

Banks and the revival of SME and MSME customers in COVID-19



Abstract

The financial crisis triggered by the current pandemic has impacted mostly the Small and Medium-sized Enterprises (SME) and Medium-sized Enterprises (MME) sectors. While some have closed doors permanently, others are in the process of doing so.

Worldwide, SMEs and MSMEs are the backbones of the economy. In every sector, there is huge dependence on such SMEs. For instance, established car manufacturers depend on dealers to sell their cars while spare parts would be supplied through others. A significant segment of the population depends on these SMEs for their livelihood.

Statistics¹ from the SME Chamber of India reveal that SMEs account for 45% of industrial output and 40% of the total exports in India. Therefore, their role is crucial for socio-economic development as any disruption in the supply chain would impact the other stakeholders in the chain as well as the livelihood of many. This paper focuses on how banks need to strategize to enable their SME and MSME customers to turnaround their diminishing business volumes.

Stumbling blocks along the growth path

As per the MSME Ministry's FY19 annual report, the MSME sector is dominated by micro-enterprises. India has IRS 6.33 crore MSMEs, out of which 6.30 crore - 99.4% are micro-enterprises.

Despite such huge numbers, SMEs and MSMEs, apart from surviving the direct impact of COVID-19 on their businesses, have to contend with many other challenges. These include:

Unforeseen and evolving government regulations

These include factors such as abrupt disruptions in the supply and demand cycles due to lockdowns and rising geopolitical tensions and the associated regulatory changes impacting demand and supply.

Sustaining costs

Fallouts of the pandemic have compelled MEs to rethink the feasibility of continuing their businesses due to increasing cost pressures such as large capital investments, staff salaries, rents, and other consistent OpEx payouts without relevant sustained income.

[1] SME Chamber of India, About MSMEs in India, <https://www.smechamberofindia.com/about-msme-in-india.php>; Accessed Jun 2, 2021

Easy access to loans

Creditworthiness, which can be an impediment to securing bank loans even during normal economic circumstances, is currently proving to be a big roadblock. Undeniably, there exists a huge potential for banks to tap into this huge market. However, the pandemic has exacerbated issues to lending owing to the increased risks of default.

Lack of demand

Except for essentials, consumers are wary of venturing out of the safety nets of their homes, leading to drop in demands. Spending patterns have also changed as a result of the heightened economic uncertainty, with consumers thinking twice before making large or unnecessary purchases.

Uncertainty

Until/unless a majority of the population is vaccinated, the future will continue to look bleak and uncertain.

Shortage of skilled work force

The return of a majority of the migrant labor class to their hometowns has created a shortage of labor, thereby impacting productivity and bottom lines.

Despite these formidable challenges, the need of the hour for any SME is to keep their working capital up and running. While most businesses may not be contemplating expansions at this stage, they should prioritize re-establishing their stagnant or depleting revenue streams and further enhancing them.

For e.g., restaurants, retail shopping establishments, etc., will have to ensure their stocks are adequate to cater to the needs of the few potential customers they might encounter if there are large-scale disruptions in demand impacting their revenue stream.

Implementing stopgap remedial measures

Banks and financial institutions (FIs) need to look at a combination of quick fixes to aid the segment while in parallel, working on long-term measures to facilitate growth in the SME and MSME sectors. Here are some quick remedial measures that can be easily considered by banks and FIs:

Promoting government guarantees

Owing to the rise in loan defaults and bad debts, banks are reluctant to disburse fresh loans to the SME sector. Many are likely to shy away from further financing as well. In light of this, the government has stepped in with various schemes to stimulate financial impetus. These include:



INR 3 lakh crore (about USD 39 billion) collateral-free loans with 100% credit guarantee.



INR 20 thousand crore (USD 2.6 billion) subordinate debts for stressed MSMEs.

Injecting liquidity into the system

Regardless of the pandemic, liquidity is not a major concern in emerging markets such as India. With robust government back-up, banks can focus on providing better-structured financing for the SME sector. Furthermore, Credit Information Bureau (India) Limited (CIBIL) needs to look at realigning credit scores as overall credit ratings have deteriorated.

Financial stimuli from the government notwithstanding, banks will need to strategize well, plan and identify a pool of industries to be financed while exercising utmost caution. To start with, banks need to identify and target specific industries with high demand and high employment index such as hotel industries, FMCG businesses, etc. This will be an enabler to drive demand in other industries such as the food and retail industries. Moreover, such a move will lead to a cascading impact in demand creation due to increased employment and purchasing power.

