

# Co-creation: An Exploratory Study of MSMEs & Large Banks in India

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*The major factor which reduces the profits of Indian banks relates to the policies of Government of India. The government has rules which mandated banks operating in India to help the priority sectors which included Medium and Small Enterprises (MSMEs). The lending rules to MSMEs increased the Non Performing Assets (NPAs) as MSMEs did not adopt the best management practices and there was no strategic planning. As a strategy banks converted this regulatory issue into an opportunity by using co-creation of intangible resources such as Customer Relations with corporate, Information Technology implementation and Best Management Practices dissemination. They used these intangible resources to reduce risks and NPAs, increase profits and help MSMEs to be contemporary, thus creating value through partnership.*

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## Introduction

As a result of various factors including information non-availability, non-implementation of professional working systems, and past experience of NPAs (Non Performing Assets), banks tend to detest lending finance to Small and Medium Enterprises in India (MSMEs) (RBI, 2005). On account of growth potential, employment generation capacity, export generation, and their role as the seedbed to new entrepreneurship MSMEs are an important segment of industrial and services sectors in India. (RBI, 2010)

Indian SMEs have come a long way since liberalization in 1991. According to Rajan Kumar, Former CMD, Indian bank and VC, CVC 2010, "Experience has shown that the SME sector is becoming more efficient in terms of production vis-à-vis persons employed. According to the recent report by the Ministry of Micro, Small and Medium Enterprises (MSMS), the production during 2008-2009 went up by 11.4% whilst the number of persons employed rose by 5.2%. In the same fiscal year, 1.237 million new enterprises were added to

this sector. This speaks of better utilisation of capacity and effective practices being followed by this sector.”

**Banks are the major funds provider to the SMEs.**

Banks are the major funds provider to the SMEs. A RBI circular in FY 2005-06 made it mandatory for banks to lend to SMEs sector (priority sector lending). Due to the problems with regard to profits of SMEs and Non Performing Assets and risks in lending, banks operating in India (both Indian and multinational) need to provide unique solutions to SMEs for mutually sustainable growth.

### **Micro, Small & Medium Enterprises (MSME)**

Micro, Small and Medium enterprises sector (MSME) (in this paper we will be using MSME and SMEs as interchangeable as in India SMEs are known as MSME legally) (Table 1) accounts for about 45% of the manufacturing output and 40% of the total exports of India as per value. Besides manufacturing more than 6000 products (Table 2) ranging from traditional to high tech items this sector also employs approximately 60 million persons in 26 million units (Table 3). The uniqueness of this sector is that it has registered a higher growth rate than the rest of the industrial sector (MSME 2010).

**Table 1: Micro, Small & Medium Enterprises Development (MSMED) Act, 2006: MSME Definitions**

Type of Enterprise	Manufacturing Sector: Investment in Plant & Machinery	Service Sector: Investment in Equipment
Micro Enterprises	Does not exceed ₹25 lakh rupees	Does not exceed ₹10 lakh rupees
Small Enterprises	More than ₹25 lakh rupees but does not exceed ₹5 crore rupees	More than ₹10 lakh rupees but does not exceed ₹2 crore rupees
Medium Enterprises	More than ₹5 crore rupees but does not exceed ₹10 crore rupees	More than ₹2 crore rupees but does not exceed ₹5 crore rupees

Note: 1 crore = 10 Million

*Manufacturing Enterprise:* Manufacture or production of goods pertaining to any industry is specified in the first schedule to the Industries Act 1951. The manufacturing enterprises are defined in terms of investment in Plant and Machinery. *Service enterprise:* The enterprises engaged in providing or rendering of services are defined in terms of investment in equipment.

**Table 2: Products of MSMEs**

Name	Share		
Rubber & Plastic Products	6%	Basic Metal Industry	10%
Electrical & Machinery Parts	6%	Chemical & Chemical Products	12%
Metal Products	8%	Food Products	12%
		Others	36%

Source: MSME, Annual Report 2009-10

**Table 3: MSME Performance: Units, Investment, Production Employment & Exports (at 2001-02 Prices)**

Sl.No	Year	Total MSME (Lakhs)	Fixed Investment (Rs Crore)	Production (RS Crore)		Employment (Lakh persons)	Exports (Rs. Crores)
				Current Prices	Constant Prices (2001-02)		
1	2002-03	109.49 (4.07)	162317 (5.16)	314850 (11.54)	306771 (8.68)	260.21 (4.36)	86013 (20.73)
2	2002-04	113.95 (4.07)	170219 (4.87)	364547 (15.78)	336344 (9.64)	271.42 (4.31)	97644 (13.52)
3	2004-05	118.59 (4.07)	178699 (4.98)	429796 (17.90)	372938 (10.88)	282.57 (4.11)	124417 (27.42)
4	2005-06	123.42 (20.76)	188113 (4.07)	497842 (5.27)	418884 (15.83)	294.91 (12.32)	150242 (4.37)
5	2006-07	261.01 (21.50)	500758 (111.48)	709398 (166.20)	NA	594.61 (42.49)	182538 (101.62)
6**	2007-08	272.79 (4.51)	558190 (11.47)	790759 (11.47)	NA	626.34 (5.34)	202017 (10.67)
7**	2008-09	285.16 (4.53)	621753 (11.39)	880805 (11.39)	NA	659.35 (5.35)	NA

Note: Figures in brackets show the % growth over the previous year. The data for the period up to 2005-06 is only for small-scale industries (SSI). Subsequent to 2005-06, data with reference to micro, small and medium enterprises are being compiled.

