Budget 2019: For These Small Businesses in Gujarat, Loans Take Far Too Long

In October last year, Bhavin Chaudhary lost a potential client from Singapore for nylon made at his factory because an Rs 30-lakh loan to buy new equipment took longer than usual. Chaudhary, 25, had started the unit 18 months ago to expand his family business. And he wanted to acquire a warping machine that holds strands of yarn parallelly for the weft to be woven across into fabric.

“Banks are taking extra precautions,” the owner of Symphony Textiles that makes everything from denim and linen to polyester told BloombergQuint at his unit in Chhatral in Gandhinagar, Gujarat. “They ask for more papers—that is good, we are ready to comply. But they are taking so much time,” said Chaudhary whose first Rs 6-crore loan for the new factory was approved in a month and a half. The second one took two-and-a-half months. “Banks are confused about how and whom to lend.”

An hour’s drive south in the Naroda industrial cluster near Ahmedabad, Mitesh Seth, 53, faces a similar hurdle. His factory has been shaping plastic into caps for pickle containers to engine oil cans for 30 years. He now wants to make bottles, but banks are not willing to lend to buy new moulding machines.

“We don’t have enough funds to grow,” Seth, the owner of Dhiren Plastics Industries, said as a worker fed small discs into a machine that spewed red caps for PET jars. “We want to import machines from Europe or Japan but don’t have sufficient collateral for a loan.”

Delayed loan approval and lack of credit was the common grouse of the three small businesses BloombergQuint spoke to in Gujarat—Prime Minister Narendra Modi’s home and India’s third-most industrialised state after Tamil Nadu and Maharashtra. Flow of credit to such 6.3 crore so-called micro, small and medium enterprises in the country is crucial, as according to government estimates, they employ 11.1 crore people and contribute about 30 percent to India’s $2.7-trillion GDP.

Part of the reason why some MSMEs faced issues in accessing credit recently could be the debt crisis at Infrastructure Leasing & Financial Services Ltd. that made bankers cautious, according to Rajneesh Singhvi, director at SME Consulting. “In the past six months, I have personally witnessed slow offtake of credit for the MSME sector. The extra cautiousness is reflected in slow processing of documents and even refusal.”

Prime Minister Narendra Modi recently launched a loan-in-59 minutes scheme in an outreach to small businesses ahead of the next general election. That came after the cash ban and goods and services tax caused back-to-back disruptions.

But credit shortage is not new. The finance gap between credit demand and supply for small businesses in India is at $230 billion, or 11 percent of the nation’s GDP, according to estimates of International Finance Corporation in 2017.

Share of loans to MSMEs in total bank credit fell from 16 to 13 percent in the last decade, according to RBI data, as banks focused on large corporates in the heady days of growth.

MSMEs face constraints in accessing credit through formal channels because about 97 percent of them operate in the informal sector, Harendra Behera and Garima Wahi wrote in

RBI’s Mint Street Memo in August last year. “…most of them are in niche segments where credit appraisal is a major challenge.”

Also, the corporate-lending binge more than doubled Indian banks’ bad loans to over Rs 10 lakh crore, bulk of it coming to state-run lenders. Nearly half of the public sector banks now face the regulator’s lending restrictions.

As a result, most public-sector banks now prefer to lend to customers with a credit rating of at least BBB-, according to Saikat Roy, head of SME division at CARE Ratings. Small businesses have a higher risk profile and their balance sheet strength and liquidity position do not allow them to get investment grade ratings, he said. “Banks are still taking time to fit MSMEs within their new lending norms.”

Life after Note Ban, GST

Prime Minister Narendra Modi on Nov. 8, 2016 outlawed old high-value currency notes to crack down on ill-gotten wealth. That sucked out 86 percent of the currency from the economy.

And while cash-dependent small businesses were still recovering from the setback, goods and services tax was rolled out eight months later. That brought a large number of MSMEs under the tax net for the first time, increasing compliance through multiple returns and tax credits for manufacturing inputs.

It was a struggle just to keep the machines running, said Chaudhary who started the new factory in July 2017, seven months after the note ban and the month GST was implemented. “Most clients did business in cash, so it affected us.”

Small manufacturers, and their clients and vendors had to get used to the GST and electronic bills. “They [clients] took their time to change. We were stuck with no orders and no work,” Chaudhary said. He had spent most of his cash in paying an advance to a construction company and for buying new machines.

Left with nothing to run the factory, he lost international clients. And Symphony Textiles hasn’t fully recovered.

The business has never been that slow, he said. “Earlier we used to have buyers before the fabric was made. After GST and demonetisation, we have to find them. The stock keeps piling up.”

For Seth’s plastic business, GST proved to be a boon after the initial bump. His sales have grown by more than half as he no longer pays excise duty on finished goods. Still, multiple revisions in GST rates continue to be a problem as they disrupt the supply chain.

That’s not wholly correct as all the rates have been lowered which is a good thing, according MS Mani, partner at consulting firm, Deloitte India. “The rates will eventually stabilise. But because of the way GST works, a lot of unorganised small players will now have to be tax-compliant to remain within the system.”

Chaudhary agreed with Seth though. “Because of changing tax rates, I have to alter my fabric prices and clients are not happy with such frequent changes,” he said. “I’m just starting out. I have to build the company to last.”

Subsidy Bump

Another concern is the slow transfer of subsidies. The government allows refund of part of the interest on loans taken to start a new factory or expand business.

Suresh Patel, 55, partner in Jatin Rice Mills at Chhatral, had to wait for a year and a half to get the subsidy after he decided to buy new machines. “I asked an agent to finish the documentation and it took six months to put all the papers together,” Patel, said. “And then it took a year to get the subsidy amount.”

Chaudhary’s interest subsidy on the first Rs 6-crore loan he took in 2017 hasn’t been approved yet. “I applied online and they have inspected the machinery, bills and everything,” he said. “Yet, every time I call them, there’s a standard reply: it’s in progress.”

Most businesses are either not aware of subsidies or don’t know how to avail them. They end up approaching the wrong department and forms keep piling up as there is no single window to address the issue, according to Chandrakant Salunkhe, founder and president of the SME Chamber of India.

Seth, who received the subsidy six months after he borrowed Rs 25 lakh the last time in April 2016, has another problem. It’s a one-in-a-lifetime incentive and he can’t claim it in the future. Small businesses need more such incentives, he said. “If there’s no help, how will they grow.”