How SMEs can leverage Credit Guarantee Schemes

What is the issue?

The deserving small and medium enterprises (SMEs) whose growth and ability to generate employment are impaired for want of credit due to the lack of collateral.

How significant are SMEs?

- Contributes ~ 30% to India's GDP
- Employs ~ 11 crore people
- Constitutes ~ 40% of total exports
- More than half of them located in rural India
- Huge potential to boost self-reliance (Atmanirbhar Bharat)
- An estimated 15% of MSME debt demand is funded by the formal financial sector and only 32%of MSMEs are served by financial institutions.

What are Credit Guarantee Schemes (CGS)?

- A CGS provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on the loans made to an enterprise in case of default, typically in return for a fee.
- In 2000, Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) was put forth and promoted by the Ministry of MSMEs and SIDBI.
- CGTMSE cumulatively accorded guarantee approvals for Rs. 2.6 lakh crore to a total of nearly 66 lakh accounts, under guarantee schemes.
- **Concerns**
    - poor unit economics for bigger lenders
    - low levels of formalisation of enterprises
    - a high level of information asymmetry between enterprises and lenders
    - an incentive system that favours risk aversion of the lending officers
- The Budget has indicated that the CGTMSE will be revamped with necessary funds which could benefit from the following factors.
    - a sharper focus on learning the credit profiles
    - A comprehensive measurement tool to assess the key links of the value chain
    - Deeper engagement from private sector and MSMEs for learning and quicker adoption of successful outcomes

What measures will be appropriate in relevance to SMEs?

- **'A Test and Learn' Framework -** Given the general apprehension that SME loans are risky, bankers seek collaterals.
- 3-5 % of the overall trust fund can be set aside for a 'test and learn' initiative, wherein a set of sand boxes can be designed with promising partners to expand lending.
- The mechanism could be operationalised through a set of Member Lending Institutions (MLIs)

and branches across the country to cover a significant population.
- This could enable wider participation from the private sector.
- **Comprehensive Tracking and Measurement Mechanism-** Currently, the right of extension of credit guarantee to a MSME borrower remains with the branch functionaries and lacks transparency for oversight by the higher authorities.
- There is no mechanism to assess the demand for credit guarantee in the sector.
- CGTMSE could evolve a suitable tracking system to help MLIs review cases and also capture the data regarding the need for CGTMSE-backed assistance in the sector.
- **Deeper Engagement with the Broader Ecosystem-** It would be prudent to involve private sector lenders and borrower representation in the governance and advisory of the programme to enable early adoption of solutions.
- These measures can go a long way in discovering solutions that can scale, debottleneck the clogs that hinder the credit flow, and help in more effective incentive system.

Reference

1. https://www.thehindubusinessline.com/opinion/how-smes-can-leverage-credit-guarantee-schemes/article6523412ece