\*\* Projected

Source: MSME, Annual Report 2009-10

MSME sector contributes to approximately 8% of the India's GDP and 45% of Indian industrial production (Table 4)

**Table 4: Contribution of MSMEs to GDP in India**

Year	Contribution of MSMEs (%) at 1999-2000 prices	
	Total Industrial Production	Gross Domestic Product (GDP)
1999-2000	39.74	5.86
2000-2001	39.71	6.04
2001-2002	39.12	5.77
2002-2003	38.89	5.91
2003-2004	38.74	5.79
2004-2005	38.62	5.84
2005-2006	38.56	5.83
2006-2007**	44.12	7.44
2007-2008**	45.00	8.00

\*\*The data for the period up to 2005-06 is only for small scale industries (SSI). Subsequent to 2005-06, data with reference to micro, small and medium enterprises are being reflected.

Source: MSME, Annual Report 2009-10

### Problem Faced by MSMEs

The major problem Indian MSME faces is availability of an adequate amount of finances (Thampy, 2010).

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In India, banks are the providers of funds to the Industry. Especially for SME's, banks are saviors as SMEs do not have access to capital markets (Thampy, 2010; Todd & Javalgi, 2007). From the year 2005-06 and after the RBI circular, Government of India and the banks have started to pay considerable attention to the SMEs sector as it comes under the priority sector lending. Indian banks are required to give a minimum 40% of the adjusted net bank credit to the priority sector and foreign banks have a minimum 32% exposure to the priority sector (RBI, 2009). The biggest problem the bank faces while extending credit to SMEs is the credit risk of the SMEs. Borrowers have more information on projects than the banks (Myers & Majluf, 1984). There is the absence of a mechanism to bridge the information asymmetry between the borrowers and the lenders (Todd & Javalgi, 2007)

A bank considers two aspects in their credit decisions: a) the interest rate on the loan and b) the credit risk of the loan. A person will agree to pay higher interest on loans to projects, which has more risks. Greater risk projects have high risk of interest default (Stiglitz & Weiss,

1981). It is also argued that the issue of bank competition and credit availability may matter to SMEs as they are more vulnerable to information problems, and SMEs are more bank dependent than the large enterprises (Carbo, Rodrigues & Udell, 2008). It was also found that once the Government gives the priority lending status to SMEs, they have considerably beneficial impact on increase in sales due to availability of bank credit (Banerjee, Cole & Duflo, 2003). It was also argued that banks are reluctant to give loans to SMEs as they have lower profitability and are regarded as high-risk borrowers due to low capitalization, insufficient assets and high mortality rates. (Bhattacharya, Faiz & Zohir, 2000).

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### Bank Size & SME Lending

It was found that large institutions have comparative advantages in lending to more transparent SMEs (Berger et al., 2005b). Less competitive markets may be associated with more credit availability as competitive banking markets can weaken relationship building by depriving banks of the incentive to invest in soft information (Petersen & Rajan, 2002). It was experienced that the organization structure of banks in India and the processes within them have taken the banks far from task orientation and have cre-

ated a specific bias against small loan portfolios (Mirris et al., 2001). As the quality of information also influences decisions on loan finances (Das, 2007) Indian SMEs have in the past compounded the non-performing assets (NPAs) of the banks. Unless detailed information of these SMEs are available, banks will not give loans to them (Thampy, 2010).

### **Foreign Banks & SME Lending**

Foreign banks in transition economies do not normally lend money to SMEs, small traders, informal sector and farmers. They feel comfortable lending to less risky businesses such as transnational corporations and big domestic corporate houses. (Weller, 1999). Foreign banks offer exclusive banking rather than inclusive banking (EPW Research Foundation, 2006). The Latin American experiences say that some foreign banks make more loans to small businesses than by domestic banks (Clarke et al., 2005). Clarke, Cull, Peria, Soledad & Schetz (2005) found that significant market penetration by foreign banks in a developing economy context might adversely affect credit disbursement to small and medium enterprises. Banks that have their headquarters abroad and are large and centralized may lack the organizational dexterity to engage with small and young firms successfully (Berger et al., 2005b).

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Studies have also shown that credit rationing, on account of risk averseness, is not specific to domestic private and foreign banks (Bannerjee & Duflo, 2004).

