MSME PULSE

APRIL 2020

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Executive Summary

MSME credit continues to have lowest default rate in commercial lending: The default rates across all MSME segments continue to be lower than large corporate NPA rates. The NPA rates for Micro segment MSMEs have remained stable. Within the Micro loans segment <10L ticket size loans have observed a reduction in default rates. However, Small and Medium segment NPA rates continue to increase for last three quarters consecutively.

Public Sector Banks gain market share in MSME lending: Public sector banks (PSBs) had been losing market share continuously over a long period of time. Surge in both NBFCs and private banks market share had been the reason for PSB segment losing its share. However, in the quarter ending Dec '19, public sector banks have gained market share in MSME lending, for the first time in the past few years. As of Dec'19, PSB market share stood at 49.8% in overall MSME lending book, with highest market share in Micro segment at 59.2%.

Micro segment showed fresh credit disbursals worth ₹92,262 crores in 2019: Lenders disbursed ₹92,262 crores worth of fresh credit towards the Micro segment. While private banks and public sector banks have roughly similar share on fresh credit disbursed in the Micro segment, the growth trends differ significantly when analysed at a granular sub-segment level.

Maharashtra had highest share; Rajasthan clocked fastest growth on fresh credit disbursals in the Micro segment for 2019: Maharashtra, Tamil Nadu and Andhra Pradesh cum Telangana grabbed the largest share of fresh disbursals in the Micro loans segment. While Rajasthan, Delhi and Madhya Pradesh showed fastest growth in fresh disbursals in the Micro segment. However, the trends differ when analysed lender category wise- for instance, micro segment credit landscape in Uttar Pradesh is dominated by Public sector banks; in Tamil Nadu by Private Banks and in Rajasthan by Non-Banking Financial Companies (NBFCs).

Structurally stronger MSMEs are likely to be least impacted in the lockdown: Lockdown impact on any entity will depend on multiple factors; two of the most critical factors being credit leverage and the liquidity position of the entity. Deeper insights can be gained on these two factors at an entity level by studying the CMR and utilization rates of these entities. By simulating these two elements on past events like GST implementation, IL&FS crisis, and rise in NPA rates, we have observed and concluded that entities with low leverage and higher liquidity had lowest default rates during and post these events.

While the impact of the lockdown may be more pronounced than that of the earlier events, but the core essence of the simulation study highlights that 'structurally stronger MSMEs will be the least impacted'. The findings of the study on the structural position of the MSMEs prior to the lockdown concludes that almost 2 out of 3 MSMEs are well placed to surge through this lockdown and 30% are very strongly positioned.

Commercial credit exposure for Dec'19 stood at ₹64.04 lakh crores with YoY expansion at 3.9%: The total on-balance sheet commercial lending exposure in India stands at ₹64.45 lakh crores as of Jan '20, which was ₹64.04 lakh crores in Dec '19. Of this, MSME Segment is at ₹17.75 lakh crores credit exposure as of Jan'20. Important to note that MSME segment has observed lowering of credit exposure across most sub-segments of MSME lending in the last few quarters. Large corporates segment is at ₹46.7 lakh crores credit exposure and has observed a YoY expansion of 6.3%.

Utilization rates of working capital limits for MSMEs have been reducing: Reducing utilization levels of working capital limits in MSMEs has been one of the reasons for lowering of credit exposure for the segment. The drop in utilization rates for private banks has accelerated rapidly while that of PSBs has been milder.

[1] Commercial loans classified on the basis of credit exposure aggregated at entity level, Very Small: <10L; Micro1: 10L-50L; Micro2: 50L-1Cr; Small: ≥1Cr <15Cr; Medium: ≥ 15Cr <50Cr; Large ≥ 50Cr. Micro segment includes Very Small, Micro1 and Micro2 segments. MSME segment is summation of Micro, Small and Medium segments

Commercial lending - Portfolio and NPA trends

The total on-balance sheet commercial lending exposure in India stood at ₹64.45 lakh crores as of Jan'20, which was at ₹64.04 lakh crores for Dec'19. MSME Segment is at ₹17.75 lakh crores credit exposure as of Jan'20 and has observed reduction in credit exposure across most sub-segments of MSME lending. Large corporates segment is at ₹46.72 lakh crores credit exposure as of Jan '20 and has observed a YoY expansion of 6.3% for the period Dec'18 to Dec'19[2].

Exhibit 1: on Balance-Sheet Commercial Credit Exposure (In ₹ Lakh Crore)

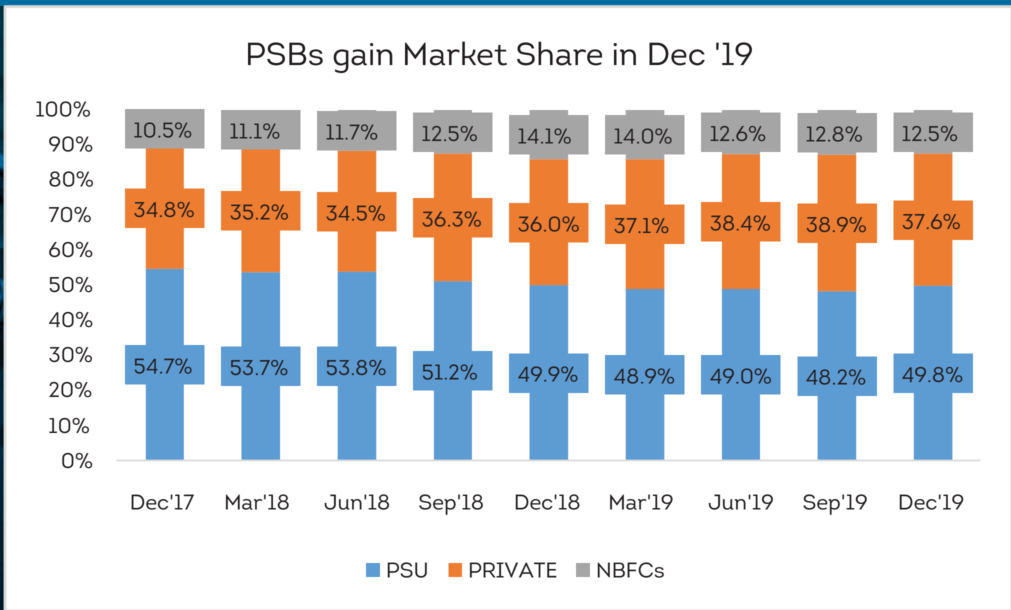
	Very Small <₹10 Lakhs	Micro 1 ₹10-50 Lakhs	Micro 2 ₹50 Lakhs- 1 Crores	Small ₹1-15 Crores	Medium ₹15-50 Crores	Large >₹50 Crores	Overall
Dec'17	0.75	1.85	1.26	7.67	4.32	37.16	53.01
Mar'18	0.83	1.97	1.35	8.27	4.56	40.61	57.60
Jun'18	0.84	2.00	1.37	8.39	4.58	39.27	56.45
Sep'18	0.84	2.05	1.41	8.54	4.65	42.68	60.17
Dec'18	0.89	2.20	1.50	8.91	4.79	43.35	61.63
Mar'19	0.92	2.26	1.55	9.16	4.95	46.00	64.85
Jun'19	0.89	2.22	1.52	9.04	4.82	46.30	64.80
Sep'19	0.89	2.23	1.52	8.93	4.74	46.74	65.04
Dec'19	0.93	2.15	1.44	8.74	4.68	46.10	64.04
Y-o-Y growth	4.7%	-2.2%	-3.6%	-1.9%	-2.2%	6.3%	3.9%
Jan'20	0.88	2.17	1.46	8.72	4.51	46.72	64.45

[2]Commercial loans classified on the basis of credit exposure aggregated at entity level, Very Small: <10L; Micro1: 10L-50L; Micro2: 50L-1Cr; Small: ≥1Cr <15Cr; Medium: ≥ 15Cr <50Cr; Large ≥ 50Cr. Micro segment includes Very Small, Micro1 and Micro2 segments

MSME Lending market share: Public sector banks reverse losing trajectory

Public Sector Banks have traditionally been the dominant lenders to the MSME sector. In the last few quarters, Private Banks and NBFCs have strongly competed with Public Sector Banks in clawing a larger share of the MSME sector. However, that trend has started to change in Dec '19 quarter with Public sector banks having regained market share from 48.2% in Sept '19 to 49.8% in Dec '19.

