

Discussion Paper - India

Cluster Financing

Key Facts

SBA 6 Sub-dimension:
6.1.5 6.2.4

Country:
India

Results & Impact:

- Over six thousand Clusters in traditional handloom, handicrafts and modern SME industry segment
- MSMEs constitutes of the largest segment of Indian clusters
- Outstanding credit from branches in MSME clusters: EUR 40,679 million (USD44,818.93 million) (March 31, 2013)
- Public sector banks accounting: EUR 28,546 million (USD 31,451.14 million) (March 2013)
- Private sector banks accounting: EUR 12,133 million (USD 13,367.79 million) (March 2013)

A. Policy Level

The MSME sector plays a vital role in manufacturing (45%), exports (40%), and employment generation, employing an estimated 60 million people spread over 26.5 million enterprises. Public policy has accorded high priority to this sector to achieve balanced, sustainable, equitable, and inclusive growth. MSMEs primarily rely on bank finance for their operations, and so a timely and adequate flow of credit to the sector has been an important public policy objective.

Despite increased credit to the sector in recent years, access to adequate and timely credit is still one of the constraints faced by the sector, due to traditional issues of information asymmetry and high transactions costs.

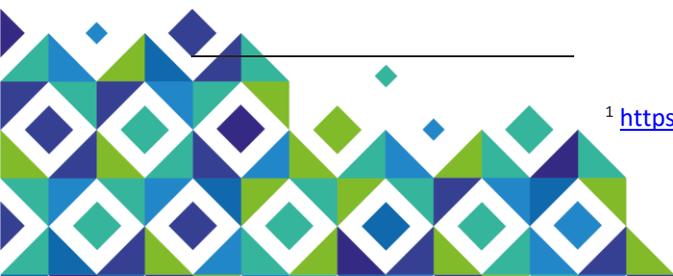
BACKGROUND

- The government has adopted the cluster development approach as a key strategy for enhancing productivity and competitiveness, as well as capacity building to MSMEs.
- As per Circular RPCD.SME & NFS.No.BC.90/06.02.31/2009-10 dated June 29, 2010: Banks are advised to open more MSE focused branch offices at different MSE clusters which can also act as counselling centres for MSEs. Each lead bank of the district may target at least one cluster.

B. Programme Level

A cluster is a group of enterprises located within an identifiable and, as far as practicable, contiguous area and producing the same or similar products or services. The essential characteristics of enterprises in a cluster are: similarity or complementarity in methods of production, quality control and testing, energy consumption, pollution control; similar levels of technology and marketing strategies or practice; channels for communication among the members of the cluster; and common challenges and opportunities. Banks have been advised¹ by the Reserve Bank to increasingly adopt the cluster-based approach for SME financing, since it can reduce transaction costs and

¹ <https://www.rbi.org.in/commonman/English/Scripts/FAQs.aspx?id=966>



mitigate risks. A cluster-based approach to lending is more beneficial for the following reasons: (a) Banks deal with well-defined and recognized groups; (b) there is appropriate information for risk assessment; and (c) clusters can be monitored by lending institutions.

The entities involved in the implementation of the cluster-based approach include the **Government of India**, which has identified the clusters; the **Reserve Bank of India**, that issued policy guidelines to banks to encourage cluster financing; and the **scheduled commercial banks** (falls under the Reserve Bank of India Act, 1934) that are implementing the guidelines. There has been no opposition to the initiative, as the guidelines have been issued by the Reserve Bank in its capacity as regulator of the commercial banks.

C. Action Level

Adoption of the cluster approach by the government and the Reserve Bank has resulted in implementation of the following measures:

- State Level Bankers Committee (SLBC), the highest body of bankers, which discusses state-specific issues relating to credit flow mainly to review the institutional arrangements for delivering credit to the MSME sector, especially for the 388 clusters identified by United Nations Industrial Development Organization (UNIDO), spread over 21 states in various parts of the country.
- The Ministry of MSME has also approved a list of clusters under the scheme to improve the credit flow to identified clusters of MSMEs in 121 Minorities Communities Concentration Districts.
- Banks have been advised to open more MSME-focused branch offices near different MSME clusters and have been permitted to categorize their general banking branches having a minimum of 60% of their advances to MSME sector as specialized MSME branches. Public sector banks will maintain specialized MSME branches in identified clusters or centers with a preponderance of small enterprises to allow entrepreneurs to have easy access to bank credit and bank personnel with the required expertise.

Innovative and Revolutionary Step Change

Regional offices of the Reserve Bank organize two to three town hall meetings each year in MSME cluster areas (unbanked or under-banked clusters) to create awareness of banking facilities among MSMEs, link them to the formal banking system, and obtain feedback on problems faced by enterprises in accessing bank finance.

D. Key Success Factors

- India's new manufacturing policy aims to address infrastructure bottleneck that support industries to organize themselves into clusters and adopt a model of self-regulation, access to finance is a key pillar of this policy.
- Improved capacity and commitment of the implementing agencies (the Government of India, Reserve Bank, and Scheduled Banks). The active participation by public and private sector banks resulted in a win-win situation for MSME sector, with banks getting bankable projects and the MSME units getting access to timely and adequate credit.
- The commitment of the Reserve Bank provides comfort to the banks.