

Spoilt for choice?

Though there are various funding options available for SMEs, there are quite a few revisions that industry needs to turn into MNCs. Those who have crossed the barriers suggest a few tips. **Arshiya Khan** presents a few cases

The history of Small and Medium Enterprises (SMEs) dates back right from Cipla to Dr Reddy's Laboratories. Driven by knowledge skills, low costs, improved quality and demand (domestic and international), they have now scaled up to become MNCs.

There are many other companies who have followed league, like Ajanta Pharma, Fourrts Labs, Fabtech and Virchow Laboratories to name a few. And the common thread that binds them together is that they started with a small amount and have now grown big. However they had their own set of ups and downs.



SMEs: the growth engine of pharma?

Indian pharma's double digit growth to a large extent is due to the SME segment, which is more focused on India Inc's daring forays internationally through big-ticket mergers and acquisitions (M&As) in recent times.

Slated to be worth \$ 10 billion and growing at about nine percent annually, Indian pharma industry ranks high in terms of technology, quality and range of medicines manufactured. Globally, it ranks fourth in terms of volume and 13th in terms of value. Contribution of SME sector for reaching such a height is enormous.

Pre and post SME era

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- T S Krishnaswamy
Deputy General Manager
State Bank of India (SBI)

"During 1990s the government was interested in generating employment therefore they encouraged SMEs. They gave us soft loans, minimum investment subsidy and other schemes that helped us. But the scenario has changed now. There is no support from the government."



- M Narayana Reddy
President,

Traditional Indian pharma SMEs were less transnationalised as compared to their large counterparts. Their thrust was on the domestic market and their cost-competitiveness was sufficient in providing them a sustainable growth within the protective domestic market. However, post 1990s these SMEs were exposed to global competition and hence they stepped in the international market to survive.

Thereafter there have been many opportunities but due to lack of confidence and weak balance sheets they have not been able to grab all of it. The other hurdle that deterred the growth of SMEs was inadequate access to finance. They also lacked access to Private Equity (PE) and Venture Capital (VC) funds and hence had a very limited access to secondary market instruments. As per industry sources, ICICI Bank was the earliest and the only bank offering PE for SMEs at that time. And mostly SMEs approached them if they failed due to patent laws or/and some other scientific reasons.

The saga does not end here. This is now coupled with lack of backing from the government. M Narayana Reddy, President, Bulk Drug Manufacturers' Association (BDMA) and Managing Director, Virchow Laboratories gives a flashback. Thirty years

Bulk Drug Manufacturers' Association
(BDMA)
Managing Director
Virchow Laboratories

ago he started Virchow Laboratories with a minimum amount of Rs 10 lakh and now they have a turnover of Rs 750 crore. They were funded by the Canara Bank. He informs, "At that time the government was interested in generating employment therefore they encouraged SMEs. They gave us soft loans, minimum investment subsidy and other schemes that helped us. But the scenario has changed now. There is no support from the government. We at Virchow at that time had a continual growth. There was no downturn for a single year."

But with time the attitude of entrepreneurs has changed. Says Aasif Khan, Managing Director, Fabtech Technologies, "The Indian SME growth is despite the government. We only need an attitude change in the government. The rest will follow." However Reddy feels the government should come forward. If they encourage SMEs and make people work it will create employment. Without productivity if the government is supporting people, then it is wasting money." Rather than doing that the government should focus on building infrastructure and better roads, he adds. And as far as support from the banks is concerned they are here for business and to earn profits, so they cannot just fund, they have to get the returns as well. Therefore where ever there are opportunities for business, government should encourage, he adds.

Still on the same pitch

This has not changed much in recent times. SMEs still face fragmented markets and are vulnerable to market fluctuations. They lack easy access to inter-state and international markets due to patent laws. The access of SMEs to technology and product innovations is also limited due to lack of information and awareness of global best practices and they face considerable delays in the settlement of dues/payment of bills by the large scale buyers.

However Fabtech is a case in point which has had a smooth growth.

The only hurdle Khan feels is, "Bank funding is simple but the procedure is lengthy. It has to be as fast as they claim in the ads." State Bank of India (SBI) has a solution. T S Krishnaswamy Deputy General Manager, SBI informs, to ensure timely availability of funds and faster access to funds, the process of sanctioning has been streamlined by SBI through processing cells set up exclusively for this purpose. SMECCC (SME City Credit Centres), have been set up across the country in key cities to process loan proposals up to Rs 1 crore. All key branches around these centres have been linked to these SMECCCs. Others are processed through credit committees. Proposals above Rs 1 crore are sanctioned through CPCs (Credit Processing Cells). SMEs with exposure of above Rs 1 crore are being serviced through RMMEs (Relationship Managers for Medium Enterprises). RMMEs are one man contact for Medium Enterprise customers and all their needs are serviced by RMMEs.