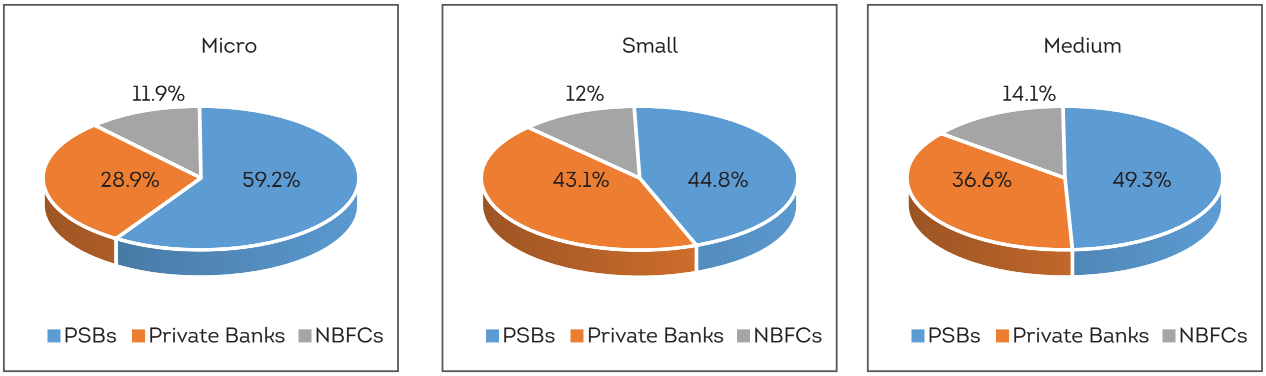
Exhibit 2: Proportionate share of Lenders in MSME over 2 years



*Other lenders excluded for market share analysis

Share of lenders across segments: PSBs continue to be the dominant contributors in providing credit to Micro segment borrowers, holding almost 60% share in this segment. PSBs are playing a critical role in enabling financial inclusion of Micro Enterprises. The share of PSBs and Private Banks in the Small segment of borrowers is the same, with each having a market share of about 44%. Medium segment, which has the larger ticket size MSME loans, is again dominated largely by PSBs.

Exhibit 3: Share of Lenders across MSME Segments



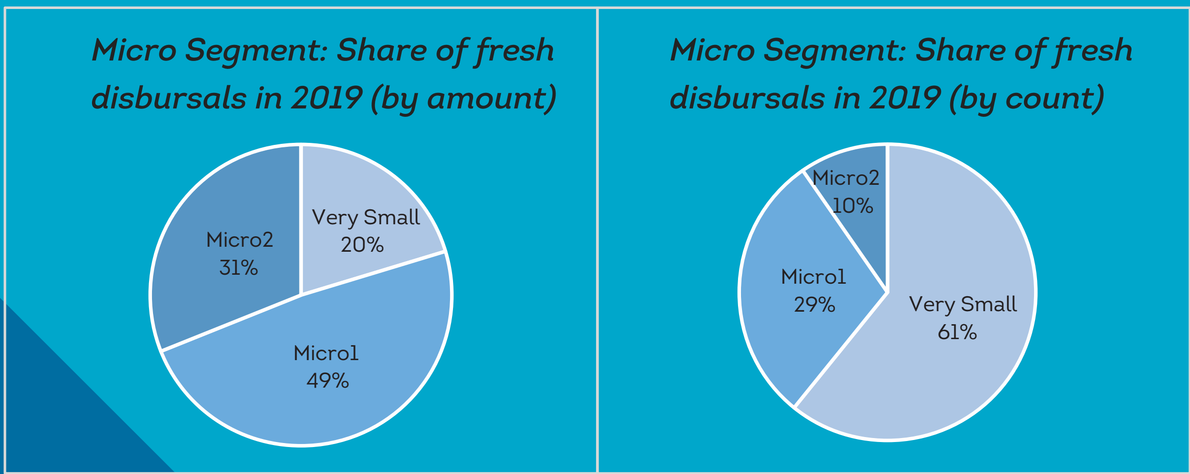
Credit Disbursements in Micro Segment

As can be seen from Exhibit1, credit exposure across most of the sub-segments of MSME lending has reduced over the last few quarters. However, the study on fresh disbursals suggests credit disbursals to the tune of ₹92.3 thousand crores was done in 2019 to the Micro loans segment[3].

Fresh credit by lender and ticket size

In the Micro loans segment of MSMEs, very small ticket size loans (<10L) have the largest share by count of credit facilities disbursed. In terms of amount disbursed, the Micro-1 ticket size loans (10L-50L) have the largest share of fresh credit disbursed.

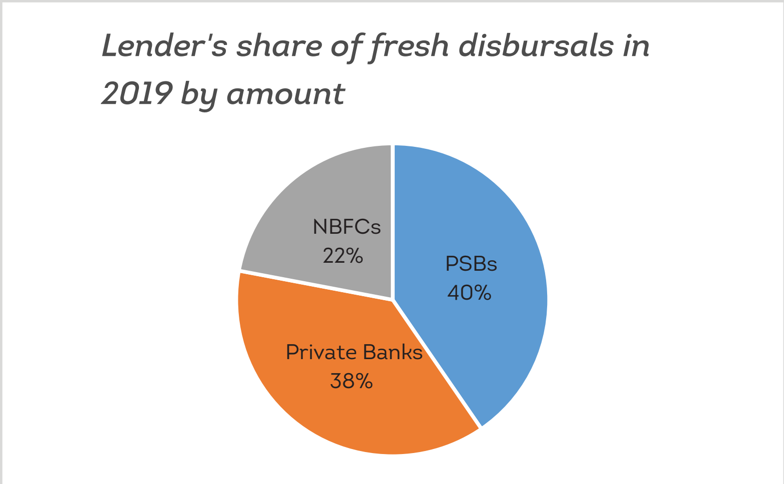
Exhibit 4: Proportionate share of fresh credit disbursed in Micro segment



[3]Commercial loans classified on the basis of credit exposure aggregated at entity level, Very Small: <10L; Micro1: 10L-50L; Micro2: 50L-1Cr. Micro segment includes Very Small, Micro1 and Micro2 segments.

