore & above, and 1.5:1 for limits of less than one crore , we may adopt preferential treatment for Micro & Small segment borrowers. Accordingly, we may prescribe Maximum DER of **2.5:1 in the case of Micro and Small Enterprises enjoying working capital limits of over Rs.5.00**

Crores and **2:1** in the case of Micro and Small Enterprises enjoying working capital limits **up to Rs.5.00 Crores.**

- ✓ Minimum Current Ratio 1.20:1 for accounts with limits up to Rs 5 crores, where Turn Over Method would be applied for assessment of the Working Capital (as against 1.33 prescribed normally). For limits above Rs. 5.00 crores CR 1.33:1
- ✓ Average Debt Service Coverage Ratio (DSCR) of **1.50:1** as against 1.75:1 prescribed normally.

For permitting continuance of MSE accounts with rating below ‘B’, the existing powers as approved in Credit Risk Management Policy will be applicable. (ie.CGM and above @ 50% of delegated powers)

8. Credit Appraisal : Broadly the appraisal would involve:

- ✓ Proper identification of the borrowers in accordance with KYC Norms/Guidelines, the borrowers’ experience, educational and social background, technical/ professional competence, integrity, initiatives, etc,.
- ✓ Checking out for Wilful Defaulters’ List of RBI, CIBIL report, Specific Approval List (SAL) of ECGC etc.
- ✓ The acceptability of the product manufactured, its popularity/market demand, market competitors.
- ✓ Evaluation of State and Central Govt. Policies (enabling environment) with specific reference to the Enterprise in question, Environmental stipulations, Availability of necessary infrastructure-roads, power, labour, raw material and markets.
- ✓ Techno-economic Appraisal of units **.**
- ✓ Project Cost, the borrowers own financial contribution, projections for three years, and other important parameters which would include the Break-EvenPoint (BEP), liquidity, solvency, and profitability ratios, etc,.

9. Working Capital Assessment

For working capital limits up to Rs.5 Crores , **Turnover Method** would be applicable as per the **Nayak Committee Recommendations** for financing working capital needs of the MSEs @ 20% of the **projected turnover** based on the assumption of a three month operating cycle**.** <u>Second method may be resorted in specific cases with **longer** operating cycle.</u> Branches should obtain and ssesses h latest audited financials of the constituent in all cases of WC limits above Rs.10 lakhs

The next year’s sales projections made by the borrower, however, would have to be corroborated by the trend in sales over 2 years, last year actual sales through verification of the following indicative parameters (besides the financial data submitted by the borrower):

- ✓ Sales Ledger/Sales Turnover.
- ✓ Credit Summation in the account.
- ✓ Sales Memos or Invoices/Delivery Challans.
- ✓ Sales Tax Paid/Turnover Tax/Excise Register, as applicable,
- ✓ Electricity Bills –wherever applicable.
- ✓ Orders on hand/expected orders.
- ✓ Installed capacity vis-à-vis the projections.
- ✓ Overall market trend etc,.

Such projections should be within reasonable limits say 25% over last year’s sales. However, in exceptional cases deviations from this may be allowed supported by cogent reasons with proof thereof.

10. Current Ratio:

While a benchmark current ratio of 1.33:1 is always desirable, MSEs may be permitted to maintain a minimum current ratio of 1.20:1.

11. Debt:Equity Ratio:

The following may be accepted as the benchmark in this regard:

- ✓ Limits up to Rs.5 Crores to Micro & Small Enterprises:2:1
- ✓ Limits over Rs.5 Crores to Micro & Small Enterprises: 2.5:1

12.CREDIT RATING MODEL

To assesses the cost of loans to MSE sector, we may adopt a transparent rating system with cost of credit being linked to the credit rating of enterprise. In this connection, IRMD has recommended the following Credit Rating Model for MSEs.

