DECEMBER 2018

MSME PULSE

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ANALYTICAL CONTACTS

TransUnion CIBIL

Vipul Mahajan
JVP & Head, Commercial Products
vipul.mahajan@transunion.com

Rahul Vithani
AVP, Commercial Products
rahul.vithani@transunion.com

Saloni Sinha
Manager, Commercial Products
saloni.sinha@transunion.com

SIDBI

Y. Munni Kumari
General Manager
kumari@sidbi.in

Rudra Prasanna Mishra
Assistant General Manager
rudrapmishra@sidbi.in

Ramesh Kumar
Assistant Manager
rameshkumar@sidbi.in

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1. EXECUTIVE SUMMARY

Total credit exposure in India stands at ₹105.5 lakh crores: Total credit exposure stood at ₹ 105.5 Lakh Crores as of Sep'18. MSME Credit accounts for ₹24.7 Lakh Crores including credit to MSME entities and credit to individuals for business purposes. Large and MID Corporates account for ₹44.4 Lakh Crores. Other than ₹36.5 Lakh Crores of Agri & Retail Credit segment, the MSME Credit exposure is at 35.6% of the overall exposure to businesses.

Credit growth recovery on a firm footing: In the previous edition of MSME Pulse, we had expected the overall credit growth to be sustainable given the growth in the Large Segment. The year-on-year (YOY) Commercial Credit growth continues to rise clocking 13.5% YOY growth in the Sep'18 quarter. Overcoming the low growth in Sep'17, the Large (greater than ₹100 Crores exposure) segment has shown three consecutive quarters of high credit growth signaling sustainability in this segment. Micro (exposure less than ₹1 Crore) and SME (₹1 Crore - ₹25 Crores) segments constitute ₹14.3 Lakh Crores credit exposure (24.3% of commercial credit exposure) with YOY growth of 22.3% and 18.4% respectively. In comparison it is 7.2% for MID (₹25 Crores - ₹100 Crores) and 12.0% for Large (greater than ₹100 Crores exposure) from Sep'17 - Sep'18.

MSME Credit Costs: The Credit cost study investigates the MSME portfolio performance from a profit & loss perspective on a quarterly basis. The study has been done from Sep'16 - Jun'18. The study shows that new NPA Rate of the MSME segment has been between 1% - 1.5% per quarter and recovery rates have been between 0.4% - 0.8%. The industry annual credit cost in the 4 quarters from Jun'17 - Jun'18 is 1.8%. Given that the net interest margin (NIM) in this segment range from 4% - 7% depending on the type of loan and risk of the borrower, the Return on Asset (ROA) of lending in the segment can be estimated to be between 2% - 5%, which is a healthy rate of return.

Loan Stacking Study: Banks need to be prudent with borrowers taking multiple loans within 60 days. The loan stacking study shows that default rates in borrowers taking multiple loans from multiple lenders within a period of 60 days have increased from 2.5% - 4.4% from Sep'15 - Sep'18. This has been due to a slight deterioration in acquisition quality measured by the proportion of fresh acquisitions in the low risk CMR-1 to CMR-3 bands compared to other bands. The study also shows that NBFC borrowers are more prone to exhibiting Loan Stacking behavior with 23% of borrowers sanctioned by NBFCs exhibit Loan Stacking behavior and NBFCs contributing to about 45% of sanctions under Loan Stacking.

Vintage Analysis: NPA vintage study defines how the quality of acquisitions have moved in the MSME segment. All the fresh acquisition in a period is considered and default rates within the portfolio is observed in the subsequent quarters. The vintage curve for fresh acquisitions done from Mar'14 - Jun'18 is analyzed. It is observed that the MSME default rates have remained stable till 4th quarter in the range of 0.5%-0.8% and default rates between 1.5%- 2.5% by Q8. Private Bank's acquisitions are stable with default rates of 0.1% - 0.3% by Q4 and 0.5% - 0.8 % by Q8. The default rates of Public Sector Banks are higher at 0.7% - 1.3% by Q4 and 1.9 - 3.0% by Q8. The default rates of NBFCs are higher than Private Banks but lower than Public Sector Banks at 0.4-1.6% by Q4 and 1.5-3.0% by Q8.

NBFC Share in MSME lending has been increasing: The share of NBFCs in new credit sanctions to the MSME segment has increased from 13% in (Sep'15) to 17% in (Sep'18). Number of NBFCs having over ₹100 Crores MSME portfolio has increased in the same period from 51 to 77, while total number of such financial institutions stands at 128. Sectors, which are the most dependent on NBFC funding, include Transport & Logistics which have 35% dependency on NBFC finance, Real Estate, Education, Healthcare, Mining & Construction. NBFCs are most active in the top 10 locations (top locations basis portfolio size) where their contribution of fresh loan sanction to the MSME segment is 22%.

2. TOTAL CREDIT OUTSTANDING IN FORMAL LENDING

Total credit exposure in India stood at ₹105.5 Lakh Crores as of Sep'18. There are two categories of credit to MSMEs - i. Credit offered in the name of an entity and ii. Business Loans offered to individual borrowers. Overall MSME Credit accounts for ₹24.7 Lakh Crores. the Large and MID[1] Corporates account for ₹44.4 Lakh Crores. Excluding the ₹36.5 Lakh Crores of Agri & Retail Credit exposure, the MSME credit exposure is at 35.6% of the overall exposure to businesses.

Total Formal Credit in India is ₹105.5 Lakh Crores

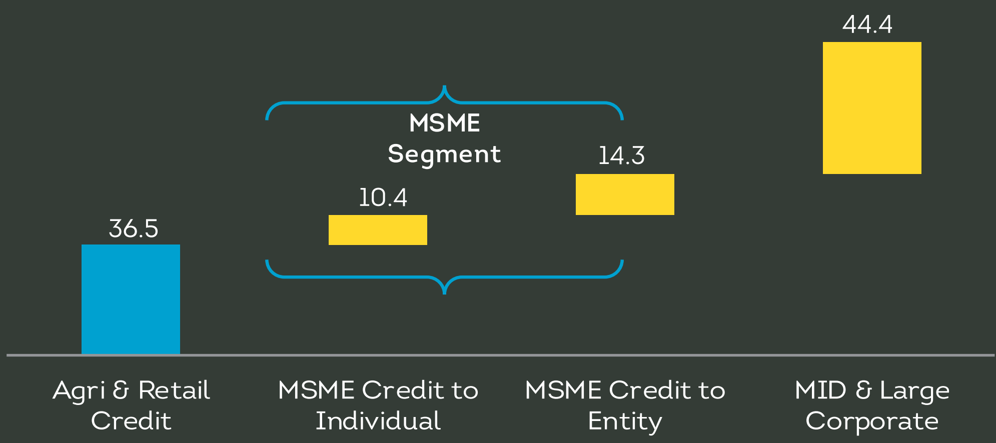

Figure 1: Distribution of total formal lending (in ₹Lakh Crores)

[1]Commercial loans classified into various segments basis credit exposure aggregated at Entity level , Micro less than ₹1 Crore, SME ₹1 Crore - ₹25 Crores, MID ₹25 Crores - ₹100 Crores, Large >₹100 Crores, Stated credit exposure is fund based.

3. COMMERCIAL LENDING - PORTFOLIO AND NPA TRENDS

The total on-balance sheet Commercial Lending exposure in India stood at ₹58.7 Lakh Crores, as of Sep'18 with the Micro and SME segments constituting ₹14.3 Lakh Crores exposure (~24.3% of commercial credit outstanding). Large corporates having aggregated credit exposure of more than ₹100 Crores, account for ₹38.9 Lakh Crores (~66.2% of commercial credit outstanding).

Micro Loans (less than ₹1 Crore) and SME Loans (₹1 Crore - ₹25 Crores) continue to surge in the commercial lending space showing YOY growth of 22.3% and 18.4% respectively. While MID (₹25 Crores - ₹100 Crores) segment has grown at 7.2%, the Large (>₹100 Crores) segment has shown reasonable growth after Sep'17, growing at 12.0% from Sep'17 to Sep'18.

Table 1: On balance-sheet Commercial Credit exposure (In ₹ Lakh Crore)

	Micro <₹1 Cr	SME ₹1-25 Cr	MID ₹25-100 Cr	Large >₹100 Cr	Overall[2]
Sep'16	3.0	7.5	4.8	34.1	49.4
Dec'16	2.9	7.5	4.9	34.3	49.6
Mar'17	3.1	7.8	4.9	34.1	50.0
Jun'17	3.3	8.1	5.0	34.4	50.8
Sep'17	3.5	8.5	5.2	34.7	51.8
Dec'17	3.7	8.9	5.4	36.4	54.5
Mar'18	4.0	9.6	5.5	37.8	57.0
Jun'18	4.2	10.0	5.5	38.3	58.1
Sep'18	4.3	10.0	5.5	38.9	58.7
Y-o-Y Credit growth (From Sep'17- Sep'18)	22.3%	18.4%	7.2%	12.0%	13.5%

NPA Trends in Commercial Lending: The overall NPA rate of Commercial Lending was at 17.5% in Sep'18 versus 15.5% in Sep'17. The stock of gross NPA in commercial exposure increased by ₹2.23 Lakh Crores in Sep'18 over Sep'17.

