A Platform of Think Tank

And Transformational Change.

Sri M Maheshwar Rao, IAS, **Date: 15/04/2020**
Secretary – MSME & MINES
Department of Commerce and Industries,
Government of Karnataka
VikasaSoudha
Bengaluru.

Sub: Financial Solution for MSME during COVID-19 as a CRISIS Management Strategy

Dear Mr. Rao

Greetings from the team of Vision Karnataka Foundation

As part of the deliberation for addressing the COVID-19 difficulties and mitigating the challenges emerging out of this unprecedented outcomes we have from VKF taken measures to actively participate with the govt in the progressive solutions and crisis management with research and analytics along with on ground activities for deliberation with our state level task force. We have focused on the MSME/SME and Agriculture and related domain like food processing and supply chain. We have a full fledged Analytics Experts working to give a better spectrum of the situation and Action Plan to enable smooth Functioning with the government resources and other stake holders.

We hope to be of support and add value in the tremendous work you are doing .Hence our team has come up with a series of recommendations and strategies on various critical challenges that you are currently encountering. Please feel free to approach us for any support that you may deemed fit for the betterment of the state and the country

We have come up with a strategic Financial solution that will enable MSME to get benefit of quick financial access, working capital and Credit line to get back into production and restore the healthy status of the unit.

We have a full-fledged Analytics Experts, Financial experts, Ex Bankers from Deutsch Bank, ANZ Bank, SIDBI and Reserve Bank of India team working to give a better spectrum of the situation and Action Plan to enable smooth Functioning with the government resources and other stake holders.

Vision Karnataka Foundation’s approach is as follows:
1. Community First Loss Guarantee Fund
2. Peer to Peer Lending Model for SMEs
3. Fund Manager as a Joint Venture
4. Recommendation to allow Long Term Repo Operation (LTRO) for financing to MSME

In this regards we request your dept to kindly issue a circular to the industrial association and bodies in the state to take imitative to raise their own corpus fund against which we can officially assist in the creation of the solution of financial instruments as described in the document for immediate support to the MSME

With kind regards

(K. AMARANARAYANA) IAS (Retd.)
President,
VISION KARNATAKA FOUNDATION.

VISION KARNATAKA FOUNDATION vision document of solution of financial instruments to bring liquidity in the market for MSME

In the midst of unprecedented Global pandemic with Corona Virus we have witnessed the impact on the ailing industry already affected by the slow down globally and the volatile market conditions resulting in the lockdown measures by the Govt of India nationally. This lockdown has further brought forth several challenges to MSMEs who are reeling under the shutting down of the entire market as other markets also across the world have followed the action. This has disrupted the supply chain and led to decline in productivity. While both the Central Govt and State Govt are doing its best to handle the situation across the country and taken a lot of commendable measures to protect the interest of the industry, the main fight to protect the lives of the citizens continuously will go on for several weeks.

The corona virus outbreak and the ensuing lockdown will have major impact on the country's employment scenario. As per the survey conducted by Confederation of Indian Industry (CII), there will be a loss of about 30% of the jobs. Since the MSME sector is the second largest employment provider, their employees will get hit the most.

The time has come for the industry bodies and associations to push forward and take their role at the central stage and demonstrate the ability to bounce back. Essentially to now deal with its problem statements and take collective ownership of chartering its own path with solutions that are innovative and relevant to the times in discovering ways to survive this pandemic impact; charter new pathways and get into the story of growth again with new approaches to the changing market demands and opportunities by re purposing and pivoting business with innovative solutions to the emerging realities.

Impact:

The lockdown will impact significantly on consumption, which is the biggest component.

- Abrupt stop of urban activity could lead to a steep fall in consumption of non-essential goods
- The impact would be even more severe if domestic supply chain disruption caused by the 21-day lockdown were to affect the availability of essential commodities.
- Job Losses will have impact on purchasing power of people and will result in lower demand for products and services.