### **Research Setting & Data**

A number of studies have looked at measures of SMEs credit availability, activities and general economic performance and their association with indicators of market power such as concentration and regulatory restrictions on entry and competition (Allen & Gregory, 2006). The empirical results were mixed. Elsas, 2005; Karceski et al., 2005; Cetorelli & Strahan, 2006; Petersen & Rajan, 1995; Cetorelli & Gamber, 2001 found favorable effects. One study found that the results depend on how market power is measured with concentration measures and the Lerner index generally showing conflicting results (Carbo-Valverde et al., 2006).

Value proposition is “An analysis or statement of the combination of goods and services offered by a company to its customers in exchange for payment.” Strategy is based on a differentiated customer value proposition. Satisfying customers is the source of sustainable value creation” (Kaplan & Norton, 2004). “Developing a value proposition is based on a review and analysis of the benefits, costs and value that an organization can deliver to its customers, prospective customers, and other constituent groups within and outside the organization. It is also a positioning of value, where value = benefits - cost (cost includes risk).” “Co-creation is a form of business strat-

egy that emphasizes the generation and ongoing realization of mutual firm-customer value” (Prahlada & Ramaswamy, 2004). “Co-created value arises in the form of personalised, unique experiences for the customer (value-in-use) and ongoing revenue, learning and enhanced market performance drivers for the firm (loyalty, relationships, customer word of mouth)” (Ibid)

Firm marketing mix is influenced by industry environment (competitors, distributors, suppliers and customers), and country environment (economic, social, political, physical and technological) (Jobber, 1998). SMEs have three circles of influence: 1) firm specific (entrepreneurial orientation, capital, size, global mindset, training and R&D), 2) industry specific (competitive intensity, growth, concentration, differentiation, barriers to entry and support services) and, 3) country specific (regulatory, telecommunications, legal, socio-cultural, economic, electronic support) (Tedd & Javalgi, 2007).

Our research process is divided into four steps of analysis. First, at the firm level, we analyzed the SME’s challenges, business environment changes and financial factors, which have been dealt within the MSME part of this paper, and the remaining was dealt with in the banking part. Second, we analyzed the Indian economy with respect to MSME’s challenges and opportunities. Third, we analyzed the banking industry in India (opportunities, strategies for growth). We also studied the importance of SMEs for banks. We examined the Standard Chartered and ICICI Intel value propositions

for SMEs. We developed a model of value proposition looking at the above factors between banks and SMEs.

### **Indian Economy**

India is the world’s 12th largest and the 2nd fastest growing economy. The Centre for Monitoring Indian Economy (CMIE) has estimated India’s gross domestic product (GDP) to expand at 9.2 per cent in 2010-11 as compared to 7.4 per cent in 2009-10. As a result of the rise in wages and salaries in the corporate sector and the impressive growth in services, the consumer spending increased in the year 2011. India’s capital formation increased due to the robust foreign capital inflows and domestic project investments. According to UNCTAD’s World Investment Prospects Survey 2009–2011, India is the second most attractive destination for FDI (after China) in the world (IBEF, 2011).

### **Banking Industry**

The Indian banking is one of the most robust and well-oiled systems in the world. In the annual international ranking conducted by the UK-based Brand Finance Plc, 18 Indian banks have been included in the Brand Finance® Global Banking 500. According to the study, Indian banks contributed 1.7 per cent to the total global brand value at US\$14,741 million and grew by 19 per cent in 2011. (IBEF, Banking Report 2011).

With respect to gross bank credit, nationalized banks hold the highest share of 51.5 per cent in the total bank credit,