Diving deeper into the respective segments reveals that the NPA rates in the Micro and SME segments have reduced from 8.7% (Sep'17) to 8.5% (Sep'18) and 11.4% (Sep'17) to 11.3% (Sep'18) respectively, over the last one year. The growth rate in credit exposure is higher as compared to the

[2]The overall exposures have been updated for all quarters as the credit exposure estimation methodology for all segments has been updated.

growth in gross NPA amount in the Micro/SME segment, contributing to the reduced gross NPA rate. The MID segment, where stock of gross NPA added is ₹14.7 Thousand Crores between Sep'17 and Sep'18. For this segment, credit growth is lowest at 7.2% while the gross NPA has increased by 16.8% in Sep'18 over Sep'17, resulting an increased NPA rate. The pool of gross NPA amount has increased by 75% in the LARGE segment in the two year period from Sep'16 - Sep'18.

Range bound NPA for Micro and SME Segment, MID segment deteriorating consistently

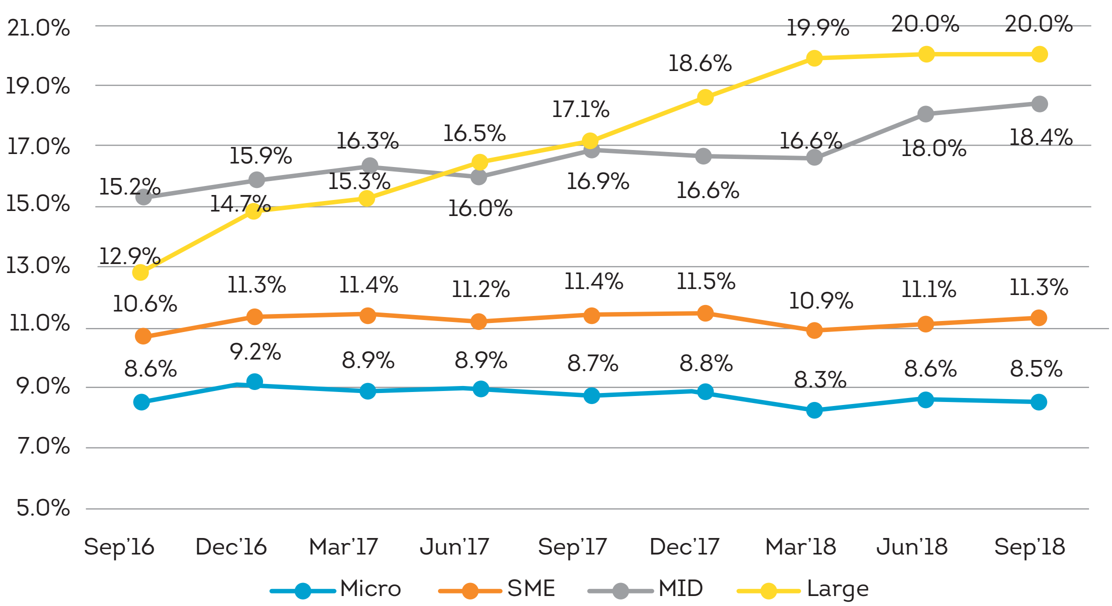

Figure 2: Segment-wise NPA Rate in the last 2 years

MICRO AND SME SEGMENTS

In order to estimate the total credit supply in MSME sector, two major components have been considered -

1. Commercial entities with aggregate exposure up to ₹25 Crores
2. Individuals in retail borrowing for commercial end use (Indicatively this comprises of Business Loans, Commercial Vehicle, Construction Equipment Loans, Loan Against Property and other Retail Loans (non-consumption) taken by self-employed individuals and professionals)

Within the exposure to Commercial entities, Micro is further classified as Very Small, Micro1 and Micro2 and the SME segment is classified as SME1, SME2 and SME3[3].

Table 2: MSME exposure to entity and individual (In ₹ Lakh Crores)

Period	Very Small Less than ₹10 Lakhs	Micro1 ₹10-50 Lakhs	Micro2 ₹50 Lakhs - 1 Crore	SME1 ₹1-5 Crores	SME2 ₹5-10 Crores	SME ₹10-25 Crores	MSME Loans to Individual	Total up to ₹25 Crores
Sep'16	0.58	1.46	0.97	3.06	1.79	2.64	5.48	15.97
Dec'16	0.56	1.42	0.95	3.06	1.81	2.67	6.30	16.77
Mar'17	0.58	1.49	1.01	3.22	1.87	2.75	7.22	18.14
Jun'17	0.64	1.57	1.06	3.36	1.93	2.81	7.96	19.33
Sep'17	0.70	1.65	1.12	3.58	2.00	2.90	8.15	20.10
Dec'17	0.79	1.79	1.18	3.78	2.12.	3.07	8.33	21.06
Mar'18	0.83	1.94	1.28	4.15	2.28	3.21	9.04	22.72
Jun'18	0.84	2.04	1.36	4.40	2.38	3.28	9.67	23.95
Sep'18	0.83	2.05	1.37	4.40	2.37	3.27	10.40	24.69
Y-o-Y growth (From Sep'17- Sep'18)	18.1%	24.1%	22.3%	22.9%	18.6%	12.7%	27.6%	22.8%

[3]MSMEs are classified into various segments basis ticket size of loan amount disbursed, Micro 1 less than ₹50 Lakhs, Micro2 ₹50 Lakhs - 1Cr, SME1 ₹1Cr - 5Cr, SME2 ₹5Cr - 10Cr, SME3 ₹10Cr - 25Cr

For the period Sep'17 - Sep'18, the Commercial Entities segment exhibited credit growth of 19.6% and the Individual segment at 27.6% leading to a consolidated growth of 22.8%. Very Small entities segment (less than ₹10 Lakh exposure) has shown YOY credit growth of 18.1% for the quarter ending in Sep'18, while the same segment had witnessed YOY growth of 29.9% for the quarter ending in Jun'18. Entities having exposure between '₹10 Lakhs - ₹5 Crores' have reported the highest credit growth in the Sep'18 ending quarter.

Within the Commercial MSME segment, the NPA rates are higher for larger exposures, although Very Small segment also has shown higher NPAs. The NPA rate for MSME loans taken in individual capacity are significantly lower compared to MSME loans to entities. The NPA rate of individual loans is in the range of 2% - 2.3% compared to 8% - 14% for loans to Commercial entities.

