e-ISSN : 2347 - 9671, p- ISSN : 2349 - 0187
EPRA International Journal of Economic and Business Review | Vol - 3, Issue- 5, May 2015
Inno Space (SJIF) Impact Factor : 4.618(Morocco) ISI Impact Factor : 1.259 (Dubai, UAE)

MICRO SMALL AND MEDIUM ENTERPRISES AND THE BANKING SECTOR IN INDIA

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ABSTRACT

Micro, Small and Medium Enterprises' (MSMEs) contribution in the development of world economy has been significant, both in terms of contribution to GDP and creation of employment opportunities. Economic growth of any country is closely associated with MSME development and there exists a positive relationship between the relative size of the MSME sector and economic growth. MSME Sector has helped in nurturing of thousands of entrepreneurs and they have setup a unit of their own. It is rightly known as the engine of growth as the share of contribution of this sector has registered a remarkable growth in the last decade. The main advantage of this sector is that it provides a large employment at a low capital cost. Unfortunately, MSMEs are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of MSMEs in developing countries rating access to finance as a major constraint. They might not be able to access finance from local banks at all, or face strongly unfavourable lending conditions, even more so following the recent financial crisis. Banks in developing countries are in turn hampered by the lack of lender information and regulatory support to engage in MSME lending. The overall result is absence of a well-functioning MSME lending market, and MSMEs are impeded in their growth, with negative consequences for innovation, economic growth and macro-economic resilience in developing countries. The present paper attempts to identify the role of banking sector in the upliftment of MSMEs in India. The researcher tries to analyze the growth in Bank credit for the MSME sector over the last decade. This paper is based on extensive review of literatures on Banking sector and their contribution in encouraging MSMEs. The review showed that the Bank credit has increased significantly for the MSME sector since the priority sector lending norms were implemented but still there is a significant gap that needs to be fulfilled when it comes to the fulfilment of the credit needs of the MSME sector.

KEYWORDS: *Banks, Credit, Financial Institution, MSME, Entrepreneurship.*

INTRODUCTION

Micro, Small and Medium Enterprises' (MSMEs) contribution in the development of world economy has been significant, both in terms of contribution to GDP and creation of employment opportunities. Economic growth of any country is closely associated with MSME development and there exists a positive relationship between the relative size of the MSME sector and economic growth. MSME Sector has helped in nurturing of thousands of entrepreneurs and they have setup a unit of their own. It is rightly known as the engine of growth as the share of contribution of this sector has registered a remarkable growth in the last decade. The main advantage of this sector is that it provides a large employment at a low capital cost.

The role of Micro, Small and Medium Enterprises Sector in achieving the expected growth rate for our country cannot be overlooked. The biggest contribution of this sector is that it nurtures the budding entrepreneurs and motivates them to try innovation in various forms. A growth in the MSME sector ensures industrialisation in backward areas. Over the last few years, MSME Sector has constantly been growing at an average growth rate of 12 percent and because of this; the share of manufacturing sector in the overall GDP of our country has risen to 16 percent. With the country moving towards a more inclusive growth agenda, a robust MSME sector can accelerate the growth rate, as they do not necessitate huge investments while simultaneously acting as ancillary units to larger industries. Hence, for the growth of the manufacturing sector in the country and specifically in the eastern region, there is a need to focus on the MSME sector.

India is heavily dependent on the MSME Sector since the MSMED Act was implemented in 2006. This sector has approximately 32 million units located in different parts of the country and is currently employing more than 70 million people. It is the second largest employment provider after agriculture in our country. MSME sector manufactures more than 6000 different products, so it gives an idea about the depth in variety of this sector. As of now, this sector is contributing about 45% of the total manufacturing output and their share in exports is approximately 40%. It has been well acknowledged by the government and other governing bodies that the share of MSMEs contribution in economy of India is raising at a high rate and it is expected that the GDP contribution of the manufacturing sector would reach 25% by the end of 2022.

Micro, Small and medium enterprises (MSMEs) are a key driver for economic growth and access to finance is a key constraint to development of micro, small and medium enterprises (MSMEs) in emerging economies. Availability of adequate and timely credit, high cost of credit, collateral requirements, access to equity capital and rehabilitation of sick enterprises are few of the major problems confronting the MSME sector in India. It thus emerges that adequate, timely and affordable credit is one of the bigger issues for the MSME sector.

There are several reasons which demotivate the financial institutions and banks in approving the loan application of the MSMEs. One of the primary reasons why banks turn down the loan requests made by most of the MSMEs is because of their nature. Most of the MSMEs are opaque. They don't function in a transparent manner. When opaqueness is referred then it basically means that, it is quite difficult to figure out about the payback capability of the firm. It's hard to determine, whether the firm has feasible projects and whether it would be able to make profit in the future. These all factors would determine whether the firm would be in a position to payback interest and the total principal amount at a later stage to the bank.