**Table 5: MSME s Challenges and Opportunities**

Challenges Faced by SMEs	Opportunities	Strategies for countering the challenges and capitalizing on opportunities
<p>Lack of credit/finance/capital. Cost of capital is often too high.</p> <p>Access to technology.</p> <ul style="list-style-type: none"> <li>• Training/human resources development</li> <li>• Funding for research &amp; development</li> <li>• The cost of complying with national and international standards (e.g. ISO) can also be very expensive for SMEs.</li> <li>• WTO commitments-especially for developing countries, (such as TRIPS etc.) can be difficult for SMEs.</li> <li>• Weaknesses in transportation and infrastructure- Limited information on possible markets and clients in domestic and exporting into foreign markets.</li> <li>• Economic Cycle- SMEs are often the most vulnerable in times of economic recession.</li> <li>• Lack of insurance.</li> <li>• Bilateral/regional agreements run counter to WTO spirit e.g. NAFTA which may restrict market access to India.</li> <li>• Labor and environmental forums as 'nontrade' issues/political levers may act as additional detriments and may not be in sync with socio-economic realities in developing countries.</li> <li>• Labor productivity, capabilities need huge investment. The raw material price indices have risen faster than the machinery price index but very few of them have resort to value engineering techniques for efficient</li> </ul>	<p>Automotive industry turnover is estimated to reach US\$ 145 billion by 2016</p> <ul style="list-style-type: none"> <li>• Automobile production increased from 8.5 million units in 2004-05 to 14.1 million units in 2009-2010 at a compound annual growth rate (CAGR) of 10.7 percent.</li> <li>• The Indian chemicals industry is highly fragmented and is currently going through a major restructuring and consolidation phase. The Indian chemicals industry is the twelfth-largest industry in the world and the third largest in Asia in terms of volume. Industry exports grew at a CAGR of 18 percent between 2003-04 and 2008-09 (USD 35 billion).</li> <li>• The production of electronic component segment for 2009-10 is estimated to be US\$ 2.78 billion with a growth rate of 11 percent.</li> <li>• The total production of consumer electronics in 2009-10 is estimated to be US\$ 6.28 billion, indicating a growth of 18 percent.</li> <li>• Industrial machinery recorded the highest growth rate of 45 percent, increasing from US\$ 741 million (INR 35.59 billion) in 2007-08 to US\$ 1,074 million (INR 51.54 billion) in 2008-09.</li> <li>• Indian engineering exports increased at a compound annual growth rate (CAGR) of</li> </ul>	<ol style="list-style-type: none"> <li>1. Strategic Project Management (project preparation, formulation, implementation)</li> <li>2. Implement International Accounting Standards and best financial management processes.</li> <li>3. Professional management in family owned business and others.</li> <li>4. Tie-ups with technology and management consulting firms.</li> <li>5. Knowledge bank for industry, product, technology, international data.</li> <li>6. Strong suppliers, client' relationships.</li> <li>7. Costumer acquisitions, B2B, B2C.</li> <li>8. Focus on resource development as per industry requirements.</li> <li>9. International expansion.</li> <li>10. Developing product development (design, production, marketing, service) capabilities and competencies.</li> <li>11. Training and development.</li> <li>12. IT Implementation.</li> <li>13. Developing alliance strategies (contracting, licensing, franchising, JVs) both domestic and international.</li> <li>14. Building strong focus groups (industry) with the government.</li> <li>15. Cluster focus strategies.</li> </ol>

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<p>raw material usage and cost reduction.</p> <ul style="list-style-type: none"> <li>• Low industry-institute interaction in India.</li> <li>• Despite large scale SME presence in engineering sector it is characterized by relative lack of sub-contracting arrangements, thus losing out on opportunities to exploit horizontal economies of scale or specialization.</li> <li>• Lack of competitive efficiency to face the international competition successfully.</li> <li>• Cost leadership to cope with changes in products and production technologies, reduction of import duty, the SME sector will have to undergo many internal and external transformations.</li> <li>• Strategies for countering the challenges and capitalizing on Opportunities.</li> </ul>	<p>13.7 percent over the past four years to reach US\$ 34 billion in 2009-2010.</p> <ul style="list-style-type: none"> <li>• The food processing industry in India is at an early growth stage, with low penetration levels and high potential.</li> <li>• The size of the food processing industry in India has increased from US\$ 57 billion (INR 2,736 billion) in 2004 to US\$ 75 billion (INR 3,600) in 2007.</li> <li>• The Indian gems and jewellery sector is expected to grow at a compound annual growth rate (CAGR) of around 13 percent during 2011-2013.</li> <li>• On the back of healthy demand from Western markets like the US and Europe, India's gems and jewellery exports rose by about 22 percent year-on-year (y-o-y) to US\$ 2.86 billion in January 2011.</li> <li>• India's manufacturing clusters are doing well and are becoming excellent in infrastructure growth.</li> </ul>
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with SBI and its associates at 23.2 per cent and new private sector banks at 13 per cent. Foreign banks, old private sector banks and regional rural banks held relatively lower shares in the total bank credit with 5.3 per cent, 4.6 per cent and 2.5 per cent respectively. (IBEF Banking report 2011).

#### **Income**

As can be seen from Table 6, Growth of income of SCBs (Commercial Banks) during 2008-09 decelerated to 25.7 per cent from 34.3 per cent in 2007-08, but was higher than the growth rate of 24.4 per cent in 2006-07. The income to assets ratio improved marginally to 8.8 per cent from 8.5 per cent 2007-08. Reflecting the lower lending rates, growth of interest income of SCBs in 2008-09 decelerated to 26.0 per cent as compared to 33.2 per cent in the 2007-08.

#### **Sectoral Deployment of Bank Credit**

As can be seen from Table 7, the deceleration in bank credit growth wit-

**Table 6: Important Financial Indicators of Scheduled Commercial Banks (Rs. crores)**

Item	2006-07		2007-08		2008-09	
	Amount	Per cent to Assets	Amount	Per cent to Assets	Amount	Per cent to Assets
1	2	3	4	5	6	7
1. Income	2,74,716	7.9	3,68,873	8.5	4,63,837	8.8
a) Interest Income	2,31,675	6.7	3,08,482	7.1	3,88,816	7.4
b) Other Income	43,041	1.2	60,391	1.4	75,021	1.4
2. Expenditure	2,43,514	7.0	3,26,147	7.5	4,11,066	7.8
a) Interest Expended	1,42,420	4.1	2,08,001	4.8	2,63,221	5.0
b) Operating Expenses	66,319	1.9	77,283	1.8	89,268	1.7
<i>Of which: Wage bill</i>	36,148	1.0	39,954	0.9	47,660	0.9
c) Provision and Contingencies	34,775	1.0	40,864	0.9	58,578	1.1
3. Operating Profit	65,977	1.9	83,590	1.9	1,11,349	2.1
4. Net Profit	31,203	0.9	42,726	1.0	52,771	1.0
5. Net Interest Income/ Margin (1a-2a)	89,255	2.6	1,00,481	2.3	1,25,596	2.4

