Interview of CEO, CGTMSE published in DARE Sunday, 31 August 2008

Typically, when you think investor, you think of a VC or a PE fund. We do not consider a bank to be an investor into the business, even though banks provide the working capital into all businesses and project funding into most.

This month we speak to OS Vinod, CEO of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). CGTMSE provides backend guarantees to banks for loans up to Rs 50 lakh, so that small entrepreneurs and startups do not need to provide collateral guarantees.

Can you give us a brief of what CGTMSE is all about?

To make it short, we want that entrepreneurship should be encouraged in the country. We have a large population of youngsters who are looking for jobs; but jobs are not easily available. To create more jobs, we need more businesses; we need more entrepreneurs, many of them in the small and micro sector. But even after 60 years of independence, when you go to a bank and ask for a loan the problem of collateral keeps coming up.

O S Vinod
Credit Guarantee Fund Trust for Micro and Small Enterprises

This has been the biggest problem that small and micro entrepreneurs have been facing in the country. Bankers usually look at small and micro enterprises as high risk. So, the government decided to set up a credit guarantee organization that would provide comfort to the bankers in lending to the small and medium sectors.

There is nothing new about credit guarantee. It is not as if we have found some new solution to the problem. Credit guarantee organizations have been around in so many countries. We have a single product whereas there are many variations of this around the world. In the Indian context, it is for the first time that micro and small sectors are been looked at as special focus areas. That is the reason why the government set up this agency.

If you see our performance in the last 7-8 years, we have not even touched one lakh cases. This is a very small number, considering the overall picture of the micro and small sector in the country.

What only less than a lakh entrepreneurs? What is the limiting factor?

We face a unique situation. Unless a loan is given, we can’t cover it. So, we

actually need to encourage the bankers to lend to the sector. We also need to see that they lend to the sector without any collateral. These are two very important things.
Bankers take a very cautious approach because of the small size of each deal and the high churn rate, the heightened default probability.
They are also right in a way. If you do not reliable financial statements and credit records, banks take a very cautious stand. Without all these, it is very difficult to assess the reliability. CGTMSE has been set up to reduce the risk in lending to the micro sector.

Like you said, banks need to be encouraged to lend. Is CGTMSE doing anything to encourage that?
If the proposal is otherwise good, banks in the normal case should lend with or without collateral. If the proposal is not so good also, banks may lend for various reasons.
What we are trying to tell the banks is -- you don't appraise the collateral but the project. If the project is good, and then the second issue of collateral comes in and we will step in. So, banks have to move from collateral-based lending to project-based lending, which was not happening. Now, it is happening, but in a very small way. Secondly, in banks, in lending, there are issues in terms of accountability. Whether there is collateral or no collateral, if any loan goes bad, there are accountability issues. So, many managers are very right in saying, why get into all these hassles? Don't lend and you won't get into any problems. That is another way of playing safe.
But in the last couple of years, we are seeing a shift in the bank's perception. If you see our own experience, out of one lakh cases that we did, more than 75% were done in the last 2-3 years. This year, in the first quarter itself, we have done about 12,000 cases. I think there is gradual shift taking place. But like I said, in this country, whatever you do, it is like a drop in the ocean. One can never get the feel that you have done enough.

Just a hypothetical question, you said you have done about a lakh cases so far. If you were to fully utilize your capabilities how many cases can you guarantee?
You want us to do ten lakhs? More? We can do that!
Right now, we have about Rs 1,900-2,000 crore available with us. If we were to leverage this, say by five times, we can easily guarantee loans of about Rs 10,000 crore. And this is a very conservative estimate.
There are guarantee organizations abroad, which have been leveraging much more like for example in Germany, where the leveraging is 25-26 times. There the banking systems are far more sophisticated. Our committed corpus is Rs 2,500 crore (2000 crore from the government and 500 crore from SIDBI). If you take five times leveraging, we can do about Rs 12,500 crore of guarantees as on date.
We have in place the technology to support us and we are quite confident of our ability to scaling up. But, we are dependent on the bankers. This is a demand-

driven scheme. The more the bankers demand, the more we give.