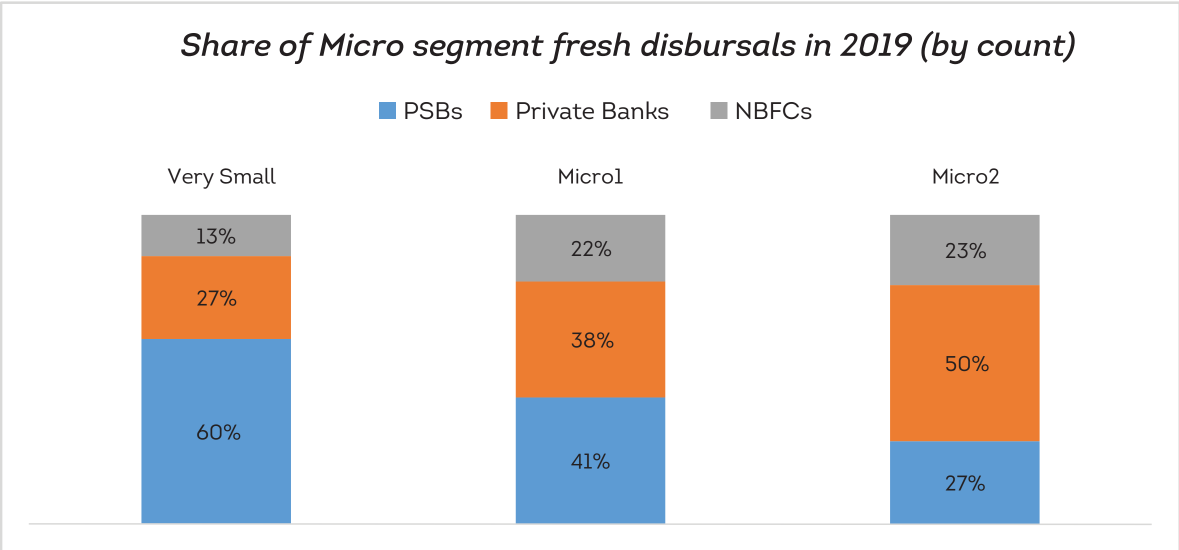
Reference lender type wise categorization, both PSBs and Private Banks have almost the same share in amount of fresh credit disbursed in the Micro segment of MSMEs. NBFCs contribute to lending to Micro segment as well- ₹1 out of every ₹5 given to this segment in 2019 is by NBFC.

Exhibit 5: Lender-wise share of fresh credit disbursed in Micro segment



However, the trends are very different when analyzed at the granular ticket size level. There is a clear shift in lender wise market share on fresh disbursals as per the ticket sizes in the Micro segment. Higher the ticket size, more the market share of fresh disbursals by Private Banks and NBFCs. In the very small segment (<10L), PSBs lead the fresh credit disbursal with 60% share, which drops to 27% in the Micro2 segment (50L to 1CR). The trend is reverse for private banks and NBFCs with both gaining share as the ticket size grows

Exhibit 6: Share of fresh disbursals in Micro segment for lenders and ticket size by count



Fresh credit by State and Lender Category

Fresh disbursals in Micro segment are also observed across States. Top 15 states account for over 80% of total credit disbursals in 2019, by amount. Maharashtra and Tamil Nadu together account for over 1/5th of the fresh disbursals. Highest rate growth in fresh disbursals of 2019 over 2018 was observed for Rajasthan while lowest growth happened in Odisha, among the top 15 states.

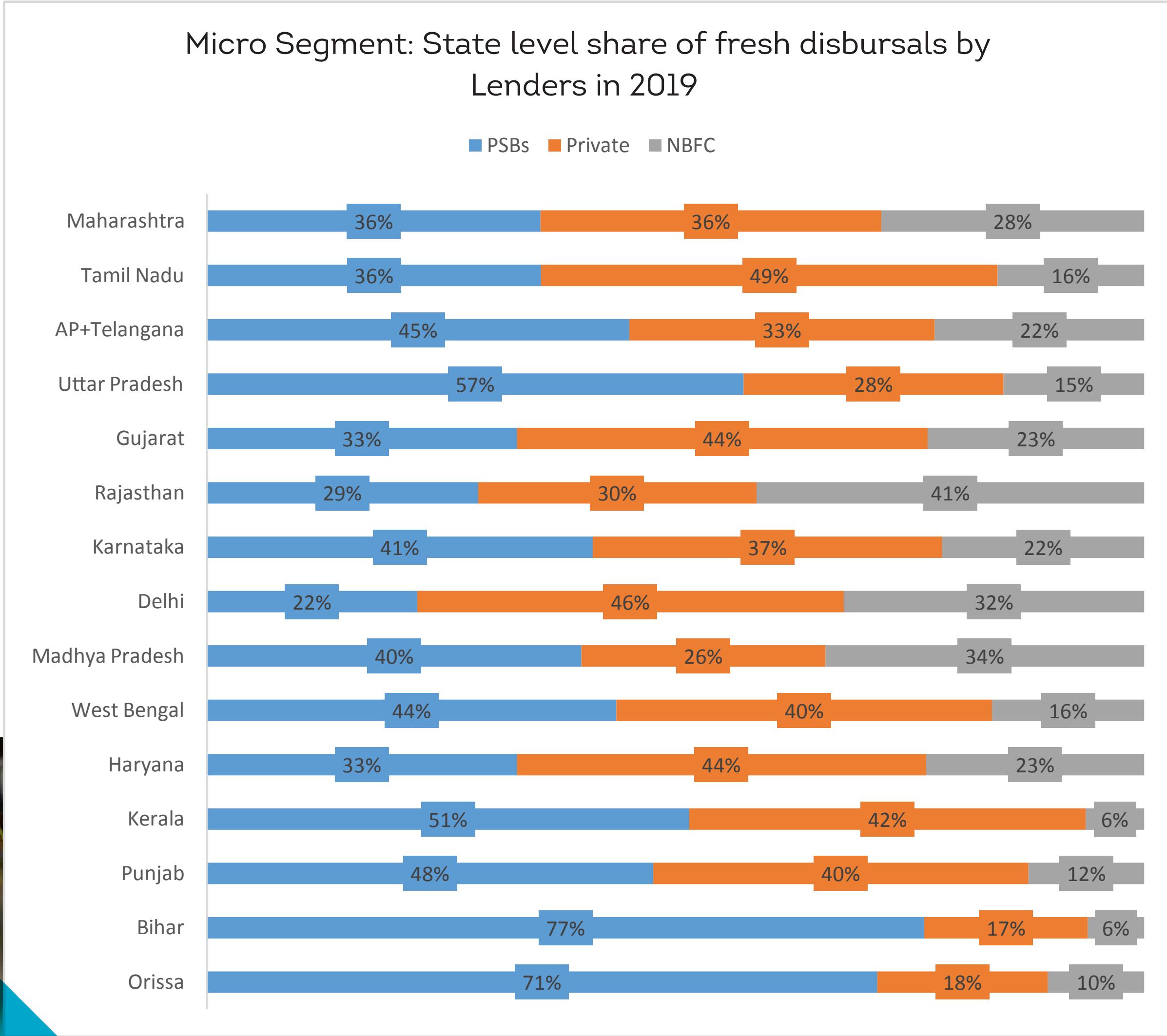
Exhibit 7: State-wise fresh credit disbursed in 2019 for Micro loans segment of MSMEs