Note: The number of scheduled commercial banks was 82 in 2005-06, 79 in 2006-07 and 80 in 2007-08.

**Table 7: Sectoral Deployment of Gross Bank Credit (variations over the year)**

(Amount in Rs. crores)

Sector	2007-08		2008-09	
	Amount	Percent	Amount	Per cent
1	2	3	4	5
1. Agriculture & Allied Activities	44,966	19.5	63,313	23.0
2. Industry	1,69,536	24.3	1,87,515	21.6
3. Personal Loans	54,730	12.1	54,991	10.8
<i>of which: Housing</i>	26,802	11.6	19,165	7.4
4. Services	1,32,419	31.5	93,580	16.9
<i>Of which:</i>				
Wholesale Trade (other than food procurement)	5,559	11.1	11,723	21.0
Real Estate Loans	19,235	43.6	28,261	44.6
Non-Banking Financial Companies	30,094	61.5	19,835	25.1
Total Non-Food Gross Bank Credit (1 to 4)	4,01,650	22.3	3,99,400	18.1
<i>Of which:</i>				
Priority Sector	1,11,414	17.5	1,68,506	22.5

Notes: 1. Data are provisional and relate to select banks. Data also include the effects of mergers of Bharat Overseas Bank with Indian Overseas Bank, American Express Bank with Standard Chartered Bank and State Bank of Saurashtra with State Bank of India. Gross bank credit data include bills rediscounted with the Reserve Bank, Exim Bank, other financial institutions and inter-bank participations.

Source: Sectoral and Industrial Deployment of Bank Credit Return (Monthly).

nessed during 2007-08 continued in 2008-09 as well mainly reflective of the slow-down in real economy as also cautious approach adopted by banks against the backdrop of growing uncertainties. The during 2008-09.

data suggests that growth rate of bank's lending to industries, personal loans and services sector witnessed a deceleration, while bank's lending to agriculture and allied activities increased substantially

**Table 8: Priority Sector Lending by Public & Private Sector Banks (As on the Last Reporting Friday of March)**

Item	Public Sector Banks		Private Sector Banks	
	2008	2009P	2008	2009P
1	2	3	4	5
Priority Sector Advances#	6,10,450 (44.7)	7,20,083 (42.5)	1,64,068 (42.5)	1,90,207 (46.8)
Of which:				
Agriculture^	2,49,397 (18.3)	2,98,211 (17.2)	58,566 (17.1)	76,062 (15.9)
Micro and Small Enterprises	1,51,137 (11.1)	1,91,307 (11.3)	46,912 (13.7)	47,916 (12.0)

P : Provisional

# : In terms of revised guidelines on lending to priority sector, broad categories include agriculture, small enterprises sector, retail trade, microcredit, education and housing.

^: Indirect agriculture is reckoned up to 4.5 per cent of ANBC for calculation of percentage.

Figures in parentheses represent percentages to net bank credit/adjusted net bank credit (ANBC)/credit equivalent amount of off-balance sheet exposures (CEOBSE) whichever is higher.

### Opportunities for Indian Banks

Indian banking is experiencing growth due to favorable demographics. Rising income levels and rising literacy rates, specially in rural areas have increased the need for banking. Between 2006 and 2026, the working population (25–60 years) is expected to increase from 675.8 million to 795.5 million giving rise to a favorable market for banks. The per capita GDP is expected to increase from US\$ 380.8 in 2000–01 to US\$ 2,097.5 in 2026, reflecting higher disposable incomes. Significant latent demand

for retail banking services is expected, given a low penetration level of approximately 59 per cent.

**Indian banking is experiencing growth due to favorable demographics.**

The MSME sector assumes importance in the economy due to its employment potential and regional dispersal. The total credit provided by public sector banks to the MSME sector in 2009–2010 was US\$ 58.0 billion, which formed 13.2

per cent of Adjusted Net Bank Credit/Credit Equivalent Amount Off-Balance Sheet Exposure (ANBC/CEOBSE) and 32.2 per cent of the total priority sector advances by these banks.

