

Solutions for SMEs from inside the 'Budget' prism

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Budget 2008 has evoked mixed feelings – a solid grey instead of pure black or white. Investment bankers, taxation pundits, industrialists, capital market stalwarts, politicians and the common public have discussed in-depth the impact of the Budget on many industries and demographic segments, but not so much has been said about small and medium enterprises (SMEs).

India has 8000 companies listed in the stock exchange, a significant number of which is family-owned. The rate of growth in the conversion of SMEs to large enterprises has been increasing by the year. Despite the importance enjoyed by SMEs, they continue to face many impediments in their day-to-day operations.

CAPITAL STARVATION

In the interest of inclusive growth, policy-makers should avoid introducing distortionary measures that would create long-term structural problems. The Finance Minister,

Mr P. Chidambaram, did just that with the Rs 60,000-crore loan waiver creating a two fold impact:

Encouraging the continuance of the moral hazard problem when banks can still not distinguish between good and bad loans with the waiver; and

The elated farmer still remains ill-equipped to repay future loans, what of training in improving farm productivity and cash flow sustenance?

The priority sector lending reforms have already sucked a significant share of banks' loan base. The reimbursement of the farmers' bad loans from the exchequer will certainly have to be reciprocated by continued lending to the same loan recipients – probably the same share of bad loans will recur.

As a profitable independent company, answerable to its shareholders, banks will try and make the best of the balance disbursable base. Banks continue to lend to SMEs mostly on collateral. In the past, most SMEs had a strong asset base by holding real estate, but not so currently, given the soaring land

prices. Hence, what is there for them to collateralise – inventory? Furthermore, the working capital lending is largely dependant on the historical financial performance of these companies than its future potential.

In all, banks are forced to take the risk of loss by lending to farmers, having high moral hazard problems, but are unwilling to take the same risk of lending to SMEs, where the problems of moral hazard and adverse selection are less pronounced.

In such a situation, the presence of institutions that assess credit worthiness of SMEs would set a strong edifice for a long-term benefit of these companies.

Having examined the debt side, let's analyse the equity side – the ability of SMEs to attract capital from private equity/venture capital funds.

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