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The Need for a Credit Bureau for the Non-Corporate Small Business Sector in India

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Abstract:
The Non - Corporate Small Business Sector in India today is the largest contributor of GDP, contributing to 45% of the GDP. This sector is considered as the backbone of the economy, three times the size of the corporate economy. About 50 crore lives depend on this sector for their livelihood. 90% of the county's employment is generated by this sector consisting of 46 crore employees.
A large portion of this sector runs as Own Account Enterprises (OAE). This sector consists of about 5.7crore enterprises such as simple manufacturing units, shopkeepers, fruit and vegetable venders, repair and maintenance shops, small scale food processors, street vendors, dairy farmers, poultry units etc.
While all this could be fascinating, the credit facilities provided to this sector is substantially disappointing. 90% of this sector does not get access to outside sources of finance. They rely on local money lenders and other unreliable sources of finance. Over the decades many efforts have been made to tap this opportunity in a profitable manner. These efforts have however largely failed despite a great lead by the RBI and the Government. Less than 15% of bank credit goes to this sector. RBI constituted a Committee chaired by Shri Y. H. Malegam to study issues related Micro financial problems in India in 2011. One important recommendation of this committee was creation of one or more credit bureaus for the Micro finance sector.
This paper brings about the importance and the need for an exclusive credit bureau to cater to the needs of the Non - Corporate Small Business Sector. This study will help to understand the importance of a Credit Bureau for the banks catering to the Non-Corporate Small Business Sector.

1. Introduction
The Non-Corporate Small Business Sector has become strategically important for lending industry for the huge potential latent in it. Although the demographics are attractive it also contains a huge risk of defaults and increase in Non-performing Assets (NPAs). Lenders rely on credit bureaus for evaluating the creditworthiness of their customers. Credit Bureaus play a larger role today than ever before.
Credit bureaus in India focus on all kinds of customers and do not give the special attention that this unique sector demands. Multiple bureaus catering to same type of customers can lead to multiple credits from different lenders who are not members of all bureaus. Thus there is a need for a credit Bureau that caters to the need of the OAE sector exclusively.

2. Literature Review
This section gives a brief of some articles that bring about the importance of Credit Bureaus, the small business sector and their problem in India.
(R.G.Saraiya, 1972) in his report, 'Report of Banking Commission', made an important recommendation for setting up of one or more Credit Intelligence Bureaus as a statutory body which would furnish adequate and reliable credit information to banks and other financial institutions.
(Lahiri, 2012)in his work talks about some of the major issues that MSMEs face like competition from large industries due to withdrawal of subsidy, lack of infrastructure, anti-dumping policy, challenges on product standardization, total quality management etc. His focus was on the impact of withdrawal of protective policies for the Micro, Small and Medium Enterprise (MSMEs) by the government as part of reforms in 1991. He used the annual average Growth rate (AAGR) as a major statistical tool to compare the performances of MSMEs during the pre and post-liberalization period with the help of four economic parameters namely No. of units, production, employment and export. The impact was that globalization process has expanded the market facilitating supply of superior technology and has also forced the MSMEs to face ruthless competition from large domestic firms and the MNCs. The study results

showed that except marginal increase in growth rate in employment generation, the growth rate in other parameters was not encouraging during the liberalization period.

(Nigam, 2012) in an interview to Business line talks about the importance of CRISIL ratings for SMEs. Interest rate decisions and credit limit decisions are the most important reasons why SMEs must get themselves rated. Ratings can increase the probability of lenders to decrease the interest rates by 0.25-1.25 per cent to SMEs that enjoy higher credit ratings. Good ratings can also increase the credit limit that may not have been offered.

(Arunachalam, 2011) in an article for a newspaper talks about the difficulties in setting up a credit Bureau for the Micro finance sector. Some of the issues he points out are lack of strong leadership, no serious regulatory support, unrealistic targets, lack of reliable ground-level data, IT issues and lack of focus on execution.

