# SME INSIGHTS

*A Newsletter from ONICRA*

Onicra Credit Rating Agency of India Limited

## ABOUT ONICRA

Onicra Credit Rating Agency is an active player in the Credit and Performance Assessment space. It provides analytical risk assessment and rating solutions to MSMEs and Corporate.

These ratings enable the lender or service provider to make smart, value based decisions on the MSME or the corporate by arming them with essential information that includes financial, operational, 3-Dimensional analysis that provides a holistic view about the entity.

### About Onicra MSME Ratings

The Ministry of MSME through NSIC has signed a memorandum of understanding with Onicra to provide performance and credit rating services to MSME units. The rating creates awareness about the strengths, weaknesses, opportunities and threats, and assists in identifying areas of improvement for the MSME unit. Under this scheme, the MSME unit only pays 25% of the rating fee to Onicra while the rest 75% is subsidized by NSIC.

The company has rated around 21018 MSMEs since inception.

### NSIC scheme features


### Benefits of NSIC-Onicra Performance and credit rating

- Assists in risk management by highlighting parameters measuring operational, financial and business risk.
- Enhance acceptability with Banks, Financial Institutions and provides access to cheaper and timely credit.
- It is a “holistic health check-up of the unit” that establishes credibility, goodwill and assists in dealing with large companies.
- Helps in marketing and serves as first point to generate interest among potential partners.

# ECONOMIC PERSPECTIVE

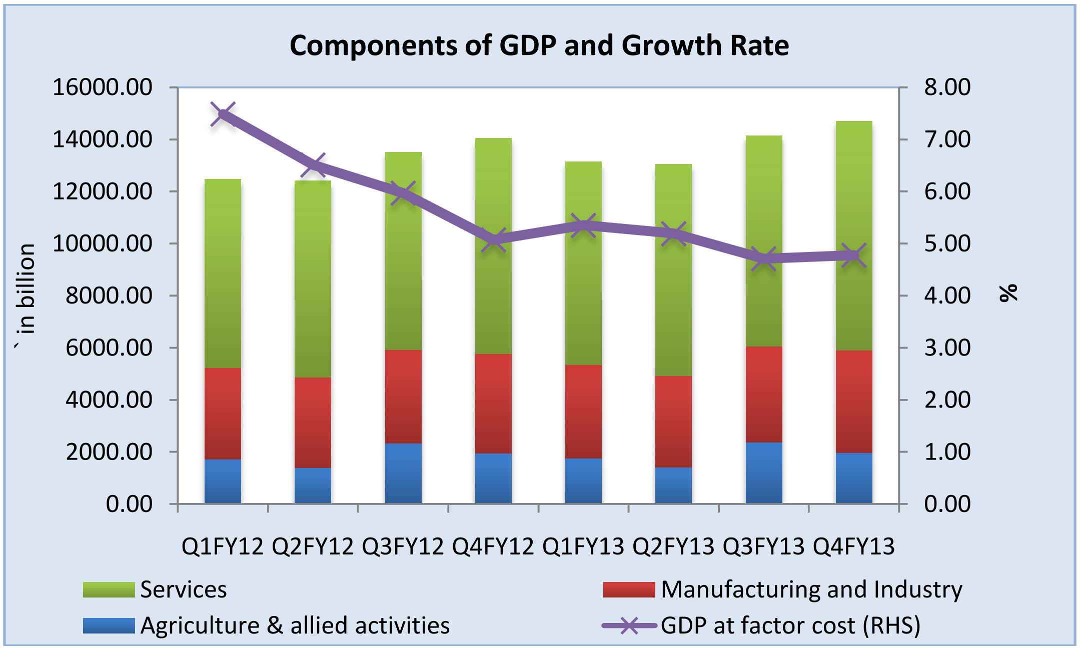
## Executive Summary

The Indian Economy has witnessed a sluggish trend in the FY12 and the same story has continued in FY13 also. The economic growth is likely to drop further from 6.48% in FY12 to somewhere in the range of 4.5-5.0% in FY13. Reasons for the decline are partly global and partly domestic.

On the domestic front, the Indian Economy continued to decline in all its sectors. Rainfall played an important role in the decline in agriculture sector, while the manufacturing and service sector continued to decline in the wake of tighter monetary policies, delays in projects due to government regulations, weakening consumption and declining exports. The mood of investments in the economy has weakened and the deployment of bank credit into corporate has increased at a declining rate. The challenge now is to boost the investments into the economy while maintaining the inflation under control.

Global reasons for the decline in the economic growth continued to be in the form of Euro Risk and fiscal consolidation in US. While the US fiscal consolidation has begun, it has proved to be a two-edged sword. On the one hand, it offers hope of increase in trade of services form Indian economy thereby reducing the current account deficit (CAD). At the same time, it has led to an exodus of FIIs from the Indian market to the more resilient US economy. The demand for Indian goods has decreased and the CAD has increased due to rising import bill on account of increasing oil bill and gold and silver imports. While it is expected by the various agencies that the global economy will recover in FY14, the Indian economy will take its cue from there.

## Economic Growth




Source: CSO

* GDP at constant price

### Composition of Sub Sectors of GDP

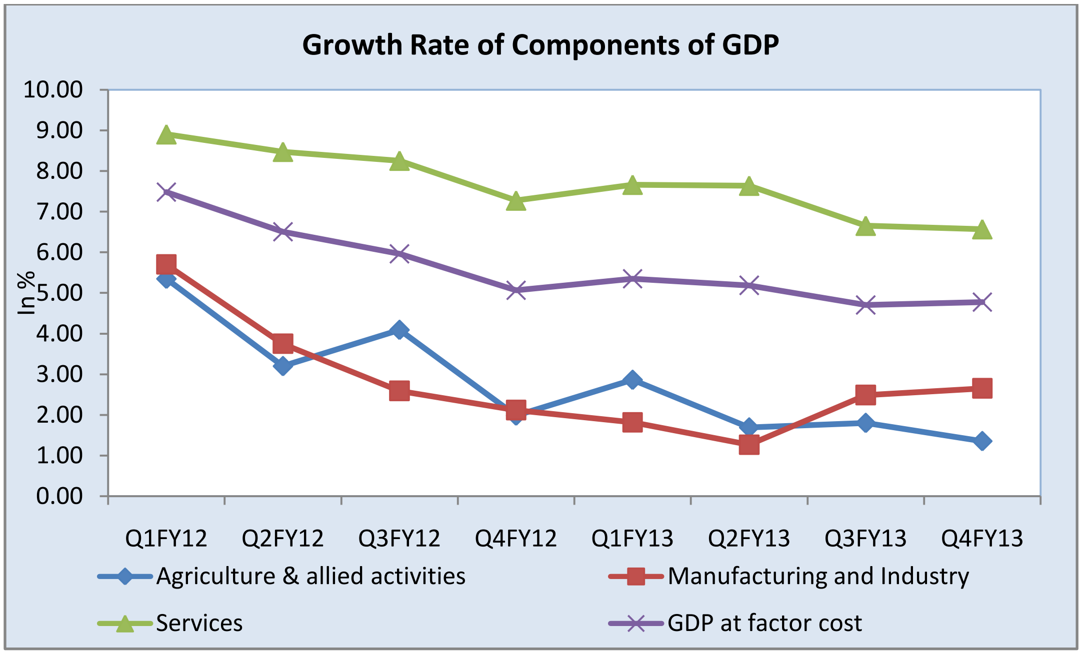
(Amount in ` Billion)

| Sector | Q1FY12 | Q2FY12 | Q3FY12 | Q4FY12 | Q1FY13 | Q2FY13 | Q3FY13 | Q4FY13 |
|---|---|---|---|---|---|---|---|---|
| **Agriculture & allied activities** | **1719.66** | **1389.87** | **2338.94** | **1946.49** | **1768.88** | **1413.34** | **2381.06** | **1972.82** |
| **Manufacturing and Industry** | **3524.72** | **3475.81** | **3590.46** | **3833.99** | **3588.9** | **3519.99** | **3679.91** | **3935.81** |
| Mining & Quarrying | 262.05 | 239.42 | 273.45 | 307.58 | 263.02 | 243.45 | 271.57 | 298.15 |
| Manufacturing | 2033.49 | 1998.73 | 2026.65 | 2171.36 | 2012.3 | 2000.01 | 2076.89 | 2227.28 |
| Electricity, Gas & Water Supply | 245.08 | 245.99 | 246.86 | 250.2 | 260.18 | 253.86 | 257.98 | 257.16 |
| Construction | 984.1 | 991.67 | 1043.5 | 1104.85 | 1053.4 | 1022.67 | 1073.47 | 1153.22 |
| **Services** | **7230.58** | **7545.4** | **7583.13** | **8256.78** | **7784.76** | **8121.96** | **8087.72** | **8799.18** |
| Trade, Hotel, Transport and Communications | 3489.03 | 3464.52 | 3567.68 | 3881.89 | 3701.97 | 3699.96 | 3795.5 | 4122.91 |
| Finance, Insurance, Real Estate & Business Services | 2296.38 | 2344.6 | 2385.86 | 2461.24 | 2509.55 | 2539.96 | 2572.16 | 2685.16 |
| Community, Social & Personal Services | 1445.17 | 1736.28 | 1629.59 | 1913.65 | 1573.24 | 1882.04 | 1720.06 | 1991.11 |
| **GDP at factor cost** | **12474.96** | **12411.08** | **13512.53** | **14037.26** | **13142.54** | **13055.29** | **14148.69** | **14707.81** |