13. PARAMETERS FOR RATING

I. INDUSTRY RISKS

- Raw Materials
- Infrastructure (Building, Power, fuel, labour, transportation etc)
- Location
- Technology
- Industrial climate & relationships
- R & D Arrangement

II. MANAGEMENT RISK

- Experience of the group
- Experience of the promoter/s
- Employed executives

III.OPERATIONAL RISK

- Supply of information to the Bank
- Record of Irregularity
- Limit Management
- Dealing with us
- Limit Utilization
- Compliance of sanction stipulations

IV. MARKET RISK

- Product
    - Marketing arrangements

V. COLLATERAL

VI. FINANCIAL RISK

- Liquidity
- Profitability
- Interest Coverage Ratio
- Leverage
- Solvency
-

14. Rating chart of Micro & Small Enterprises

Rating chart specifically for Micro & Small Enterprises (MSE) with **exposure Rs 10 lakh and above upto and including Rs 50 lakh** has been prepared in consultation with IRMD which is annexed with this note. *For new projects as well as existing projects in MSE sector, for which our exposure is Rs 10 lakh and above upto and including Rs 50 lakh, this rating methodology must be used*. The marks shall be averaged wherever the attribute is not applicable.

For accounts with exposure above Rs 50 lakh, the current rating methodology as applicable for that account (e.g. trading, SSI upto Rs 200 lakh, industry etc.) has to be employed.

We shall continue the same grading (as existing for rating, as given below) for this rating as well.

Marks (%)	**Rating grade**	**Signifying**
Above 80	SIB AAA	Highest Safety
Above 70 to 80	SIB AA	High Safety
Above 60 to 70	SIB A	Adequate Safety
Above 55 to 60	SIB BBB	Moderate Safety
Above 50 to 55	SIB BB	Inadequate safety
Above 45 to 50	SIB B	High Risk
Above 40 to 45	SIB C	Substantial Risk
Less than 40	SIB D	Default

15. Criteria for considering loans to Micro Enterprises upto the cut-off point:

Though the rating is applicable only for exposures of Rs. 10.00 lacs and above, due care should be taken in identifying borrowers below this cut-off point. Such category being fairly small players need sympathetic approach. The parameters set out for rating should not be neglected in selecting the beneficiaries . Loans be permitted for productive purposes and for only viable activities. The size and nature of the facilities should be appropriate to the category of clientele and the purpose.

16.Collateral Security and Margin Norms:

As per extant RBI guidelines, Micro & Small Enterprises with limits upto Rs.10 lacs may be sanctioned credit facilities without any collateral security. Instructions have been issued to branches in this regard already. Margin requirements will be as applicable for general loans.

17. Time Norms for Disposal of Applications:

The time frame stipulated for disposal of loan applications , as already provided in our
Loan Policy is applicable for applications from MSE borrowers also.

Where the proposal falls within	Branch Power RO Power	Within 7 days, after receipt of details required/final clarification Within 10 days, after receipt of details required/final clarification
	HO Power	Within 15 days, after receipt of details required/final clarification
	MC Power	Within 30 days, after receipt of details required/final clarification

18. Delayed payment:

Under the Amendment Act, 1988 of Interest on Delayed payment to Small scale and Ancillary industrial undertakings, penal provisions have been incorporated to take care of delayed payments to MSME units.

- **i.** The agreement between seller (MSME unit) and buyer shall not exceed 45 days. The buyer to make payment on/before the date agreed on by him and the supplier in writing, or in case of no agreement, before the appointed day.
- **ii.** In case the buyer fails to make the payment of the amount to the supplier, he shall be liable to pay compound interest with monthly rests to the supplier, from the appointed day or on the date agreed upon, at three times the Bank Rate notified by Reserve Bank.
- **iii.** In case of dispute , a reference shall be made to the Micro and Small Enterprises Facilitation Council, constituted by the respective State Government.

19 .Rehabilitation of Sick units & Debt Restructuring

The Bank's extant instructions and RBI guidelines on the Rehabilitation of Sick Units would be applicable *mutatis mutandis* to MSE sector also. Bank has already adopted a policy on'Debt Restructuring and Rehabilitation for SMEs' vide DBR A3/159 Dt 12.12.05 which will be binding.

20. Display of MSE Policy

The reviewed MSE policy guidelines would be displayed on the Bank's website.

21. Bank's Commitment

The Bank is committed to the following:

- To provide checklists along with applications to MSE clients

- To issue acknowledgements upon submission of application forms.
- To comply with the stipulated time norms for disposal of applications.
- To adopt Turnover Method prescribed by Nayak Committee for all Working Capital advances up to Rs.5 Crores.