However, there could be possibilities of pseudo demands in the markets. A sudden spurt in car or bike sales does not necessarily indicate sustained and lasting demand. It could simply be attributed to the fear of traveling in close proximity with the public transport systems.

SME financing remains one of the most impactful aspects to boosting industry sentiment. It is imperative to identify areas beyond financing, which will help the SMEs stay relevant and seamlessly cater to customer demands. In the long run, this will be a crucial factor to ensuring long-term sustainability and retaining end customer loyalty. To enable a smooth and quick transition for the SMEs to bounce back to pre-COVID-19 levels of business, it is important to build an ecosystem and usher in changes to help them adapt to the changing economic landscape.



Enabling long-term fixes

Following are some of the areas wherein banks can help boost the revival of SME and MSME customers with long-lasting remedial measures:

Facilitating quick disbursements

Banks can expedite the onboarding processes for quicker SME and MSME loan disbursements. These schemes would be applicable for a limited timeframe, however, with extensions as deemed necessary. For e.g., providing self-service channels, video KYCs for faster loan approvals, and auto-extraction of data for faster processing time by leveraging the custom-made cognitive solutions, etc.

Guiding customers going digital (Digital SME)

Guide customers in selecting the appropriate technology solution that enables seamless transition to newer and improved working models that cater to changing demand patterns.

Providing consulting services

SMEs are often averse to taking risks owing to their lack of awareness in staying competitive. The visibility and cross-learning that banks have across various business lines and verticals can be used to identify and suggest best practices to customers. This could be a potential opportunity for banks to further assist their customers expand their horizons.



Increasing awareness among clients on initiatives like the Government Market Place (GeM).



Sharing knowledge on open platforms which can be leveraged, credit evaluation, use of next-gen technologies to stay abreast of the current digital trend etc.



Helping the garment industry make adjustments in their core focus areas to stay relevant - socks manufacturers doubling up as mask or PPE manufacturers whenever required, etc.

Enabling credit information dissemination

A 2018 survey of 91 banks in 45 economies, has documented that the availability of credit information is a critical factor impacting SMEs access to finance.

Compared to larger firms, it can be more difficult for an SME to develop a credit history as they have less access to traditional sources of finance such as banks and other financial institutions whose data is typically used in the production of credit reports. At the same time, SMEs do not generally have access to fixed assets, such as land or buildings, which are usually required by banks as collateral to secure loans.

For banks to be able to actively lend to the SME and MSME segments, credit information is a critical factor, particularly in developing economies where 70% of banks reported that the presence of a credit bureau facilitates lending to this category of borrower. Private and public entities that extend credit to SMEs have payment information that can help other parties to assess a firm's creditworthiness. The most common creditors in the developed markets for small firms include commercial banks, other non-bank financial institutions, and credit card issuers. Even for SMEs that do not have a traditional banking relationship, real-sector companies (such as suppliers that provide trade credit) and non-financial creditors (such as retailers and utility providers) can provide valuable information on a firm's repayment history, allowing potential lenders, including banks to assess their creditworthiness. In this context, banks can advise the customers on the credit rating agencies to be approached and the mandatory documentation.

Aiding the revival of the small and medium industries

Looking ahead, banks must continue to focus on working alongside their clients to help them avail financing and re-empower them to run their businesses in a competitive manner. They can play a key role in helping SMEs and MSMEs adapt their current operating models to drive efficiency, build resilience, and enhanced agility across business entities. Banks can also help enhance their market optics and ensure that customers are aware of timely opportunities to innovate and increase profitability, given their reach across industries and categories.

There is hardly any nation, industry, or economy that has emerged unscathed from the ravages of the pandemic. While it is unknown as to how long the ripple effects will last, it is clear the banks need to evolve for the better to cope with future uncertainties.

However, with risks come opportunities, and banks have proved to be exceptionally resilient and agile in adapting to such extenuating circumstances. In the days to come, with advanced risk management and top-notch analytical proficiencies, banks ought to be well poised to playing a vital role in reviving the flagging fortunes of SMEs and MSMEs.

About the author

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Pradnya Khadilkar is a domain expert with TCS' Banking, Financial Services, and Insurance business unit. She has 23 years of experience in banking and financial services. She has handled various portfolios including operations, risk management, presales & solutions function for commercial banking domain across geographies. She is a trade finance domain expert and is a Certified Documentary Credit Specialist (CDCS certified). She holds a degree in Science from Mumbai University.

Awards and accolades



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