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EDITORIAL

Karnataka State Industrial Times

Higher Interest Rates, not in the Interest of SMEs

Although several financial sops have been announced by the Government of India towards effective and profitable running of SMEs, recent moves by the Government have left the small scale sector high and dry. Especially with the Reserve Bank of India (RBI) raising key rates for lending by 25 basis points, small industries are feeling the heat and the problem just got compounded with rising inflation and the recent petrol hike. Add to that Indian SMEs have to contend with foreign SMEs who being comfortable with their lower interest rates are successfully flooding their products in the Indian market.

Interest rates have risen northwards by nearly 3.5 per cent since January 2011 and now hovers around 15 to 16 per cent which puts the very existence of small units in question. Till recently interest rates charged by banks from the SME sector ranged between 13 to 15 per cent while it is between 10 to 11.5 per cent for the rest of the industry. While the bigger companies can tap credit from their shareholders, small units are dependent mostly on banks. Adding salt to the wound is the timing of the rate hike, this being the festival season where small units have large orders and high inventories which leave these minions with higher debt and more spend on payment of interests leading to non-profitability. Many SMEs have laid off workers due to the adverse financial conditions wherein the cost of finance had increased by nearly 45 per cent leading to an increase in unemployment in the sector.

Today, the SME sector accounts for nearly 35-40 per cent of the country's output and this is set to grow further. The high interest rate means killing the golden goose, because servicing high cost loans may lead to project delays and deferment of capital expenditure. The higher interest rates are likely to affect the bottom line of SMEs which may lead to rise in Non Performing Assets (NPAs).

What can be done?

- The SME sector needs different treatment in terms of the attitude of lenders who need to adopt a broad-minded approach while working with entrepreneurs and their business models and finance requirements, SMEs should seek funds from angel investors, venture capitalists or private equity players.
- Banks and Non Banking Financial Companies can partner with SMEs by providing them with financial advisory services particularly on sourcing funds, managing cash flows and optimal deployment of funds.
- Procurement of loans at interest rates of around 11 per cent should be comfortable for small units at present.
- Liberalising the norms for NPAs would prove beneficial because as per present laws a default of three months makes a unit an NPA.
- The separate exchange for SMEs announced recently provides them an opportunity to raise funds from public.

Things could look better for the small and medium sector in the near future going by the Government's proposal to provide SMEs, credit at lower rates through an interest subvention scheme. The subsidised loans would be applicable for small units selling both in the domestic and foreign markets. This is the first time that a call has been made for subvention for the whole SME sector in India. Under the subvention scheme, banks give credit to chosen sectors at lower interest rates (depending on the rate of subvention) which would be later reimbursed by the Government. The Reserve Bank of India is also set to step up the cash flow into the small scale sector by directing banks to enhance their credit disbursement to the sector. It remains to be seen how the Government will walk the talk in the interest of the SMEs.

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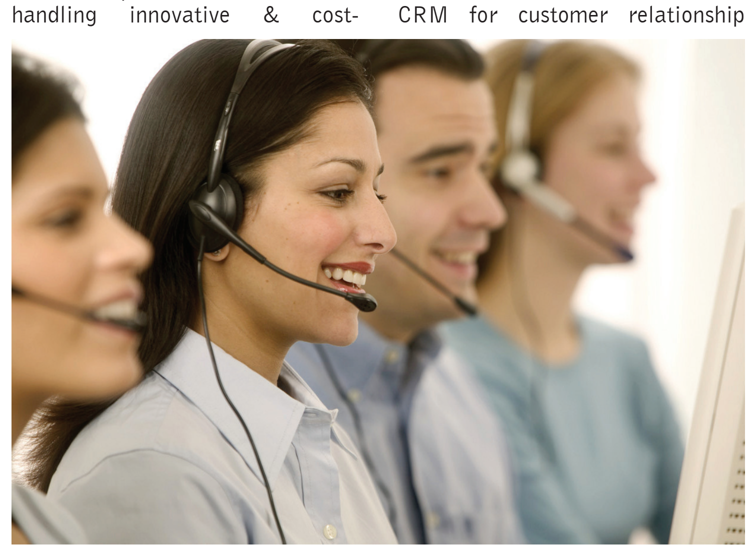

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