Private final consumption expenditure by purpose	Share, per cent
Food and non-alcoholic beverages	26.3
Alcoholic beverages, tobacco and narcotics	1.9
Clothing and footwear	5.8
Housing, water, electricity, gas and other fuels	13.7
Furnishings, household equipment and routine household maintenance	3.2
Health	4.5
Transport	17.6
Communication	2.7
Recreation and culture	0.8
Education	4.0
Restaurants and Hotels	2.2
Miscellaneous goods and services	17.2

Source: First revised estimates of national income, consumption & expenditure, saving & capital formation, MoSPI, Pg 31, January 2020.

The share is as percent of private consumption in domestic market.

Gross Value Add as at the end of 2019 March:

Gross Value Addition of 2018-19 is taken as a basis of calculating the business size of the country. The GVA assumes 2011-12 as the base year.

BusinessToday.In

Sector	GVA (₹ in lakh cr)	% to total
Agriculture, forest and fishing	27.76	16
Industry	37.08	22
Mining and quarrying	4.10	3
Manufacturing	28.18	16
Electricity, gas, water supply and other utilities	4.80	3
Services	107.15	62
Construction	13.76	8
Trade, hotel, transport, communication and services relating to broadcasting	31.51	18
Financial, real estate and professional services	36.66	21
Public administration, defence and other services	25.22	15
TOTAL	171.99	100

*Figures for 2018-19

(Source: Reserve Bank of India, Handbook of statistics on the Indian Economy 2018-19)

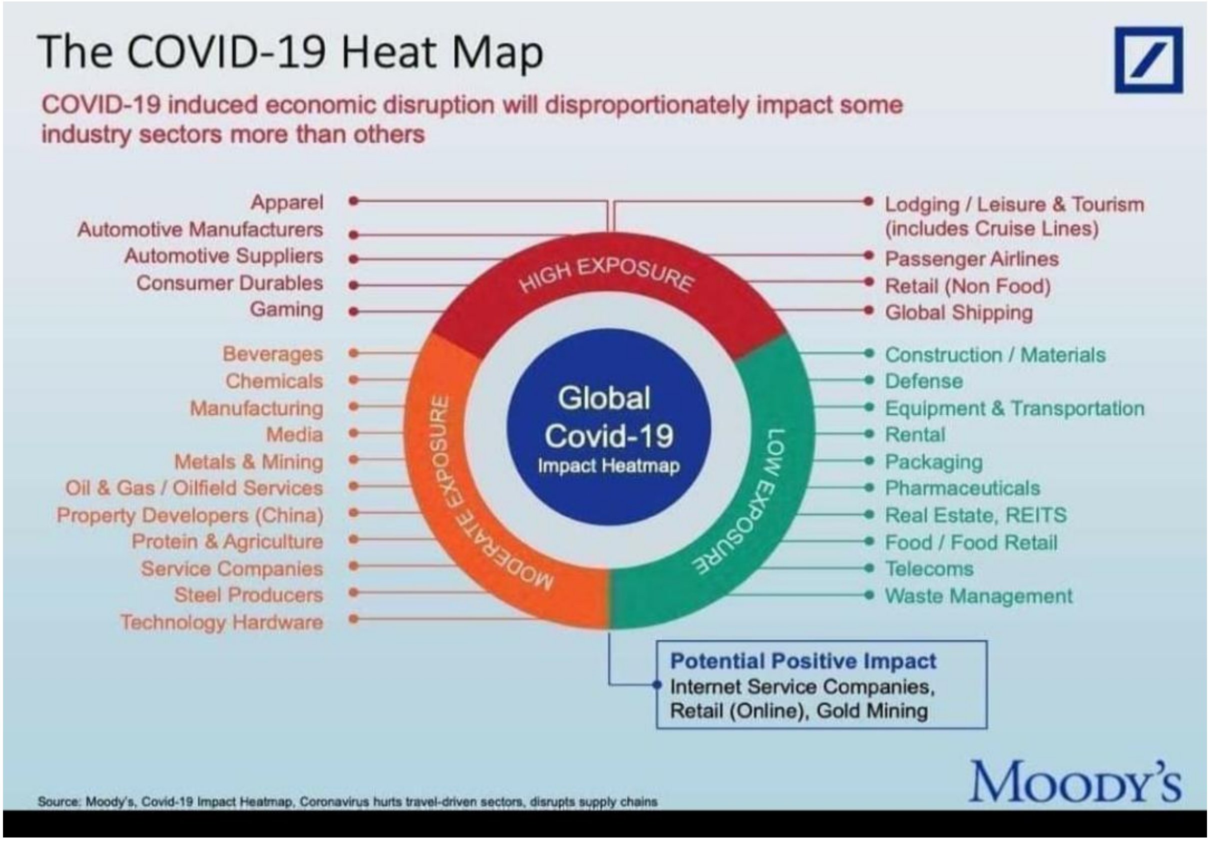
Cost of Lockdown:

Based on the industries which are closed for the 21 days and plus another one week for to restart the operations cycle, we can safely assume we have lost one month of productive time of the country (except for the essential services sector).

BusinessToday.In

Sector	Disruption severity	Loss estimated (₹ lakh cr)
Mining and quarrying	Complete	0.31
Manufacturing	Near complete excluding medicines etc	2.16
Construction	Complete	1.06
Trade, Hotel, transport, communication and services relating to broadcasting	Near complete excluding broadcasting	2.42
Financial, real estate and professional services	Near complete except banking and healthcare services	2.81
Total		8.76

Karnataka having a GDP growth of around 9.5% for 2012-18. This could be impaired and we may see one or two quarters GDP fall by about 3% to 4%.MOODY's have given a guidance on what are the industries that will be impacted most as below:



Impact on MSMEs:

Work Force 	• Workforce safety. • Working at Company site may not be feasible. • Employee morale • Remote Working capabilities • Mobility of people • Business continuity. • Job Losses
Supply Chain  	• May have to look for alternative supply source • May have to look for substitute parts • Price variance of raw materials/inputs • Importing could be a big issue • Expensive substitutes. • May not be able to supply to customers fully • May have to prioritise Customers - it may result in loss of business

Finance and Liquidity

 	
	• Direct effects on the business:
	  ○ Working capital woes
	  ○ Loan paying capability
	  ○ Real estate costs
	  ○ Paying salaries to employees
	  ○ Paying suppliers & reduced window of supplier credit
	  ○ Increased payment cycles from customers
	• Future time-based payment liabilities such as term loan repayments, etc.,
	• Difficulty in ascertaining cash flows
	• Lack of money to grow business

Impact on Working Capital of MSMEs:

Potential Working Capital Impact on MSMEs				
Parameter	**Low**	**Medium**	**High**	**Comments**
Price Variations of Key Raw Materials		✓		Only Consumer supplies are largely secured as they are part of essential list of government. Inter state food movements are erratic and may impact prices in next few weeks. State policies on transport, e-commerce will decide future price movements. Some product prices are expected to go down in the short term due to down turn in demand. Import dependent sector may see some volatility in the long term
Production Shutdown			✓	Generally Industries are shut down across state, except for some industries such as dairy/agri products, essential goods manufacture.Either the factories are shutdown completely or skeletal staff will work. Will lead to a cascading impact even after the lockdown restrictions have been eased owing to global slowdown in demand
Cashflow Constraints			✓	Generally MSMEs are largely leveraged due to either high labour intensity or dependency on raw materials which are mainly cash and carry – cash flow constraints will happen sooner than later; sales will be impacted due to distress in other sectors. Will have impact on working capital needs during lock down, will also have an impact on supply chain, future investments and expansions.
Supply Chain Disruption		✓		Impact on markets, relationships with downstream and upstream enterprises, pressure to look for newer markets etc.
Workforce			✓	Contractual, wage labour will get impacted more leading to lay offs, unrest, lowering of purchasing power
Consumer Sentiment		✓		Negative sentiment and diminishing liquidity will impact most of the consumer goods industries, retail, service enterprises.
Exports (Where applicable)	✓			With the global affect, there will be huge impact on exports as global demand is expected to come down significantly

