Growing importance of co-lending in Financial Intermediation

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The Micro, Small and Medium Enterprises (MSMEs) sector plays an important role in enhancing and ensuring India's socio-economic development. The sector has gained significant importance due to its contribution to the country's Gross Domestic Product (GDP) and exports. It is estimated that MSMEs have generated more than 111 million jobs through 63.38 million enterprises and contribute over 30% of the nation's GDP and more than 40% of the country's overall exports.

However, one of the sectors that was most impacted by the COVID-19 pandemic and global uncertainties, was the MSME sector. Further, the prolonged pandemic has resulted in global slowdown and all-time high inflation rates.

As the pandemic worsened, it became certain that the MSME sector would require a helping hand to survive. The Reserve Bank of India (RBI), to mitigate the impact of the pandemic on the vulnerable sections of the society, revised and rechristened its 2018 framework for co-origination of loans into a more flexible framework of Co-Lending Model (CLM) in 2020. This model facilitates collaboration between banks and registered Non-Banking Financial Companies (NBFCs)/Financial Technology (Fintech's) firms, thus, enabling priority sector lending at an affordable cost. The idea was to improve flow of credit to the unserved and underserved sectors of the economy such as MSMEs. A co-lending arrangement usually involves two or more parties coming together for a specific purpose or a project. Such an arrangement allows them to use their respective strengths and capabilities for the benefit of MSMEs. Co-lending allows for increased liquidity and credit penetration.

Co-lending

1. Introduction

In 2018, RBI rolled out guidelines for co-origination of Priority Sector Loans by Scheduled Commercial Banks with Non-Banking Financial Companies - Non-Deposit taking - Systemically Important (NBFC-ND-SIs)[1]. Later, in 2020, RBI rolled out amended Co-Lending Model (CLM)[2]. Further to this, in 2021, the revised guidelines related to Transfer of Loan Exposure, which are also applicable to co-lending transactions came in force. In addition to this, there are Securitization of standard assets directions, 2021 and Master direction - Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021[3].

2. Objectives of the Co-lending

The objectives of the co-lending are as follows:

- Help NBFCs in increasing their reach towards the growth of MSMEs.
- Help MSMEs in giving access to formal low-cost credit.
- Promote MSME funding through MSME focused NBFCs.
- MSME to get banking facilities (e.g. Forex transaction) through NBFCs through various arrangements with bank.

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[1]RBI/2018-19/49 FIDD.CO.Plan.BC. No.08/04.09.01/2018 date September 21, 2018.
[2]RBI/2020-21/63 FIDD.CO.Plan.BC. No.8/04.09.01/2020-21 dated November 05, 2020.
[3]RBI/DOR/2021-22/85 DOR.STR.REC.53/21.04.177/2021-22 circular dated September 24, 2021.

3. Scope of the Co-lending

The co-lending can be done between any Schedule Commercial Bank (SCB) and RBI registered NBFCs (including HFCs).

4. Target Segment

The vision of co-lending is to deploy low-cost funds through NBFCs in the priority segments like MSME and granular assets space in all geographies.

Over the last two years, MSMEs have proved themselves as a key player in the consumer market in the Indian economy in terms of last-mile delivery, community support and even encouraging adoption of digital technology. This happened despite the challenges being faced by MSME sector in the wake of market downturn to maintain cash flow and access working capital, while dealing with supply and workforce disruptions. It is no surprise that MSMEs have emerged as a backbone for global economies market like India.

However, despite the pivotal role MSME sector holds in Indian economy, they face challenges in accessing credit, which hinders their ability to navigate volatile market dynamics.

In order to help MSMEs, National Small Industries Corporation (NSIC) was set up as a Public Sector Unit (PSU) in the year 1955 to provide handholding and positive eco-system to MSMEs through various interventions created by it over a period of time. NSIC has been working to support, promote and strengthen the growth of MSMEs in the country. NSIC is a profit-making dividend paying company.

NSIC carries forward its mission to assist Micro, Small & Medium Enterprises by providing specially tailored schemes for them. To enhance the competitiveness of MSMEs, NSIC provides integrated support services under marketing, technology and other support services.

Credit Support to MSMEs

Access to timely and adequate credit is the need of the hour for MSMEs growth and development. Indian banks have been advised to achieve 20% year-on-year growth in credit to Micro and Small Enterprises. Also, the allocation of 60% of the MSME advances to the Micro Enterprises is to be achieved.

Meeting credit needs of MSMEs through tie-up arrangement with banks

One of the major challenges faced by MSMEs is inadequate access to finance due to lack of financial information and non-formal business practices. To overcome these problems, NSIC has entered into tie-up arrangements with various public sector & private banks/Financial Institutions (FIs) for helping MSMEs in accessing credit for working capital requirements and other expenses. NSIC has taken initiative of on-line finance facilitation to facilitate easy access to finance for MSMEs. The portal allows MSMEs to apply online for loan from various banks which have tie-up arrangements with NSIC. Further, web linkages with portals of various banks are also created to ensure speedy disposal of credit proposals, thus, saving time and cost of MSMEs.