### Growth Rate of Sub Sectors of GDP

(In %)

| Sector | Q1FY12 | Q2FY12 | Q3FY12 | Q4FY12 | Q1FY13 | Q2FY13 | Q3FY13 | Q4FY13 |
|---|---|---|---|---|---|---|---|---|
| **Agriculture & allied activities** | 5.35 | 3.20 | 4.09 | 1.98 | 2.86 | 1.69 | 1.80 | 1.35 |
| **Manufacturing and Industry** | 5.70 | 3.75 | 2.59 | 2.12 | 1.82 | 1.27 | 2.49 | 2.66 |
| Mining & Quarrying | -0.43 | -5.33 | -2.63 | 5.17 | 0.37 | 1.68 | -0.69 | -3.07 |
| Manufacturing | 7.41 | 3.06 | 0.66 | 0.11 | -1.04 | 0.06 | 2.48 | 2.58 |
| Electricity, Gas & Water Supply | 6.59 | 8.44 | 7.66 | 3.54 | 6.16 | 3.20 | 4.50 | 2.78 |
| Construction | 3.77 | 6.52 | 6.89 | 5.09 | 7.04 | 3.13 | 2.87 | 4.38 |
| **Services** | 8.91 | 8.48 | 8.26 | 7.27 | 7.66 | 7.64 | 6.65 | 6.57 |
| Trade, Hotel, Transport and Communications | 9.51 | 7.00 | 6.88 | 5.07 | 6.10 | 6.80 | 6.39 | 6.21 |
| Finance, Insurance, Real Estate & Business Services | 11.61 | 12.34 | 11.42 | 11.35 | 9.28 | 8.33 | 7.81 | 9.10 |
| Community, Social & Personal Services | 3.54 | 6.47 | 6.84 | 6.81 | 8.86 | 8.39 | 5.55 | 4.05 |
| **GDP at factor cost** | 7.49 | 6.51 | 5.97 | 5.07 | 5.35 | 5.19 | 4.71 | 4.78 |

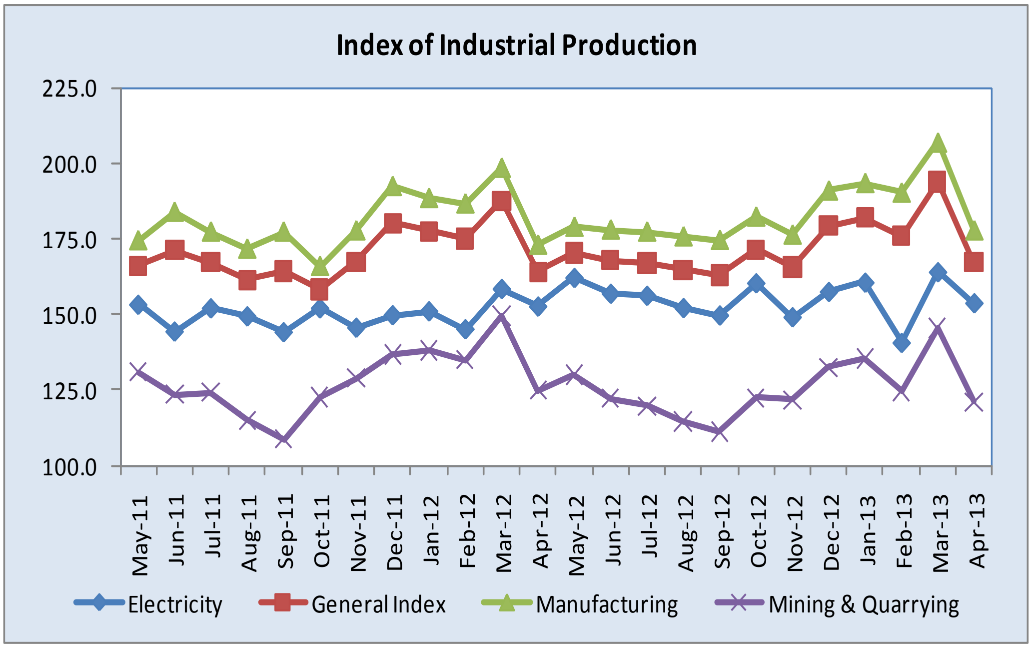



The declining growth rate of GDP over the last two years speaks poorly of the performance of the Indian Economy. Slight buoyancy has been noted in the Manufacturing and Industry sector in the last 2 quarters but that is not enough to set off the decline in the agriculture and service sector. The annual growth rate of the Indian economy has also suffered a decline. The growth rate for FY13 is estimated to be close to 5.0% down from 6.5% in FY12. Except for community, social and personal services sector, no other sector has surpassed its performance over the last year. This sub sector has witnessed an increase due to its growth in Q1-Q2FY13. Over the FY13, this sub sector has also witnessed a decline. As a result, the services sector has been able to maintain its growth rate at approx. 7% p.a.

**Agriculture and Allied Activities**

Agriculture contributed 13.41% of GDP in Q4FY13; however the growth rate of the sector has been lowest in the period. As per the data released by Department of Agriculture and Cooperation, improvement in the rainfall during the end of the FY13 has led to an improvement in the Rabi production. Although Rabi crops such as coarse cereals, pulses, and oilseeds registered growth, it was too insignificant to pull the sectoral growth rate. Kharif production has declined during the year.

**Manufacturing and Industry**




While the sectors – Electricity, Gas and Water supply have seen slower growth, the mining sector has seen a fall in output. Failing health of the power companies, scarcity of production of resources like gas and red tape on new oil and gas projects and their pricing has curbed the growth of electricity, gas and water supply sector. Mining sector continues to reel under the tint of infrastructure impingements and delays in regulatory and environmental clearances by government. The decline in output of mining sector has been significant at 3.1% in Q4FY13.

While the manufacturing sector has shown signs of improvement in the H2FY13, the construction sector has also contributed to the aggregate manufacturing and industry sector growth in Q4FY13.

In annual growth terms, the growth in the manufacturing and construction sub-sector has been a result of the production growth in coal, refinery products and cement. The growth in steel has stagnated while fertilizer industry has registered a decline in production in the last year.

**Service**

The service sector has seen a decline in its growth rate in Q4FY13 due a decline in the growth of Finance, Insurance, Real Estate, and Business Services sub sector. In quarterly growth terms; trade, hotel, transport and communication has maintained its growth rate over each quarter in the year in the range of 6-7%. This has been due to the growth in the private corporate sector in this particular sub sector. However, in annual growth terms, the sub-sector has also declined. The quarterly growth of community, social and personal services sector has been declining, though in annual terms, the sub sector has done better than the last year. The continual depreciation of Rupee has led to a decrease in foreign trade of services and travel. A low market sentiment and declining global economy has led to low growth rate of the services sector.

## Consumption Drivers

| Growth in % | Q4FY12 | Q4FY13 |
|---|---|---|
| Production of Food Products and Beverages | 4.80 | 4.33 |
| Production of Apparel | -0.96 | 18.55 |
| Production of Consumer Goods | -0.40 | 0.40 |
| Deployment of Bank Credit to Housing | 10.67 | 0.26 |

* Source: RBI

The above table indicates that there has been a significant growth in the apparel and a small growth in the consumer goods sub sector in the Indian Economy. This is indicative of the increasing investment of the FDI in the textile sector.

The demand-supply gap in the housing sector is expected to widen in the wake of less number of economical units being built. The same is reflected in the decline in the deployment of bank credit to the housing sector.