Vision Karnataka Foundation proposes

1. COMMUNITY FIRST LOSS GUARANTEE FUND

2. PEER TO PEER LENDING MODEL for SMEs

3. FUND MANAGER AS A JOINT VENTURE

4. RECOMMENDATION TO ALLOW LONG TERM REPO OPERATION (LTRO) FOR FINANCING TO MSME

1. COMMUNITY FIRST LOSS GUARANTEE FUND model approaches to deal with the urgency of the situation to enable a solution-oriented approach by self-help approach and pooling of the existing resources powered by the local ecosystem support rather than depend on the external sources thereby increasing the exposure to risk and anxiety. The Industry bodies and Associations can pool contribution from its members in the district a set of voluntary Contribution FUND that will be treated as a corpus which will act as the base of the credit line creation and multiply it to 10 times with Financial Support and IT infrastructure backing for the transaction to efficiently handled.

Feature

The Corpus FUND example is INR 10 Crore then through the **CFLG** Fund approach we can secure a credit of INR 100 Crore to be initiated to the members of the Association and Industry Body

This will ensure instant financial assistance and credit line to the MSMEs in 48 hours and there will be no pressure of the CIBIL or CRISIL ratings to qualify for the fund as the facility will be availed on the following parameters

1) Purchase order value by discounting

2) Deal flow of the transaction value

3) Ecosystem guarantee

4) GST filing

2. Peer-to-Peer lending to SME

Current Pandemic Covid-19 has affected every one of us and SME which is the lifeline of the Indian economy is feeling the pinch of it. SME units are the second largest employment provider and to sustain this pandemic they can't depend only on the assistance from banks and government.

Extraordinary times like this requires innovative and out of box thinking to support the requirements of needy. SME units do require funds urgently to pay salaries, utility payment, rent and other statutory dues. Most of the SME units have receivables from PSU and other corporate clients who are the intermediary users of their output, however, the current difficult time has resulted in the delay of these payments and SME units are feeling the liquidity crunch. This situation can be eased and funds can be made available to SME units for payment of salaries and other statutory payments through instruments like community financing, crowd funding or Peer-to-Peer lending.

These instruments will not only enable the affected units to pay salaries to its employees but also not put stress on scarce government resources at this hour of crisis. Process flow of these instruments is proposed as under;

1. Identify the SME's cluster wise who require funds
2. Identify the quantum of funds required to sustain those units for the next three months
3. Pool receivables of each unit, Bifurcate the receivables from PSU's,Receivable's from Corporates and other receivables
4. Nominate ESCROW agent (Any Local Commercial Bank) for channelling the transaction
5. Earmark margin of 25% from Government receivables, 30% from other corporate receivables and 40 to 50% for other receivables and arrive at the quantum of securities available
6. Get these receivables assigned to ESCROW agent
7. Execute tripartite agreement among each SME unit, ESCROW agent and debtors of payment of those assigned bills directly to ESCROW agent
8. ESCROW agent agrees with facilitators like VKF/Crowd funding platform, Peer-to- peer lending platform to raise the funds and lend it to needy SME's as per available fundable receivables.
9. ESCROW agent notifies the total amount of receivables for each unit and eligible finance limit for each unit to the facilitator
10. Facilitator raise the funds and deposit the same in an ESCROW account
11. ESCROW agent enters into a loan agreement with individual SME units and releases the funds to the nominated account of respective SME for release of salaries and other statutory dues.
12. ESCROW agent is required to check the funds are not being diverted for any other purpose than the sanctioned for. SME promoters also ensure that these funds are for emergency requirements only and they should not pay themselves, salaries and remuneration are to be paid only to employees other than family members from these funds.
13. Debtors to pay on due date to nominated ESCROW agent
14. ESCROW agent to square the loan account for the received amount and recover the amount of loan along with interest, facilitator charges and ESCROW management fee.