Salient features of Bank Credit Facilitation Scheme

- It facilitates credit to MSMEs by having an integrated mix of various public and private sector banks.
- It opens the option for MSMEs to switch over to different banks.
- It provides assistance to MSMEs in completing the documentation process, before submitting it to the bank.
- To facilitate large number of MSMEs who are desirous of availing credit facilities.
- To provide handholding support to MSMEs.

Financing procurement of raw materials & marketing activities (short-term)

NSIC provides support to MSMEs to process raw materials by making arrangements with bulk manufacturers. It also provides financial assistance to MSMEs for procurement of raw materials by making payment to suppliers.

Benefits of the Scheme

- It provides credit support up to 180 days for the procurement of raw material.
- This scheme provides support to MSMEs for bulk purchases, cash discounts, etc.

NSIC also provides financial assisstance for marketing activities such as Tender Marketing, Exports and Bill Discounting to Micro, Small & Medium Enterprises.

Self-Reliant India (SRI) Fund

The Hon'ble Finance Minister, announced creation of a Fund of Funds (FoF) for Micro, Small and Medium Enterprises (MSMEs) under the Atmanirbhar Bharat package on the 13th May 2020, to address severe shortage being faced by MSMEs in securing growth capital. Consequently, Ministry of MSME, Government of India, designated the National Small Industries Corporation (NSIC) to execute Fund of Funds scheme of Rs.10,000 cr., by anchoring it through a 100% owned subsidiary company. Accordingly, NSIC Venture Capital Fund Limited (NVCFL) was incorporated as a wholly owned subsidiary of the National Small Industries Corporation (a Miniratna Public Sector Enterprise (PSE) under the MoMSME catering to the MSME segment) for implementing the Fund of Funds, named as Self-Reliant India (SRI) Fund.

The 'Self Reliant India (SRI) Fund' is launched as the first scheme of NVCFL. SRI Fund will employ a 'Fund-of-Fund' investment strategy wherein, the fund shall invest in SEBI registered Category I and Category II Alternative Investment Funds ("Daughter Funds"), which shall in turn, invest in MSMEs. The Daughter Funds (DFs) shall invest at least 5 times the amount of capital received from SRI Fund (net of fees and expenses) in MSMEs, defined as per the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.

Objectives of SRI Fund

The objective of SRI Fund is to provide funding support to the MSMEs through the Daughter Funds as growth capital in the form of equity or quasi-equity for enhancing equity like financing to MSMEs, listing of MSMEs on stock exchanges. It also empowers MSMEs to produce globally competitive products and services through strategic and operational guidance. SRI Fund has a fund life of 15 years and can commit minimum Rs. 25 cr. and up to 20% of DF fund size or Rs. 2,000 cr., whichever is lower. The other objectives of SRI Fund are as follows-

- Enhancing equity, quasi equity and debt financing, as per the relevant SEBI guidelines for MSMEs;
- Supporting the speedy growth of MSMEs and thereby, ignite the economy and create employment opportunities;
- Supporting enterprises which have the potential to graduate beyond the MSME bracket and become National / International champions; and
- Supporting MSMEs which help making India self-reliant by producing relevant technologies, goods and services.

Role of SRI Fund

- Within 1 year of its operations, SRI Fund has held 15 Investment Committee Meetings and has provided final approval to 33 Daughter Funds with commitment of Rs. 4,805 cr. Investment Committee (IC) has also provided preliminary approval to 5 Daughter Funds with commitment of Rs. 470 cr.

- This offering by the Government of India through NSIC and NVCFL will go a long way in providing the much-needed growth capital to MSMEs, so that they can become champions and also graduate from the MSME segment. This should also enable MSMEs to tap the equity market for low-cost, long-term funding.
- Until 30th September 2022, SRI Fund has invested Rs. 274 cr. across 125 MSMEs generating ~ 20,000 jobs, spread across the country, through 22 Daughter Funds that are empaneled with SRI Fund. This investment into MSMEs from SRI Fund has helped them raise additional capital of Rs. 2,335 cr. of investments from all investors, thereby, providing a catalytic capital to MSMEs. Over the entire term of SRI Fund, it is expected to support 2,700 MSMEs.

Support provided to beneficiary MSMEs from SRI Fund

The aim of funding provided by SRI Fund is to help the investee companies to scale and grow into mature businesses that can attract larger rounds of equity capital which will have a large multiplier effect. SRI Fund till August, 2022 has benefited 94 MSMEs to the tune of Rs. 227.34 crore. These beneficiary MSMEs operate in sectors such as Defence, Education, Agriculture, Retail & FMCG, Climate, Healthcare and others. This funding may be utilized in the following ways:

1. To help increase the capital spent thereby, expanding manufacturing capacity;
2. To hire more talented team members, thus, generating more employment; and
3. For research and development to launch new products.

