Liquidity lifeline: On Nirmala’s MSME package

Introduction

The first tranche of announcements made by Finance Minister Nirmala Sitharaman under the Atmanirbhar Bharat Abhiyan on Wednesday is impressive indeed.

Focus areas

- The measures announced will go a long way in lifting the spirits of the two key and troubled sectors of MSMEs and non-banking finance companies.
- While for the MSMEs it is an existential crisis, for the NBFCs it is one of liquidity.

Fiscal package for MSMEs

- The massive ₹3-lakh crore collateral-free assistance handed out to MSMEs will help them crank up their operations.
- The Government has extended a sovereign credit guarantee for the complete amount as banks may otherwise have been reluctant to support troubled borrowers.
- The ₹20,000 crore partially guaranteed subordinated debt programme and the ₹50,000 crore fund of funds scheme will help boost the equity portion on MSME.

Subordinated Debt

Subordinated debt is riskier than unsubordinated debt. Subordinated debt is any type of loan that's paid after all other corporate debts and loans are repaid, in the case of borrower default. Borrowers of subordinated debt are usually larger corporations or other business entities. Subordinated debt is the exact opposite of unsubordinated debt in that senior debt is prioritized higher in bankruptcy or default situations.

When a corporation takes out debt, it normally issues two or more bond types that are either unsubordinated debt or subordinated debt. If the company defaults and files for bankruptcy, a bankruptcy court will prioritize loan repayments and require that a company repay its outstanding loans with its assets. The debt that is considered lesser in priority is the subordinated debt. The higher priority debt is considered unsubordinated debt.

Fiscal Stimulus to NBFCs

- NBFCs, housing finance firms and micro finance entities get a much required liquidity boost in the form of a ₹30,000 crore scheme wherein their debt paper will be fully
guaranteed by the government.
- With this, and the partial credit guarantee scheme of ₹45,000 crore, the government has broken the logjam wherein banks were unwilling to extend credit despite the RBI’s strong push.
- This should largely attenuate the liquidity crisis in the non-banking space for now.

The Minister has also done well in addressing the liquidity issues of power distribution companies through a ₹90,000 crore infusion that will be securitised on their receivables and backed by a State government guarantee.

While the headline numbers appear big, the reality is that the government will be called upon to bear the liability only if the economic situation becomes hopeless; it may not come to that.

Issues
- The government did not specify interest cap on these loans without leaving it to individual lenders as each of them has its own rate structure.
- The scheme could have been extended until the end of this financial year instead of until October 31.
- India is now entering the monsoon season when activity is traditionally dull, so it is not clear how many borrowers will get the benefit.
- There are no measures for the migrant workers in its announcements.