CRISIL's analysis of nearly 1,700 MSMEs (annual turnover up to Rs 2.5 billion) shows that their working capital gap — or the difference between current assets and current liabilities (excluding short-term bank borrowings) — has widened consistently since the financial year 2015.

Short-term debt raised by these enterprises — for working capital needs — grew just eight per cent annually, which is significantly lower than their funding requirement.
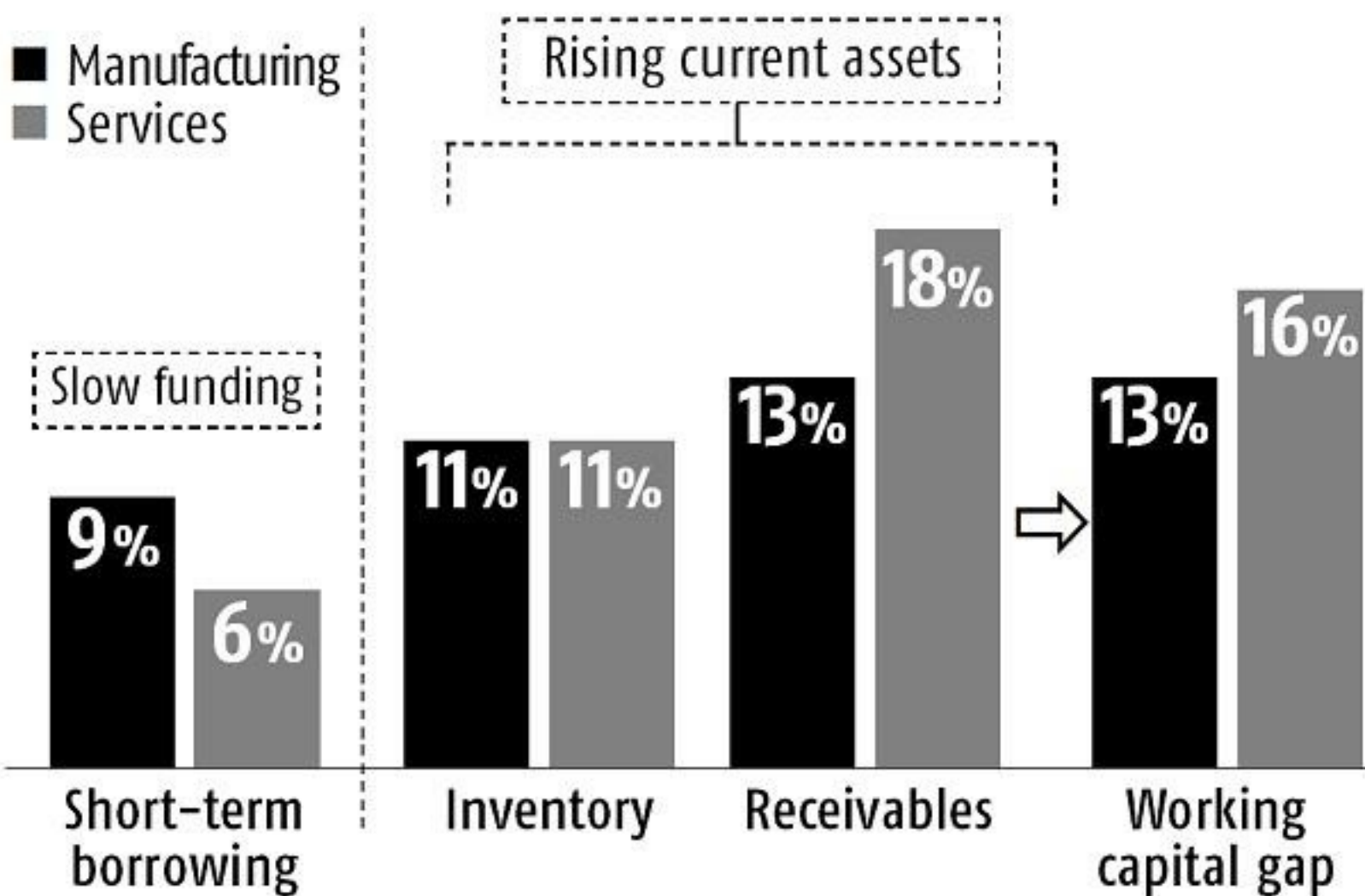
The trend would have continued in the last financial year, too, for two reasons: one, the introduction of the Goods and Services Tax led to increased working capital requirements in the transition phase; and two, lower credit disbursal by banks to MSMEs. According to the Reserve Bank of India, credit to MSMEs in the manufacturing sector registered a negative growth of one per cent last fiscal.

The working capital gap is a critical barometer of an enterprise's ability to meet its daily financing needs for production and services. A widening gap means funding needs to be raised from financial institutions or from own sources, to scale up business.

The gap is widening faster for the services sector at 16 per cent annually, compared with 13 per cent for the manufacturing sector. This is largely because of payment delays, especially in the services sector.

In manufacturing, the gap is wider in the faster-growing industries such as auto components, electronic/electrical equipment and chemicals, where funding is required to buy raw material to match increasing sales. In services, industries which require high working capital deployment, such as logistics, distribution and construction-related enterprises, are witnessing widening gaps. Given that banks are very cautious about lending, NBFCs may continue to tap this big opportunity and expand credit to MSMEs.

# Widening working capital funding*

- ■ Manufacturing
- ■ Services

Rising current assets

Slow funding

**Short-term borrowing:** Manufacturing 9%, Services 6%

**Inventory:** Manufacturing 11%, Services 11%

**Receivables:** Manufacturing 13%, Services 18%

**Working capital gap:** Manufacturing 13%, Services 16%

*Percentages represent average annual increase in absolute values