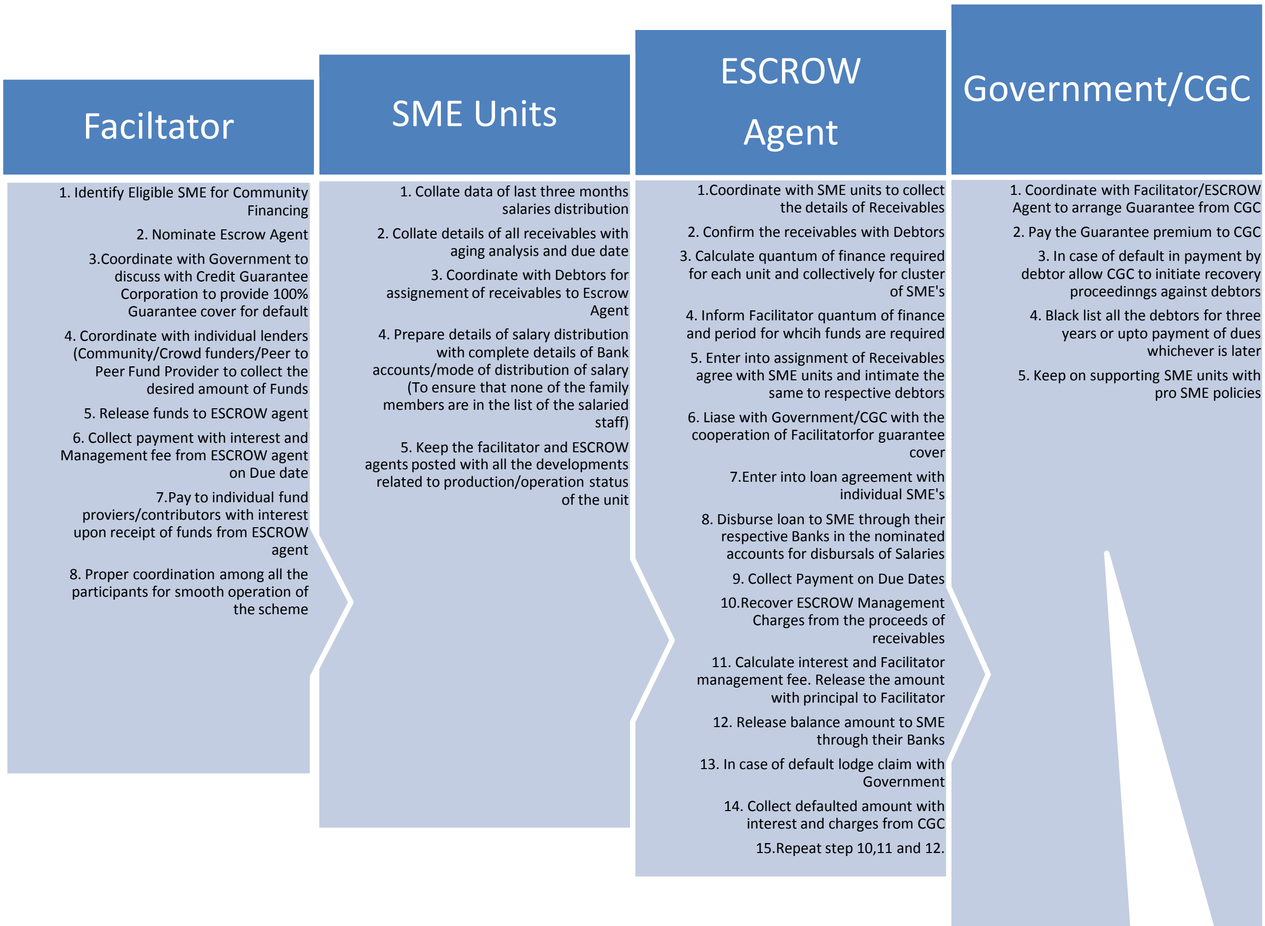
15. ESCROW agent releases Principle amount, interest and facilitator charges to Facilitators.