## Investment Drivers

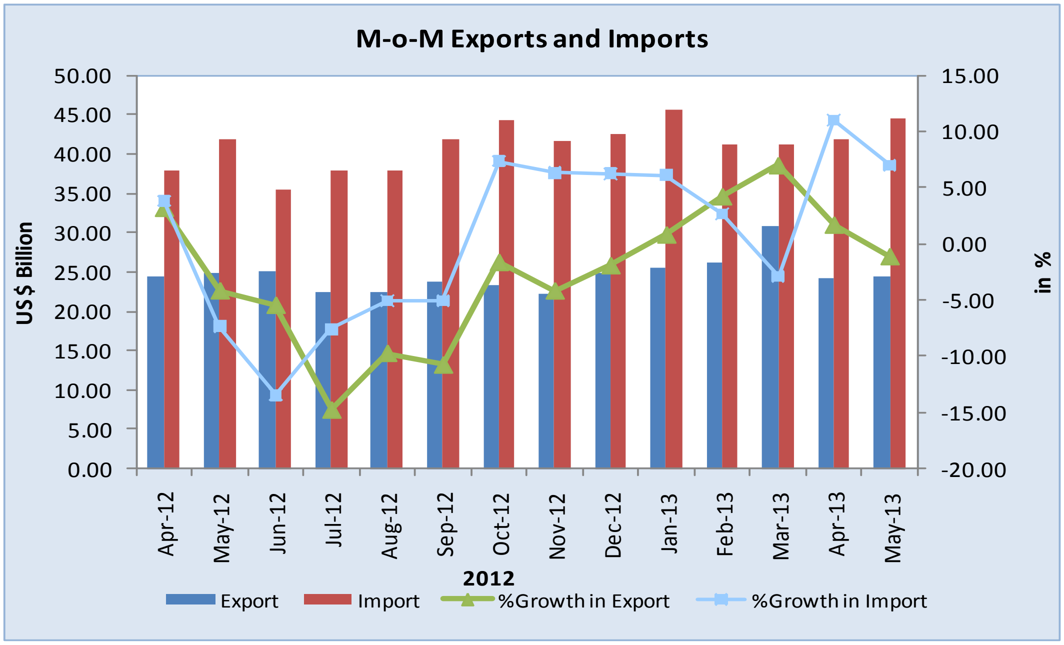
**Industry wise Deployment of Gross Bank Credit**

| Particulars | Share toward Deployment of Gross Bank Credit (%) (As on 19th April 2013) | Growth % (Y-O-Y) | |
|---|---|---|---|
| | | April 2013 | April 2012 |
| Infrastructure | 33.92 | 21.02 | 17.44 |
| Basic Metal & Metal Product | 14.06 | 19.96 | 22.43 |
| Textiles | 8.29 | 16.50 | 9.07 |
| Chemicals & Chemical Products | 6.85 | 22.75 | 17.64 |
| All Engineering | 5.82 | 14.75 | 24.64 |
| Food Processing | 5.49 | 32.99 | 21.98 |
| Gems & Jewellery | 2.82 | 20.76 | 27.97 |
| Vehicles, Vehicle Parts & Transport Equipment | 2.62 | 10.50 | 17.32 |
| Petroleum, Coal Products & Nuclear Fuels | 2.38 | -6.49 | 17.64 |
| Construction | 2.38 | 8.59 | 12.94 |
| Cement & Cement Products | 2.04 | 23.39 | 21.84 |
| Mining & Quarrying (incl. Coal) | 1.46 | -0.17 | 17.66 |
| Rubber, Plastic & their Products | 1.41 | 6.58 | 13.05 |
| Paper & Paper Products | 1.31 | 18.19 | 16.59 |
| Beverage & Tobacco | 0.72 | 7.72 | 12.80 |
| Leather & Leather Products | 0.39 | 9.13 | 6.45 |
| Wood & Wood Products | 0.35 | 26.70 | 25.17 |
| Glass & Glassware | 0.33 | 17.52 | 16.26 |
| Other Industries | 7.35 | -11.86 | 40.07 |
| **Industries** | **100.00** | **15.52** | **19.93** |

Registering a growth of 15.52% (YoY) as on April 2013, vis-à-vis 19.93% for the corresponding period last year, credit deployment towards industry has remained subdued. Infrastructure (33.92%), basic metal and metal products (14.06%), textiles (8.29%), engineering (5.82%), chemical and chemical products (6.85%), food processing (5.49%) and petroleum & coal products & nuclear fuel (2.38%) industries have accounted for major shares in overall credit to industry.

Credit deployment growth to infrastructure sector was higher than last year mainly due to increased credit deployments in power (from 18.5% in April 2012 to 32.30% in April 2013) which accounts for 19.44% of total credit to infrastructure industry and roads (from 21.2% % in April 2012 to 20.1% in April 2013), which accounts for 5.99% of credit to infrastructure industry. There has been an increase in credit deployment towards textile industry due increase in credit deployment toward cotton textile and jute. Growth in credit deployment toward food processing industry has also increased, as the demand for packaged food is increasing. But growth of credit deployment in mining & quarrying and petroleum, coal products & nuclear fuels has remained subdued, mainly due to delay in project clearances from government agencies.

## Export-Import Trend




**Foreign Trade (USD Billions)**

| Year | Export | %Growth in Export (YOY) | Import | %Growth in Import (YOY) | Trade Balance |
|---|---|---|---|---|---|
| Apr-12 | 24.50 | 3.20 | 37.90 | 3.80 | -13.40 |
| May-12 | 24.77 | -4.16 | 41.95 | -7.36 | -16.27 |
| Jun-12 | 25.07 | -5.45 | 35.37 | -13.46 | -10.30 |
| Jul-12 | 22.44 | -14.80 | 37.94 | -7.61 | -15.49 |
| Aug-12 | 22.33 | -9.74 | 37.95 | -5.08 | -15.62 |
| Sept-12 | 23.70 | -10.78 | 41.78 | -5.09 | -18.08 |
| Oct-12 | 23.25 | -1.63 | 44.21 | 7.37 | -20.96 |
| Nov-12 | 22.30 | -4.17 | 41.59 | 6.35 | -19.29 |
| Dec-12 | 24.88 | -1.92 | 42.55 | 6.26 | -17.67 |
| Jan-13 | 25.59 | 0.82 | 45.58 | 6.12 | -19.99 |
| Feb-13 | 26.25 | 4.23 | 41.18 | 2.65 | -14.92 |
| Mar-13 | 30.85 | 7.00 | 41.16 | -2.90 | -10.31 |
| Apr-13 | 24.16 | 1.70 | 41.95 | 11.00 | -17.78 |
| May-13 | 24.50 | -1.11 | 44.64 | 6.99 | -20.14 |

Source: Ministry of Commerce & Industry

India's exports declined by 1.1% to USD 24.50 billion in May 2013 as compared to the same month a year ago. Imports, on the other hand, rose by 7% to a four-month high of USD 44.64 billion in the month of May 2013. As a result, the trade deficit widened to USD 20.14 billion from USD 16.27 billion a year-ago. This was the third-highest level of the trade deficit in a year. The current account deficit (CAD) and continuous decline in the value of rupee in comparison to USD have been the major concerns for the Indian economy. However the fall in rupee has helped some industries like IT and Pharma, but the continuous rise in import bill lead by oil, gold and fertilizers and protectionism & contraction in demand in western countries has affected the CAD.

Exports declined for eight straight months starting May 2012 to December 2012 mostly due to contraction in demand in the European Union (EU) and the USA. However, In January to April this year, exports posted a small growth, but fiscal deficit continued to be high because of higher growth in imports.

There has been a decline in global import demand following the global economic crisis and this has affected India's exports. The dip is more pronounced in high-value exports such as processed petroleum. The other key products which have witnessed a decline in exports include apparels, precious stones, electronic equipment, and iron and steel, to name a few. These products account for almost 60.00% of the country's total exports. However, from January to April there has been a revival in the export, mainly due to increase in exports of agriculture and allied products.

India's exports in May were at USD 24.50 billion compared to USD 24.77 billion in the same month of 2012 witnessing a decline of 1.1% in May after a suspension of gold exports in special economic zones (SEZ), under which it has been made mandatory that even in SEZ, gold units shall comply with the notification of minimum value addition of 3% in gold jewellery and 5% in gold and precious stone studded jeweler. The weakness in European markets too impacted the country's exports.

The imports continued to grow at a rate close to 7% leaving a trade deficit of over USD 20 billion. The most worrisome remained the gold and silver imports, which grew by 89% to USD 8.39 billion. The trade deficit at USD 20.14 billion due to high gold and oil imports remained at a seven-month high. Imports during May, 2013 were valued at USD 44.64 billion representing a growth of 6.99% in Dollar terms and 8.04% in Rupee terms over the level of imports valued at USD 41.95 billion in May, 2012, mainly due to increase in oil imports, valued at USD 15.02 billion which was 3.05% higher than oil imports valued at USD 14.57 billion in the corresponding period last year. The non-oil imports during May, 2013 were estimated at USD 29.62 billion which was 9.10% higher than non-oil imports of USD 27.15 billion in May, 2012.