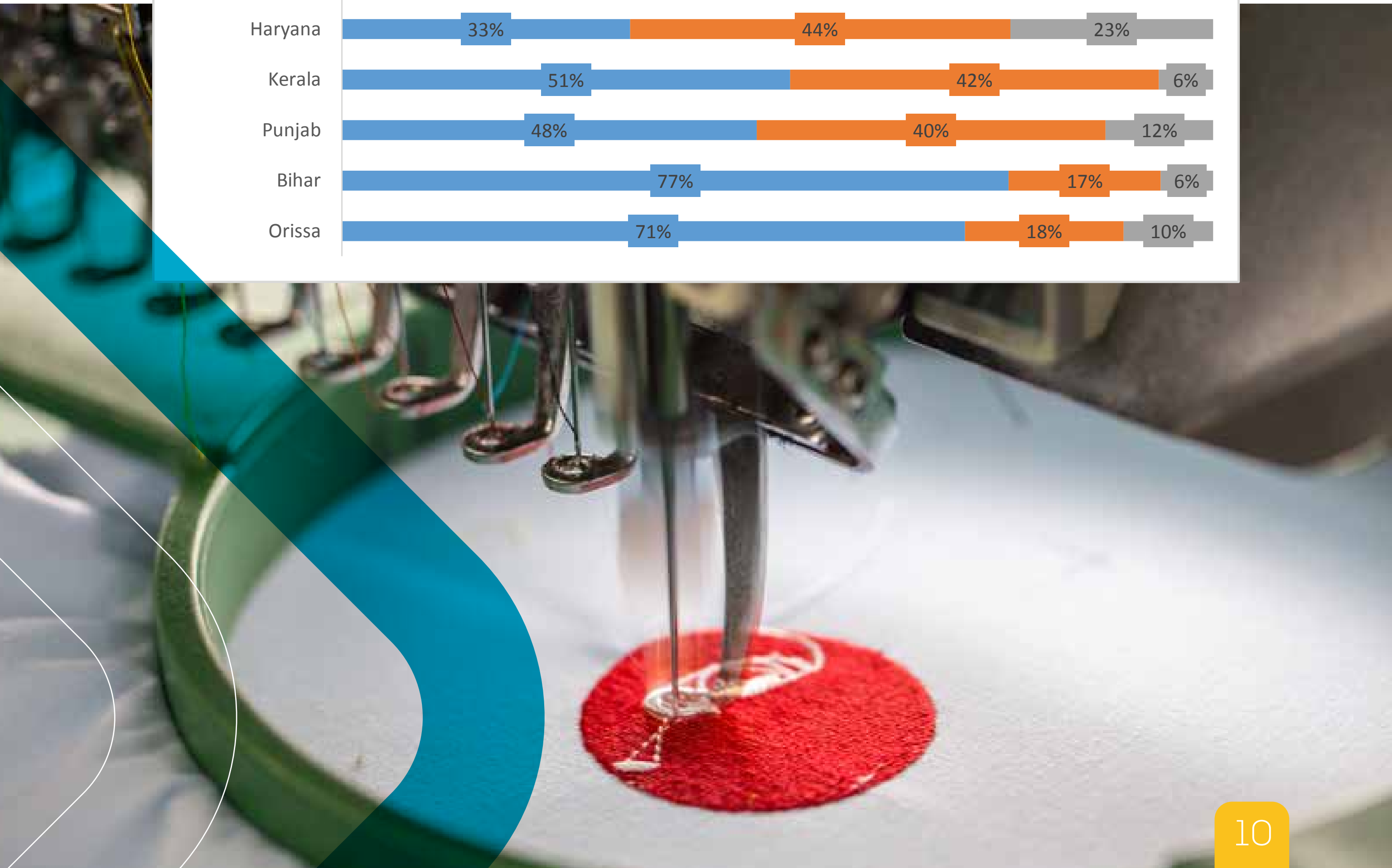
Top 15 states with fresh credit disbursed in Micro loans segment of MSMEs for 2019

State	Amount ₹crores	Share %	YoY growth
Maharashtra	10,293	11%	1%
Tamil Nadu	8,923	10%	-4%
AP+Telangana	7,031	8%	-5%
Gujarat	6,673	7%	-4%
Uttar Pradesh	6,408	7%	-9%
Rajasthan	6,052	7%	15%
Karnataka	4,653	5%	4%
Delhi	4,201	5%	14%
Madhya Pradesh	3,859	4%	10%
West Bengal	3,696	4%	3%
Haryana	3,539	4%	-4%
Kerala	3,429	4%	2%
Punjab	2,821	3%	-9%
Bihar	1,909	2%	-3%
Orissa	1,534	2%	-13%
Rest of the States	17,240	19%	6%

However, when analyzed by lender type, the trends vary for each state. PSBs have been the predominant provider of fresh credit to Micro segment in Uttar Pradesh, Bihar and Orissa. In these states contribution to fresh loans by Private Banks and NBFCs has been as low as 23%. Although, Private Banks have played a dominant part in Tamil Nadu and Gujarat. And NBFCs have been the major player in the market in Rajasthan.

Exhibit 8: State-wise share of fresh credit disbursed in 2019 for Micro loans by lender





Liquidity Position

Reduced working capital utilization rates across segments is one of the reasons for shrinkage in overall credit outstanding in the MSME segment. Working capital utilization is defined by the ratio of total outstanding balance to the total credit limit sanctioned for working capital loans. Working capital utilization is observed for various MSME segments across different lender categories for the period Dec'17 to Dec'19. The study suggests that for PSBs the working capital limits have dropped across segments, with the exception of the very small segment. However, for PSBs the drop in utilization levels is very mild. Whereas, for Private Banks the drop is sharper, across segments.