16. ESCROW agent releases the remaining amount to the respective SME Unit Facilitator releases interest and principal amount to fund providers.

17. The government is required to facilitate this entire transaction either through provision of government guarantee or through guarantee of Credit Guarantee Corporation for full amount, Interest, Facilitator charges and ESCROW management fee.

18. Premium of Credit Guarantee Corporation shall be borne by the government.

Flow Chart for the proposed process



Example:

Let us assume that facilitator identifies 10 SME units in a cluster with following receivables

	Amount in INR			
SME Unit No.	Receivables Due from PSU's	Receivables Due from Corporates	Other Receivables	Total Receivables
1	12,00,000	15,00,000	2,00,000	29,00,000
2	25,00,000	17,50,000	5,00,000	47,50,000
3	15,00,000	5,00,000	4,00,000	24,00,000
4	20,00,000	-	8,00,000	28,00,000
5	50,00,000	2,00,000	5,00,000	57,00,000
6	10,00,000	10,00,000	5,00,000	25,00,000
7	40,00,000	22,00,000	18,00,000	80,00,000
8	18,00,000	3,00,000	4,50,000	25,50,000
9	20,00,000	6,00,000	-	26,00,000
10	70,00,000	35,00,000	10,00,000	1,15,00,000
Total	2,80,00,000	1,15,50,000	61,50,000	4,57,00,000

ESCROW agent will confirm these receivables with individual buyers, ie. Individual PSU’s, Corporates and other buyers. Total Receivables for the identified cluster of SME’s are INR 4.57 Crores. ESCROW agent upon confirmation will do the necessary documentation and provide details to CGC. CGC will check and confirm if any of the buyer/debtor is blacklisted. ESCROW agent will calculate the requirement of funds after deduction of margin of 25%, 30% and 50% for PSU, Corporates and other debtors respectively. The following will be the eligibility of each of the units.

	Amount in INR				
SME Unit No.	Receivables Due from PSU's	Receivables Due from Corporates	Other Receivables	Total Receivables	Eligibility
1	12,00,000	15,00,000	2,00,000	29,00,000	20,50,000
2	25,00,000	17,50,000	5,00,000	47,50,000	33,50,000
3	15,00,000	5,00,000	4,00,000	24,00,000	16,75,000
4	20,00,000	-	8,00,000	28,00,000	19,00,000
5	50,00,000	2,00,000	5,00,000	57,00,000	41,40,000
6	10,00,000	10,00,000	5,00,000	25,00,000	17,00,000
7	40,00,000	22,00,000	18,00,000	80,00,000	54,40,000
8	18,00,000	3,00,000	4,50,000	25,50,000	17,85,000
9	20,00,000	6,00,000	-	26,00,000	19,20,000
10	70,00,000	35,00,000	10,00,000	1,15,00,000	82,00,000
Total	2,80,00,000	1,15,50,000	61,50,000	4,57,00,000	3,21,60,000

Total eligibility will be INR 3,21,60,000/-, let us assume that total salary and other statutory dues payables are only 2.50 Crores for three months for the above 10 SME’s. ESCROW agent will intimate this to the facilitator to arrange funding of INR 2.50 Crores. The facilitator will collect through community lenders and release the same to ESCROW agent.

Government will Release the premium to CGC to cover the amount of INR 3.21 Crores Escrow agent will release the payment to individual SME through their nominated banks. Let us assume that the due date of all the receivables is after 90 days.