## Interest Rate

| Item/Week Ended | 2012 1-Jun | 2013 31-May |
|---|---|---|
| Cash Reserve Ratio | 4.75 | 4.00 |
| Bank Rate | 9.00 | 8.25 |
| Repo Rate | 8.00 | 7.25 |
| Reverse Repo Rate | 7.00 | 6.25 |
| Deposit Rate | 8.00/9.25 | 7.50/9.00 |
| Call Money Rate(Weighted Average) | 8.10 | 7.22 |

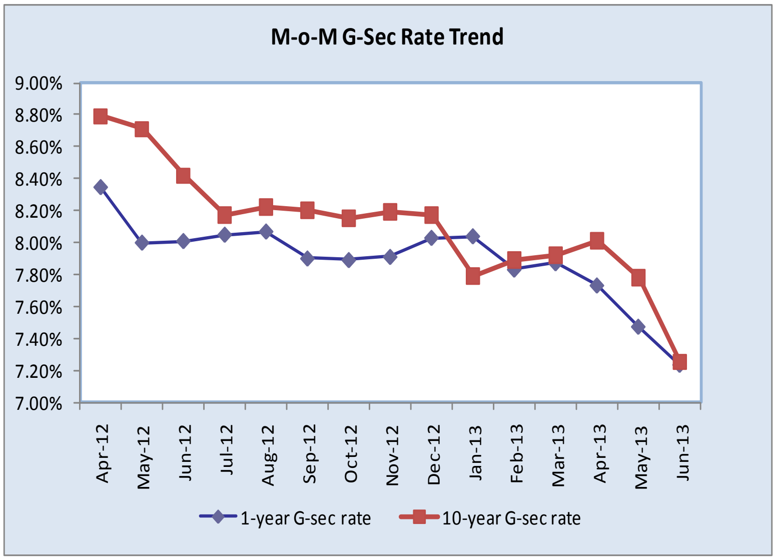
Source: RBI

Based on an assessment of the current macroeconomic situation, the Reserve Bank of India has reduced the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points from 7.50% to 7.25% from 3rd May 2013. Consequently, the reverse repo rate under the LAF stands adjusted to 6.25% and the marginal standing facility rate and the Bank Rate to 8.25%.

Global financial market conditions have been stable in the recent past, but global economic activity has weakened.. Although there has been notable softening in the inflation during last few months, but the depreciation in rupee and increasing gap between retail inflation (as indicated by CPI) and wholesale inflation is exacerbating the challenge for monetary management and it is depicted by no changes in policy rates in recent mid quarter review on 17th June.

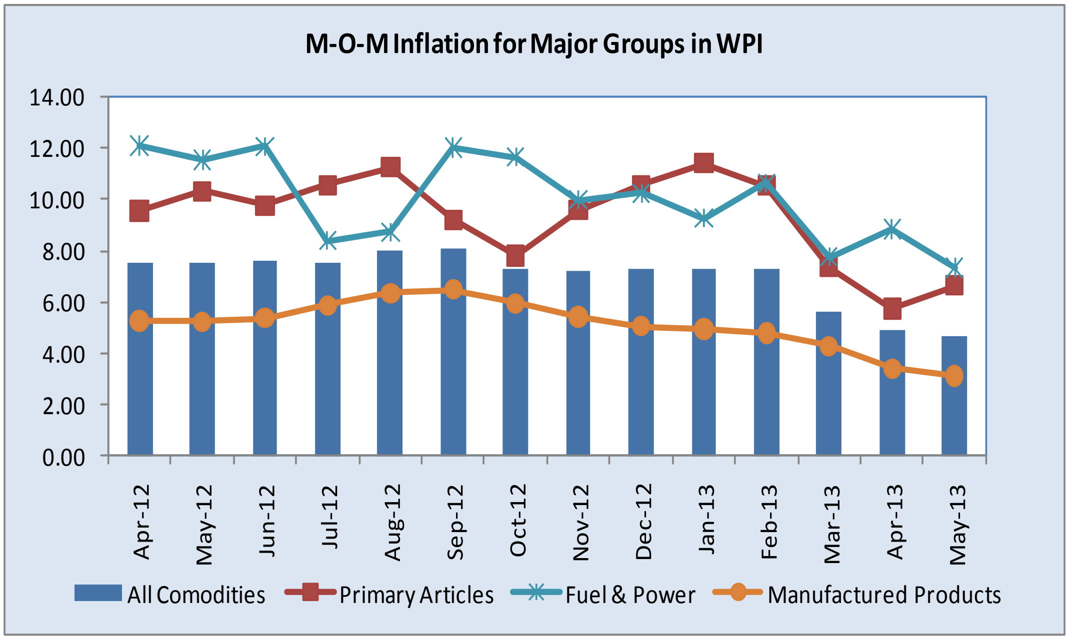
The yield on Indian government bonds has shown a downward trend since April 2012. There has been a sharp fall in the yield for January 2013 on account of postponement in the Government borrowings program, the expectation of rate cut and `8,000 Crores Open Market Operation (OMOs) in order to infuse liquidity in the system by buying back government bonds.

The government securities yields declined sharply in the month of May 2013 as the macro economic data and lower commodity prices indicated that the RBI may have the head room to reduce key interest rates to support growth. After the release of the IIP data showing sluggish industrial output growth and CPI & WPI data showing moderation in inflation, G-sec yields declined sharply. The rally in the G-sec market was supported mainly by record high volumes.




Source: FIMMDA

## Inflation




Source: RBI

**WHOLESALE PRICE INFLATION**

| Commodity | Weight | Apr 2012 | May 2012 | Jun 2012 | Jul 2012 | Aug 2012 | Sep 2012 | Oct 2012 | Nov 2012 | Dec 2012 | Jan 2013 | Feb 2013 | Mar 2013 | Apr 2013 | May 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **All Commodities** | 100.00 | 7.50 | 7.55 | 7.58 | 7.52 | 8.01 | 8.07 | 7.32 | 7.24 | 7.31 | 7.31 | 7.28 | 5.65 | 4.89 | 4.70 |
| **Primary Articles** | 20.12 | 9.55 | 10.31 | 9.75 | 10.54 | 11.23 | 9.22 | 7.81 | 9.56 | 10.56 | 11.41 | 10.54 | 7.36 | 5.75 | 6.65 |
| Food Articles | 14.34 | 10.92 | 10.63 | 10.91 | 10.17 | 9.34 | 8.06 | 6.72 | 8.80 | 10.63 | 12.35 | 11.95 | 8.63 | 6.08 | 8.25 |
| Non-Food Articles | 4.26 | 1.40 | 8.57 | 7.18 | 13.34 | 14.08 | 10.43 | 11.43 | 14.04 | 13.56 | 13.00 | 10.71 | 9.32 | 7.59 | 4.88 |
| **Fuel & Power** | 14.91 | 12.10 | 11.53 | 12.07 | 8.39 | 8.74 | 12.00 | 11.65 | 9.97 | 10.25 | 9.27 | 10.64 | 7.76 | 8.84 | 7.32 |
| **Manufactured Products** | 64.97 | 5.27 | 5.24 | 5.37 | 5.87 | 6.36 | 6.47 | 5.95 | 5.41 | 5.04 | 4.95 | 4.80 | 4.28 | 3.41 | 3.11 |

For most of FY12, the Wholesale Price Inflation (WPI) remained around 7%. The defensive moves through policy rate changes, has shown its effect in the last three months which has resulted in m-o-m decrease in the inflation trend.

Pressure on the prices of Primary Articles has eased significantly to 6.65% in May 2013 as compared to 10.31% in the corresponding period last year. Also inflation related to fuel & power has fallen to 7.32% in May 2013 from 11.53% for the corresponding period last year on the back of fall in the global crude oil prices which helped to moderate inflation rate in products whose prices were market determined such as price of petrol. Due to subdued global and domestic demand the inflation for manufactured product has declined to 3.11% in May 2013 from 5.24% in May 2012.

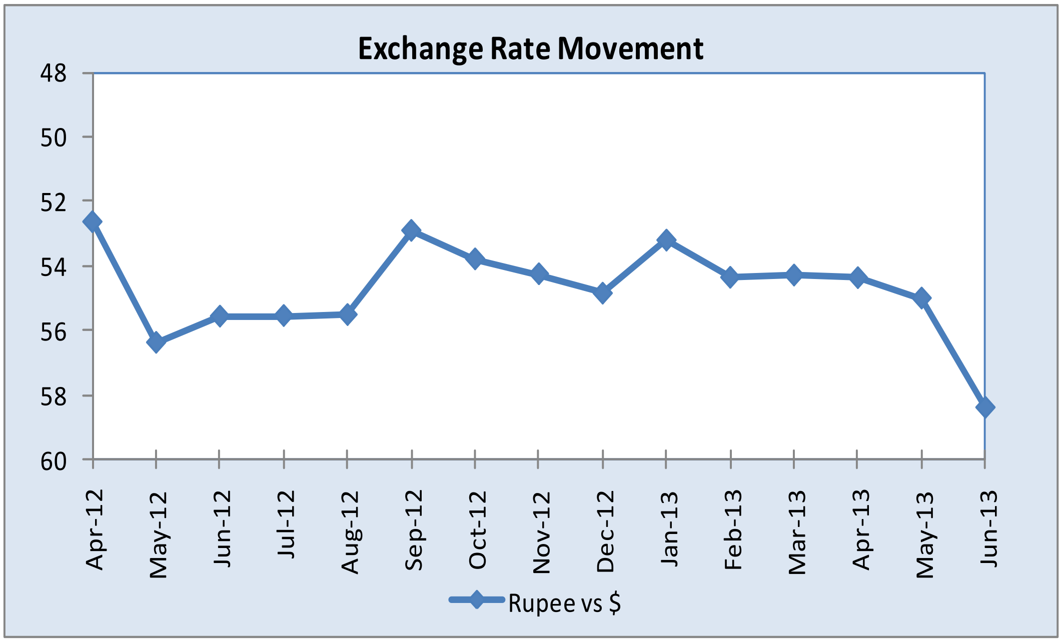
Monthly trend in inflation in case of primary articles has been highly volatile in the last three months. Inflation for food articles increased significantly in May 2013 due to rise in the prices of vegetables as well as commodities such as cereals, rice, onion, egg, meat etc. However, non food articles inflation declined considerable due to decrease in the prices of fibers and oil seeds.