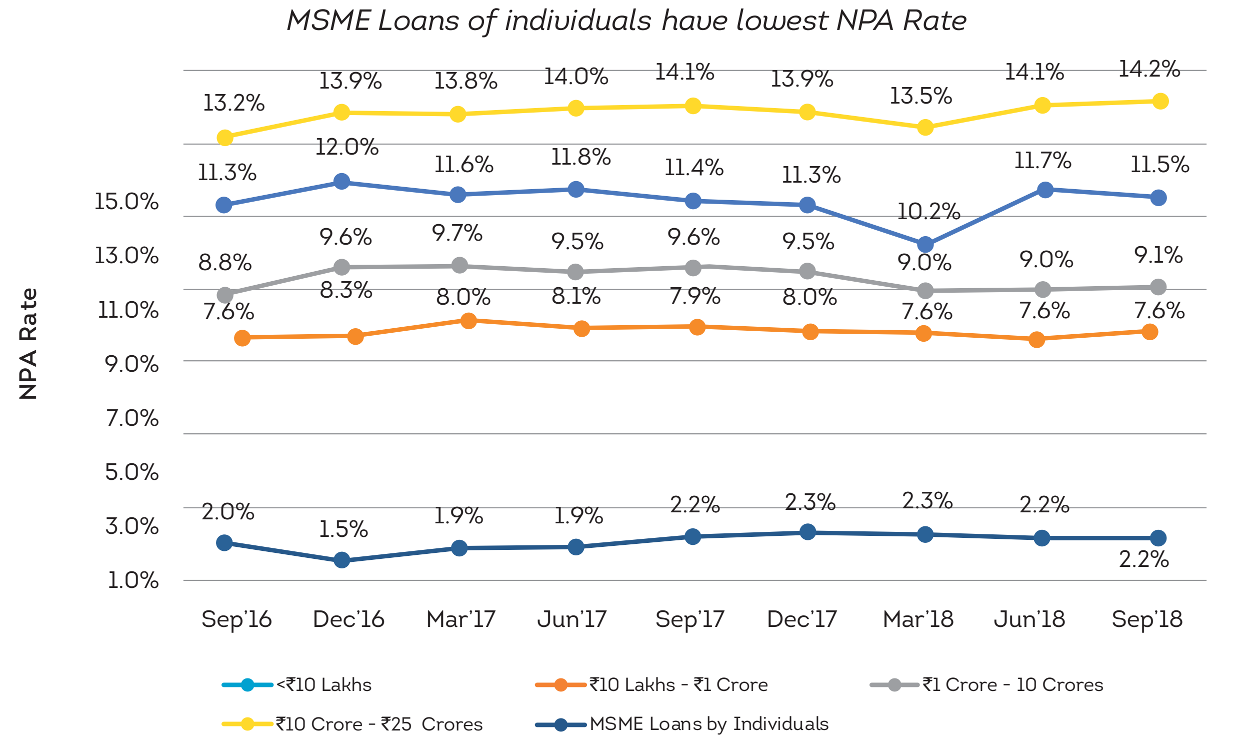

Figure 3: NPA Rates of MSME Segments

The stock of gross NPA in the MSME segment has shown a minor increase of ₹1.6 Thousand Crores during the Dec'17 to Mar'18 period as compared to ₹3.9 Thousand Crores in the same period a year before (Dec'16 to Mar'17). The Very Small segment (<10 Lakh) has witnessed reduction of ₹450 Crores gross NPA amount compared to previous quarter. One of the factors contributing to reduction in gross NPA is the RBI notification published in Feb'18, according to which entities were to be tagged as NPA after 180 days from the date of first default, instead of 90+ days past due. Very high credit growth coupled with reduction in gross NPA amount led to a sharp decline in the gross NPA percentage across the MSME segment for the quarter ending in Mar'18.

INCREMENTAL CREDIT COST BUILD UP IN MSME LENDING

This section deep dives into the quarterly credit costs in MSME segment.

The analysis is done by considering the net of forward and backward flow of accounts from the Standard to NPA stage. The NPA flow from Quarter 1 to Quarter 2 is defined as:

the NPA Base in Next Quarter = NPA Base of Previous Quarter + Fresh NPAs (Forward Flow) – Recoveries in Continuing NPA Accounts (NPA Reduction) – Recoveries from NPA flow back to Standard (Backward Flow) – Write-offs.

For this study we have not considered the impact of write-offs.

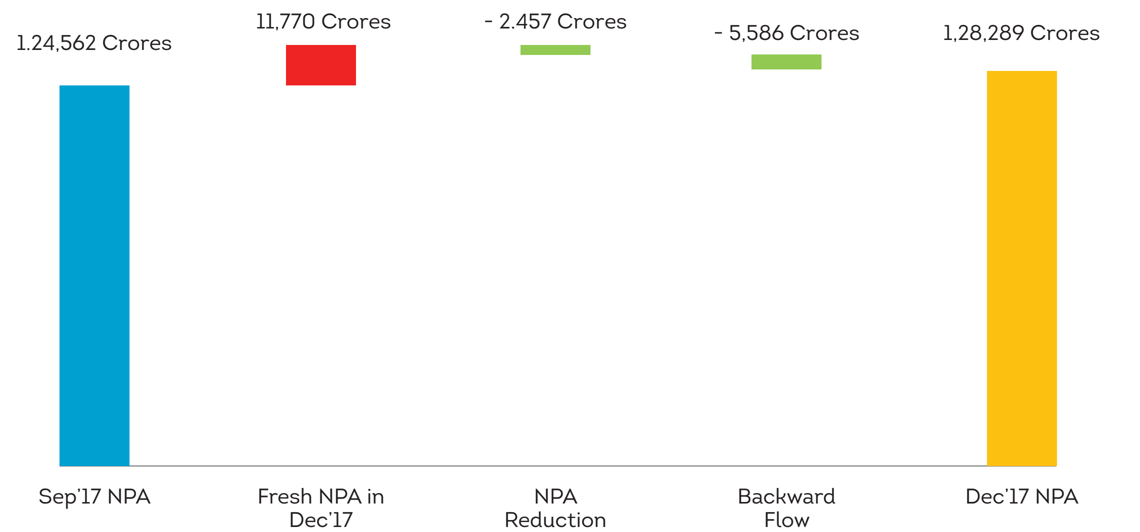

Figure 4: Sample NPA flow chart for Dec'17

Fresh NPA Rate = $\dfrac{\text{(Balance of New NPA Classified during the Quarter)}}{\text{(Total Balance of Standard Portfolio of previous Quarter)}}$

Fresh NPA Rate (Dec'17) = $\dfrac{11{,}770}{9{,}86{,}673} = 1.2\%$

Recovery Rate = $\dfrac{\text{(Recoveries in Continuing NPAs + Recoveries from NPA flow back to Standard)}}{\text{(Total Balance of Standard Portfolio of previous Quarter)}}$

Recovery Rate (Dec'17) = $\dfrac{(2{,}457+5{,}586)}{9{,}86{,}673} = 0.8\%$

Incremental Credit Cost = Fresh NPA Rate – Recovery Rate

Incremental Credit Cost (Dec'17) = 1.2%-0.8% = 0.4%

The study shows that fresh NPA Rate in the MSME segment ranges between 1% - 1.5% per quarter and recovery rates range between 0.4% - 0.8%. The study shows that the recovery efforts in the industry are strengthened in the March quarter which leads to a lower incremental credit in cost this quarter while the June quarter has higher New NPAs compared to other quarters.

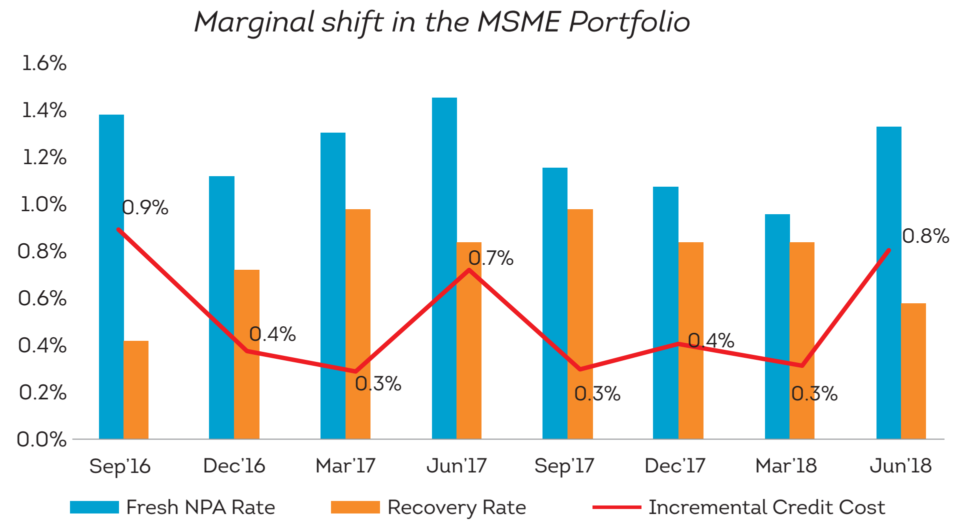

Figure 5: Credit cost over 8 quarters

For Private Banks, the fresh NPA Rate in the MSME segment ranges from 0.2% - 0.8% per quarter and recovery rates range from 0.1% - 0.6%. Private Banks have shown high recovery from the Dec'17 quarter and hence the incremental credit costs have been negative for these quarters. The higher recoveries may be due to the new Bankruptcy Code and stricter actions on defaulters.

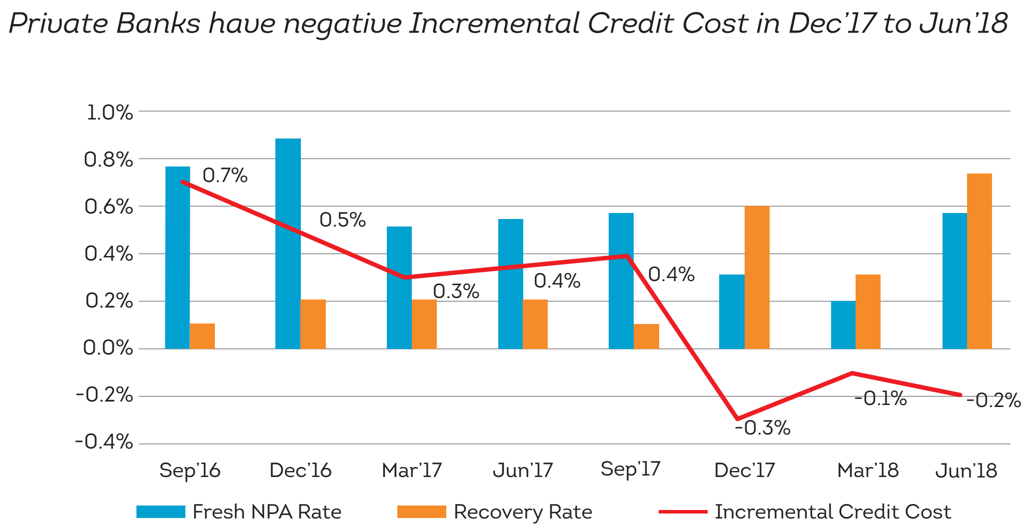

Figure 6: Credit cost for Private Banks

The fresh NPA Rate in MSME segment for Public Sector Banks (PSBs) range from 1 % - 2% per quarter and recovery rates range from 0.5% - 2%. PSBs have shown higher recovery rates as a percentage of the portfolio due to higher stock of NPA accounts and focused recovery efforts deployed by the banks in the past few quarters. However, the credit costs have remained high for PSBs due to the high additions from fresh NPAs.

