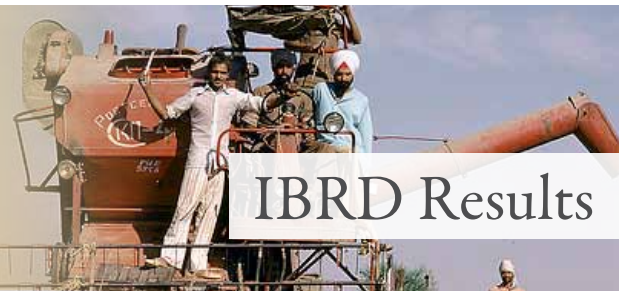




# Fueling the Engines of Business Growth in India: Small- and Medium-Sized Enterprises



## SYNOPSIS

Small- and medium-sized enterprises are the engines of economic growth and job creation but these enterprises need ready access to credit to begin operations and grow. Through a project launched in 2005, IBRD has helped India channel finance to more than 900 small- and medium-sized enterprises, businesses that boosted their productivity and that today employ an estimated 74,000 people. An additional loan in 2009 has extended loans to 1,000 such enterprises.

## Challenge

Vibrant small- and medium-sized enterprises (SMEs) are key engines of economic growth. They have significant potential to create and provide jobs, especially for people who are making the transition out of agriculture and into urban environments. However, in India SMEs' access to adequate and timely financing on competitive terms, particularly longer-term loans, is challenging. This problem has been exacerbated by the global financial crisis, and the ensuing slowdown in credit growth in the Indian financial sector has meant reduced availability of even shorter-term, working capital funding. Credit growth to SMEs declined sharply in the aftermath of the global financial crisis. In 2008, the credit growth rate to SMEs was only 7.4 percent, compared to over 35 percent a year earlier. Data shows that the share of credit to SMEs as a percentage of total credit fell to 10 percent in the year ending March 2009, from 11.6 percent in March 2008. This slowdown has hampered the growth of SMEs and impacted overall growth and development.

## Results

**IBRD has helped channel much needed-funding to Indian SMEs.** This was provided initially through a parent project

that was approved by the Bank's Board in November 2004 and more recently through an ongoing, additional financing project approved in April 2009. The parent project comprised US\$120 million in IBRD funding, of which US\$115 million was for a credit facility component and US\$5 million for a pilot risk-sharing facility. In addition, donor grants were leveraged from the UK's Department for International Development (around US\$37 million) for technical assistance. The second phase of financing involves US\$400 million in IBRD funding. Both projects entail loans to the Small Industries Development Bank of India (SIDBI), a public sector development finance institution for SMEs.

In the *parent project*, IBRD funds—channeled as loans through SIDBI—reached 927 SMEs in 10 Indian states. A survey by an independent agency (JPS Associates) in 2008 showed that two-thirds of the surveyed beneficiary-SMEs have used the funds to upgrade their technology, which, in turn, helped increase productivity (to US\$16,110 in sales per employee from US\$14,085). Sales and profits in the SMEs surveyed grew on average by 19 percent per annum and 15 percent per annum respectively, after receiving a SIDBI loan. Extrapolating from the survey sample data for 267 beneficiary SMEs, the estimated annual sales turnover of the 927 beneficiary SMEs was US\$1.2 billion and they employed 74,000 people.

*“My first loan from SIDBI, for just Rs. 4 lakhs (US\$8,000) helped me break into the export market,”* says **I C Agarwal, engineer-turned-entrepreneur, Delhi**

Ten years ago, I C Agarwal, an engineer-turned-entrepreneur, had an export order from Japan, but no funds to complete it. That was when he took his first loan from SIDBI and he hasn't looked back since. Agarwal is the only small-scale Indian manufacturer to supply precision auto accessories to world-renowned firms such as Caterpillar in the US, as well as to firms in Japan, Europe, and China.

Today, he employs more than 400 people. A commitment to quality and intellectual investment in the skills of his workers are his top priorities. *“The customers are constantly upgrading their technology, so we have to keep pace too,”* he says, proud of his product, his workforce, as well as his strict adherence to his clients' tight delivery schedules.

Surveyed SMEs also reported impressive compliance with environmental practices under the project. Loans have, on average, been for five years—a loan term not readily available to SMEs from the banking sector. The pilot risk-sharing facility introduced a guarantee product designed in line with good international practices that provided loan guarantees to 64 SMEs (of which 34 were new projects, six were SMEs that were diversifying and 24 were SMEs that were expanding business).

In the few months of implementation of the second IBRD project in 2009, over 1,000 SMEs have been provided term and working capital loans totaling around US\$125 million. These include loans against receivables that provided these SMEs much-needed liquidity support as they coped with the legacies of the financial crisis: namely longer inventory and payment cycles from their customers, which are typically large firms. Against the backdrop of the financial crisis, this funding has helped SIDBI play a vital counter-cyclical role in funding SMEs, even as banks had slowed such lending.