On a monthly basis the inflation for manufactured products has fallen from 3.41% in April to 3.11% in May driven by fall in wholesale prices for rubber & plastic products, transportation equipment, machinery and machinery tools, sugar, rice bran etc.

Inflation for fuel and power decline in the month of May 2013 due to decline in the global commodity crude oil prices such as liquefied petroleum gas and petrol prices. Also there has been a slight decline in the prices of the high speed diesel in May 2013.

## Financial Market

**Currency Market**

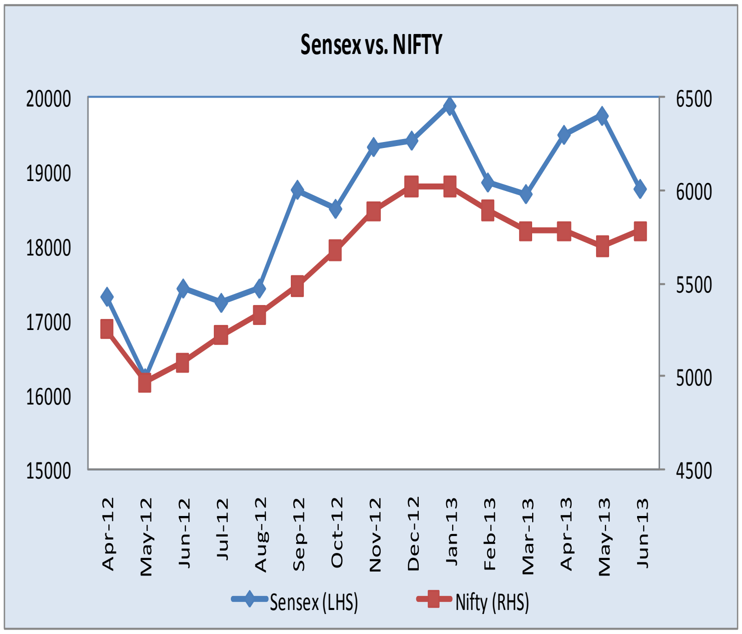


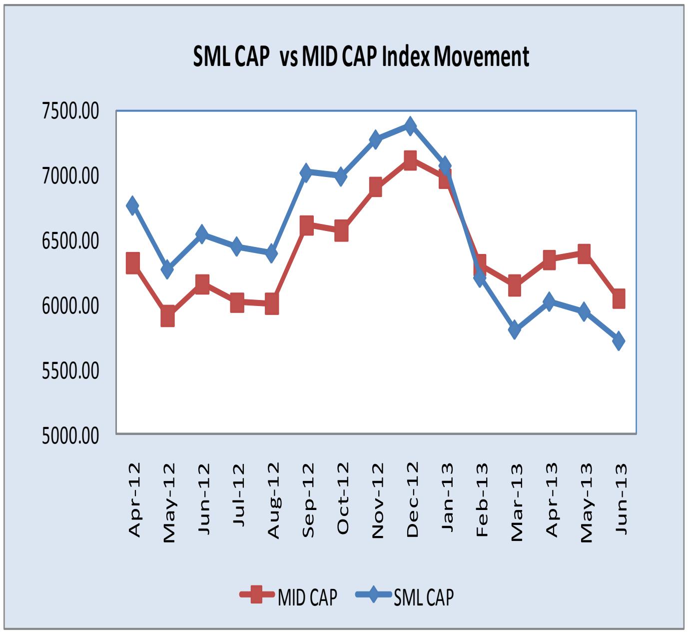

Source: RBI

The rupee leads the losers' chart among Asian currencies in the April-June quarter by plunging 8.6%, during the period due to massive capital outflows on worries of withdrawal of the US stimulus and reported cash crunch in China. The rupee lost 8.6% in the quarter as foreign investors sold a whopping USD 7 billion in June alone in debt and equities, recording the worst fall in a decade among the Asian currencies. The rupee closed at an all-time low of 60.72 against the US dollar on June 26 on heavy capital outflows and month-end dollar demand from importers.

Since May 27, FIIs have pulled out nearly USD 8 billion, from the domestic market after pumping in over USD 15 billion into the country since January, according to Securities and Exchange Board of India (SEBI) data. The rupee had attempted a recovery on 28th June with 91 paise gain, or 1.4%, to close at 59.38. This was on the unexpected improvement in the CAD, which in the March quarter fell to 3.6% against 6.7% in the December quarter of last fiscal. It is expected that the rupee could see some consolidation in the near term, with the Unilever's billion dollar open offer for HUL and Diageo's open offer for United Spirits would bring in good dollars coupled with the government reform measures like gas and coal pricing and getting stalled projects restarted.

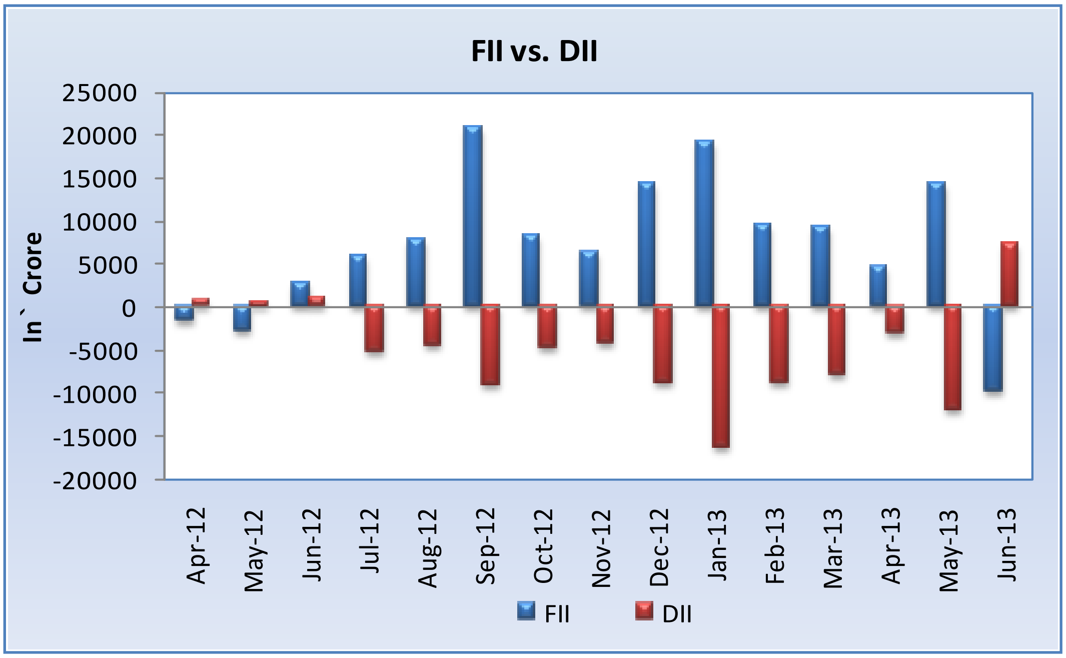
**Equity Market**




Source: BSE & NSE

**FII vs. DII Movement**




Source: SEBI

After witnessing a rally in Q3 of 2012-13, the domestic equity markets weakened during Q4, mainly on account of domestic political uncertainties at the centre in the wake of coalition politics process, slowdown in GDP growth and exports, and lower corporate earnings of some blue chip companies for Q3. During 2013-14 (up to April 26, 2013), BSE Sensex recorded gains of 2.4% mainly on account of hopes of rate cut and fall in commodity price. Depreciation of rupee value against the dollar continued to weigh on the market sentiment as the local currency traded at around 60.72 levels. The main market mover, Foreign Institutional Investors have been on a selling spree and have offloaded over USD 7 billion in debt and equities in June alone. Small-cap and Mid-cap indices underperformed the S&P BSE Sensex and fell by 2.16 and 2.56% respectively due to heavy sell-off from retail investors who feared FIIs would start liquidating positions in shares where they had high ownership.