REVIEW OF LITERATURE

Hossain (1998) stated that the inability to access credit is one of the major bottlenecks of MSMEs, as most of the developing economies have poorly developed banking sectors. For most developing and transition economies, the common challenges for SMEs typically include financing, overcoming institutional, legal and administrative barriers and accessing network support.

Weller (1999) argued that big foreign banks are not willing to lend finance to MSMEs, small traders, farmers and the informal sector but they tend to serve less risky undertakings like Trans National Corporations (TNCs) and big corporate groups

Bhattacharya (2000) pointed that banks consider MSMEs as unprofitable and unattractive undertakings, and thus have some hesitation while providing loan to MSMEs. Banks consider MSMEs as high-risk borrowers because of their insufficient assets, high mortality rates and low capitalization.

Lean & Tucker (2000) found in their study that only two third of the MSMEs used the bank overdraft facilities. The overall process revealed that the MSME owners faced many difficulties while using various products offered by banks. They concluded that, banks didn't have much knowledge about the nature of the MSMEs businesses and even MSMEs didn't have much knowledge about the various lending criteria used by the banks. When the owners were asked about the most difficult problem while obtaining finance from banks then most of them cited the lack of securable assets as the major constraint.

Petersen & Rajan (2002) identified that credit scoring helps in reducing the information asymmetry with regards to MSMEs and also stated that the geographic proximity of the borrower and lender is not crucial to loan decisions.

Banerjee (2003) highlighted that there is a great role of hard data like financial information and soft data like feedback from vendors in understanding the credit risk of business while lending to MSMEs.

Fielden (2003) stated that women entrepreneurs were comparatively more dissatisfied as compared to their male counterparts when availing a loan from a bank was concerned. He stressed on the point that, according to the Bank Manager, women do not fit very well as the owner of the unit and they perceive that women cannot run a business effectively. Bank Managers thought of women as someone who runs low technology enterprises and operates mostly in service sectors. He finally concluded that, when it comes to the matter of risk then men and women perceive it differently and most of the women are a bit hesitant to use their house as collateral.

Dallago & McIntyre (2003) stated that MSMEs are not themselves sufficient for growth without the proper development of institutions and support structures.

Batra & Mahmood (2003) argued that MSMEs in developing countries in East Asia receive support from local governments in the form of micro finance, interventions to increase private sector training, technology development, and market information.

Frame & Woosley (2004) concluded that credit scoring tends to increase MSMEs' access to debt capital.

Fraser (2005) conducted his survey on MSME units and concluded that obtaining finance from bank was one of the major problems for MSME unit owners. He found that at the start-up stage obtaining finance was a problem for 10 percent of the units. Further, he pointed out that, the small businesses needing credit for expansion were rejected by banks in 11 percent of the cases. He found that in 19 percent of cases the units received credit less than what they applied for and finally he found that 8 percent of the units didn't apply for credit from banks because they were sure that their application would not be accepted.

Clarke (2005) found that some foreign banks lend more money to MSMEs than domestic banks.

Venkatesh & Nguyen (2006) pointed out that the achievement stage for any particular MSME is to have adequate access to external sources of finance. An important aspect for MSME sector development is access to finance particularly from financial institutions.

Beck & Demirguc-Kunt (2006) highlighted that timely access to finance is a crucial hurdle especially for MSMEs and banks play a significant role in providing timely credit to the MSME units. The authors concluded that the constraint of availability of timely credit for the MSME sector can be resolved to a certain extent with the help of innovative financial instruments.

Haselmann & Wachtel (2007) conducted a study in 20 transition economies and concluded that foreign banks are more inclined towards lending of loans to MSMEs, if creditor protection is strong.

Das (2007) highlighted that the improvement in the quality of financial information is noted to be an important requirement for increasing the flow of credit to MSMEs because the quality of decisions also influences decisions on loan finance.

De Haas & Van Horen (2010) analyzed the syndicated loan market and how banks adjust their lending behaviour during a financial crisis and found that the reduction in bank lending during the crisis can at least partly be attributed to banks' increased monitoring and screening efforts.

Naidu & Chand (2011) highlighted that the inability to obtain external financing, inability to obtain internal financing, insufficient capital and start up costs are the common financial problems of MSMEs. The study revealed that the inadequate credit from banks is the major reasons for finance problems of Micro Enterprises.

