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Risk Management in Credit to Micro-Small and Medium Enterprises

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Abstract: **The present article deals with micro, small and medium enterprises and their role in economic growth and employment generation in the Indian context. The Origin, Growth and various problems have been facing by the micro small and medium industries. The credit requirements of these industries, and the various banks attitude towards lending loans and their management.**

Keywords: **Micro Small and Medium Industries, Origin, Growth and Various Problems.**

1. INTRODUCTION

Credit Risk analysis is the method, calculates the credit worthiness of a business organization. The lack of professional judgment and experience leads to the risk misinterpretation, misunderstanding, is communication, miscalculation and misuse of soft information. This aspect exposes the lending organization to risk. The manual credit risk evaluation systems are quite expensive to maintain, due to high cost of training, maintaining the qualified and experienced personnel. The credit risk analyst needs to analyze and deal with large number of differently valuated factors in short time.

Small and Medium scale Enterprises (MSME) sector is one of the fastest growing industrial sectors all over the world. A strong and vibrant MSME sector in the country is one of the key elements responsible for attaining, financial inclusive growth. The Government of India (GOI) and Small Industries Development Bank of India (SIDBI) have set up the Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGTMSE) in August 2000, to provide guarantee support to banks and lending institutions for their exposure to the Micro, Small and Medium Enterprises (MSME) sector. The Micro, Small and Medium Enterprises development (MSMED) Act, 2006 is the first single comprehensive legislation covering all the three segments.

2. DEFINING MICRO, SMALL AND MEDIUM ENTERPRISES

Micro, small and Medium Enterprises Development (MSMED) Act, 2006 classified the Micro, Small and Medium Enterprises (MSME) in two classes.

A) Manufacturing Enterprise – The enterprise engaged in the manufacture of production of goods pertaining to any industry specified in the first schedule to the industries. The Manufacturing Enterprises are defined in terms of investments in Plant & Machinery.

B) Service Enterprises: The enterprises engaged in providing or rendering of services and are defined in terms of investments in equipment.

The limit for investment in plant and machinery/ equipment for manufacturing / service enterprises, as notified, vide S.O. 1642 (E) dtd. 29-09-2006 are as under:

MANUFACTURING SECTOR	MICRO ENTERPRISES	Investment in plant & machinery Does not exceed twenty five lakh rupees
	SMALL ENTERPRISES	More than twenty five lakh rupees but does not exceed five crore rupees
	MEDIUM ENTERPRISES	More than five crore rupees but does not exceed ten crore rupees
SERVICE SECTOR	MICRO ENTERPRISES	Does not exceed ten lakh rupees
	SMALL ENTERPRISES	More than ten lakh rupees but does not exceed two crore rupees
	MEDIUM ENTERPRISES	More than two crore rupees but does not exceed five core rupees

3. ROLE AND IMPORTANCE OF MSMES

At global level Micro, small and medium enterprises (MSMEs) have been accepted as the engine of economic growth for promoting equitable development. MSMEs constitute over 90 percent of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, the MSMEs play a pivotal role in the overall industrial economy of the country. MSMEs in India account for more than 80 percent of the total number of industrial enterprises and produce over 8000 value-added products is estimated that in terms of value, the sector accounts for 45 percent of the manufacturing output and 40 percent of the total export of the country and employs over 6 crore people. Further, the MSME sector has consistently registered higher growth rate compared to the overall industrial sector. The major advantage of the sector is its employment potential at low capital cost. This sector employs an estimated 6 crore persons spread over 2.6 crore enterprises and the labor intensity in the MSME sector is estimated to be almost 4 times higher than the large enterprises.

The contribution of micro, small and medium enterprises (MSME) sector to manufacturing output employment and exports of the country is quite significant. According to estimates, in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 percent of the total exports of India. The MSME sector employs about 42 million persons in over 13 million units throughout the country. There are more than 6000 products, ranging from traditional to high-tech items, which are being manufactured by the Indian MSMEs.