Exhibit 9: PSBs utilization rates for working capital limits

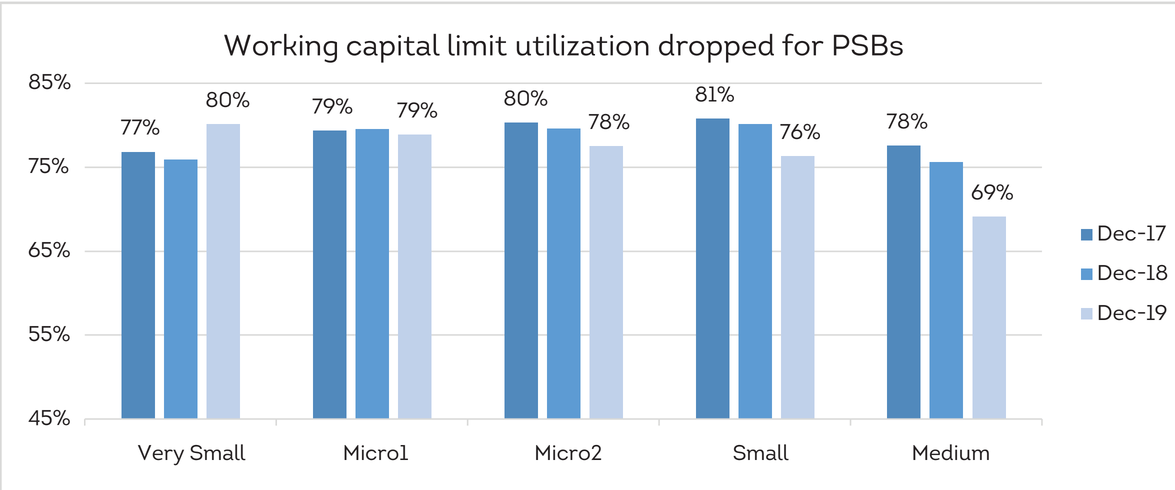
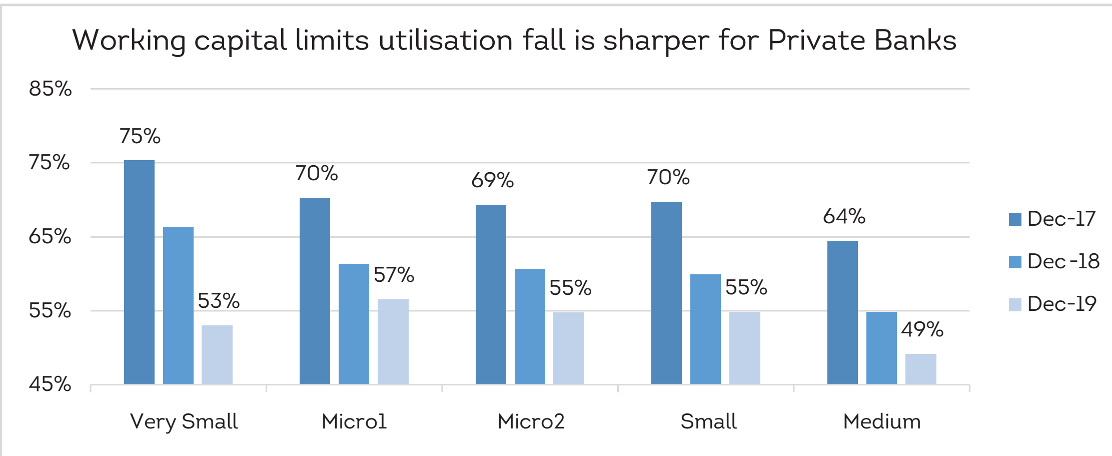


Exhibit 10: Private Banks utilization rates for working capital limits



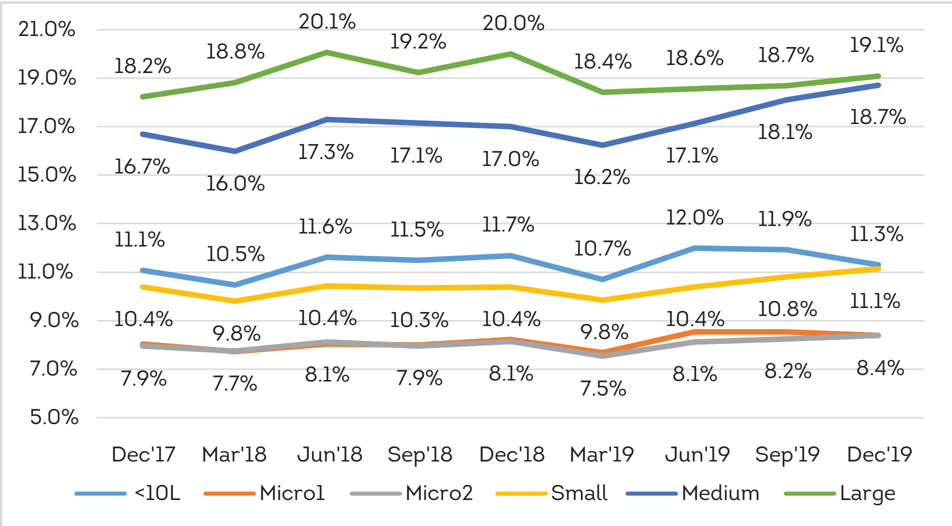
However, credit sanctioned by lenders continues to be buoyant. Public sector banks have provided 17% of their Dec'18 MSME outstanding as new sanctions/renewal in 2019. Private Banks have provided 20% of their Dec'18 MSME outstanding as credit in 2019. However, NBFCs have lagged behind due to their ongoing liquidity crisis situation, but credit extended by NBFCs, as a proportion of Dec'18 outstanding balance is 31%.

NPA Trends in commercial lending

The overall NPA rate on commercial lending was at 17.4% in Jan'20 and 17.3% in Dec'19, marginally lower than 17.5% in Dec'18, but higher that 16.8% in Sep'19. Delving further into individual segments, NPA rates in Micro1, Micro2 and Small segment have remained range bound.

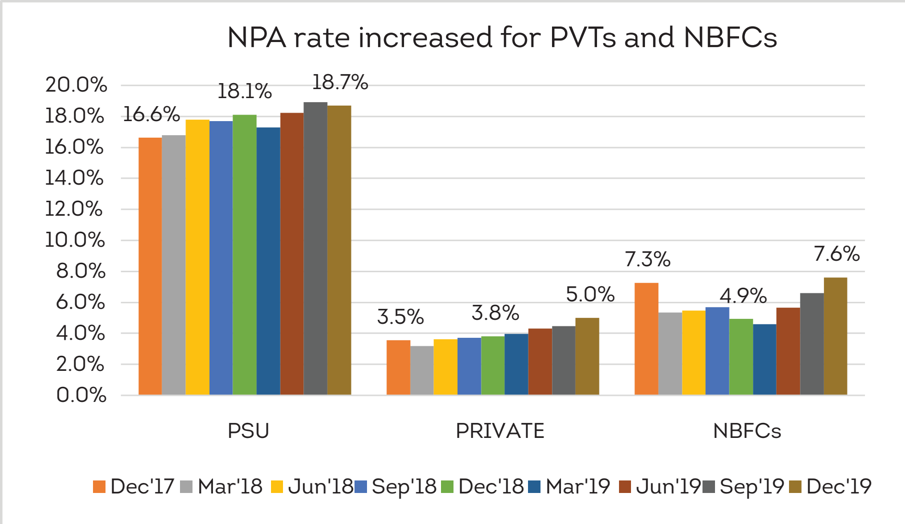
Within the MSME segment, the NPA rates are higher for larger size exposures. The exception to this trend is the Very Small segment (less than ₹ 10 lakhs exposure) which has a higher NPA rate of ~11.3% in Dec'19. The Medium and Large corporate segments also exhibit higher NPA rate of 18.7% and 19.1% in Dec'19, higher as compared to Sep'19.

Exhibit 11: Segment-Wise NPA Rate



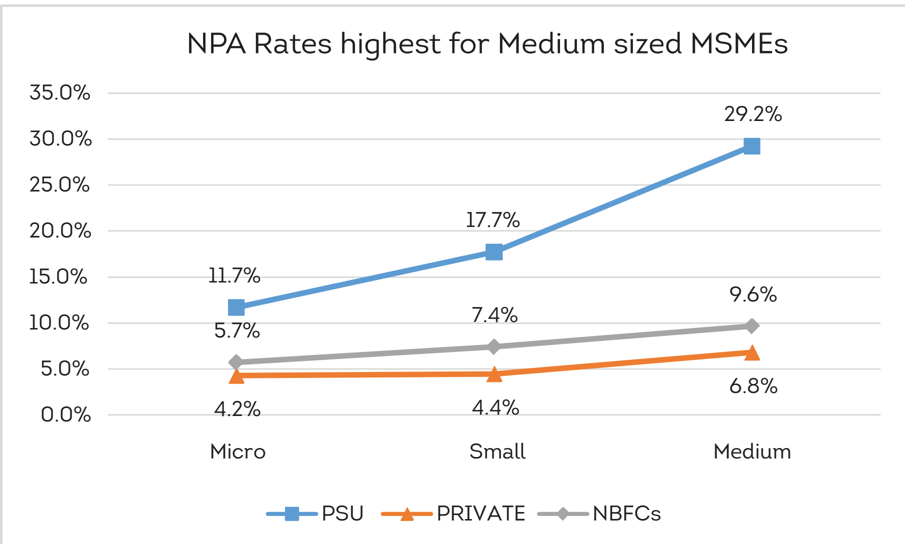
NPA Rate for MSMEs across lenders: Private Banks exhibit NPA levels in the range of 3% - 5% in the MSME segment. Within this, New Private Sector Banks on an average exhibit the lowest delinquency rates. The NPA level of PSBs has increased from 18.1% in Dec'18 to 18.7% in Dec'19. NBFCs have also witnessed an increase in NPA rates in the quarter ending Dec'19.