In addition, as the RBI acknowledged, capital flows have moderated reflecting risk-off sentiment triggered by apprehensions of possible tapering off of quantitative easing by the US Fed. So far in June, the equity markets have witnessed capital outflow of USD 7 billion by foreign institutional investors (FIIs) as against a robust inflow of USD3.8bn by them in May 2013.

The faltering currency hit bonds and stocks as foreign investors, worried about an early end to US stimulus and looking to see their returns eroded, have sold a combined net of more than USD 7 billion in both markets in the month of June. The problems are being compounded by perceptions India is ill suited to defend the currency in the near-term. The Reserve Bank of India has around USD291 billion in currency reserves, enough for only seven months of import cover.

The government has promised measures to attract foreign investment, but remains hampered by a perception that previously announced measures such as opening up the retail sector have faltered in their implementation. The government is also due to announce measures such as opening up the telecom and defence sectors for foreign investment, adopting the same playbook in September when the country sparked a rally in markets by opening up the retail and aviation sectors to foreign investment.

## Outlook

India's economic growth rate slipped to a decade low of 5% in 2012-13 on account of poor performance of manufacturing and mining sectors. The government has pushed through numerous reform measures over the past nine months.

The growth rate of the Indian economy is expected to pick up, although gradually but will continue to remain below the higher average growth rate of the last five years. This expectation would be driven on the back of normal monsoons giving a good harvest, increase in investments in a favourable interest rate regime and gradual recovery in industrial production. Above all it is assumed that the government will expedite projects that have been held up and also start spending on capital projects, which has been held up on account of fiscal constraints. This will also be supported by affirmative action by the RBI, though the timing could be more during the second half of the year. Further it is assumed that the government will focus more on policies that do not require legislative approval in order to revive the growth process and that while one can hope for important bills to be moved in the Parliament, the assumption here is that this may not happen and in terms of policy, the situation would largely be a status quo.

# MSMEs IN INDIA

## Overview

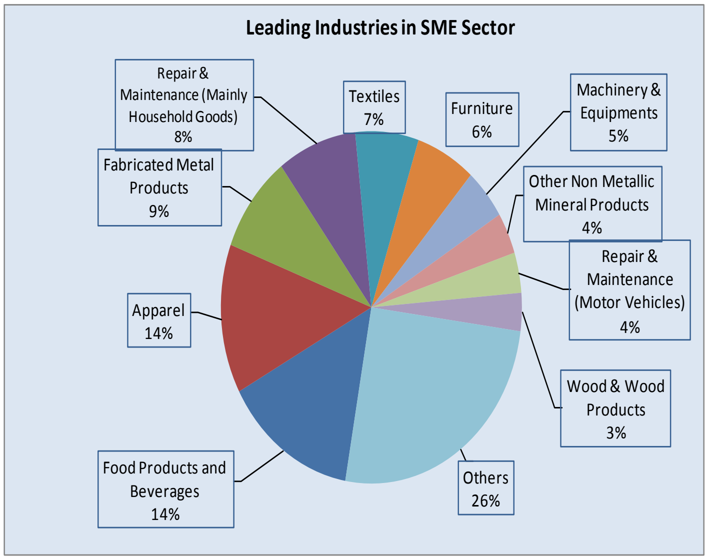
The Micro, Small and Medium Enterprises (MSMEs) play a pivotal role in the economic and social development of the country, often acting as a nursery of entrepreneurship. SMEs are the driving force behind a large number of innovations and contribute to the National growth through employment generation, investments and exports. The MSME sector contributes significantly to the country's manufacturing output, employment and exports and is credited with generating the highest employment growth as well as accounting for a major share of industrial production and export.

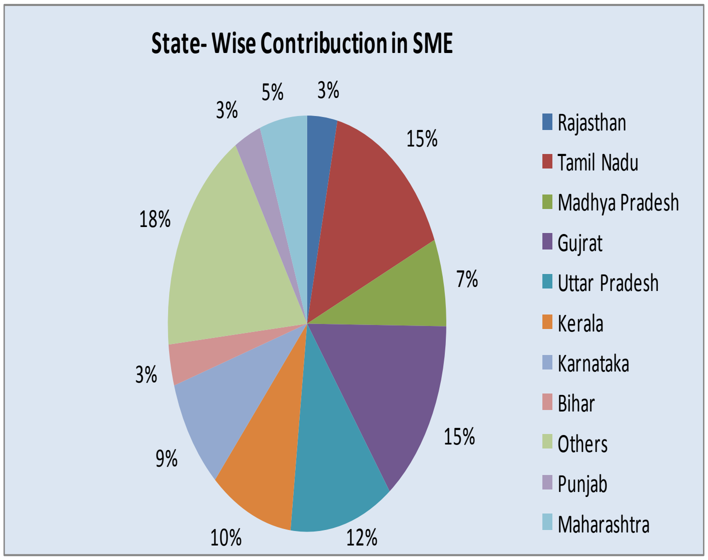
Key highlights of the MSME Sector:

- MSMEs account for about 40% of India's manufacturing output
- MSMEs account for about 40% of India's total exports
- The sector employs about 101 million people in more than 44 million units spread across the country providing 70% of the employment opportunities
- MSMEs manufacture more than 8,000 products ranging from traditional to high tech items
- For FY12, total production coming from MSME sector was projected at ` 18344.33 billion, an increase of more than 11% over the previous year

## Major Industries and State Wise Contribution in SME

The leading industries with their respective shares as well as state-wise contribution in SME are as depicted below:



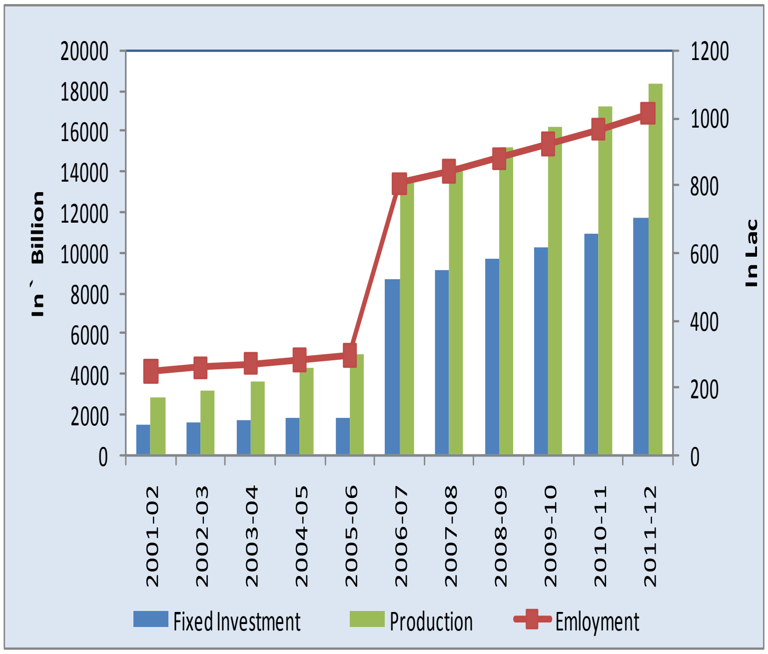




Source: Government of India, MSME Annual Report 2012-2013

The major contribution comes from Apparel & Food Products and Beverages (14%) followed by Fabricated Metal Products (9%) and Repair and maintenance of household goods (8%). Gujarat (15%) and Tamil Nadu (15%) are major states in which SMEs are operating.

## Growth Trend of MSMEs in Indian Economy

The MSMEs contributed significantly to the Indian economy, with more than 44 million units employing more than 101 million persons as at the end of FY12. Productivity of the MSME sector has been improving significantly with fixed investments and employment growing consistently over the past few years. This is a direct indication of the efforts focused on this sector to integrate the workforce with technological enhancements to increase production. Fixed investments in the MSME sector between FY02 and FY12 has grown at a CAGR of 22.53% and employment has grown with a CAGR of 15.04%. Total production by the MSMEs for FY12 is projected to have grown by 6.55% (YOY) to ` 18343.32 billion. Between FY02 and FY12, the sector's total production grew at a CAGR of 20.58% - reiterating the substantial contribution of the MSMEs to the Indian economy




In order to understand the impact of SMEs on the Indian economy; one must study the trend and pattern that has been prevalent in the preceding years. The growth of MSME sector can be shown through following table:

| Year | Total MSMEs (In Lac) | Employment (In Lac) | Fixed Investment (In ` Crore) | Production (in ` Crore) |
|---|---|---|---|---|
| 2001-02 | 105.21 | 249.33 | 154349 | 282270 |
| 2002-03 | 109.49 | 260.21 | 162317 | 314850 |
| 2003-04 | 113.95 | 271.42 | 170219 | 364547 |
| 2004-05 | 118.59 | 282.57 | 178699 | 429796 |
| 2005-06 | 123.42 | 294.91 | 188113 | 497842 |
| 2006-07 | 361.07 | 805.23 | 868583 | 1351383 |
| 2007-08# | 377.37 | 842.23 | 917437 | 1435179 |
| 2008-09# | 393.70 | 881.14 | 971407 | 1524234 |
| 2009-10# | 410.82 | 922.19 | 1029331 | 1619355 |
| 2010-11# | 428.77 | 965.69 | 1094893 | 1721553 |
| 2011-12# | 447.73 | 1012.59 | 1176939 | 1834332 |
| CAGR | 15.58% | 15.04% | 22.53% | 20.58% |

