COVID-19 | "ATMANIRBHAR" PACKAGE | Day #1

Summary of announcements impacting the MSME & NBFC sectors

BACKGROUND

In his nation-wide address on May 12, 2020, Prime Minister Narendra Modi announced a Rs. 20 lakh crore stimulus package to tackle the impact of coronavirus. In his address, the Prime Minister announced that the Ministry of Finance will be holding a series of press conferences in the coming days to provide details of the package. On May 13, 2020, the Ministry of Finance announced the first measures to support the ailing economy, especially Micro, Small and Medium Enterprises (MSMEs) and Non-Banking Financial Companies (NBFC).

The Government appears to have struck a fine balance between managing the fiscal position and providing much needed support to the economy by reducing the immediate cash outgo while simultaneously extending support to the entities and intermediaries with sufficient liquidity. At a time when the economy is facing a supply shock (due to supply chain disruptions across sectors) and resultant demand slowdown (due to income shock the population attempting to reduce consumption), any stimulus to revive the demand would have resulted in waste of resources as incremental capex/investments are not possible during this time. At this juncture, it was important to provide support on wages and liquidity so that small businesses can gradually resume their activity once the lockdown restrictions are eventually phased out across the country. The current package addresses both these factors by covering measures on liquidity and solvency, and hence are positive for NBFCs lending to the MSME segment.

The Government announced three steps specifically addressing liquidity and solvency of MSMEs:

1. **Rs. 3 lakh crore** emergency credit line up to 20% of existing debt outstanding (as of February 29, 2020)
2. **Rs. 20,000 crore** of subordinated debt support to stressed entities; and
3. **Rs. 50,000 crore** of equity support for viable MSMEs. Under this scheme, the Government will set up a mother fund with Rs. 10,000 crore of capital which will in turn infuse capital into a series of daughter funds in a staggered manner (Please refer to **Annexure A** for scheme details).

The announcements are expected to support the viability of the stressed MSMEs for a period 4-5 months. Let us illustrate this with an example. High level financials for a typical MSME unit* are as below:

HEADING	%	REMARKS
Revenue	100%	• Revenue from Exports/Domestic activities
Raw Material Costs	65-70%	• Raw material costs (may vary depending upon the industry)
Opex	15-20%	• Personnel and administrative costs (fixed + variable)
Financing Charges	3-5%	• EMI + Principal outgo • Debt outstanding - 25%-35%, • Banks generally fund 20%-25% of the revenue as a limit, other unsecured lenders may provide additional loan of 5% of the revenue); blended interest rate is generally ~15%
PBT	6-16%	• PBT Margin
PAT	4.5-11%	• PAT Margin

** indicative financials for a typical entity engaged in manufacturing sector, could vary as per industry*

For any MSME unit to sustain, enterprises will need to incur ~ 3-5% in debt servicing and ~7-10% for fixed opex on an annualised basis during the lockdown period. This suggests that for an MSME with Rs. 100 crore in revenue, the fixed outgo is estimated to be ~Rs. 1.2 crore per month during the lockdown. Under the current scheme, entities are eligible for 20% of additional credit line (~Rs. 5 crore in above example). This is sufficient to support the enterprises for ~4 months as MSMEs come out of the stress faced due to lockdown.

The Government has also undertaken to release all receivables due to MSMEs by the government and CPSE (Central Public Sector Enterprises) within the next 45 days. This is expected to be funded by government borrowings as the Government has increased of the revised target of gross borrowing to Rs. 12 lakh crore for FY21 (up from the existing target of Rs. 7.8 lakh crore). Payment by State Government authorities will be a key monitorable as several state governments themselves are stressed in terms of cash flow.

In connection with the liquidity of intermediaries (NBFCs/MFIs), the announcements finally addressed the need for direct intermediation via 100% government-backed guarantees, and recognised MFIs as a key component within India's development engine. The Government announced Rs. 30,000 crore towards a special liquidity scheme, fully guaranteed by Government, specifically for NBFCs/HFCs/MFIs, where investment will be made via both primary and secondary market transactions in investment grade debt papers of the said lending institutions. This is expected to provide ample liquidity to the NBFC sector (through primary transactions) and Mutual Fund sector (through secondary transactions). Generating liquidity for the secondary market is also expected to protect cost of funds of NBFCs against the forced sale of debt papers by mutual funds.