MEDHODOLOGY

The present study is basically based on secondary data. The qualitative literature survey provided in-depth insight about the issues pertaining to the approval of credit for MSMEs and the attitude of Indian Banks towards them. The data for the study has been collected from various MSME Annual Reports, RBI Reports on banks and Annual Reports of SIDBI.

OBJECTIVES

- ⇨ To highlight the role of Banks in upliftment of MSME Sector in India
- ⇨ To identify the issues regarding credit approval for MSMEs

Table – 1 Credit flow to MSMEs by Commercial Banks in India

Years	Amount (In Crores)	Credit Flow to MSMEs (In Percentage)	Growth to Total Percentage
2005-06	76114	9.5	2.05
2006-07	82434	8.1	2.08
2007-08	104703	8	2.27
2008-09	116908	18.2	2.11
2009-10	256128	19.9	3.19
2010-11	324838	21.3	3.47
2011-12	418759	23.8	3.84
2012-13	486490	24.9	4.13
2013-14	578646	26.4	4.27

Source: RBI Bulletin

Table-1 highlights the Credit Flow to MSMEs from the commercial Banks. It can be depicted from the table that over the last decade the amount disbursed by the commercial banks to the MSME sector has increased at a moderate pace. Even the percentage share of credit has increased at a moderate rate over the last decade. After the priority sector lending norms were implemented and MSME lending was put under priority sector lending, banks have started lending to this sector as well. The percentage of credit to MSME sector was 9.5% in 2005-06 and it increased to 26.4% in 2013-13 reflecting an increase of 177% over the last decade.

Table – 2 Financing Schemes by Commercial Banks for MSMEs

Banks	Schemes
Union Bank of India	Union high pride, Union support, Union transport, Union Cyber etc.
P.N.B.	PNB Vikash Udyami, PNB SME Sahayog scheme etc.
Syndicate Bank	Synd Vyapar, Synd Udyog, Synd Swarozgar Credit Card, Synd Laghu Udhyami Credit Card, Synd General Credit Card etc.
Dena Bank	Dena Shakti Scheme[for women entrepreneurs], Scheme for financing wind mills Channel financing scheme for dealers / suppliers etc.
UCO bank	SME Medium Term Loans, Scheme for Financing Energy Efficiency Projects etc.
Allahabad Bank	Micro, Small & Medium Enterprises (MSME) Advances etc.
Andhra Bank	Composite loan scheme, Composite loan scheme, Term Finance, Open cash credit (OCC), AB Power Tools (Shakti) etc.
ICICI Bank Ltd.	The ICICI bank edge, vendor bill discounting, SME dialogue etc.
HDFC Bank Ltd.	Working capital finance, construction equipment loan, commercial vehicle finance, Credit substitute, Export credit etc.
Yes Bank Ltd.	Working capital loans, Term loans, Export finance etc.
Axis Bank	Financing to Non-Priority Sector Entities, Overdraft against Property, Financing to Priority Sector Entities, Term Loan against Property, Lease Rent Discounting, Business Loan for Property (BLFP) etc.
Kotak Mahindra Bank	Kotak Business Loan, Working Capital Finance, International Import Finance, International export Finance.

Source: *Compiled from various brochures of Banks*

Table-2 lists the Financing Schemes by Commercial Banks for MSMEs. The table clearly mentions the initiatives taken by various government sector and private sector commercial banks to encourage the budding entrepreneurs to start a unit of their own. Banks have launched various innovating schemes to cater the needs of the MSME Sector. MSMEs can apply for credit through these schemes and the credit amount is disbursed within a short duration of time. The paper work has been kept relatively simple under these schemes.

ISSUES REGARDING CREDIT APPROVAL FOR MSMES

MSMEs are a fundamental part of the economic fabric in developing countries, and they play a crucial role in furthering growth, innovation and prosperity. Unfortunately, they are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of MSMEs in developing countries rating access to finance as a major constraint. They might not be able to access finance from local banks at all, or face strongly unfavourable lending conditions, even more so following the recent financial crisis. Banks in developing countries are in turn hampered by the lack of lender information and regulatory support to engage in MSME lending. The overall result is absence of a well-functioning MSME lending market, and MSMEs are impeded in their growth, with negative consequences for innovation, economic growth and macro-economic resilience in developing countries.

In the recent years, access to timely credit for MSME sector has become more costly and relatively hard to obtain. Banks are getting a bit apprehensive while sanctioning loan to this sector. Unable to get timely credit from financial institutions blocks various growth opportunities for the MSME sector. Access to timely finance has always been considered as a vital factor for the growth of firms and it becomes extremely important in case of MSMEs. They need finance to meet their daily business needs, make timely payments and to grab lucrative opportunities.