### **Best Practices in Indian Banking**

a) With an increasingly global footprint, the Indian banking industry has adopted certain global best practices such as Basel II. This international standard implementation helps Indian banks to position themselves at an international level and also provide confidence to foreign players planning to establish businesses in India. By March 31, 2009, all commercial banks in India, excluding RRBs and local area banks, have become Basel II compliant (RBI 2010).

b) Improved risk management practices: Net NPAs, as a percentage of advances, reduced to 1.1 per cent in 2009–2010 from nearly 8.1 per cent in 1996–97 (RBI 2010).

c) Upgrading business models: Banks have started laying more emphasis on fee-based services, such as distributing mutual funds and insurance policies, credit cards, wealth management and equity trading services.

Development of newer modes of banking: India has now entered the era of online banking, e-commerce and m-commerce, which makes banking simple. Also, the use of ATMs and credit cards has increased

significantly in the last few years (RBI, 2010)

d) Product innovation:

There has been a major change in the products offered by banks, from a few standard credit and deposit products to a number of customized offerings to suit the requirements of various categories of customers. (IBEF Banking, 2010)

e) Alliances with non-traditional players:

Due to the global financial crisis, tighter regulations for non-banking entities are being implemented. Main focus of the regulations has been to provide a level playing field between bank-sponsored NBFCs and non-bank associated NBFCs besides other issues of regulatory convergence and regulatory arbitrage (IBEF Banking, 2010)

Though its domestic credit growth has moderated in FY10 to 17.2%, which actually was in line with the YoY in the industry. The credit growth is expected to post a CAGR of 22.3% during FY10-12 with overseas contributing around 20% of the credit growth. Domestic loan growth would be diversified among all sectors (20% YoY growth in corporate loans, 18% in SME and retail each in FY11) and overseas loan book will comprise mainly buyer's credit (IDBI, 2011)

Rising NPAs in the banking industry is a challenging task for the industry. NPAs are increasing in retail and SME segments because in these segments mostly loan is provided not taking suffi-

cient securities. In these segments there is also high default risk faced by banks. The other challenge to the banking industry is assets – liability mismatch, as the duration of banks liability is different from duration of banks assets and from investments. Other challenge for the industry is high attrition rate (IDBI, 2011)

### **Value Proposition to SMEs**

#### **a) A Case of Standard Chartered (SC) Bank in India:**

Providing dedicated banking channels and resources to meet the unique need of SMEs Standard Chartered Bank is in for the last 10 years in India SMEs ecosystem. The study conducted by Standard Chartered found that Indian SME customers were lost between corporate clients and high profile individual customers. Clubbing SMEs with retail would not have given any value addition to SMEs and with corporate clients they will be a miss fit. SME needs are very different both from corporate and retail points of view. Standard Chartered Bank created a separate SME banking segment. Standard Chartered found that Indian SMEs require the following services: 1) financing to working capital and cash flow management, 2) investment management for growth and expansion, 3) risk management for hedging volatility, and 4) Idle cash management. Standard Chartered Bank created SME relationship managers who acted as one-stop shop for SME customers. These managers helped SMEs in bundling products and services, which fulfilled the distinct need of the clients.

Standard Chartered Bank launched its SME Banking World Debit Card, a cash management tool that provides convenience, savings and relationship rewards for small and medium enterprise (SME) customers. This debit card is available to all SME customers having a transactional account with the Bank. The card has the feature of being a first-to-market proposition of enabling different limits for different cardholders, thus mitigating the risk due to multiple cards. The card also has a high daily cash withdrawal and spending limit of up to a maximum of Rs. 5 lakh to support business spends.

“It is clear that SMEs have needs beyond mere access to finance. In fact, a lot of SMEs we do business with are cash rich. As of today, we have twice the amount of money we have lent to SMEs as deposits that have been mobilized from this sector. In the months to come, we are looking at earning from fee incomes (comes from processing trade transactions), interest rate hedging and insurance lending to the SME sector. It’s a healthy mix:” says Subroto Som, Global Head - SME Banking SCB.

#### **b) Bringing Technologies to Small Business in India: ICICI Intel Case:**

ICICI Bank collaborated with Intel to give value proposition to SMEs in India through finance SME technology needs and increasing PC penetration. This project helped SMEs realize their technology needs. Intel is providing hardware and software configurations, as well as, training packages while ICICI Bank is providing flexible and affordable fi-

ancing options. SMEs need not go to any one else for their technology and finance needs. ICICI became a one stop solution provider.

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Challenge	<ul style="list-style-type: none"><li>• Increase ICT penetration in SME market. Help India's burgeoning SME segment obtain the technology they need for successful businesses.</li><li>• Enhance affordability and lending instruments available to SMEs. Tap into the high potential of the SME segment to develop profitable financial lending business.</li></ul>
Solution	<ul style="list-style-type: none"><li>• PC financing solutions. Collaborate with Intel India to provide easy and affordable financing options to enable SMEs to purchase IT solutions to meet their needs.</li><li>• Utilize Intel's channel resources. Utilize Intel's extensive ecosystem network, SME marketing team, support teams and OEM channel for on-ground execution of the Office Equipment Financial Program</li></ul>
Benefits	<ul style="list-style-type: none"><li>• Improve prospects for economic growth. Broaden and accelerate affordable financing and access to ICT for SME strengthening overall market sector and country competitiveness, innovation and growth</li></ul>

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*Source:* Case Study, Intel World Ahead Program

“This product suits the needs of SMEs in India. It is characterized by easy access, personalized service and provides me with flexibility to plan IT equipment. It is very convenient” says Salim Shapoorwala, Jt. MD, Oxford Industries Ltd.