4. PROBLEMS OF MSMES

Despite being pillars of economy, the MSMEs continue to face several problems in their day-to-day operations, i.e, in production and marketing of their products. They find it difficult to sell their output at remunerative prices and cannot spend much on advertising, marketing research, etc. They also face stiff competition from large firms. Inadequate infrastructural facilities and access to credit are other major problems. MSMEs are often unable to procure adequate financial resources for the purchase of machinery, equipment and raw materials as well as for meeting day-to-day expenses. Further, they find it difficult to recruit and motivate skilled managerial and technical personnel. They are mainly reluctant to adopt modern methods of organization and management. Despite constituting more than 80 percent of the total number of industrial enterprises and supporting industrial development, many MSMEs in India have problems such as sub-optimal scale of operation, technological obsolescence, supply chain inefficiencies, increasing domestic and global competition, fund shortages, change in manufacturing strategies and turbulent and uncertain market scenario.

5. RISKS FACED BY MSMES

Risk is omnipresent and all pervasive in any walk of life. It is more so in the business sectors, particularly in Small and Medium Enterprises (SMEs). “Risk” is traced with the Latin word Rescum, Which means Risk at Sea. In business, risk is always measured against capital and therefore the Capital to Risk-weighted Assets Ratio (CRAR) is much in vogue. Risk is the potentiality that both expected and unexpected events may have an adverse impact on the capital and earnings. The term "Risk", all mean financial risk or uncertainty of financial loss, Risk in terms of occurrence frequency, can be measured on a scale, with certainty of occurrence at one and certainty of non-occurrence at the other end. When the probability of occurrence or nonoccurrence is equal, risk is the greatest. Risk can be broadly defined as any issue that can impact the objectives of a business entity, be it financial service or commercial. Risk Management is an ongoing process that can help improve operations, prioritize resources, ensure regulatory compliance, achieve performance targets, improve financial stability and ultimately, prevent loss/damage to the entity. As per the RBI guidelines, there are basically three types of risks viz Credit Risk, Market Risk and Operational Risk. While the credit risk is associated with the default of counter party, market risk relates to changes in the earnings as well as capital on account of changes in the market variables and the operational risk is the residual risk which does not directly relate to credit or market risk.

Risks Specific to SMEs:

Business entity needs risk management systems but the SMEs need much more to manage and control risks due to their very size and several limitations. This is not true in the case of large corporate entities where professional personnel take care of many aspects pertaining to risk. All risk taking units must operate within approved procedures, limits and controls. There is no specific definition for SMEs, which normally cover closely held or unlisted companies, partnership firms, proprietor concerns, etc. There exists fundamental difference between the way they function and the way they will be served in the financial market.

6. RISK MANAGEMENT PROCESS

The prime functions of risk management are to identify measure and more importantly monitor the risk. Risk management activity is a pro-active action in present for securing the future. Managing risk is nothing but managing change, before the risk manages the persons concerned. .Undesirable events, the probability of their occurring and their possible impact vary considerably from business to business and from industry to industry. The processes of managing the risks are;

I. The first step is to identify the events which could cause a loss or disruption to the Business.

II. Those events should then be analyzed to ascertain the likelihood of their occurring and how serious the result would be if they occur. Start simply by assessing each event as. very likely", moderately likely" or ,,very unlikely". Prioritize them by putting a dollar value on each one (e.g. the replacement cost of a critical piece of machinery; or in the case of potential bad debts, the total value of amounts owed by customers).

III. Attend to the most likely and the most expensive events first.

IV. For each possible event, develop procedures commensurate with the level of risk the business is willing to accept.

V. Once a procedure is put in place, it should be monitored to ensure it is properly implemented and is effective.

7. CONCLUSION

Functions of risk management should actually be the entity specific, dictated by the size and quality of the balance sheet, complexity of functions, technical/professional manpower and the status of Management Information System in place. Any risk management model is as good as the data input. In the present scenario, where profits are derived mainly from trading in the market, one can no longer afford to avoid measuring risk and managing its implications thereof. To the extent the SME should take risk consciously, anticipate adverse change and hedge accordingly, it becomes a source of competitive advantage as it can offer its products at a better price than its competitors. What can be measured can also be managed. It should be clearly understood that risk mitigation efforts are more important and vital than capital allocation against inadequate risk management system.

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