ISSN: 2348 9510
International Journal Of Core Engineering & Management (IJCEM)
Volume 3, Issue 7, October 2016

IMPROVING CREDIT HEALTH FOR MSMES: A STUDY OF THE CREDIT GAP IN MSMES FINANCING AND ITS EFFECTS ON MSMES

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Abstract

MSMEs finances primarily depend on internal sources of finance (personal savings, loan from relatives, and loan from local money lenders) than that of institutional financing by banks and other financing institutions. An indication is that even in current times, commercial banks constitute the largest source of financial assistance for the MSME sector at about 87 per cent, but from the banks perspective, MSME credit as a percentage of net bank credit of commercial banks has been below 15 per cent. Banks perceive MSMEs as risky field of investment due many reasons like Low growth rate of MSMEs, MSMEs following unofficial business methods , incapability of MSMEs owners and managers to provide adequate collateral securities, Lack of credit worthiness and goodwill, relatively high costs of processing, Lack of clear cut picture due to poor reporting of firm data. In this backdrop this paper provides a picture of the finance required/demanded by MSMEs and sanctioned by bank and financial institutions. A descriptive analysis was done to permit the study to make use of both quantitative and qualitative data collection techniques and data analysis procedures. In all, 112 enterprises were chosen for the research. Evidence from the analysis shows that for 52 per cent of micro, small and medium enterprises the amount financed was insufficient.

Key words: Institutional financing, commercial banks, collateral security, goodwill

I. INTRODUCTION

The MSME sector gives an imperative support to the Indian economy as it contributes significantly to growth of Indian economy with a vast network of around 3 crores enterprises, creating employment of about 7 crores individuals, manufacturing more than 6000 products, contributing about 45 per cent to manufacturing output and about 40 per cent of exports, directly and indirectly. This sector even assumes greater importance now as the country moves towards a rapid and inclusive growth agenda. Moreover, it is this sector which can help achieve the target of proposed National Manufacturing Policy of raising the share of manufacturing sector in GDP from 16 per cent at present to 25 per cent by the end of 2022.

Inspite of all these features this sector seriously faces problems in its financing. Bank and institutional finance lending is the most common source of external finance for many MSMEs, which are mostly and heavily dependent on traditional loans to fulfill their start-up, cash flow and investment needs. While it is commonly used by MSMEs, however, traditional bank finance poses challenges to MSMEs, in particular to newer, innovative and fast growing enterprises, with a higher risk-return profile. MSMEs generally have restricted access to finance. This compels them to borrow from unregulated lending markets or from their own dealers and end up paying much higher interests. Not only does this lead to overpricing of products, but also confines the MSME entrepreneurs' ability to add value, upgrade technology, quality and adopt modern management methods. Thus accessibility of adequate finance at affordable cost is significant for Indian MSMEs.

II. FINANCING OF MSMES

MSMEs require timely and adequate capital infusion through term loans and working capital loans, particularly during the early and growth stages. Historically the MSMEs have relied on following sources for financing their needs

1. Retained earnings, funding through sale of assets
2. Ancestral capital, personal savings, loans from relatives, loans from unregulated market
3. Institutional financing from scheduled commercial banks
4. Venture capital funds/ seed funds Among the formal financial institutions,

III. REVIEW OF LITERATURE

Jain (1971) was of the view that the behavior of financial institutions in favour of small scale industries is biased, as they have developed a tendency of investing their funds in medium and large scale industries and the larger ones among the small scale industries.

Khanna, Sushil (1999), commented that the industrial sector failed to exploit the fruits of reforms as the industrial sector was denied of the credit at cheaper rates as promised, which had a devastating effect on the Indian firms as they had to face the giant MNCs with their traditional and outdated technology. The domestic industrial concerns were subject to rigid control over investment in plant and machinery; whereas the MNCs were allowed to bring in funds and latest technology, this changed the competitive scenario in India. The only respite available to the Indian SMEs is the available of multiple financial options. With the entry of MNCs in term lending activity, the industrial financing sector has become more competitive.

Rajendran, N (1999), revealed that there are numerous complicated procedures involved in availing loans from financial institutions with lack of coordination between the promotional institutions and government agencies, which has resulted in ineffective performance of the SMEs.

