

## 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>