#Projected

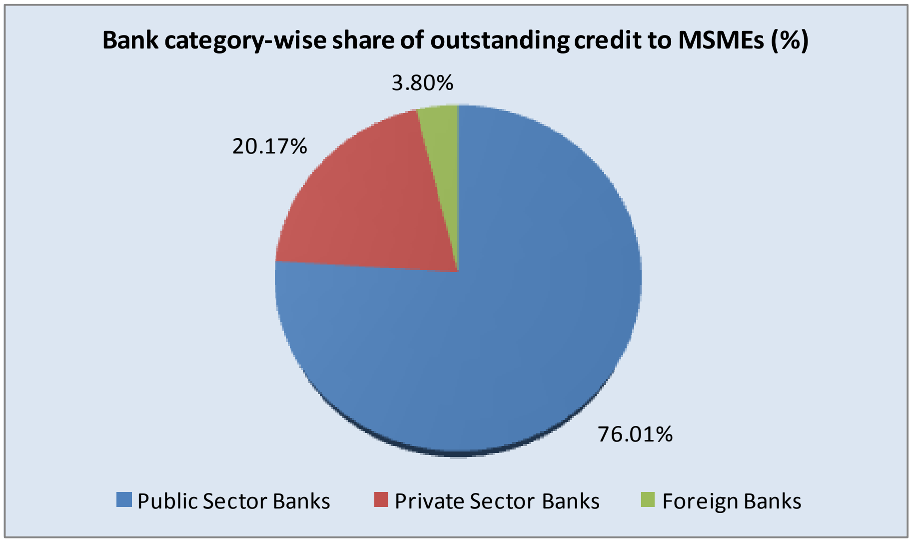
Source: Government of India, MSME Annual Report 2012-2013

## Bank Credit Deployment to MSMEs

The MSME sector has been accorded high priority in the industrial policy owing to its vital role in the economy. Long term funds requirements for the sector are generally met by institutions like SIDBI, SFCs, NBFCs, Scheduled Commercial Banks (SCBs), NBFCs etc. Working capital needs of the sector are largely met by banks. As at the end of FY12, the total outstanding credit by SCBs to Micro and Small Enterprises (MSEs) in India stood at ` 5,209.00 billion, registering a y-o-y growth of 7.19%.

The table given below provides the trend of bank credit deployment over the last 7 years depicting the growth in the credit offtake by the MSMEs:

| Year | Public Sector Banks (In ` Crore) | Private Sector Banks (In ` Crore) | Foreign Banks (In ` Crore) |
|---|---|---|---|
| 2004-05 | 67800 | 8592 | 6907 |
| 2005-06 | 82434 | 10421 | 8430 |
| 2006-07 | 102550 | 13136 | 11637 |
| 2007-08 | 151137 | 46912 | 15489 |
| 2008-09 | 191408 | 46656 | 18063 |
| 2009-10 | 278398 | 64534 | 21069 |
| 2010-11 | 376625 | 87857 | 21461 |
| 2011-12 | 395976 | 105085 | 19839 |
| **CAGR (%)** | **28.67** | **43.00** | **16.27** |




*As per Annual Report 2012-13 of Ministry of Micro, Small and Medium Enterprise, GOI

Among Scheduled commercial banks that lend to MSMEs, Public Sectors Banks (PSBs) account for a major share as compared to private and foreign banks.

## Challenges to MSME Sector

Despite its commendable contribution to the Nation's economy, MSME Sector does not get the required support from the concerned Government Departments, Banks, Financial Institutions and Corporate, which is a making the sector less competitive in the National and International Markets. SMEs faces a number of problems - absence of adequate and timely banking finance, limited capital and knowledge, non-availability of suitable technology, low production capacity, ineffective marketing strategy, identification of new markets, constraints on modernisation & expansions, non availability of highly skilled labour at affordable cost, follow up with various government agencies to resolve problems etc. Some of the major hurdles faced by the SME Sector are:

**Availability of Finance:** To receive timely and adequate finance at agreeable conditions is a tedious and cumbersome exercise for both established as well as budding SMEs. According to the Indian government survey, 90% of the total micro units in India procure funds from friends, lenders and private lenders only. Credit unworthiness and transaction costs are reported as major factors that reduce access to credit.

**Access to Markets:** The limited budgets constrain the SMEs to create market access through marketing and promotion. Internet has in fact rendered a positive impact on Indian SMEs as it has opened new ventures and expanded the horizons for SMEs. Online business to business (B2B) marketplaces could perhaps provide a viable solution to problem of creating of abundant market access as they promote instant access to global markets and industry knowledge in terms of the kind of products and services in demand.

**Lack of knowledge and access to advisory service:** the Indian MSME sector, notwithstanding its prominent role in supporting economic growth as well as creating new entrepreneurship, suffers from inadequate business advisory services to enhance their international competitiveness in the highly competitive financial markets.

**Delayed realization of receivables:** MSMEs suffer from considerable delays in settlement of dues/payment of bills by the large-scale buyers, and this adversely affects the recycling of funds and business operations of MSME units. As a result, MSMEs are often unable to hedge their cash flows due to a low ability to predict the flows

**Lack of proper infrastructure:** This includes adequate means of transport, power and electricity, water and drainage etc. These factors help to reduce the cost of procurement and holding of resources, increases their productivity and thereby lowering the production cost for the SMEs. The responsibility lies with government for better development of infrastructure and amenities in the states.

## Initiatives taken by the Government of India

To empower the SME Sector to take its rightful place as the growth engine of Indian economy, it is necessary to support the SMEs, educate and empower them to make optimum utilization of the resources, both human and economic, to achieve success. The SMEs need to be educated and informed of the latest developments taking place globally and helped to acquire skills necessary to keep pace with the global developments.

- To improve the productivity, competitiveness and capacity building of the MSMEs, the Government of India has adopted a cluster-based approach. During Apr-Jan FY12, the government has taken eight new clusters for diagnostic study, five for soft interventions, and four for setting up of common facility centres. Till Jan 2012, the government has taken a total of 477 clusters for diagnostic study, soft interventions and hard interventions and 134 infrastructure development projects.

- For the availability of equity to the MSME sector, the Government has set up an India Opportunities Venture Fund with SIDBI worth ` 50 billion.
- Allocation for the Prime Minister's Employment Generation Programme increased by 23% from ` 10.37 billion to ` 12.76 billion.
- Under the Public Procurement Policy for Micro and Small Enterprises (MSEs), Ministries and Central Public Sector Enterprises (CPSEs) are required to make a minimum of 20% of their annual purchase from MSMEs. Of this purchase, 4% to be earmarked for procurement from MSEs owned by SC/ST entrepreneurs.
- Increase in the turnover limit from ` 6 million to ` 10 million for SMEs for compulsory tax audit of accounts and for presumptive taxation.
- Exemption of capital gains tax on sale of a residential property, if the sale consideration is used for subscription in equity of a manufacturing SME company for purchase of new plant and machinery.
- Reduction in the basic customs duty to 2.5% with concessional Countervailing Duty (CVD) of 6% on specified parts, components and raw materials for the manufacture of medical devices such as disposables and instruments.
- Full exemption from basic customs duty and CVD to specified raw materials for the manufacture of coronary stents and heart valves.
- Reduction in the excise duty from 10% to 6% on matches manufactured by semi-mechanised unit

## MSMEs Future Outlook

SMEs now occupy a position of strategic importance in the Indian economic structure due to its significant contribution in terms of output, exports and employment. With the initiatives that are being taken by the government and other SME organizations, the future definitely looks bright for Indian SMEs. On the one hand, increased per capita income and consumerism have opened up numerous opportunities for this sector to enhance productivity and look at new national and international markets. On the other hand, the sector continues to face challenges like fund shortages, limited access to equity capital, technological obsolescence and lack of infrastructure facilities, among others. Despite the various challenges it has been facing, the MSME sector has shown admirable innovativeness, adaptability and resilience to survive the recent economic downturn and contribute significantly to India's industrial growth. Government policy should promote MSMEs by helping them to increase their efficiency and competitiveness within a market driven economy.