Advantages of Co-Lending

1. *Increase in reach* - Since NBFCs / Fintech's have the potential to the remotest areas of the country, underserved target groups and also have greater digital penetration. This, banks can benefit from such wider reach and large base of customers to lend to.
2. *Better customer experience* - NBFCs / Fintech's value customer service and thrives to provide them with exceptional customer experience. Therefore, the customer management gets handled by a partner in a smooth and convenient manner, which helps in attracting customers and retaining them in long run.
3. *Risk management* - Since two or more parties co-lend, the risk is divided between the parties and help reducing the credit risk. It gives an added sense of security and minimization of losses, in case of default.
4. *Lower interest rates* - Customers do not need to pay high interest rates, just to go through a convenient lending process, as they get considerably lower interest rates due to banks being on board.
5. *Assured market linkage* - The producer need not worry about market linkage and for marketing setup containing such costs to a large extent. Collaboration between large banks and niche NBFCs/Fintechs, wherein, Lending as a Service (LaaS) would become a prominent force has become quite popular. Large public sector banks benefit from partnerships with third party platforms and NBFCs/Fintechs with the last mile reach which these institutions have. Banks can provide the funds to MSMEs in Tier II/III cities and rural areas by leveraging the kind of reach NBFCs and such other platforms. They may lend to a greater number of customers and have a robust recovery mechanism in place. Such firms help banks reduce their exposure to credit risk.

Similarly, there can be a wide scope for implementation of the concept of co-lending in Central Public Sector Enterprises (CPSEs) mainly engaged in manufacturing or process industries.

These CPSEs can give assurance for procuring raw material/semi-finished goods from identified vendor. Based on this assurance, the vendor is provided finance by a financial institution to procure machines and raw material. All this can be easily structured through a tripartite agreement. To illustrate, let us take the example of NTPC. NTPC requires coal to fire its boilers to produce electricity. Coal is procured from coalfields which are often situated far away from the power plant. However, in the vicinity of the power plants, there might be a large number of farms which would be encountering the problem of disposal of their farm waste i.e. parali (stubble). Stubble burning causes widespread pollution which is a social evil and causes severe problem to health and well-being. So, NTPC can tie up with the farmers and procure briquettes, converted stubble from them to fire their boilers. The conversion of stubble is a short thermo-mechanical process for which machinery is required. Simultaneously, NTPC can also assure one or more financial institutions to provide financing to the farmers for procuring the machine and because of the assured market linkage, they will be paying the farmer regularly, as per supply made. Such an arrangement, if made, would be a win-win situation for all, as explained below:

a) Industry Major-Central Public Sector Enterprises (CPSEs) - they would get assured supply of raw material at relatively cheaper cost.

b) Financial Institution - assured of repayment and end-use of their investment.

c) Farmer - extra income from farm waste inter-alia ensuring cleanliness and hygiene.

d) Society - less pollution resulting in better quality of life.

This model can, be used by other CPSEs also for the benefit of all stake holders.

6. *Affordable housing* - Shortage in affordable housing continues to be a major concern for India, especially, for the economically weaker and informal sections of the society. To further improve the penetration in this segment, State Bank of India (SBI) has entered into partnerships with five Housing Finance Companies (HFCs), namely, PNB Housing Finance, IIFL Home Finance, Shriram Housing Finance, Edelweiss Housing Finance and Capri Global Housing Finance. This collaboration will help SBI to enhance its distribution network, as it aims to expand its credit reach to more home loan borrowers in the unserved and underserved segments.

   In another instance, Bank of Baroda (BoB) has recently launched an end-to-end digital platform in collaboration with Paisalo Digital Limited, a leading NBFC for deploying around Rs. 10,000 cr. for the benefit of Micro, Small and Medium Enterprises and women entrepreneurs. This is a laudable initiative by BoB and will definitely pave the way for other banks and NBFCs to give life to the co-lending policy of the RBI.

Conclusion

Co-lending helps banks reaching geographies/ segments where banks have very little presence and NBFCs are extending the credit with their regional knowledge/network/branches. This model has the potential to bring about a significant change in the priority sector. Large customer base and integration of technology of NBFCs such that the end users at remote places can take advantage of such schemes, combined with the robust financial backing of large institutions may transform the lending and borrowing market in the priority sector. Moreover, CPSEs as of now are not involved in any co-lending activities. However, the ways in which CPSEs contributes to co-lending in terms of financial intermediation may be explored. If the co-lending model implemented in the manner envisaged by the RBI, this may just prove to be the catalyst for the industries and in uplifting of the priority sector from its economic hardships.