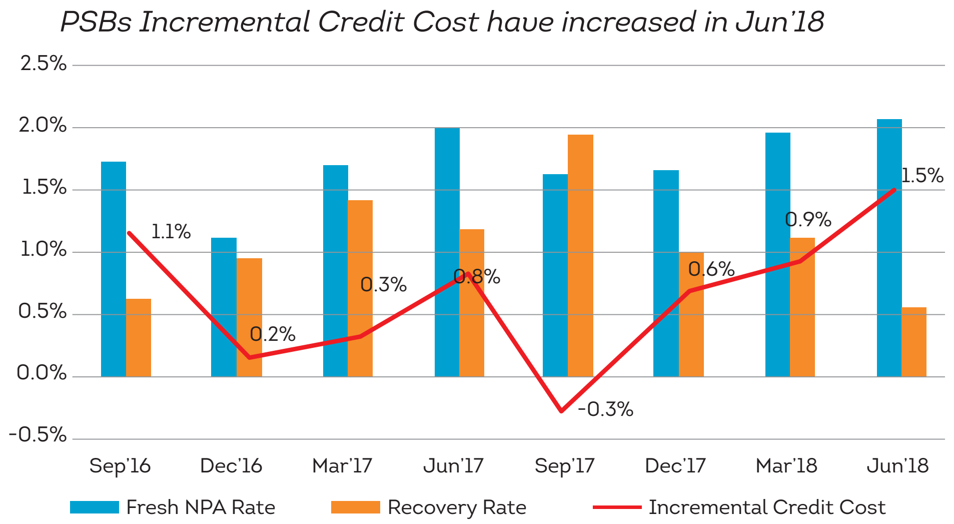

Figure 7: Credit cost for PSBs over 8 quarters

The fresh NPA Rate of NBFCs in the MSME segment ranges from 0.6% - 1.5% per quarter and recovery rates range from 0.5% - 0.6%. NBFCs had a high fresh NPA rate in Dec'16 possibly due to the revised RBI regulation on changing the NPA recognition from 180 days to 120 days from Mar'17 and 90 days from Mar'18.

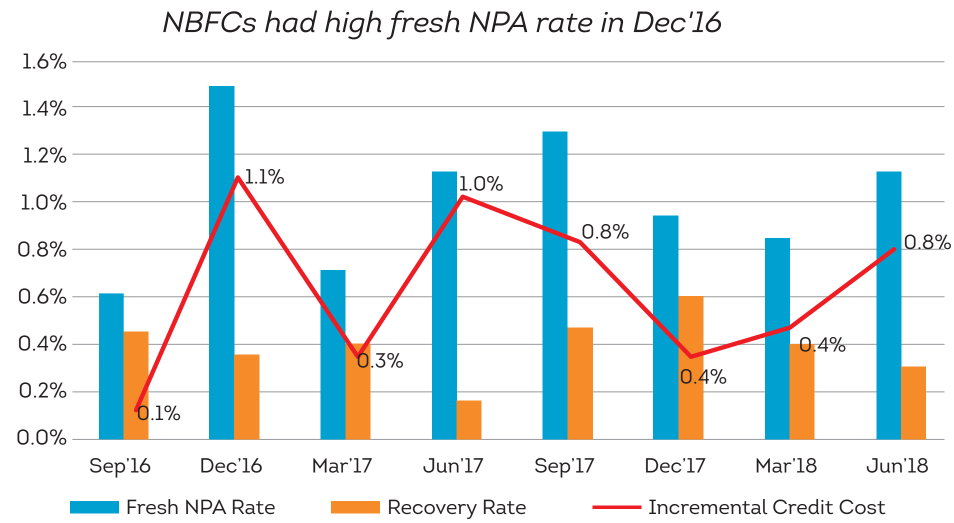

Figure 8: Credit cost for NBFCs over 8 quarters

The credit cost analysis shows that the MSME segment has stable credit costs and is a profitable segment for most lending institutions. The annual credit cost for the last 4 quarters has been 1.8%. Given that the Net Interest Margin (NIM) in this segment range from 4% - 7% depending on the type of loan and risk of the borrower, the Return on Asset (ROA) of lending in the segment can be estimated inthe range of 2% - 5%, which is a healthy rate of return.

4. COMPETITIVE LANDSCAPE: PRIVATE BANKS & NBFCs CONTINUE TO GAIN MARKET SHARE

While overall credit growth stood at 19.6% YOY (Sep'17 - Sep'18) for Micro and SME Segments, the MSME portfolio for PSBs has grown marginally at 5.4% in the last one year. For Private Sector Banks, lending to MSMEs has increased at a CAGR of 29.8% over the period of 2 years from Sep'16 - Sep'18. The market share of PSBs in MSME lending has declined to 48.1% in (Sep'18) from 58.6% in Sep'16 (55.0% in Sep'17). The market share of Private Banks has grown from 26.4% (Sep'16) to 32.6% (Sep'18) and for NBFCs, it has grown from 9.0% to 11.6% during the period of Sep'16 - Sep'18.

Market Share is shifting from PSBs to Private Banks and NBFCs

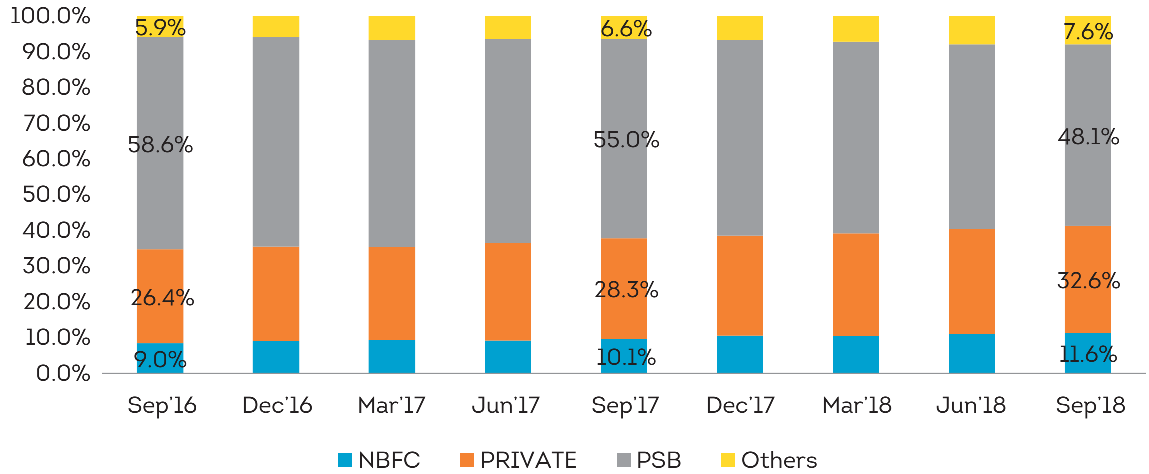

Figure 9: Share of Lender Types in MSME Segment (Loans by entity name)

The NPA rate for PSBs has increased from 14.7% in (Sep'17) to 15.6% in Sep'18 (13.4%, Sep'16) in the MSME segment. Private Banks and NBFCs exhibit NPA levels in the range of 3.0% - 5%. NBFCs have also witnessed an increase in NPA rates from Sep'16 - Sep'18.