22. Selection Criteria /Parameters

The MSE segment is a very broad term. As already mentioned, the categorization is not based on the quantum of loan , but based on the investment in plant & machinery for manufacturing units and investment in equipments for business enterprises. And for this reason, selection parameters will serve as broad indicators only.

- The applicants for facilities in the manufacturing segment should preferably have some basic qualification (such as certificate course of technical institutes having Govt. approval/ ITI certificate/DIC trained certificates) in the related area.
- In the case of applications for starting business enterprises, it must be ensured through interaction and enquiries that the borrower has the necessary business acumen and awareness about the business activity to be undertaken. Knowledge of basic accounting concepts will be regarded as an advantage.
- The entrepreneurial capabilities of the borrower should be accessed through direct interaction.
- Preference can be given for persons with some sort of experience in the line of activity. Acquaintance in the line of activity even as a worker / assistant can be regarded as a plus point.
- As part of Corporate Social Responsibility (CSR) , viable units formed by disabled persons may be considered without any discrimination.

23. Check-list for MSE Applicants

1. Duly filled in prescribed Loan Application form
2. In the case of registered manufacturing enterprises , copy of registration certificate given by DIC .
3. Audited balance Sheets with Trading and profit & Loss Account for the last three years (in case of existing units)
4. Sales Tax returns for the last 3 years(in case of existing units)

5. Income Tax and Assessment orders for the last three years for the unit as well as proprietor / partners / promoters / directors (in case of existing units)

6. Memorandum and Articles of association, Certificate for Commencement of Business for limited companies; Registered Partnership Deed for Partnerships

7. Copies of necessary permission for setting up the unit / undertake manufacturing activity obtained from competent authority.

8. Detailed project report – in case of new projects

9. Details of the Plant and Machinery to be purchased and quotations from the suppliers in case of Term Loan

10. Detailed plan & estimate for factory building / office approved by the Local Body.

11. Clearance from Pollution Control Board, Corporation / Municipality / Panchayat as per industry specific requirements.

12. Details / copies of documents of collateral security offered wherever applicable

13. Sources of adequate power and water supply with details of alternate sources of power

14. Power allocation certificate from the State Electricity Board wherever required.

15. Lease agreement of factory premises, if rented building

16. Copy of account for last one year, if account is being maintained with other bank and approaching us for fresh / takeover of facilities

17. First sanction order by the existing banker / Fis and the latest sanction order for various limits.

18. Auditor's certificate showing the nature and source of own funds, other than capital, like unsecured loans, etc. whether interest bearing or not, repayment terms, whether of long term quasi equity nature, for existing as well as funds to be raised.

19. Auditor's certificate to the effect whether revaluation of assets, if any, had been done at any stage with details.

20. Particulars regarding eligibility / availment of incentives like investment subsidy, power subsidy, interest free sales tax loan, IT holiday, EPCG, TUF loan or special schemes, etc.

21. Particulars regarding product / process quality certifications like BIS, ISO, GMP & EOU / Export house status.

22. Tie-up / ancillary / franchise arrangement for the procurement of knowhow / raw material / sale of finished goods / services etc.

ANNEXURE

CREDIT RISK RATING FRAMEWORK FOR MICRO & SMALL ENTERPRISES (MSE)

			Marks	Ma
	1Industry Risks (Production Stage Risk)			**15**
1	Business facilities (material, infrastructureetc.)	Very comfortable	5	5
		Comfortable	4	
		Moderately comfortable	2	
		Not comfortable	1	
2	Factory! main business premises	Building own or lease more than 10 years	4	4
		Rented where the remaining agreement period is more than 5 years	2	
		Rented building with short duration, satisfactory	1	
		Other cases	0	
3	Location	Prime! Industrial area	2	2
		Non Industrial area ! by lanes	1	
		Else	0	
4	Subsidy! other concessions from Government available	Capital subsidy and other subsidies available	4	4
		Subsidy! concession other than capital nature	2	
		No subsidy available	0	
2	**Management Risks**			**10**
5	Experience of the promoter!s	At least one of the promoters is a technocrat or experienced in the same line	6	6
		Promoters experienced in different line	2 – 4	
		New in the field	1	
6	Net worth of promoters	More than 3 times our exposure	4	4
		More than our exposure	2	
		Less than our exposure	0	
	3OperationalRisks			**20**