(Sridhar, July 12, 2012) talks about the increasing practice of routing loan applications of micro credit through credit bureaus in India. Such routings have proved to be beneficial to not only MFI but also to borrowers.

(Jaleel, January 2015) in his article studies the impact that a directive made by the RBI to make all credit institutions, especially the NBFCs become members of credit Bureaus in India. The first, he recognizes is '*More Information*'- this would help increase the credit data base. Secondly, *'Better Coverage'* – with increase in base, comes increase in coverage. This could improve if all credit institutions would be made to be members of all bureaus. Thirdly, *'Standard Format'* – RBI has also asked the Bureaus to shift to the standard practice followed by CIBIL (300-900 scale). This would reduce the confusions of lenders and borrowers and also help in better comparison of credit reports of different Bureaus. Fourthly, '*Cost Factor'* synergies are created with increased data and Bureaus can work together for greater innovation.

The overall impact is not only beneficial to the bureaus and the lenders but also the borrowers to make prompt payment and improve the credit Reports.

3. Non-Corporate Business Sector in India

The term 'Non - Corporate Small Business Sector' is defined as

"millions of proprietorship/partnership firms running as small manufacturing units, shopkeepers, fruits/vegetable sellers, truck operators, food-service units, repair shops, machine operators, small industries, artisans, food processors and others, in rural and urban areas. (www.smallbusinessisbigbusiness.org)

It is also referred to as the OAE (Own Account Enterprise) sector is a part of the MSME sector characterized as unorganized or self-organized sector consisting of 5.77 Crore enterprises (excluding non-agricultural enterprises construction). These enterprises are all around us in cities big and small, and in districts and villages and are economically active in a variety of ways in Manufacturing, Services and Trading.This sector has today taken the central stage for studies due to the untapped growing potential of this sector.

The OAE sector plays a crucial role in the economic development of India. It contributes to 90% of the country's employment and 45% of India's GDP. The gross value addition from this sector is close to Rs.6.28 lakh crore. The composition of this sector is 54% urban and 46% rural. 60% of all these enterprises are owned by backward classes (57% in urban and 63% in Rural) (Vaidyanathan, June 2012).