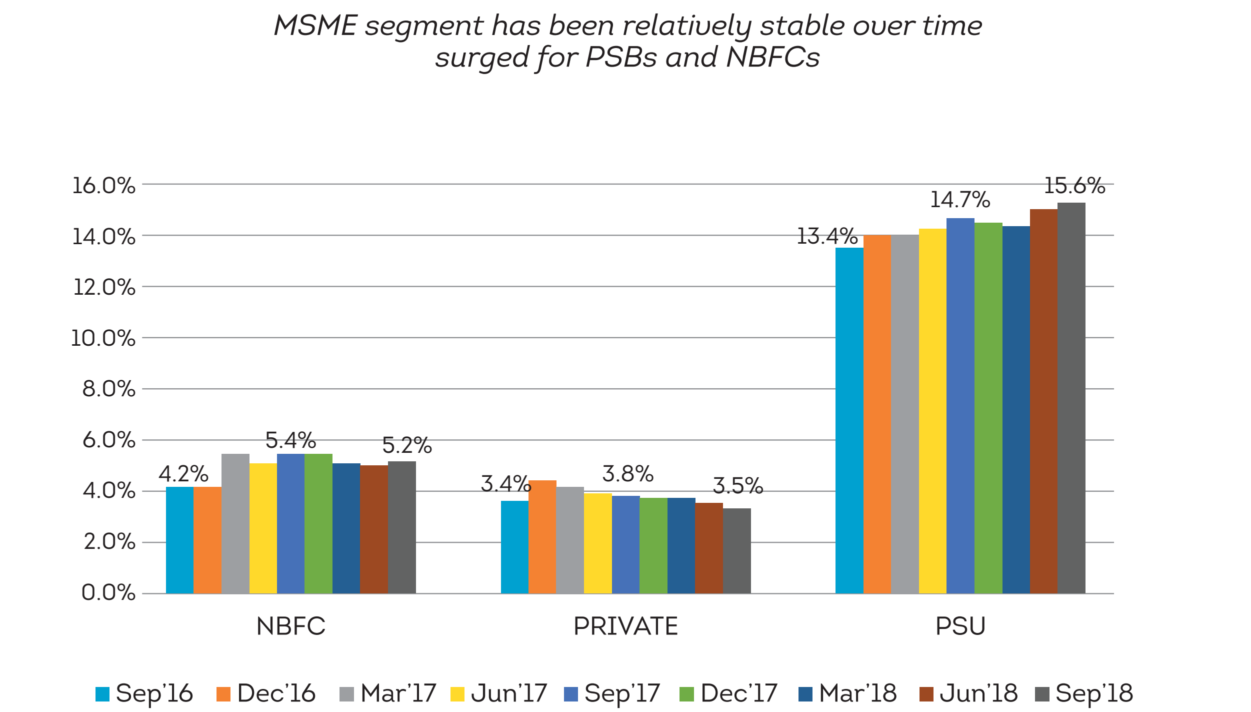

Figure 10: Lender Type-wise NPA Rate for Loans in entity name

5. LOAN STACKING IN MSME LENDING

Loan Stacking is a behavior observed in lending, wherein borrowers apply to multiple banks simultaneously or within a few days in order to get access to more funds. This may result in borrowers taking higher leverage than prudent risk norms may permit and may lead to adverse credit behavior in the future.

The MSME segment with borrowers having aggregate exposure of ₹10 Lakhs - ₹10 Crores are studied. Multiple samples from various months have been studied as the observation window and subsequently the behavior of borrowers is observed in the following 12 months to determine whether these borrowers exhibit higher risk. Also, some loan types like Commercial Vehicle Loans are excluded from the sample where it may be common business practice to avail multiple loans within 60 days period from different lenders.

5.1. About 5 - 6% of MSMEs in India take credit from multiple lenders in 60 days

Average monthly borrowers getting new sanctions in the MSME segment have been analyzed for 5 years and out of these borrowers are segregated on the basis whether they have multiple sanctions within a period of 60 days from multiple lenders.

Table 3: Loan Stacking in MSME Lending

Monthly Sanctions	2014	2015	2016	2017	2018*
Average monthly no. of MSME Borrowers getting fresh credit sanctioned (A)	21,115	26,748	34,794	42,439	51,351
Borrowers getting credit sanctioned from multiple lenders in 60 days (B)	1,506	1,580	2,008	2,098	2,842
Proportion of Borrowers with Loan Stacking (C=B/A)	6.8%	5.9%	5.8%	4.9%	5.5%

*Data up to July estimated for whole year

It is observed that while on an absolute basis the number of borrowers getting two loans sanctioned in 60 days has increased, the percentage of Loan Stacking borrowers has remained in the range of 5.5% - 6.5% from 2014 - 2018.

5.2 Loan stacked MSMEs have been 1.5 - 2x times worse since 2016

The study suggests that the borrowers seeking and availing loans from multiple lenders within a period of 60 days have exhibited higher Bad Rates compared to other borrowers post 2015. Bad Rate has been defined as a percentage of borrowers turning NPA in the next 12 months (after the latest sanction date).

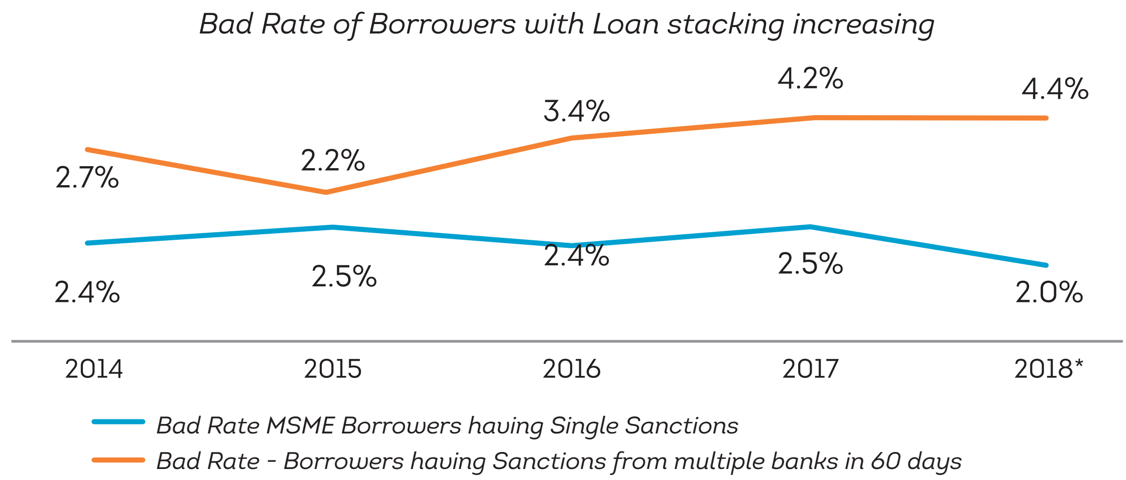

Figure 11: NPA rate over 5 years

Up to 2015 the Bad Rates of these borrowers in the next 12 months is at approximately 2.5% which is similar to borrowers having loans from a single lender. However, the bad rates post 2015 have diverged for these segments where the bad rates for stacked borrowers is around 1% - 1.5% higher than other borrowers.

5.3 Loan Stacked borrower performance is deteriorating as acquisition quality is going down

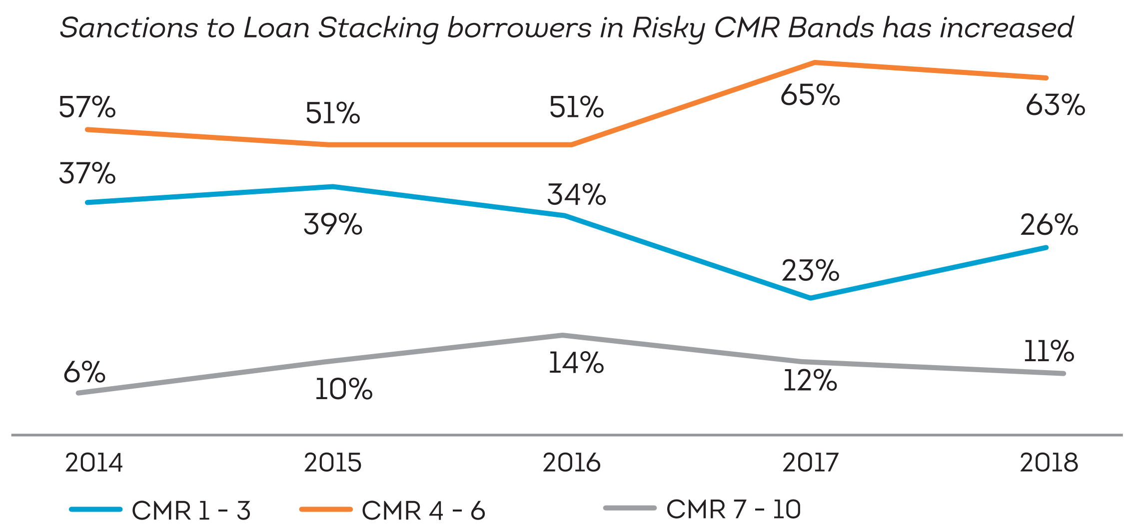

Figure 12: Proportionate share of sanctions across CMR Band for loan Stacked Borrowers

A closer look at the sourcing quality of borrowers having Loans Stacked shows that after 2015 the share of borrowers in Loan Stacking who are in Low Risk CMR Bands (CMR 1 - 3) has gone down from 39% - 26%.

At the same time the share of Loan Stacking Borrowers in Medium Risk Bands (CMR 4 - 6) has gone up by 51% - 63%. This may suggest that before 2015, while giving a loan to the borrower who has had another recent sanction, the lenders would mitigate that by a cleaner Credit History. Post 2015, the higher proportion of borrowers in Medium and High risk bands suggest that the prudence level for sanctioning to multiple loan borrowers may have been slightly relaxed.