Exhibit 12: NPA Rates of Lender Types in MSME Segment



The NPA rate for the Micro segment has been lower than Small and Medium segments. NPA rates are highest for Medium sized MSMEs across all lenders.

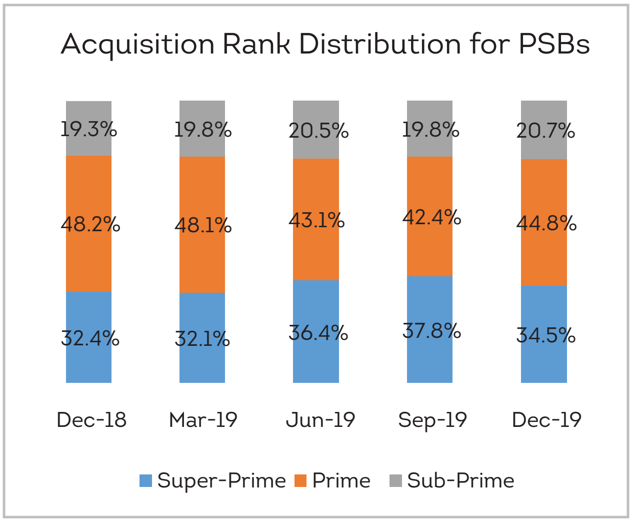
Exhibit 13: NPA Rates of Lender Types across MSME Segments

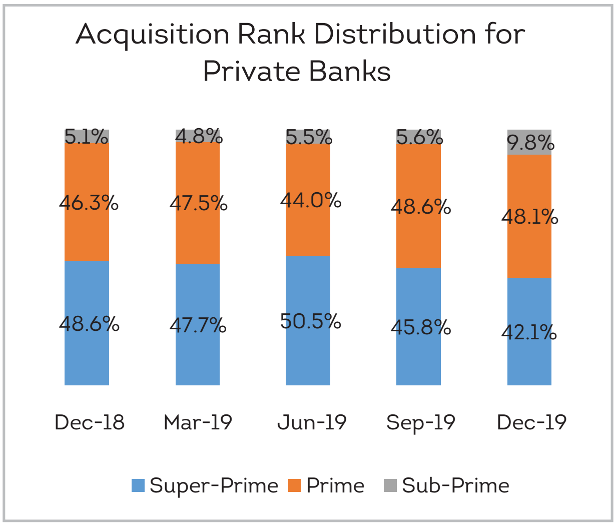


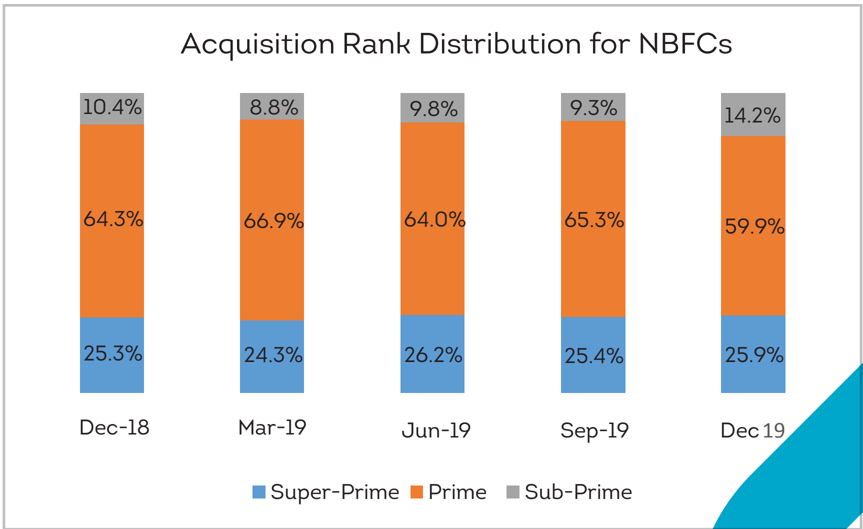
Risk profile of Acquisitions

Although delinquency has mounted for all lenders and they are likely to witness surge in NPAs, due to the adverse impact of the slowdown, a likely fallout of the COVID-19 pandemic. However, credit quality for the new MSME loans sanctioned is improving steadily for public sector banks, even though it has deteriorated for NBFCs and Private Banks.

Exhibit 14: Acquisition profile of MSME across lenders







Super-Prime: CMR-1 to 3; Prime: CMR-4 to 6; Sub-Prime: CMR-7 to 10

Structurally strong MSMEs in times of crisis

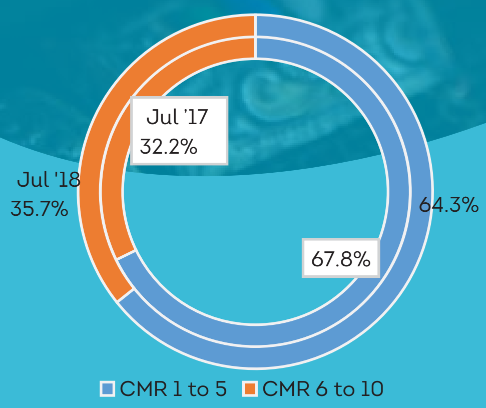
In last few years, India's credit industry has witnessed various phases like demonetization, implementation of GST, strong credit growth in 2018, PCA framework for PSBs, NBFC liquidity crisis, followed by economic slowdown and present Covid-19 pandemic situation. It is important to identify and fund the good borrowers - MSMEs that have consistently shown strong structural position deserve to be provided financial assistance in the current situation. The aim of study is to classify MSMEs who are structurally strong to tide over the pandemic situation and the following slowdown thereby. Structurally strong MSMEs will have some common financial behavior patterns.

1. They will have low leverage levels and because of lower leverage, a MSME borrower will have lesser dues to clear. Even though the RBI has recently provided moratorium which will help all types of borrowers, its vital to note that a high leveraged borrower entering into the lockdown situation would have passed through some stress which in-turn would have impacted its business model in some shape and form. CIBIL MSME Rank (CMR) factors in a borrower MSMEs leverage position and can be used as a defining indicator for leverage.
2. Structurally strong MSMEs will have high liquidity. Supply chains are virtually at a standstill, which is causing working capital gap to widen. Borrowers with high liquidity will be in a better position to service the stretched working capital cycles. Utilization rates can point towards a borrower's liquidity position as highly liquid borrowers tend to utilize their limits less.