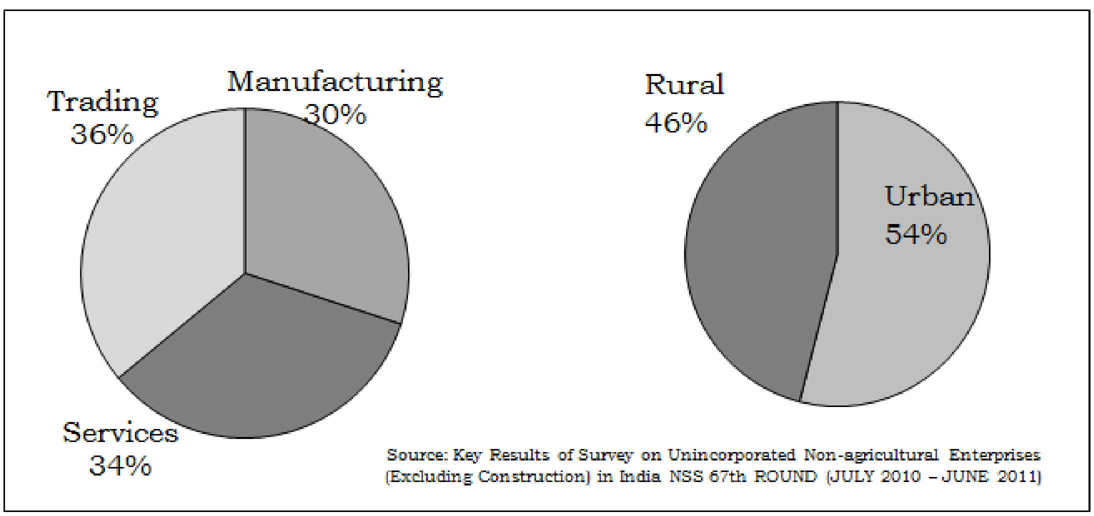

Figure 1: Distribution of the Non-Corporate Small Business Sector

	Caste Category of Enterprise Ownership			
	Non-SC/ ST	SC	ST	Total
%firms with only one person	56.9%	64.7%	55.9%	59.2%
Rural	61.6%	66.2%	56.4%	61.4%
Urban	50.1%	60.9%	54.2%	55.1%
% firms with no labor	68.0%	77.3%	76.9%	74.1%
Rural	76.5%	81.4%	81.3%	79.7%
Urban	55.7%	67.3%	60.6%	61.2%
% firms with no outside finance	92.8%	93.5%	92.0%	92.8%
Rural	92.6%	93.4%	92.4%	92.8%
Urban	93.2%	93.8%	90.7%	92.6%
% firms with institutional finance	3.6%	2.6%	3.6%	3.3%
Rural	3.6%	2.5%	3.3%	3.1%
Urban	3.7%	2.7%	4.5%	3.6%
% unregistered firms	77.4%	88.1%	87.4%	84.3%
Rural	86.5%	92.7%	92.6%	90.6%
Urban	64.3%	76.7%	67.8%	69.6%

Table 1: Firm Scale Characteristics by Caste Category
Source: (Lakshmi Iyer, October 2011)

The above table categorically states the caste wise Entrepreneurship in India. The data clearly shows the pathetic condition enterprises in India today are. While more than half of the firms are single owned, about three- fourth have no employees. 93% of firms do not get access to any source of outside finance and less than 3% resort to institutional sources of finance and the remaining resort to unorganized/ informal sources of finance. Bankers have not tapped this huge sector for decades for the simple reason that they are unprofitable.

The largest sector generates 90% of the country's employment but gets not more than 4% credit from the formal organized Banking sector. This sector is the cushion for employment in the country. When the economy is not able to generate employment, people take shelter in this sector. For a country like India, where mouths to feed are more that the hands that can work, the Non-corporate small business sector is of utmost importance to make both ends meet. The over dependence of the agriculture sector (13.7% of GDP in 2012-13) on seasonal rains in India has forced the farmers to look for other sources of income. To a large extent they found it in the OAE sector.

The credit industry found this sector highly fragmented, low on profits, high operating costs and unreliable. The term 'unreliable' was most important for the credit industry. The OAE sector was neither in a position to provide certainty of income nor worthy collateral for the credit industry. This sector proved to be more dangerous that the agricultural sector. Micro businesses in this sector are highly vulnerable to changes in business cycles.

In this background, it was the reforms of the banking industry that forced the banks and other lenders to look at the small business sector from a different point of view. Group lending and self-help group structures were brought in to create sizable credit to groups who not only had similar work, but also were used to create guarantees amongst themselves. With the rise in micro credit opportunities, Microfinance institution grew large in number. Banks lent to MFIs who further lent to the ultimate borrowers. This reduced the cost of lending for banks through this mechanism of indirect lending. Today credit institutions provide collateral-free credit to borrowers for large amounts of credit. This is where credit bureaus come to play a crucial role in providing a better and reliable form of credit to borrowers.