There is a belief that the inadequate financing problem for the MSME sector is because of the supply side. The banks and financial institutions are not sanctioning the requested credit for this sector. The banks operate in a biased manner while sanctioning credit to MSMEs when compared to sanctioning of credit to the large enterprises. MSMEs need to strive hard in order to avail timely credit from the financial institutions. Banks usually are not comfortable while sanctioning loans to the MSME units.

There are several reasons which demotivate the financial institutions and banks in approving the loan application of the MSMEs. One of the primary reasons why banks turn down the loan requests made by most of the MSMEs is because of their nature. Most of the MSMEs are opaque. They don't function in a transparent manner. When opaqueness is referred then it basically means that, it is quite difficult to figure out about the payback capability of the firm. It's hard to determine, whether the firm has feasible projects and whether it would be able to make profit in the future. These all factors would determine whether the firm would be in a position to payback interest and the total principal amount at a later stage to the bank.

While sanctioning credit, banks need transparent information of their client. They need clear information regarding their financial position, viable projects they wish to undertake and the previous transactional track record of the client. While comparing MSMEs to the large enterprises, it can be concluded that MSMEs operate in an opaque manner and it's hard to know about their operation in a transparent form. This tendency increases when we talk about developing nations. Opaqueness increases risk perception of the lenders towards MSMEs and thus they are a bit sceptical while sanctioning credit to them.

If a firm operates in an opaque environment and is unable to reveal its financial statements in a transparent manner then it becomes really hard on the part of banks to lend them with confidence. If a firm is hiding its financial statements and its previous transactions then it sends a wrong message to the financial institution, that the firm has got few contingent liabilities and various creditors are to be repaid by the firm. This increases the risk perception of banks towards these small firms and it would be reluctant to lend them or charge a higher risk premium from them.

It is often argued that many of the enterprises and MSME unit owners have creative ideas and feasible projects with them but because of the unavailability of funds, they are unable to capitalize these ideas into profits. This is due to our structural system which is unable to provide timely credit to such entities. It is evident from the various studies that access to timely finance is the biggest hurdle in the path of MSMEs and most of them cited it as the biggest bottleneck. Government has made it imperative for the banks to lend credit to the MSME sector under the priority sector lending guidelines, but still there is a significant gap that needs to be fulfilled when it comes to the fulfilment of the credit needs of the MSME sector.

CONCLUSION

Every bank has given higher importance to financing MSMEs in their growth because MSME is fast growing sector in the Indian economy. This sector has consistently registered a higher growth rate than the rest of the industrial sector. MSMEs are integral part of India's growth story. MSMEs contribute not only to the domestic market but also to exports significantly, thus earning foreign exchange revenue for the country, thereby making the sector emerge as very strong pillar in India both in terms of GDP and in terms of employment.

Banks face several problems at their end while granting loans to the MSME sector. As most of MSMEs work in the unorganized sector, so they do not maintain any proper accounts or balance sheets. Without the presence of proper balance sheets, Banks find it really difficult to lend credit to MSMEs. Banks do not have that much of trust on newly setup enterprises or the start-ups. They consider MSME projects risky and are scared of NPAs while granting credit to start ups. So, Banks generally lend only the prescribed amount to this sector as mentioned under priority sector lending obligations.

Another major problem that MSMEs face in accessing credit from banks is absence of collateral security. Banks generally require collateral security for MSME lending and it becomes a big hurdle for MSMEs in securing credit from banks. The budding entrepreneurs are unable to avail credit from banks because of the absence of credit history.

The current scenario of Indian economy is pushing RBI, to bring in a strict lending policy due to slowdown in growth, which has affected the lending policy to be more conservative with very high interest rate, which is very clearly disturbing the bottom line in the balance sheets of MSMEs . This eventually becomes more difficult for MSMEs, not only for their expansion plan but also to make the company to run in difficult situation. Bankers are far behind in lending guidelines laid down by RBI, in relation to MSME sector, the biggest challenge for Banking sector is, there is no proper mechanism, unlike bigger corporate to measure the quality of the organization in terms of asset quality, Intellectual Properties and the business through acclaimed private agencies.

Still there are various challenges which are to be addressed in this sector. Competition from large scale industries and increasing unit cost are to be minimized by adopting adequate strategies. Availability of raw material at reasonable price is an important problem faced by the sector. Hence government support in this regard will help the sector in facing the competition from the large scale industrial units. The broad picture that emerges from the various surveys of MSME financing strongly suggest that business owners view access to financing as a significant problem for business activity. There might be a financing gap despite the various public and private sector initiatives to facilitate access to financing.

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