The Bank has also developed various financial models to cater to the all the segments of units. Loans upto Rs 10 lakhs are done through a simplified product-SME Credit Card. For exposures between Rs 10 lakh and Rs 50 lakhs units are financed through a simplified scoring model-SME Smart Score. For exposures above Rs 50 lakh units are rated under the CRA (Credit Risk Assessment) model of the Bank. Exposures upto Rs 1 crore can be covered under the CGTMSE (Credit Guarantee Trust scheme for Medium and Small Enterprises).

Fabtech's smooth growth

Fabtech was started in Mumbai with a 1000 sq ft facility manufacturing laminar air flow benches. And today they have a facility of 1 lakh sq ft. with machines equipped from EU and Japan. The company had a smooth growth. Experimenting and exploring the market has been a strategy adopted by them. Until 2003 they banked with Central Bank of India and Dena Bank still continues to support them. They had positioned the company as high end engineering and construction services' company with a specialisation in pharma and electronics as

opposed to a manufacturing company.

Khan informs, last year we explored the PE market and approached more than 20 funds and six funds expressed interest. Amongst them were Navis, Kubera Partners and Franklin Templeton. We also approached funds for funding acquisitions in EU and Japan, which we did not take forward as our merchant bankers advised us to first leverage debt. Two years hence our profitability and performance has improved.

He sums the growth story as continuous learning experience, as they generated a lot of interest and people were excited with their business model and the space that they are into.

Khan stresses on the need for a more focussed approach from banks. "There is unavailability of the banks to identify dark horses, ie long term players, and also to identify potential in the company and the collateral then required. Banks should take a paradigm shift in their thinking and treat themselves as partners in growth to their customers and guide them on various aspects of financial management, cash flow planning, much like the PE fellows do, and also lend a helping hand in preparing descent project reports."

He also suggests that banks should have advisory teams for funding people who approach them. They should support in brain storming sessions. There should be an active participation in the formation of ideas.

Banking on banks

There are quite a few banks like Small Industries Development Bank of India (SIDBI), Industrial Development Bank of India (IDBI), Export-Import Bank of India, SBI, Bank of India to name a few, which have various schemes and loan options to boost the SME growth. And SBI has customised offerings especially for the pharma industry. It has included the Open Term Loan and Pharma Dosage designed exclusively to meet the needs of pharma units, informs Krishnaswamy. (Open Term Loan: Vitamin M for Pharma SMEs, is a pre-approved term loan up to a maximum amount of Rs 250 lakh to manufacturing concerns for meeting any genuine commercial purpose relating to the regular business activity of the customer). The amount sanctioned can be availed in multiple instalments over a period of one year.

The product offers advantages of lower margin requirement (contribution of promoter), multiple disbursals, flexible usage of the scheme and pre-payment.

The second scheme aimed at pharma units is Pharma Dosage. As per this scheme, the facility is in the form of a term loan meant for the purpose of any upgradation (GMP/Schedule-M), purchase of pollution equipment, investment in effluent plants, investment for setting up R&D facilities and costs towards DMF/ANDA/Patent filings. Concessions are offered in terms of lower margin, moratorium period, longer repayment period, lesser insistence on collateral and interest rate concessions linked to margin and collateral offered.

SBI is a pioneer in SME financing and has financed over 1.3 million SMEs so far. The classic example is that of Fourrts Laboratories, which was started in the year 1977 with the small capital of Rs 60,000, but with great determination. The company approached the Tamil

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- S V Veeramani
Chairman and Managing Director
Fourrts Lab
Chairman-SME Committee
IDMA
Chairman-SSI Committee
Pharmexcil

Nadu Industrial Corporation (TIC) for term loans and SBI for working capital. SBI continues to be our bankers to this date, informs S V Veeramani, Chairman and Managing Director, Fourrts Lab, Chairman-SME Committee, IDMA, Chairman-SSI Committee, Pharmexcil.

Catering to exports

As per different estimates approximately 30 percent of pharma SMEs export their products to various overseas destinations like US, Europe, Middle East, Africa etc. Moreover, according to a 2007 report of Dun & Bradstreet India (D&B India) in a strategic association with SME Rating Agency of India (SMERA) titled 'Emerging Pharmaceutical SMEs of India' exports, with a reported growth of 22 percent during the last five years, SMEs will continue to remain the biggest opportunity for pharma companies.