ICT selection, implementation, maintenance and financing from ICICI helped SMEs manage its working needs better and plan for its growth with technology.

### **Conclusions**

The opportunities provided by Indian economy and growth in manufacturing industry and sub segments of manufacturing are immense. SMEs also have opportunities plus lot of challenges. To capitalize on the opportunities and reduce the effect of challenges SMEs need to develop internal strengths.

To capitalize on the opportunities, Indian banks have repositioned them-

selves and have become operationally and strategically reoriented with lot of vigor and long term planning. They have invested huge amount of capital in developing operation efficiency and capabilities and competencies.

The opportunities and challenges faced by SMEs have made them realize that they cannot grow until and unless they develop internal recourses as well as have market strengths. Banks operating in India have developed strategies and developed internal capabilities and competencies to manage the changing trends. Banks need to leverage these strengths by giving extra value to SMEs so that the risks are reduced and banks become partner in SMEs growth, thus completing the RBI norms and increasing profits for both (banks and SMEs). Earlier banks used to just lend the money and take collateral, now they need to share their strengths by redefining the value proposition.

**Table 9: Banks Opportunities, Strategies & Value Propositions for SMEs**

Opportunities for Indian Banking	Strategies & Developing Internal Capabilities and Competencies	Value Proposition to SMEs (Partner in Growth)
<ul style="list-style-type: none"> <li>The banking penetration calculated on the basis of total number of credit accounts to total population was 95.4 per thousand in 2008-09.</li> <li>Globalisation and liberalization of the Indian economy, and the interest of foreign banks to expand in India through the inorganic route, have fuelled growth of the banking industry.</li> <li>Growth in savings deposit is expected to increase with an increase in the amount per account and a steady increase in the number of savings accounts as banks reach out to new markets.</li> <li>Rising literacy rate, socially in rural India, has increased the need for banking.</li> <li>Between 2006 and 2026, the working population (25-60 years) is expected to increase from 675.8 million to 795.5 million giving rise to a favourable market for banks.</li> <li>Projected per capita GDP is expected to increase from US\$ 380.8 in 2000-01 to US\$ 2,097.5 in 2026, reflecting higher disposable income.</li> <li>Large amount of money is remitted by non-resident Indians (NRIs), one of the largest diasporas in the world.</li> <li>Indian GDP increasing at 8% CAGR.</li> </ul>	<ol style="list-style-type: none"> <li>Any where, any time banking <ul style="list-style-type: none"> <li>Increasing branches</li> <li>Using Technology</li> <li>Integration (Core banking)</li> </ul> </li> <li>Improved processes <ul style="list-style-type: none"> <li>Core Banking</li> <li>HR Training</li> <li>Customer relationship management</li> <li>Transparent process</li> </ul> </li> <li>Bundled product offerings <ul style="list-style-type: none"> <li>Increasing emphasis by banks on fee-based services to boost income growth. (distributing mutual funds and insurance policies, credit cards, wealth management and equity trading services.)</li> <li>Corporate Banking, Retail Banking, SMEs banking and Agriculture Banking.</li> <li>Providing customized products and Faster service</li> </ul> </li> <li>Bank-customer has replaced – branch-customer</li> <li>Focus on understanding customer needs or preferences <ul style="list-style-type: none"> <li>Investing in industry/sector analysis</li> <li>Risk management/credit infrastructure</li> <li>Relationship Management</li> <li>Knowledge Management</li> <li>The banking industry in India has adopted best practices from other</li> </ul> </li> </ol>	<p>The MSME sector assumes importance in the economy due to its employment potential and regional dispersal. The total credit provided by public sector banks to the MSME sector in 2009-2010 was US\$ 58.0 billion, which formed 13.2 percent of Adjusted Net Bank Credit/Credit Equivalent Amount Off-Balance Sheet Exposure (ANBC/CEOBSE) and 32.2 percent of the total priority sector advances of these banks.</p> <p><b>Total Solution Provider (services)</b></p> <ol style="list-style-type: none"> <li>Project preparation (Setting up, expansion, modernization) services. <ol style="list-style-type: none"> <li>Due to the vertical investment the bank can use the knowledge it has gathered in this services.</li> <li>Relationship with large corporates.</li> </ol> </li> <li>Industry Analysis services <ol style="list-style-type: none"> <li>Consulting to large SMEs on further expansion through its knowledge on industry verticals and growth</li> </ol> </li> <li>Capital manager <ol style="list-style-type: none"> <li>Operations and working capital.</li> <li>SMEs customer lending processes.</li> </ol> </li> <li>Best Business Practices <ol style="list-style-type: none"> <li>IT</li> <li>HRM</li> <li>Functional levels</li> </ol> </li> <li>One stop information institute <ol style="list-style-type: none"> <li>Industry</li> </ol> </li> </ol>

(contd...)