Through leveraging donor funds to go hand-in-hand with IBRD funding, technical advisory activities—channeled

through SIDBI—have been undertaken that enable better access to finance for SMEs. Amongst other things, this has helped: improve SME appraisal techniques in financial institutions through use of credit scoring models; support development activities in SME clusters by assisting providers of technical training to SMEs to establish such facilities in the clusters, strengthening SME business associations to deliver better services to SMEs and facilitating quality control through the creation of testing facilities; SIDBI to commission policy studies undertaken by sector experts including on important topics such as corporatization and insolvency regimes for SMEs; and provide support to India's first credit bureau. The credit bureau now has over 130 million consumer accounts and 4 million commercial accounts in its database. Advisory work also has helped create the first dedicated SME rating agency in India.

An indirect contribution of the project has been the facilitation of a widely-used and expanded definition of 'SMEs'—at the time of project preparation there was no formal definition of SMEs. Broadly in line with the project definition developed in 2004, in 2006 a definition for SMEs was framed for India that helped move from an overly restrictive focus only on very small-scale, manufacturing firms, to one that included other small-scale and medium-sized firms, and also firms in the services sector. Yet another indirect impact relates to the pilot risk-sharing facility, which influenced an improvement in the design of a US\$500 million guarantee scheme that is the premier facility of its kind for SMEs in India.

Performance on *project outcome indicators* for the parent project, such as the growth of loans to SMEs, growth of long term loans to SMEs, and a reduction in non-performing loans, has been impressive. While a targeted portfolio growth of 37 percent and 26 percent was projected, respectively, for total SME lending and long-term lending, actual growth by the closing date (June 2009) was 98 percent for both. Recovery of loans has been strong and lending practices at the SIDBI branches covered by the project have improved steadily. Partly as a result of the Department for International Development (DfID)-financed technical advisory component of the project, the non-performing loans of these SIDBI branches have fallen dramatically to 1.9 percent in March 2008 from 12 percent in December 2004.

## Approach

In 2004, India's government, SIDBI and a number of commercial banks asked IBRD to support efforts to remove the bottlenecks that constrained SME access to finance, and to help foster their development. The policy dialogue and the process of preparing and implementing the IBRD projects has contributed to a growing relationship between the Bank and India in this sector.

The credit facility supported by the parent project channels long-term loans to SMEs, while a new pilot risk-sharing facility offered a new risk-based guarantee product in the Indian financial market. This facility, by sharing risk with banks, provided comfort to them that helped expand the risk frontiers of participating banks and financial institutions and in turn leveraged increased lending to SMEs. The additional IBRD project includes a focus on both term and working capital loans and is expanding the project's reach to areas not covered under the parent project, including India's low-growth states, thereby promoting inclusive growth. The approach also helped leverage donor funding to build technical capacity and create public goods through its activities and results.

## Summary Timeline

The World Bank prepared a policy note identifying key constraints in SME financing and development in 2004. This was an input into the preparation of the parent project, which started in April 2005 and closed in June 2009, just after the approval of the additional financing project in April 2009. This second project began implementation in July 2009, and will close in June 2012.

## IBRD Contribution

As mentioned above, IBRD's policy note on constraints to SME financing and development in India provided the analytical foundation for the parent project of US\$120 million in 2004. In the wake of the global financial crisis and at the request of the Indian government, IBRD provided additional financing of US\$400 million in 2009.



## Engagement of World Bank Group

IBRD worked closely with its private sector arm, International Finance Corp. (IFC), during the parent project's preparation. While the IFC is not directly engaged in project implementation, the approaches used by IBRD—in working with public sector institutions, increasing the risk appetite of banks and building credit information—and the IFC are complementary. The risk sharing-facility offered under the project is open to clients of IFC.

## Partners

The project has benefitted from very close collaboration between SIDBI, the Bank, and other development partners, with strong support from the government. The project entails cooperation with donors for the DfID-financed technical advisory component Germany's KfW and GTZ assisted with additional funding.

## Good Practices Developed/ Replicated

In addition to the development of an innovative pilot risk sharing facility, the use of a framework of environmental and social safeguards and its integration into the credit appraisal process was a significant achievement. Close col-

laboration with development partners and leveraging their resources for public goods creation and capacity development to supplement the IBRD funding has been a hallmark of the project preparation and implementation process. A strong focus on project implementation support and on results and a monitoring framework has enabled close tracking of outputs and outcomes. By working closely with SIDBI throughout project preparation and implementation, the project benefitted from improved implementation planning, reflected also in quicker disbursements and achievements of project development outcomes. Lastly, the second project was prepared in a comparatively short time frame, responding to the needs of the client for a quick response against the backdrop of the financial crisis.

## Next Steps

The implementation of the second project is underway. Keeping up the disbursement of loans to SMEs, disseminating the good practices learnt, and building the synergies between the credit line and the technical assistance provided are key focus areas. Such synergies can be built through channeling to a greater extent the credit line to areas where technical assistance and SME-cluster development activities are taking place.

## LEARN MORE

### Links to key related sites:

- [See project documents](#)
- [SME project snippets](#)
- [Learn more about SIDBI](#)
- [Learn more about the project](#)
- [Our work in India](#)
- [World Bank's Country Strategy for India 2009-2012](#)
- [Contact us in India](#)