Catering specifically to exports, EXIM bank has been supportive of the pharma industry. Remarks Samuel Joseph, Assistant Manager, Corporate Banking, EXIM bank, "Pharma has been a core focus for us. Overall pharma is mainly into exports and we have funded them thoroughly. We follow a simple approach and funding is always decided by the life of the company. We fund both the capital expenditure for setting up a facility for the exports market. For pharma we fund R&D and infrastructure. Which ever company has exports we fund them."

Though there are different funding options available, the need of the hour is: banks should have an in-depth focus on credit and finance requirements of SMEs. At times, the loan is not sufficient enough to fully fund the project. Reddy believes, "It is better to fund 100 small companies than a big company. And when you see the performance of the small companies the overall performance will be better than a big company." He suggests, let the entrepreneur invest around 25 percent and the banks can finance 75 percent. This will hook the entrepreneur and will give the bank charge of everything.

In such a case a technocrat will be in a better position to handle the work. There are people in MNCs who are good technical experts and have started their own company. These people are sound in technology but poor in financing. This is where the financial institutions play a big role.

Also keeping in mind that banks are allowed to fix their own targets for funding SMEs in order to achieve a minimum 20 percent year-on-year growth, the Government's objective is to double the flow of credit to the SME sector from Rs 67,600 crore in 2004-05 to Rs 1,35,200 crore by 2009-10 ie within a period of five years.

Therefore the role of banks, in general, has become very important in the above context and, Bank of India formulated its SME Policy in October 2005, encompassing various schemes and norms within the overall ambit of the government/Reserve Bank of India (RBI) directives. The SME sector's demands were comprehensively taken care of by the Bank through several initiatives such as, single window dispensation, proactively detecting sick and viable units in time so as to nurse them back to health through appropriate re-structuring, and financing of clusters, which would result in reducing transaction cost and greater economies of scale.

Fourrts Laboratories' a sturdy growth

Problems Faced

Funding was based on Tandon Committee Norms with insistence on maintaining Ratios and non-compliance resulted in less sanction of Working Capital

How We Over Came

We have brought in inventory controls, financial discipline, plugging back the profits into the company which have improved the rating of the company and has in turn reduced the rate of interest and cost of operations

The interest rate charged was much higher and has increased the cost of operations

This can be overcome only by bank deciding to reduce the interest rate

The Mackenzie Report of 1997 insisted on merger of small accounts with bigger branch accounts and we fit like a small drop in the ocean

The immediate acceptance in switching over to bigger branch with the advent of Mackenzie Report given us very good exposure on advances

The Bank Working Capital covered regular operations, but were not covering new product introductions, market research and product registration cost in the export market

Sought financial assistance on Market Development Expenses and for Export Production Registration.

Industry demands

Though there is funding from banks available, there are still certain revisions that should be considered. Veeramani, feels there should be reduction in the percentage of margin from 25 to 15 percent for stocks and receivables and less offering of collateral securities.

He suggests that SME's should be made aware about the existence of finance schemes. And they should also be imparted training in the areas of maintaining accounting ratios for overall improvement of the SMEs.

There should be a consideration in giving discount for prompt interest repayments and more flexibility and reducing the process time. Agrees Joseph, "SMEs do not lack funding. Banks are ready to fund SMEs. There are specialised institutions like SIDBI with a viable business model. If the entrepreneurs are able to convince, then funds are available."

Filling the missing links

There is divided opinion on SME funding in India. Reddy believes SMEs contribute significantly to the local economies but have limited access to loan funds. Whereas Khan feels, "There is enough funding available for one, there is a need to have a strong balance sheet and confidence to present your case to the money lenders."

As SMEs are often perceived as risky and costly clients, banks should therefore consider the background of the entrepreneur, feels Reddy. He feels there is also a need for a technical expert from the bank who will have a better understanding of the person and the company as well. What is required of the banks is that they need to support the entrepreneurs when they fail and study the cause of failure and help them come out of it. And this will work out only if the SMEs are more regulatory compliant since they export to countries, which has stricter compliance and regulatory standards.

Reddy feels, pharma has a very good opportunity for the SSIs, as there is vast pool of knowledge and skilled labour, which is hardly one fourth of the labour cost in the west.

And if the government supports the SMEs by providing pollution treatment plants like industrial estates and facilities by creating a separate park for the industry we will go along way.

Signing off Khan remarks, "The US government gives billions of dollars for its industry for research. The Indian government gives million of dollars for the pharma industry for research. If the allied sector gets small funding support on its R&D, just see the sea change that we will bring."

The upshot is that SMEs will continue to drive India's growth story. While many from their ranks have gone global - there are quite a few companies which are on the brink of acquiring leadership which are waiting in the wings to take advantage of the opportunities globalisation offers. Hence, it would not be too long before we see today's SMEs turning into tomorrows MNCs.