Escrow agent will collect INR 4.57 Crores from individual debtors, if there is no default by any of the debtor.

Other assumptions:

Interest rate payable to Individual contributors of fund 9% P.A. Facilitator Charges: 0.50%
Escrow Management Fee: 0.50%

Upon receipt of payment ESCROW agent will Collect INR 1.25 Lacs as its management fee.
Will Release a payment of INR 2,56,87,500/- Inclusive of, Facilitator fee of INR 1.25 Lacs, Interest amount of INR 5,62,500/- and the principal amount of INR 2.50 Crores.

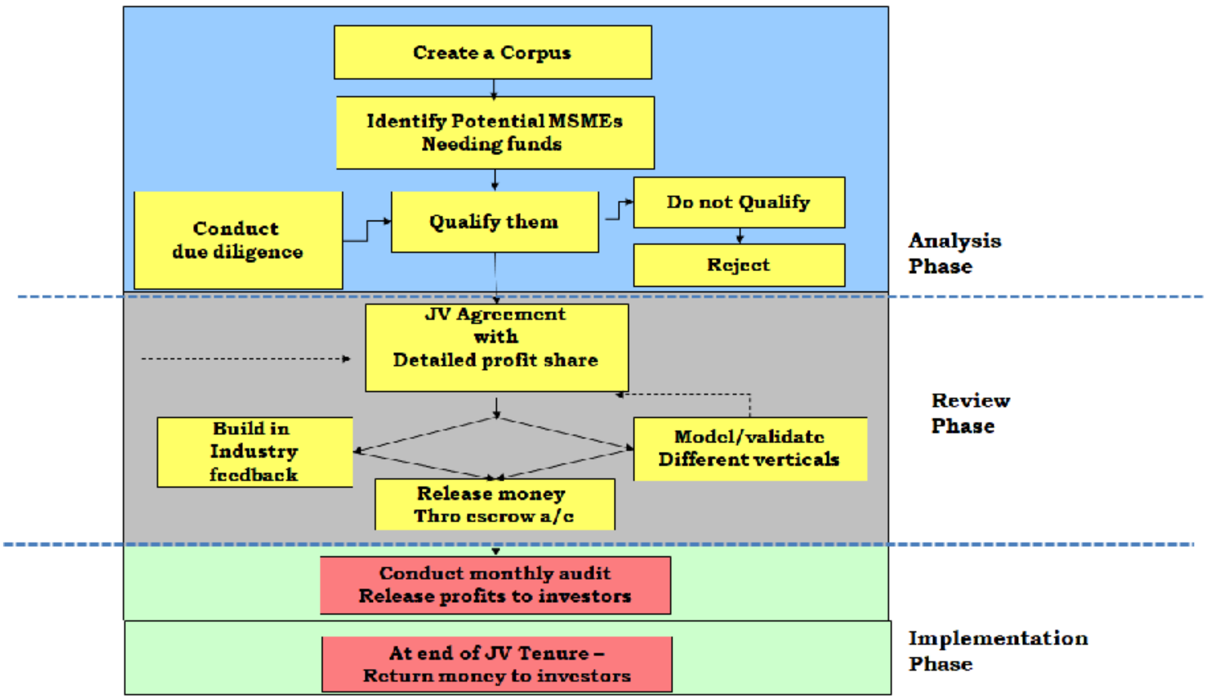
Leftover balance of INR 1,98,87,500 to the SME's units through their nominated Banks.

Given the crisis the rate of interest can be linked to deposit rates plus certain basis points like 150-250 as a benchmark interest rate. Other charges and ESCROW management fees can be pegged maximum to 1%. This scheme can be replicated in all the clusters across the country.