### Acknowledgements

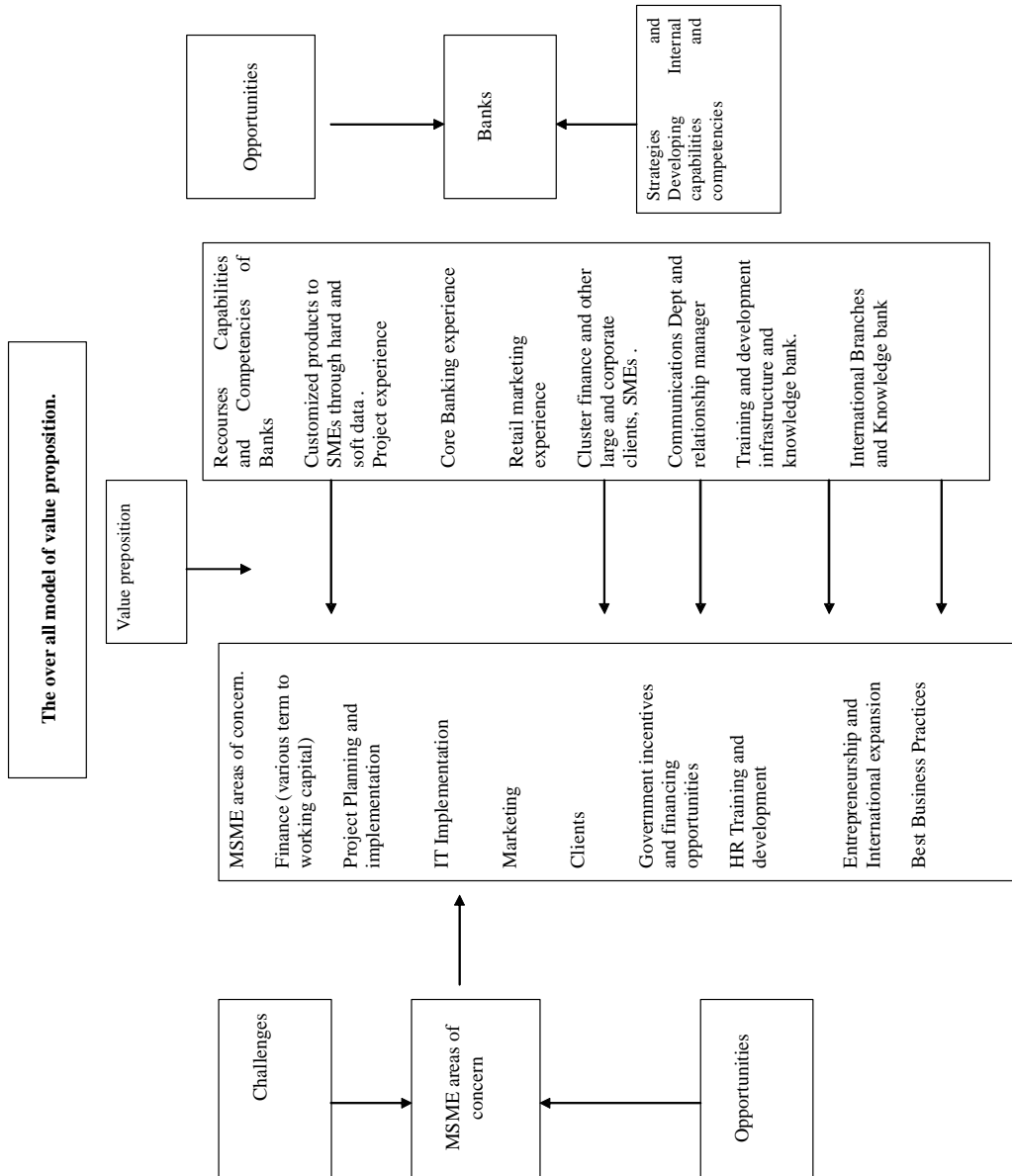
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(contd...)

- countries. Basel II
- 6. Inorganic growth
  - Banks are now acquiring targets among other categories of financial institutions, such as non-banking financial companies (NBFCs), development financial institutions (DFIs), brokerage firms, etc., to provide the entire gamut of financial services.
- 7. International Expansion
  - The bottom line is: Higher growth, improved productivity for branches, better customer profiles, implementation of technology and improved products, coupled with significant positive structural changes, have led to the improvement of Indian Banks almost all financial and operational parameters.
- b. RBI
- c. Government
- d. Taxes consulting
- e. International expansion
- 6. Training and Development
  - a. Using its training facilities to training MSMEs clients and partners.
- 7. Helping is getting customers



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