Moreover, to address the credit and rate transmission issue for low-rated NBFCs/HFCs/MFIs, the Government also announced a partial credit guarantee scheme worth Rs. 45,000 crore with 20% first loss to be borne by the Government with committed guarantee amount of Rs. 9,000 crore. The mechanism to implement both the schemes is expected to be announced soon. However, it is expected that these schemes will be driven by the national development financial institutions.

Overall, we believe that the announcements are extremely positive for the MSMEs and NBFCs lending to MSMEs. Going forward, execution remains key in order to achieve the objectives laid out in this package.

NORTHERN ARC

ANNEXURE A

Summary of Announcements covering MSMEs and NBFCs

Source: Press Bureau of India

ANNOUNCEMENTS IMPACTING THE MSME SECTOR

NO.	SCHEME	PARTICULARS
1)	***Rs. 3 lakh crore collateral-free automatic loans for businesses, including MSMEs***	• Emergency credit line will be provided to businesses/MSMEs from Banks and NBFCs up to 20% of entire outstanding credit as on February 29, 2020 • 100% credit guarantee cover to Banks and NBFCs on principal and interest • Interest will be capped • Scheme can be availed till 31st Oct 2020. • Loans to have 4-year tenor with moratorium of 12 months on Principal repayment • Funding to meet operational liabilities built up, buy raw material and restart business. • Borrowers with up to Rs. 25 Crore outstanding and Rs. 100 Crore turnover eligible
2)	***Rs. 20,000 crore Subordinate Debt for Stressed MSMEs***	• Stressed MSMEs need equity support. GoI will facilitate provision of Rs. 20,000 Cr as subordinate debt • Two lakh MSMEs are likely to benefit • Functioning MSMEs which are NPA or are stressed will be eligible • Govt. will provide a support of Rs. 4,000 Cr. to CGTMSE • CGTMSE will provide partial Credit Guarantee support to Banks • Promoters of the MSME will be given debt by banks, which will then be infused by promoter as equity in the Unit
3)	***Rs. 50,000 crore equity infusion for MSMEs through Fund of Funds (FOF)***	• MSMEs face severe shortage of equity • Fund of Funds with corpus of Rs 10,000 crore will be set up to provide equity funding for MSMEs with growth potential and viability • FoF will be operated through a Mother Fund and few daughter funds • Fund structure will help leverage Rs 50,000 crore of funds at daughter funds level
4)	***New definition for MSMEs***	• Composite criteria for Manufacturing and Services announced. • Necessary amendments to law will be brought about. • This classification helps institutions to continue to access the incentives attached with lower classifications (fewer compliances on taxations and filings, tax benefits, subsidies, lower interest rates)

5)	***Other interventions for MSMEs***	• Global tenders to be disallowed up to Rs. 200 crore, a step towards Self-Reliant India • MSMEs currently face problems of marketing and liquidity due to COVID • e-market linkage for MSMEs to be promoted to act as a replacement for trade fairs and exhibitions • Fintech will be used to enhance transaction-based lending using the data generated by the e-marketplace. • MSME receivables from GOI and CPSEs to be released in 45 days

ANNOUNCEMENTS IMPACTING THE NBFC SECTOR

NO.	SCHEME	PARTICULARS
1)	***Rs. 30,000 crore Special Liquidity Scheme for NBFCs/HFCs/MFIs***	• NBFCs/HFCs/MFIs are finding it difficult to raise money in debt markets • Under this scheme, investments will be made in both primary and secondary market transactions in investment grade debt paper of NBFCs/HFCs/MFIs • Will supplement RBI/Government measures to augment liquidity • Securities will be fully guaranteed by the Government • Will provide liquidity support for NBFCs/HFC/MFIs and mutual funds and create confidence in the market
2)	***Rs. 45,000 crore Partial Credit Guarantee Scheme 2.0 for NBFCs***	• NBFCs, HFCs and MFIs with low credit rating require liquidity to do fresh lending to MSMEs and individuals • Existing PCGS scheme to be extended to cover borrowings such as primary issuance of Bonds/CPs (liability side of balance sheets) of such entities • First 20% of loss will be borne by the guarantor, i.e., Government of India • AA paper and below including unrated paper eligible for investment (especially relevant for many MFIs) • This scheme will result in liquidity of Rs 45,000 crore