3. FUND MANAGER AS A JOINT VENTURE

Short Term Solution:

The Industry body members will create a corpus of Rs 10 Crores or more in collaboration with **Infowise Startup Catalysts Trust (a Commercial trust)*****SEBI listed AIF Fund*** with its members contributing &Infowise will monitor the disbursements and the mechanism to operate the same. They will monitor the Financial support with the MSMEs on **a joint Venture basis**. Following diagram depicts the same.



4. **Recommendation to allow Long Term Repo Operation (LTRO) for financing to SME/MSME**

Long Term Repo Operation is basically a mechanism to inject liquidity into the banking system as well as to ensure the smooth transmission of monetary policy actions and flow of credit into the economy. After RBI went for repo rate cuts, there was a question about the effective transmission of those rate cuts to the customers. So, by going for LTRO the RBI ensured effective transmission of the monetary policy decisions.

In its recent policy decision to combat the economic effects of Corona virus RBI has announced to inject liquidity of INR 1.37 Lakh Crores by way of LTRO. Banks can access these funds under LTRO at the interest rate linked to Repo rate i.e. at 4.40 % for a period of three years. Amount Borrowed under LTRO by Banks can be used to purchase the Corporate Bonds.

Since the issuance of Bonds by Corporates does involve additional costs and efforts, which SME and MSME entrepreneurs can't afford to bear, we recommend that a certain portion of amount Borrowed under LTRO be allowed to be lent to SME and MSME customers. On a fair note since 16% of the overall Bank Credit is to the SME and MSME segment, 16% of these funds i.e INR 21920 Crores can be earmarked for SME and MSME units.

Details of the above framework shall be discussed and mutually agreed upon.

Some Policy level intervention to enhance the liquidity situation

1. Govt can mark the GST numbers as MSME GST.
2. Any input from these GST will be enhanced to 110% (This makes big industries to make more transactions with MSME)
3. Bill Discounts facility for non MSME for sales made to MSME at lower interest rates. (These help the supply chain of MSME for their manufacturing and also reduce the input cost)
4. Separate link or ID for Group linked Insurance Scheme where Govt contributes X % of funds.
5. Partial School Fee Reimbursement in selected Clusters by MSME and such reimbursements will get 110-120 of Expenditure benefit under Income Tax Act just like R&D expenditure under sec 35(2)
6. Complete GST Waiver for 6 months by Transporters for goods moving to an end location where GST of the end user is MSME (as in point number 1)
7. GST % reduction for a class of Goods which increases consumption

EXPERTS Associated with this Project

1. **Sri Sunil Sahdev** - Ex MD of an International Bank

2. **Sri Gopal Nagaraj -** Ex Chief General Manager – Reserve Bank of India (RBI)

3. **Sri Ramesh Dharmaji** – Ex Chief General Manager - SIDBI

3. **Sri Joe P Thaliyath** – Ex Banker- ANZ Bank

4. **Smt Sumati Narayan** – Ex Director Deutsche Bank Operations INDIA

5. **Sri Vikram Mehta** – Ex VP AIR ASIA LTD and Chartered Accountant

6. Sri **Rajesh Chaacharia -** MPA FINANCIAL Services – A mercantile banker

7. **Sri Om Jain –** CEO - JUST Call – Debt Management Specialist having successfully raised INR 6000 Crores in the market

8. **Smt Usha Nagaraj** – Ex Chairman of a Co-operative bank

9. **Sri Sankalp Barnabas** – VP South PATYM

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19. **Sri Ananth Ravi -** Former President of Jio Reliance – INDIA

20. **Sri Sriram Sundaravadanan –** Chief Executive Officer – Multi Ventures Pvt Ltd

This is an outcome of Analytics of the data and situation to handle COVID-19 from the team headed by **Sri. Sunil Sahdev** – A former MD of an International Bank and a Senior Advisor to **Vision Karnataka Foundation and Sri. Muralidhara B S – Infowise Startup Catalyst Trust. We also Thank Sri Vishwanath B R for inputs on MSME.** The above data is a comprehensive suggestion and recommendation and not a standalone measure