5.4 NBFCs have highest share of lending done towards Loan Stacked Borrowers

Table 4: Share of lending across lenders

CY '17	NBFC/HFC	PVT./MNC	PSB	Others	Total
Borrowers without loan stacking (A)	4,594	14,646	19,376	1,725	40,341
Borrowers with Loan stacking (B)	1,405	1,218	643	28	2,098*
% Borrowers with Loan Stacking (C=B/(A+B))	23.4%	7.7%	3.2%	1.6%	4.9%

*- No. of unique borrowers

Of the total borrowers sanctioned by NBFCs, 23% borrowers exhibit Loan Stacking behavior. This number is much lower for Private/MNC lenders and Public Sector Banks at 8% and 3% respectively.

Table 5: Proportionate share of loans across lenders

	1st Loan	2nd Loan
NBFC/HFC	45%	47%
PVT/MNC	33%	33%
PSB	20%	18%
Other	2%	1%

Table 6: Transition of repeat sanctions across lenders[4]

Type of Lender 1st Lender / 2nd Lender	NBFC/HFC	PVT/MNC	PSB	Other
NBFC/HFC	63%	29%	7%	1%
PVT/MNC	40%	43%	16%	1%
PSB	23%	25%	50%	2%
Other	53%	28%	14%	6%

[4]Rows represent the lender where first loan was sanctioned to the borrower and Columns represent the lender who sanctioned second or multiple loans to the same entity.

NBFCs have a 45% share of loans given to Loan Stacking borrowers, whereas they have a share of 11% in borrowers who do not exhibit Loan Stacking.

In addition, 63% of Loan Stacking borrowers who have taken a loan from NBFC, avail the second loan from yet another NBFC. Private and Public Sector Banks have lower proportion of second loans when first loans are given by NBFCs. However, Private Sector Banks have a 43% proportion of second loans when the first loan has been given by another Private Sector Bank.

This shows that while there may be some profile overlap within Private and NBFC lenders there is a substantial segment of Loan Stacking borrowers which is exclusive to NBFCs, Private Sector Banks and Public Sector Banks.

At an industry level, Loan Stacking behavior is observed only on 5.5 - 6% borrowers and the proportion of such loans is decreasing with increased usage of Credit Information Reports prior to sanction. However, the study shows that the riskiness of such loans has increased in the last 3 years and lenders need to establish prudent processes and policies to detect and mitigate risks arising from Loan Stacking behavior.

6. VINTAGE CURVE

The NPA vintage study checks the quality of acquisitions over a period of time in the MSME segment. All the fresh acquisitions in every quarter are considered and looked at the accounts that become NPA in the subsequent quarters. Fresh acquisitions of the borrowers' segment with aggregated exposure of ₹10 Lakhs - ₹25 Crores are observed. Default rate is analyzed for fresh acquisitions done from the quarter Mar'14 - Jun'18. Rows represent the quarter in which loan was originated and columns represent the default rates defined as % of accounts with 90+ delinquency to the total loans originated in acquisition quarter in subsequent 'N' quarters.

6.1 Recent Industry vintage curve shows stable risk levels and default rates

For the loans acquired in the quarter ending Mar'14, 3.1% of the loans have turned to NPA after 18 quarters from its origination. It is also observed that MSME default rates by 4th quarter in the range of 0.5% - 0.7% and default rates by Q8 between 1.5% - 2.4%.

New Acquisition Month	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	Q16	Q17	Q18
Mar'14	0.1%	0.3%	0.4%	0.6%	0.8%	1.3%	1.5%	1.9%	2.0%	2.7%	3.1%	3.2%	3.4%	3.7%	3.7%	3.9%	3.5%	3.1%
Jun'14	0.1%	0.3%	0.4%	0.5%	0.8%	1.1%	1.4%	1.5%	2.1%	2.6%	2.8%	2.9%	3.1%	3.2%	3.4%	3.0%	2.8%	
Sep'14	0.1%	0.2%	0.4%	0.6%	0.8%	1.1%	1.4%	1.9%	2.5%	2.6%	2.7%	2.9%	3.2%	3.4%	3.0%	2.9%		
Dec'14	0.1%	0.3%	0.5%	0.6%	0.9%	1.1%	1.7%	2.1%	2.3%	2.5%	2.8%	3.0%	3.3%	3.0%	2.8%			
Mar'15	0.3%	0.5%	0.6%	0.8%	1.0%	1.6%	2.1%	2.2%	2.5%	2.9%	3.2%	3.5%	3.2%	3.0%				
Jun'15	0.1%	0.4%	0.6%	0.7%	1.1%	1.4%	1.6%	1.8%	2.2%	2.6%	3.0%	2.7%	2.6%					
Sep'15	0.2%	0.4%	0.5%	0.7%	1.1%	1.2%	1.5%	1.9%	2.3%	2.8%	2.5%	2.5%						
Dec'15	0.1%	0.2%	0.5%	0.7%	0.9%	1.2%	1.6%	2.0%	2.6%	2.4%	2.4%							
Mar'16	0.1%	0.3%	0.5%	0.6%	0.9%	1.3%	1.8%	2.4%	2.2%	2.3%								
Jun'16	0.1%	0.2%	0.3%	0.5%	0.9%	1.3%	1.8%	1.8%	1.8%									
Sep'16	0.1%	0.2%	0.3%	0.5%	0.9%	1.5%	1.5%	1.6%										
Dec'16	0.1%	0.2%	0.4%	0.6%	1.1%	1.1%	1.3%											
Mar'17	0.1%	0.2%	0.4%	0.7%	0.8%	1.0%												
Jun'17	0.1%	0.3%	0.6%	0.6%	0.8%													
Sep'17	0.1%	0.3%	0.4%	0.5%														
Dec'17	0.2%	0.2%	0.3%															
Mar'18	0.1%	0.2%																
Jun'18	0.1%																	

6.2 Private Bank quality of acquisition stable

The default rates of Private Bank acquisitions are less as compared to industry default rates, ranging from 0.1% - 0.3% by Q4 and 0.5-0.8 % by Q8 (other than a few aberrations like the portfolio sourced in Mar'16). In Private Sector banks, the acquisition quality has remained stable from Mar'14 - Jun'18.

New Acquisition Month	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	Q16	Q17	Q18
Mar'14	0.0%	0.3%	0.2%	0.2%	0.3%	0.3%	0.4%	0.6%	0.8%	1.0%	1.0%	1.1%	1.3%	1.3%	1.5%	1.4%	1.3%	1.1%
Jun'14	0.0%	0.4%	0.2%	0.1%	0.2%	0.3%	0.4%	0.5%	0.7%	0.8%	0.9%	1.1%	1.3%	1.3%	1.3%	1.4%	1.2%	
Sep'14	0.0%	0.2%	0.1%	0.1%	0.2%	0.4%	0.6%	0.8%	0.8%	0.9%	1.1%	1.1%	1.4%	1.4%	1.3%	1.1%		
Dec'14	0.0%	0.2%	0.1%	0.1%	0.2%	0.4%	0.5%	0.6%	0.7%	0.9%	1.0%	1.1%	1.2%	1.2%	1.1%			
Mar'15	0.0%	0.2%	0.1%	0.2%	0.3%	0.5%	0.6%	0.8%	0.9%	1.1%	1.2%	1.4%	1.2%	1.3%				
Jun'15	0.1%	0.2%	0.2%	0.2%	0.3%	0.4%	0.5%	0.7%	0.8%	1.0%	1.4%	1.1%	1.3%					
Sep'15	0.0%	0.1%	0.1%	0.2%	0.3%	0.4%	0.6%	0.8%	1.0%	1.5%	1.1%	1.1%						
Dec'15	0.1%	0.1%	0.1%	0.3%	0.4%	0.5%	0.7%	0.8%	1.7%	1.2%	1.1%							
Mar'16	0.0%	0.1%	0.2%	0.3%	0.4%	0.5%	0.6%	1.5%	0.9%	1.0%								
Jun'16	0.0%	0.1%	0.1%	0.2%	0.3%	0.4%	1.1%	0.7%	0.8%									
Sep'16	0.0%	0.1%	0.2%	0.2%	0.3%	1.0%	0.7%	0.8%										
Dec'16	0.0%	0.1%	0.2%	0.3%	0.5%	0.5%	0.7%											
Mar'17	0.0%	0.1%	0.1%	0.2%	0.3%	0.5%												
Jun'17	0.0%	0.1%	0.2%	0.2%	0.3%													
Sep'17	0.0%	0.1%	0.1%	0.2%														
Dec'17	0.1%	0.1%	0.2%															
Mar'18	0.0%	0.1%																
Jun'18	0.1%																	

6.3 Public Sector Banks have higher default rates, with slight deterioration in acquisition quality

The default rates of Public Sector Banks are higher with default rates of 0.7% - 1.0% by Q4 and 2% - 3% by Q8. Dec'15 acquisition displays very high default rate of loans in the subsequent quarter. Early signs of default rate are observed in Mar'15 and Jun'15 acquisitions, as high default rate is observed after 6th quarter.