## ONICRA RATED ENTITIES

### PROFILE OF ONICRA RATED MSMEs (For the Period - 8th April 2013 to 30th June 2013)

**Geographical Distribution of Ratings**

| State | Percentage Wise |
|---|---|
| Andhra Pradesh | 8.81 |
| Arunachal Pradesh | 0.09 |
| Assam | 5.82 |
| Bihar | 3.88 |
| Chandigarh | 0.14 |
| Chhattisgarh | 1.33 |
| Delhi | 1.94 |
| Gujarat | 3.41 |
| Haryana | 2.13 |
| Himachal Pradesh | 0.19 |
| Jharkhand | 0.71 |
| Karnataka | 8.57 |
| Madhya Pradesh | 4.07 |
| Maharashtra | 4.69 |
| Manipur | 0.09 |
| Meghalaya | 0.38 |
| Nagaland | 0.24 |
| Orissa | 2.32 |
| Punjab | 3.65 |
| Rajasthan | 3.93 |
| Tamil Nadu | 12.74 |
| Tripura | 0.14 |
| Uttar Pradesh | 17.76 |
| Uttarakhand | 2.04 |
| West Bengal | 10.94 |
| Total | **100.00** |

**Onicra- Rated MSME: Industry Wise Distributions**

| Industry | Number of Cases | Percentage Wise |
|---|---|---|
| Agriculture & Allied Products | 164 | 7.77 |
| Auto & Auto Components | 48 | 2.27 |
| Chemicals | 47 | 2.23 |
| Construction & Engineering | 157 | 7.43 |
| Construction-Materials | 94 | 4.45 |
| Consumer Durables | 34 | 1.61 |
| Containers & Packaging | 48 | 2.27 |
| Educational Services | 21 | 0.99 |
| Electrical Components & Equipments | 84 | 3.98 |
| Food Products | 101 | 4.78 |
| Hospitality | 26 | 1.23 |
| Household & Personal Products | 22 | 1.04 |
| Information Technology & Telecommunications | 32 | 1.52 |
| Iron and Steel | 75 | 3.55 |
| Jewellery | 26 | 1.23 |
| Machinery and Equipments | 198 | 9.38 |
| Media & Printing | 43 | 2.04 |
| Metal and Metal Products | 125 | 5.92 |
| Paper & Forest Products | 45 | 2.13 |
| Pharmaceuticals | 40 | 1.89 |
| Plastic & Plastic Products | 83 | 3.93 |
| Power & Energy | 23 | 1.09 |
| Retailing | 95 | 4.50 |
| Services | 98 | 4.64 |
| Textile | 230 | 10.89 |
| Transportation | 9 | 0.43 |
| Others | 144 | 6.82 |
| Total | **2112** | **100.00** |

### Rating Distribution: NSIC-Onicra Rating

| Rating | Q2FY13 (%) | Q3FY13 (%) | Q4FY13 (%) | Q1FY14 (%) |
|---|---|---|---|---|
| SE 1A | 0.45 | 0.12 | 0.43 | 0.43 |
| SE 1B | 1.63 | 0.67 | 1.05 | 0.66 |
| SE 1C | 1.05 | 0.55 | 0.43 | 0.38 |
| SE 2A | 9.58 | 9.37 | 10.05 | 2.75 |
| SE 2B | 31.36 | 31.41 | 32.38 | 19.51 |
| SE 2C | 19.22 | 18.98 | 14.02 | 16.24 |
| SE 3A | 15.94 | 14.57 | 15.54 | 4.02 |
| SE 3B | 13.20 | 18.31 | 20.31 | 29.92 |
| SE 3C | 6.52 | 5.57 | 5.49 | 19.37 |
| SE 4A | 0.48 | 0.00 | 0.00 | 0.09 |
| SE 4B | 0.45 | 0.43 | 0.30 | 4.50 |
| SE 4C | 0.13 | 0.00 | 0.00 | 2.13 |
| Total | **100.00** | **100.00** | **100.00** | **100.00** |

### NSIC-ONICRA Rating Definition

NSIC-Onicra Rating reflects Onicra's opinion on the company's performance capability and financial strength. Ratings are assigned on the scale given below.

| Performance Capability | Financial Strength | | |
|---|---|---|---|
| | High | Moderate | Low |
| **Highest** | SE1A | SE1B | SE1C |
| **High** | SE2A | SE2B | SE2C |
| **Moderate** | SE3A | SE3B | SE3C |
| **Weak** | SE4A | SE4B | SE4C |
| **Poor** | SE5A | SE5B | SE5C |

The benefit of getting a SME business credit rated goes beyond procuring finance at competitive rates. While drawing business from a client located in dispersed geographies of from large corporate and multinationals, the rating exercise also serves as an independent due diligence activity. Further, since Onicra examines all aspects of the SME business, the management came to know the shortcoming and areas which requires further improvement. All these benefits create confidence in the client and that has enabled ONICRA to achieve significant growth in the numbers of rating done.

Onicra has its presence across the country and has been able to reach SMEs from remote parts. Uttar Pradesh, Tamil Nadu, West Bengal, Karnataka, Andhra Pradesh and Assam have contributed majorly in establishing the strong network of the company in the Q1FY14.

### Quarterly Rating Distribution

| Rating | Q2FY13 (%) | Q3FY13 (%) | Q4FY13 (%) | Q1FY14 (%) |
|---|---|---|---|---|
| SE 1A | 0.45 | 0.12 | 0.43 | 0.43 |
| SE 1B | 1.63 | 0.67 | 1.05 | 0.66 |
| SE 1C | 1.05 | 0.55 | 0.43 | 0.38 |
| SE 2A | 9.58 | 9.37 | 10.05 | 2.75 |
| SE 2B | 31.36 | 31.41 | 32.38 | 19.51 |
| SE 2C | 19.22 | 18.98 | 14.02 | 16.24 |
| SE 3A | 15.94 | 14.57 | 15.54 | 4.02 |
| SE 3B | 13.20 | 18.31 | 20.31 | 29.92 |
| SE 3C | 6.52 | 5.57 | 5.49 | 19.37 |
| SE 4A | 0.48 | 0.00 | 0.00 | 0.09 |
| SE 4B | 0.45 | 0.43 | 0.30 | 4.50 |
| SE 4C | 0.13 | 0.00 | 0.00 | 2.13 |
| **Total** | **100.00** | **100.00** | **100.00** | **100.00** |

### Quarterly Geographical Distribution

| State | Q2FY13 (%) | Q3FY13 (%) | Q4FY13 (%) | Q1FY14 (%) |
|---|---|---|---|---|
| Andhra Pradesh | 6.21 | 6.92 | 6.43 | 8.81 |
| Arunachal Pradesh | 0.05 | 0.43 | 0.00 | 0.09 |
| Assam | 5.22 | 4.35 | 5.64 | 5.82 |
| Bihar | 4.63 | 4.23 | 2.28 | 3.88 |
| Chandigarh | 0.00 | 0.00 | 0.58 | 0.14 |
| Chhattisgarh | 0.63 | 1.78 | 1.73 | 1.33 |
| Daman | 0.00 | 0.00 | 0.00 | 0.00 |
| Delhi | 3.17 | 4.65 | 2.06 | 1.94 |
| Goa | 0.00 | 0.18 | 0.00 | 0.00 |
| Gujarat | 4.58 | 4.53 | 4.26 | 3.41 |
| Haryana | 4.58 | 2.33 | 3.18 | 2.13 |
| Himachal Pradesh | 1.63 | 0.92 | 0.14 | 0.19 |
| Jammu & Kashmir | 0.05 | 0.12 | 0.07 | 0.00 |
| Jharkhand | 5.03 | 2.33 | 0.61 | 0.71 |
| Karnataka | 7.76 | 7.90 | 8.75 | 8.57 |
| Kerala | 0.41 | 0.55 | 0.14 | 0.00 |
| Madhya Pradesh | 6.17 | 5.76 | 5.78 | 4.07 |
| Maharashtra | 5.44 | 7.96 | 6.18 | 4.69 |
| Manipur | 0.00 | 0.00 | 0.00 | 0.09 |
| Meghalaya | 0.09 | 0.49 | 0.43 | 0.38 |
| Mizoram | 2.22 | 0.00 | 0.00 | 0.00 |
| Nagaland | 0.00 | 0.00 | 0.00 | 0.24 |
| Orissa | 3.27 | 1.71 | 1.23 | 2.32 |
| Punjab | 3.76 | 3.00 | 2.57 | 3.65 |
| Rajasthan | 0.05 | 4.65 | 3.14 | 3.93 |
| Tamil Nadu | 4.08 | 10.41 | 14.96 | 12.74 |
| Tripura | 0.05 | 0.00 | 0.00 | 0.14 |
| Uttar Pradesh | 19.50 | 15.86 | 18.54 | 17.76 |
| Uttarakhand | 2.04 | 1.22 | 2.49 | 2.04 |
| West Bengal | 9.39 | 7.72 | 8.78 | 10.93 |
| Pondicherry | 0.00 | 0.00 | 0.00 | 0.00 |
| **Total** | **100.00** | **100.00** | **100.00** | **100.00** |

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