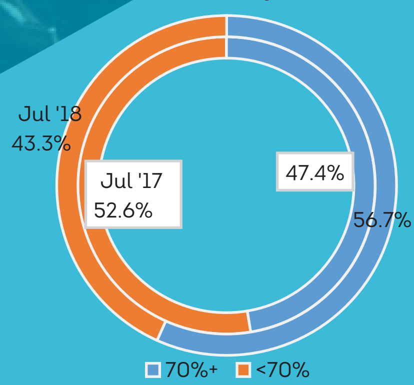
To identify the parameters to predict structurally strong versus weaker entities, default rate of MSMEs are mapped in two scenarios. CMR (CIBIL MSME Rank) and credit utilization of MSME entities are studied under two scenarios- Scenario-1 is when GST was launched in Jul '17 quarter while Scenario-2 covers the time duration when credit growth was at a peak but MSME growth began to slow down postMar'19. Scenario1 is Jul '17 (T) to Jun '18 (T+12) and Scenario 2 is Jul '18 to Jun '19. CMR and utilization level of entities active as on time period T is analyzed and its default rate is observed after 12 months. These scenarios are selected to include some of the recent stress events in the MSME lending space. Jul '17 is the GST implementation time period when MSMEs started entering the formal lending system. Sep '18 was the start of the NBFC crisis with IL&FS event. Credit growth in MSMEs started to slow-down after Mar '19.

Exhibit 15: Rank and Utilization level distribution in two scenarios

Distribution of MSMEs in Jul '17 and Jul '18



Distribution of MSMEs



Entities in CMR-1 to 5 are categorized as lower risk segment and CMR-6 to 10 are classified as higher risk segment. In Jul '17, 68% of MSMEs were in CMR- 1 to 5 and remaining 32% were in CMR-6 to 10 grades. While, in 2nd scenario, 64% of MSMEs where in lower risk CMR grade and 36% in risky grades.

MSMEs are further classified based on utilization level of less than 70% (<70%) and >70%. In Scenario 1, in Jul '17, 53% of MSMEs were in <70% bucket, whereas in scenario 2, 43% MSMEs were in this bucket.

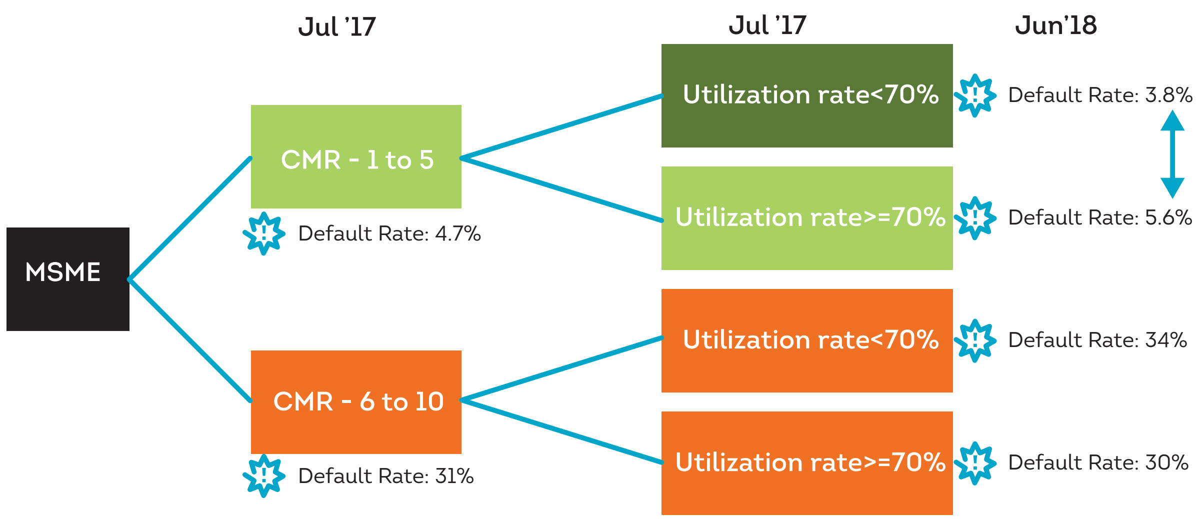
Scenario 1: Default Rate in Jun'18

Leverage and Liquidity profile of MSMEs active as on Jul '17 is considered and default rate is observed after 1 year time period as on Jun '18.

The study reveals that the entities who were in CMR-1 to 5 risk grade in July '17 have default rate of 4.7% after 1 year, whereas the default rate of CMR – 6 to 10 entities were 31% for the same time period. Using utilization as liquidity measures, it is found that there is a big gap in the default rate of entities in <70% and >=70% segments. For the low risk MSMEs (CMR 1-5), entities with lower credit utilization of <70% of credit limit utilization are reasonably steady showing default rate of 3.8%. But the default rate of MSMEs in lower risk grade with higher credit utilization is higher at 5.6%. Default rate is defined as the proportion of borrowers showing delinquency ranging from 1 day past due to NPA tagging.

MSMEs who were in CMR -6 to 10 grade in Jul '17 with lower utilization rate have default rate of 34%, while it is 30% for the entities >=70% utilization level.

Exhibit 16: Default Rates in Scenario 1 (Period Jul'17 to Jun'18)



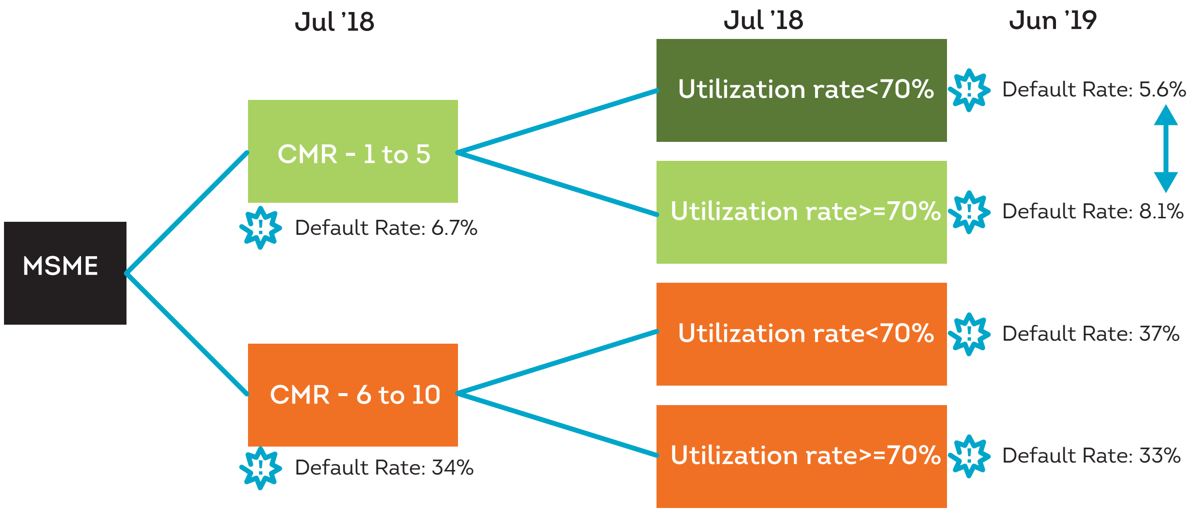
Scenario 2: Default Rate in Jun'19

Leverage and liquidity profile of MSMEs active as on Jul '18 is considered and default rate is observed after 1 year time period as on Jun '19.