7	Supply of information to the Bank	Prompt supply of information	3	3
		Delayed supply of information	1 – 2	
		Defaults in supply of information	0	
8	Record of Irregularity	No irregularity	4	4
		Rare instances of irregularity	1 – 3	
		No instance of irregularity	0	
		[Irregularity means LC devolvement, BG invocation, non-payment of installment and interest within a reasonable time, discounted cheque return more than 5% etc.]		
9	Limit Management	Within DP with fluctuating balances	3	3
		Occasional over drawings, but within permissible level	2	
		Limit rarely used and within DP	1	
		Overdrawn frequently and watch category	0	
#	Dealing with us (including deposit ssesses ho as well)	More than 10 years	5	5
		Less than 10 years but more than 8 years	4	
		Less than 8 years but more than 6 years	3	
		Less than 6 years but more than 3 years	2	
		Less than 3 years	1	
		New account	0	
#	Limit Utilization	Credit turnover more than 4 times of limit and more than 80% of the sales are routed through a/c	3	3
		Credit turnover more than 3 times of limit and more than 60% of the sales are routed through a/c	2	
		Credit turn over more than 2 times of limit and more than 40% of the sales are routed through a/c	1	
		Other cases	0	
#	Compliance of sanction stipulations	100% compliance	2	2
		Majority complied	1	
		Poor compliance	0	
4	**Market Risks**			**10**

U	Product reservation	Reserved for the MSE sector	3	3
		Not reserved	0	
U	Product nature	Item with high demand	4	4
		Ancillary units or captive consumption	3	
		Normal products with moderate demand	2	
		Luxury products with limited market	0	
U	Marketing arrangements	Proper marketing tie-up is done or captive consumption	3	3
		Other marketing methods	1	
		Open marketing	0	
5	**Facility Risks**			**15**
U	Property security coverage (primary and collateral)	>= 125%	10	10
		2. Prorata for all coverage 25-125%		
		25%	2	
		<25%	0	
		If 2nd Charge, only 50% marks		
U	Nature of collateral	Liquid security (eligible financial collateral as NSC, LIC, FD) up to 50% available	5	5
		ECGC/ guarantees from other Governmental agencies available	3	
		Mortgage of prime property	2	
		Other mortgages	1	
		Other cases	0	
	6Financial Risks			**30**
U	Current Ratio	CR >= 1.33	5	5
		CR < 1.33 > 1.20	4	
		CR < 1.20 > 1.10	3	
		CR < 1.10 > 1.00	2	
		CR<1	0	
U	Operating Profit margin (Operating profit / sales)	Increased	3	3
		Maintained	2	
		Reduced	1	
		Loss	0	

U	Cash Profitability	Increased	5	5
		Maintained	4	
		Reduced	2	
		Loss	0	
U	Interest Coverage Ratio	If >=2	5	5
		If <2>1.5	3	
		If <1.5>1.25	2	
		If <1.25	0	
U	TOL/TNW	<=3	3	3
		>3<=4	2	
		>4.0 <=5	1	
		>5	0	
U	Growth in Sales Turn over compared to previous year	Above 25%	3	3
		Above 10%	2	
		Less than 10%	1	
		Reduced	0	
U	Stock Turn over Ratio	>=6	3	3
		<6>=4	2	
		<4>=3	1	
		<3 =0	0	
U	Debtors Turn over Ratio (Including Debtors> 6 months)	>=6	3	3
		<6>=4	2	
		<4>=3	1	
		<3 =0	0	
	Total			**100**
	Adjusted total			
	Rating Awarded			
	Rating Awarded			
	61 to 70	SIB A	*Adequate*	
	71 to 80	SIB AA	*High Safety*	
	Above 80	SIB AAA	*Highest Safety*	

	46 to 50	SIB B	*High Risk*
	51 to 55	SIB BB	*Inadequate safety*
	56 to 60	SIB BBB	*Moderate Risk*
	40 to 45	SIB C	*Substantial Risk*
	Less than 40	SIB D	*Default*