4. The Role of Credit Bureau

Credit Bureaus or Credit Information Bureaus (CIB) (also known as credit referencing agencies or credit intelligence firms or credit reporting agencies) is a company that collects information from various sources and provides consumer credit information on individual consumers for a variety of uses. It is an organization providing information on individuals' borrowing and bill-paying habits (Arthur O'Sullivan, 2003). CIBs play an important role in the credit industry. CIBs (a) maintain a data bank on borrowers from lending institutions;(b) collect and collate, trade, credit and financial information on borrowers and prospective borrowers of lending institutions; (c) store the information so collected; and (d) furnish credit information to its members (consists of Banks, Non-Banking Financial Companies, Housing Finance Companies and Credit Card Companies use CIBIL's services and other Financial Institutions) on request and in confidence. Data sharing is based on the Principle of Reciprocity, which means that only Members may access Credit Information Reports from the Bureaus

CIBs collate credit information mainly from 3 sources – (i) Public domain data (Court judgments, records of the Registrar, published information on firms, corporates, etc.) (ii) Negative listing (where credit granters list defaulting payers) (iii) Closed user groups where subscribing credit institutions provide full details of their client's payment profile at periodical intervals (i.e., positive and negative data).The data obtained is analyzed and converted into meaning full information that is crucial for lending decisions. A credit bureau

is thus a facilitator for credit dispensation and helps mitigate the credit risk involved in lending. It creates a formal credit referral system, which is highly reliable and at the same time, easily accessible to the eligible user group.
The Credit Information Bureau provides a platform for sustainable growth of the Rural Financial Services Sector. CIBs help lenders to find the right customers, make faster decision making in regard to sanction of credit and also help in making decisions regarding period of credit, interest to be charged, collateral required and finally the amount of credit that came be given on the basis of the borrowers' credit report. Credit reports help in fraud and loss Prevention, and enable the member institutions to achieve higher accuracy in risk prediction.
In India, there are currently four credit bureaus the oldest being Credit Information Bureau of India (CIBIL) established in 2004 by SBI (40%), TransUnion (10%), HDFC (40%) and Dun & Bradstreet (10%). This was followed by the coming of Equifax Credit Information Service and Experian Credit Information Company of India in 2010. These Bureaus are changing the dynamics of lending business in India. Banks find the credit reports of customers useful not only for risk management but also prevent customers from taking multiple credits without the consent and knowledge of previous lenders. The fourth Bureau, High Mark Credit Information Services was established around the same time as the previous two, but with a specialized focus on micro credit. Today it is the largest Micro Finance Bureau in the world catering to only Retail credit lending industry.

5. The Need for an Exclusive Credit Bureau for the Non-Corporate Small Business Sector

In the latest development, RBI has mandated all the credit lending institutions to become members of CIC (Credit Information Companies/ Credit Bureaus). This would help the CICs to improve coverage. In another directive it has asked the CICs to standardize their processes and reports for comparisons among CICs.
Senior analysts have pointed out that this move by the RBI may not reap the benefits that it wishes to achieve. Lenders are mandated to register with any at least one the Bureaus but not all. When all lenders are registered with all bureaus it will help in eliminating borrowers taking multiple credits from multiple sources without having the worth of borrowing. This proposition may not be favorable for the lenders as registration and maintenance are costly for lenders. This problem mainly occurs due to multiple Bureaus doing the same work for all customers. Even though we have a bureau exclusively for micro lending, other bureaus also cater to micro lending and create more of confusion than a solution. This is a bigger problem when it comes to the Non-corporate Business sector. This sector consists of enterprises who are really not firms and at the same time not individuals either. Their need for finances is larger that individuals and the chances of them to take multiple loans are higher than for individuals.
One solution to this problem is bringing all small businesses under one roof. The government has already come out with a proposal to set up a developmental organization to cater to the needs of the Non-corporate business sector. When all borrowers come under one roof, the major problems of multiple finances are reduced and the bureau also stands to gain on specialization of credit reports for the niche borrowers they cater to.

6. Summary and Conclusion

Credit Bureaus are the need of the hour for different sectors of borrowers having different needs and characteristics. Bureaus do not give the kind of attention that each of these sectors need. The Non-Corporate sector is one such important sector that lies between the formal MSME sector and individual borrowers. Treating them the same as the two could be dangerous. Also, multiple bureaus increase the chances of multiple lending. The solution is an exclusive credit bureau exclusive for the Non-corporate small business Sector.

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