The study reveals that the entities who were in CMR- 1 to 5 risk grade in Jul '18 have default rate of 6.7% after 1 year, whereas the default rate of CMR- 6 to 10 entities was meteorically higher at 34% for the same time period. For the low risk MSMEs (CMR-1 to 5), entities with lower utilization at <70% of total credit limit utilization have default rate of 5.6%. But the default rate of MSMEs in lower risk grade with higher credit utilization is high at 8.1%.

Borrowers who were in CMR- 6 to 10 grade in Jul '18 with lower utilization rate have default rate of 37%, while it is 33% for the entities >=70% utilization level.

Exhibit 17: Default Rates in Scenario 2 (Period Jul '18 to Jun '19)

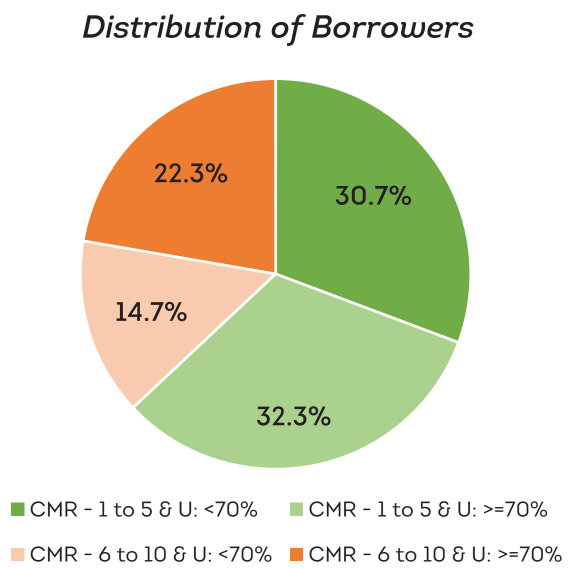


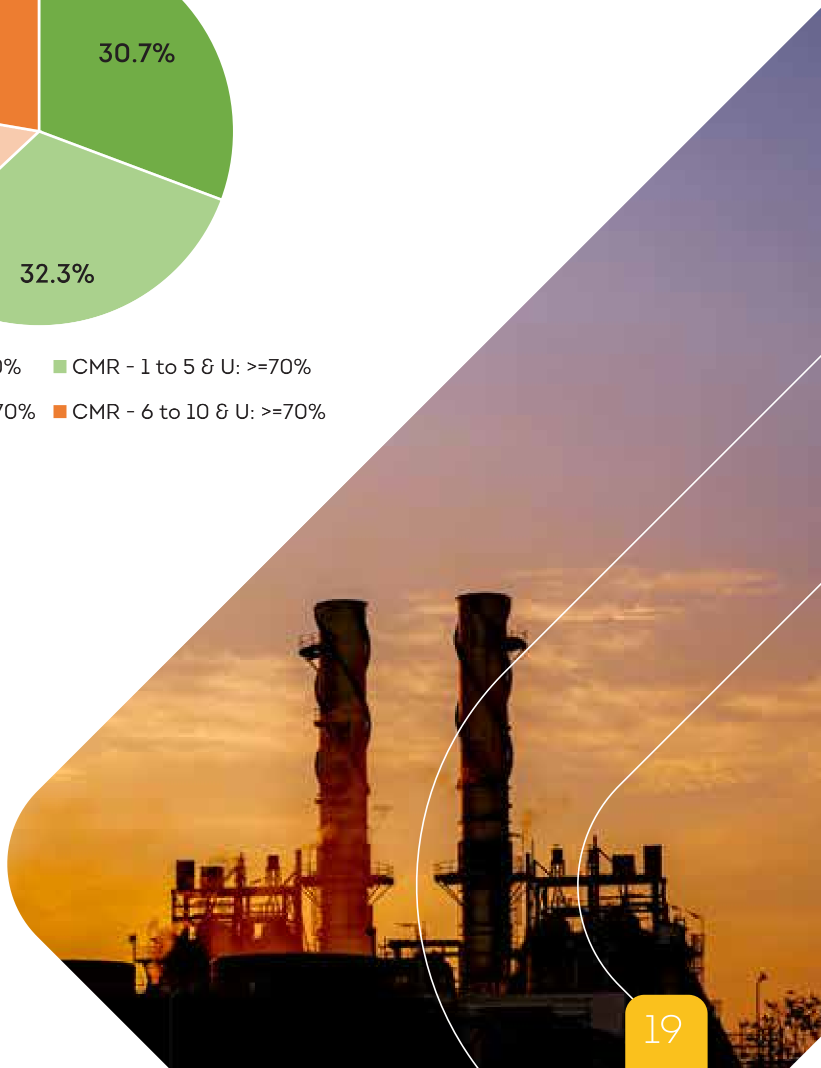
For both the scenarios, it is observed that in the most stable cohort of entities in the rank segment of CMR- 1 to 5, adding utilization factor on top of it, project a drastic increase in default rates. It is therefore very important to track the changing CMR and liquidity as part of credit monitoring in current dynamics.

Current liquidity and leverage position of MSMEs

As of Jan '20, 63% of the active MSMEs are in the structurally strong risk segment of CMR- 1 to 5 while 37% MSMEs are in CMR - 6 to 10. Utilization rates of Working Capital limits of these entities are also analyzed. About 31% of total MSMEs fall in the structurally very strong segment (CMR – 1 to 5 and <70% WC utilization level) which provides good opportunities to the lenders to lend to this segment while ensuring good portfolio quality.

Exhibit 18: Distribution of MSMEs as of Jan '20





Conclusion

Banks and credit institutions of India have played a significant role in strengthening India's MSME sector. In last 2 years, the on-balance sheet credit exposure of MSME sector has increase over ₹2 lac crores. Micro segment (aggregate credit exposure <1cr) has been the biggest beneficiary, with fresh credit disbursals of ₹92,262 crores in 2019. Every lender has played a unique role, be it Rajasthan for NBFCs, Tamil Nadu for private banks or largest market share of public sector banks. And in the challenging times, due to the outbreak of COVID pandemic, banks and credit institutions shall look for opportunities to strengthen their relationship with MSME sector.

The outbreak of COVID pandemic will impact profitability of MSMEs due to declining market demand and rising operating costs in the new way of working. In such a situation, while providing moratorium is RBI mandate, but the challenge is to separate MSMEs that are making use of the moratorium to bring back their cash flows from the MSMEs that are just delaying the default cycle. The scenario testing study at the events of GST implementation and IL&FS crisis suggests that structurally stronger MSMEs have always sailed through the storm better.

About SIDBI

Small Industries Development Bank of India (SIDBI), is the Principal Financial Institution for the Promotion, Financing and Development of the MSME sector and for the coordination of the functions of the institutions engaged in similar activities. The business domain of SIDBI consists of MSMEs, which contribute significantly to the national economy in terms of production, employment and exports. SIDBI meets the financial and developmental needs of the MSME sector with a Credit+ approach to make it strong, vibrant and globally competitive. For more information, **visit www.sidbi.in.**

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Our mission is to create information solutions that enable businesses to grow and give consumers faster, cheaper access to credit and other services. We create value for our members by helping them manage risk and devise appropriate lending strategies to reduce costs and increase portfolio profitability. With comprehensive, reliable information on consumer and commercial borrowers, they are able to make sound credit decisions about individuals and businesses. Through the power of information, TransUnion CIBIL is working to support our members drive credit penetration and financial inclusion for building a stronger economy

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