Ultimately, the entrepreneur cannot come to you directly. He has to come through the bank?
We have no relationship with the entrepreneur. We have relationships with the bankers.

How can the entrepreneur make the bank move his case to you?
One is the awareness. If you are not aware, you cannot ask for it. Second, the banker also should be aware. It is not only that the client is aware but the bank is not aware. If both are aware, then I think there is a lot of positivity and synergy. Our experience shows that wherever clients and bankers are aware, coverage has been higher.

Any geographical patterns?
Tamil Nadu and Kerala. Tamil Nadu is the highest in terms of numbers and Kerala is number two. If you look at Kerala's example, today you cannot call it one of the most economically developed states, but the coverage of our guarantee scheme has been quite good. That shows that if you have a very knowledgeable banker and a well-informed public, the marriage can be good.

Let me come back to the guarantee part specifically, is it an overall guarantee for the entrepreneur or is it the guarantee for the project? I, as an entrepreneur, could have multiple projects under guarantee?
The scheme says upto Rs 50 lakh per borrower. There could be multiple projects covered.
Suppose, you take a loan for Rs 10 lakh; subsequently, you want to expand, you can take another Rs 10 lakh and so on till 50 lakh without collaterals.

As an entrepreneur, can I demand the bank to move it to you?
I think we need to move to that position, where every individual as a matter right should be able to ask for that. Ultimately, the banker decides. He can always say this is not a viable proposal and you will have a tough time explaining to him that it is a viable proposal.

What can an entrepreneur do to move his case to you?
One he needs to be sure of what he is getting into. He needs to have a very proper assessment of his own project. He needs to be able to convince the banker that is worth investing. Then when it comes to collaterals, he can always mention our scheme.

Typically when a bank comes to you after appraising a project do you do a repeat appraisal?
Here in India, we have chosen a model where we trust completely on the banker's ability to assess the project. We don't question them.

How much time does it take for you to process an application?
It takes 24 hours or less.

What is your default rate?
Default rate is negligible. Our total guarantees as on date must be around Rs 3,300 crore, and we would have paid out around Rs 11 crore. There is not a single case pending with us for pay out. That is also a 24-hour turnaround. The bank makes a claim today and tomorrow morning, the cheque is out.

They do the due diligence and they get to you?
There is no due diligence. If something goes wrong, they have to file the claim with us. While filing the claim, there are five or six columns they have to tick. One is whether the guarantee is valid. Whether they have classified the specific loan as an NPA (non performing asset) in their books, Third is if they have classified it as an NPA, have they issued a recall notice, fourth is whether they have filed in the appropriate forum, and fifth whether there is a certification from an AGM level officer. If these things are there, we simply issue a cheque. There is nothing more we need to know. Once that has been done, there is no value addition from our side.
We pay 75 % of the guaranteed amount immediately. The remaining 25% we pay after the total process is over. After the decree is obtained. Ultimately we share the default 3:1.

Is that why the banks are holding back because they have to bear 25%?
You cannot have a situation where you have a 100% guarantee scheme. If you see internationally also, guarantees have been ranging between 50-80%. There is a case where they have done 100%, once I think, but they found the default rate rising dramatically.
We need to be somewhere where it interests the banks to get covered, but at the same time it cant be 100% in their favor. 75% to 80% is the global practice.

What is the biggest challenge going ahead?
One is that we need to scale up in a big way. That is the biggest challenge. Second is that more than actually covering the number of loans, personally I feel, that CGTMSE should be in a position to encourage the banks to lend at a lower rate. If that happens then I think the guarantee mechanism can work well because it removes a lot of apprehensions of the banker should come down for the SMEs. When that happens the take off stage would be ready.