New Acquisition Month	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	Q16	Q17	Q18
Mar'14	0.1%	0.3%	0.6%	0.7%	1.1%	1.8%	2.0%	2.5%	2.7%	3.6%	4.2%	4.1%	4.3%	4.8%	4.9%	5.1%	4.6%	4.3%
Jun'14	0.1%	0.3%	0.5%	0.7%	1.2%	1.5%	1.9%	2.0%	2.9%	3.6%	3.6%	3.9%	4.1%	4.2%	4.4%	3.9%	3.8%	
Sep'14	0.1%	0.3%	0.5%	0.9%	1.1%	1.6%	1.9%	2.7%	3.4%	3.5%	3.7%	4.1%	4.1%	4.4%	4.0%	3.9%		
Dec'14	0.1%	0.4%	0.7%	0.9%	1.3%	1.5%	2.4%	3.0%	3.0%	3.4%	3.9%	4.0%	4.4%	3.9%	3.8%			
Mar'15	0.5%	0.8%	0.9%	1.3%	1.5%	2.3%	2.9%	2.9%	3.3%	3.8%	4.1%	4.4%	4.2%	3.8%				
Jun'15	0.2%	0.6%	0.9%	1.0%	1.7%	2.2%	2.2%	2.5%	3.1%	3.7%	3.9%	3.8%	3.4%					
Sep'15	0.3%	0.6%	0.7%	1.1%	1.5%	1.7%	2.0%	2.6%	2.9%	3.4%	3.3%	3.3%						
Dec'15	0.1%	0.3%	0.7%	1.0%	1.1%	1.5%	2.2%	2.6%	2.9%	2.9%	3.0%							
Mar'16	0.1%	0.4%	0.7%	0.8%	1.2%	1.9%	2.4%	2.8%	2.9%	2.9%								
Jun'16	0.2%	0.4%	0.5%	0.8%	1.3%	1.8%	2.1%	2.5%	2.4%									
Sep'16	0.2%	0.3%	0.5%	0.8%	1.2%	1.6%	1.9%	1.9%										
Dec'16	0.1%	0.2%	0.5%	0.7%	1.1%	1.4%	1.6%											
Mar'17	0.2%	0.3%	0.5%	0.9%	1.2%	1.4%												
Jun'17	0.1%	0.4%	0.7%	0.9%	1.1%													
Sep'17	0.2%	0.4%	0.6%	0.7%														
Dec'17	0.2%	0.3%	0.5%															
Mar'18	0.1%	0.3%																
Jun'18	0.2%																	

6.4 Recent acquisition quality went down for NBFC

The default rates of NBFCs are higher than Private Banks but lower than Public Sector Banks with default rates of 0.4% - 1.3% by Q4 and 1.5% -3% by Q8

New Acquisition month	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	Q16	Q17	Q18
Mar'14	0.0%	0.1%	0.3%	0.6%	0.8%	1.3%	1.7%	1.8%	1.7%	2.1%	2.5%	3.1%	3.2%	3.2%	3.0%	3.4%	2.9%	2.2%
Jun'14	0.0%	0.1%	0.3%	0.5%	0.7%	1.3%	1.4%	1.5%	1.9%	2.5%	3.1%	2.7%	3.1%	3.5%	3.9%	3.0%	2.5%	
Sep'14	0.0%	0.1%	0.3%	0.4%	0.8%	1.1%	1.3%	1.6%	2.2%	2.7%	2.5%	2.5%	3.1%	3.7%	3.0%	2.5%		
Dec'14	0.1%	0.3%	0.4%	0.7%	0.9%	1.4%	2.1%	2.9%	2.7%	2.7%	3.0%	3.8%	3.2%	2.8%				
Mar'15	0.2%	0.4%	0.4%	0.6%	0.9%	1.7%	2.3%	2.2%	2.4%	3.2%	3.8%	3.2%	3.0%					
Jun'15	0.2%	0.4%	0.4%	0.7%	1.2%	1.8%	1.8%	2.0%	2.7%	3.1%	2.7%	2.6%						
Sep'15	0.2%	0.4%	0.6%	1.1%	1.6%	1.6%	2.0%	2.8%	3.5%	3.1%	3.0%							
Dec'15	0.2%	0.4%	0.7%	1.0%	1.1%	1.5%	2.2%	3.0%	2.6%	2.7%								
Mar'16	0.1%	0.4%	0.7%	0.7%	1.1%	1.9%	2.5%	2.2%	2.3%									
Jun'16	0.1%	0.3%	0.5%	0.8%	1.7%	2.4%	1.9%	2.1%										
Sep'16	0.1%	0.3%	0.6%	1.3%	2.4%	1.9%	2.0%											
Dec'16	0.0%	0.1%	0.4%	1.0%	2.2%	1.5%	1.7%											
Mar'17	0.0%	0.2%	0.5%	1.6%	1.2%	1.4%												
Jun'17	0.0%	0.4%	1.2%	0.8%	1.2%													
Sep'17	0.0%	0.8%	0.4%	0.7%														
Dec'17	0.8%	0.1%	0.3%															
Mar'18	0.0%	0.1%																
Jun'18	0.0%																	

For Private Banks, to deteriorate to 1% default rate takes 10-11 quarters which is actually a good trend whereas for the other lenders to deteriorate to 1% it takes 4-6 quarters.

7. NBFC IMPACT ON MSME LENDING

Share of NBFCs in lending to MSMEs has increased in recent quarters and MSME lending portfolio has gone up from 9.0% - 11.6% from Sep'16 - Sep'18.

NBFC Market share has increased from 9% - 11.6%

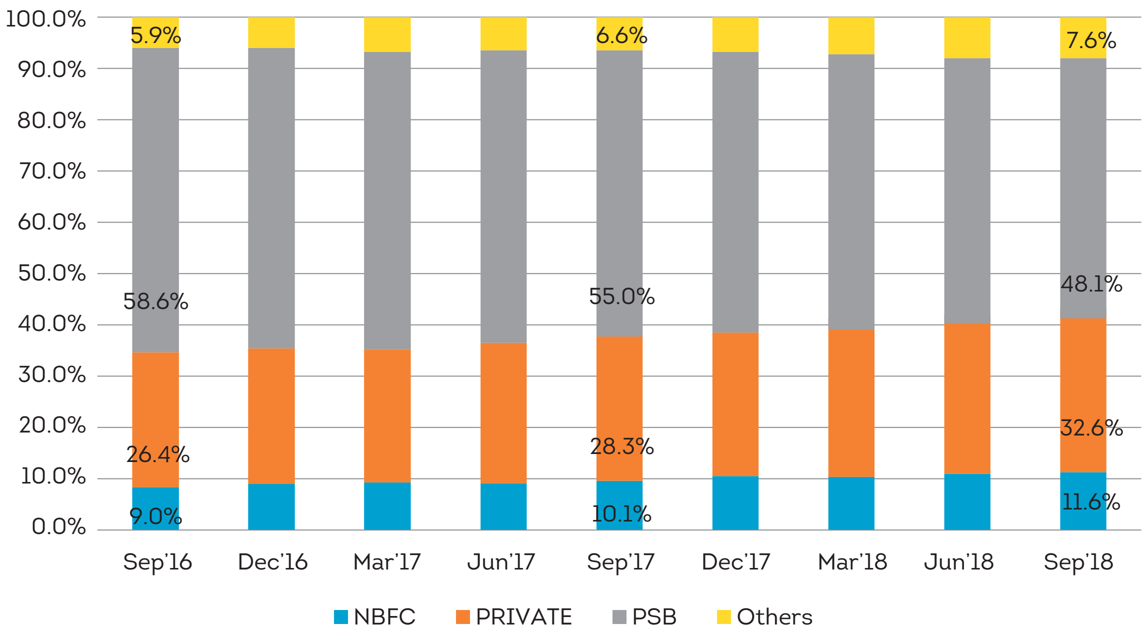

Figure 13: Proportionate share of MSME loans across lenders

By sanction amount NBFC share in fresh sanctions has gone up from 13% in (Dec'15) to 17% in (Sep'18).

NBFCs have become a material contributor to the credit supply to MSMEs and any disruption in the form of constraints in lending by NBFCs can have an impact on the credit supply to the MSME segment.

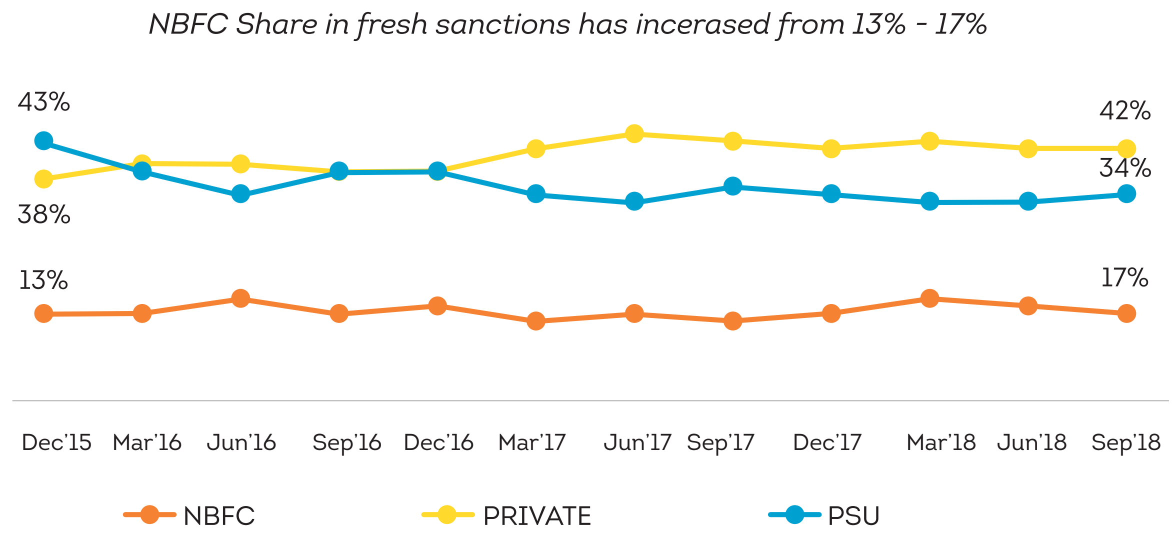

Figure 14: Proportionate share of new sanctions across lenders

In addition, given the potential growth rates and stable asset quality a high number of NBFCs have scaled up their MSME lending business. The number of NBFCs having more than ₹100 Crores MSME portfolio have increased from 51 in Sep'15 to 77 in Sep'18. The total number of financial institutions having a MSME portfolio of > ₹100 Crores is 128, which means there are 51 other institutions including PSBs, Private Banks & MNCs.

Number of NBFCs with more than 100 Crores of MSME Portfolio have increased from 51 to 77 in 3 years

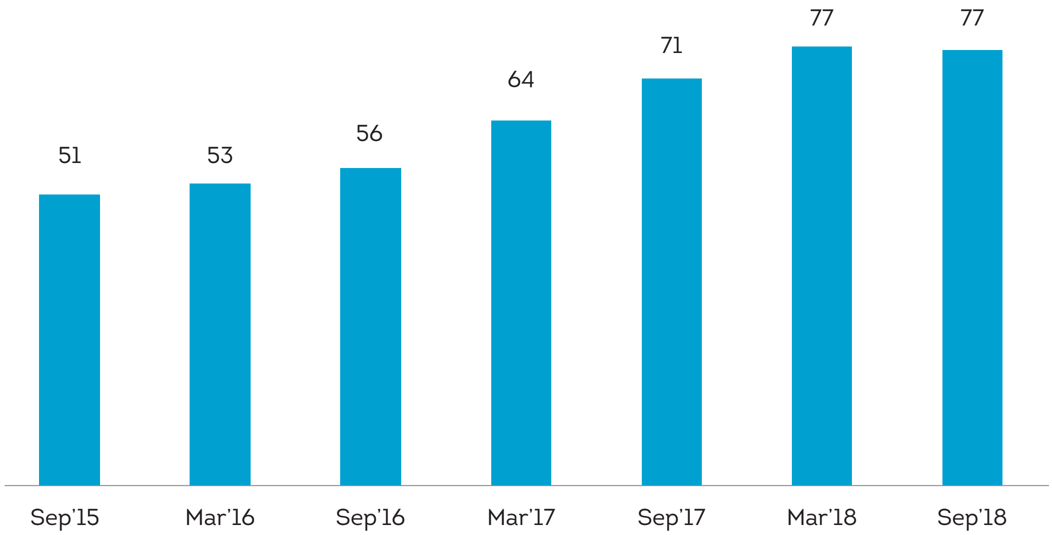

Figure 15: YoY addition of NBFCs having ₹100 Crores+ MSME Portfolio

Within the MSME segment, we have studied various sectors, which have a substantial part of credit flow coming from the NBFCs. Transport and Logistics is one such sector which is heavily dependent on NBFCs for their loans with 35% of sanctions to the sector between Apr'18 and Sep'18 coming from NBFCs.

Other sectors like Real Estate, Education, Healthcare, Mining and Construction are also heavily dependent on NBFCs for their credit needs. These are sectors with large cash conversion cycle and require term loans for their operations and hence NBFCs are able to cater to their credit needs.

Sectors like Food Manufacturing, Chemicals, Textiles, Auto Components, which typically have large parts of their requirement as Working Capital Loans have comparatively lower dependence on NBFCs for their credit needs.

Sanction Amount share of NBFC in various sectors From Apr'18 – Sep'18			
High Proportion		**Low Proportion**	
Transport & Logistics	35%	Food Manufacturing	9%
Real Estate	27%	Chemicals	10%
Education	24%	Textiles	10%
Healthcare	21%	Auto Components	13%
Mining	20%		
Construction	20%	Overall	17%

47% of NBFC loans as a proportion of outstanding loans as on Sep'18 are Loan against Property. Commercial Vehicles and Construction Equipment Loans contribute 13% to the portfolio. Business Loans contribute 10% to the portfolio. NBFC portfolio is predominantly a term loan portfolio with Working Capital loans contributing 13% to the overall portfolio

Loan Type	Share of Sep'18 Portfolio
Loan Against Property	47%
Working Capital/Short Term Loans	13%
Commercial Vehicles/Construction Equipment	13%
Business Loans	10%
Auto Loans	5%
Others	11%

NBFCs contributed to 22% of the sanction amount in Top 10 locations by credit outstanding. The NBFC contribution in Tier 2 (25 locations), Tier 3 (25 locations) & Tier 4 (100+ locations) locations is 15.3%, 14.9% and 12.1% respectively. While NBFCs have created a wide geographical reach, their contribution to fresh loans is lower in Tier 3 & 4 locations as compared to Tier 1 & 2 locations.

Location Type	NBFC Share in Sanctions from Apr'18 – Sep'18
Top 10	22%
Tier 2	15%
Tier 3	15%
Tier 4	12%
Overall	17%

NBFCs have largely increased access to credit for MSMEs. With 77 NBFCs out of 128 financial institutions having more than ₹100 Crores MSME portfolio, NBFCs seem to be crowding the MSME lending market. The NBFC impact is high in a few infrastructure growth related sectors like Transport and Logistics, Real Estate, Healthcare and Construction as these are heavily dependent on term loans. The study also shows that the NBFC impact is highest in Top 10 locations and lowest in deeper geographies where the NBFCs have the low sanction share of 12%.

8. INCREASING ACCESS TO CREDIT FOR MSMES

The number of lenders lending in the MSME segment have increased in the last 3 years with NBFCs increasing their share significantly. As mentioned in the earlier section, number of NBFCs that have more than ₹100 Crores outstanding to the MSME segment have increased from 51 to 77 in the last 3 years. In addition, Private and PSBs have focused on the Retail and MSME segment given the challenges faced by the MID and Large corporates. This has manifested in a robust 20%+ growth in credit to the MSME segment as reflected in the credit flow data to MSME entities as well as individuals for business purposes.

However, such high growth segments with increasing competition in the lending market makes the market prone to overleveraging of certain borrower segments. While the vintage curve analysis shows that risk and acquisition quality is currently stable, financial institutions need to have robust early warning tools that can alert on signs of overleverage not only at a borrower level but also at a borrower segment level to take the right lending decisions.

While we have seen significant technological and data analytics intervention on the acquisition side reflected in usage of data and scores, such interventions are also necessary in portfolio management and early warning. Such early warning systems need to take periodic inputs from various sources including but not limited to credit data on the portfolio, cash flows of the borrowers reflected in account statements as well as GST filings, macro industry and economy level growth and profitability trends.

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.**

About TransUnion CIBIL

TransUnion CIBIL is India's leading credit information company and maintains one of the largest repositories of credit information globally. We have over 3000 members–including all leading banks, financial institutions, non-banking financial companies and housing finance companies–and maintain more than 900 Million credit records of individuals and businesses.

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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TransUnion CIBIL Limited
[Formerly: Credit Information Bureau (India) Limited]
CIN: U72300MH2000PLC128359

P: 6638 4600
F: 6638 4666
W: transunioncibil.com

One Indiabulls Centre, Tower 2A, 19th Floor,
Senapati Bapat Marg, Elphinstone Road,
Mumbai - 400 013