Himachalam D (2000), concluded that financial institutions have done a considerable work for the promotion of entrepreneurship but have failed to attract the right skillful individuals. The author suggested various measures for the promotion of entrepreneurship such as provision of complete information on various enterprise aspects, technological information, providing full assistance in preparing project reports, availability of team of experts for advices, imparting of training to entrepreneurs.

Himachalam and Viswanadha Reddy (2005) pointed out that one of the major problems encountered by entrepreneurs in availing finance from financial institutions is time lag in submission of application and disbursal of amount to entrepreneurs, they suggested that financial institutions should reduce time gap in order to better serve the SMEs.

According to Desai (2005) the multiplicity of financial institutions operating in the same field with hardly any demarcation in their specific activities led to overlapping and duplication of their efforts with the result that financially well off concerns could manage to procure financial assistance from a number of institutions, while the weaker concerns were left high and dry.

Hossain S. and Asrafuddin M., (2006) examined that, small entrepreneurs did not have access to finance from financial institutions as FIs are not available in rural areas and the banks are reluctant to provide loans to them. The financial problems encountered by the entrepreneurs include, inadequate amount of loan, excessive formalities, higher interest rate, unfavorable repayment policy and their illiteracy in following the procedures.

Saiful Islam, Md (2008), revealed that small enterprises access to banks credit remained limited even in the competitive environment, the promotional programs taken up by the bank failed to fulfill the basic objective of forwarding credit to the entrepreneurs. The findings were, given the interest rate spread there is a positive relationship between volume of profit and amount of loan disbursed. The author suggested, identifying and motivating bank officials to take the lending activity seriously, identify and motivate entrepreneurs and provide a range of services for the benefit of entrepreneurs.

Singh, Deepa and Mishra (2009) assessed the different problems faced by entrepreneurs while availing credit from nationalized banks, they viewed that banks usually insist for high collateral security, reject the loan application without giving proper reason, and take lot of time while processing a loan application of the entrepreneurs.

IV. OBJECTIVE OF THE STUDY

1. To know whether there is any significant difference between loan amount demanded and sanctioned by financial institutions.

1. Hypotheses of the study

The following hypotheses were formulated for testing

1. There is variation between loan demanded and disbursed by financial institutions among MSMEs
2. There is variation between loan demanded and disbursed by financial institutions among different sectors

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2. Methodology

2(a) Area of Study

In order to select the sample units the prime task before the researcher was to select the districts which should be representative of highly industrialized areas, moderately industrialized areas and also the under developed areas. With this objective the researcher has selected two districts of Telangana namely, Hyderabad and Rangareddy.

2(b) Sample Selection

To conduct the study, 112 MSMEs were surveyed pertaining to eight different sectors namely food, chemical, pharmaceutical, engineering, service, plastic, printing and miscellaneous were selected.

2(c) Collection of Data

Primary data for the study is collected from Micro Small and Medium enterprises by using a structured questionnaire.

2(d) Data Analysis

The information gathered was tabulated and analyzed by using percentages, t test, ANNOVA one way and Chi square test.

2(e) Reference Period

The data for the study was collected during the period May 2016.

3. Industry wise Disparity in amount demanded, Sanctioned and Disbursed

The expected returns of a project are an important factor determining the size of loans. If the financial institutions consider that the amount demanded does not match with the expected returns, the loan amount is slashed. In case of MSMEs where, paucity of finance is severe, such shrink will put them into more troubles. As the objective of this study is to find out whether there is any significant difference between amount demanded and sanctioned by financial institutions, here in this section inter industry and inter sector comparisons are prepared on the basis of absolute amount of credit demanded and supplied by financial institutions. The disparity in the amount of loans demanded and the amount sanctioned is presented in Tables 1 to 4.

Table 1 refers to the distribution of the sample entrepreneurs on the basis of the loan demanded to loan sanctioned and disbursed by financial institutions. The magnitude of total loan demanded by 112 MSMEs was Rs. 3,45,94,45,236, the total amount sanctioned was Rs. 2,55,89,46,740 which is 74 per cent of the total amount demanded and the amount disbursed was Rs. 2,39,29,51,696 which is 94 per cent of the amount sanctioned. But the percentage of amount demanded to amount disbursed is 69 per cent.

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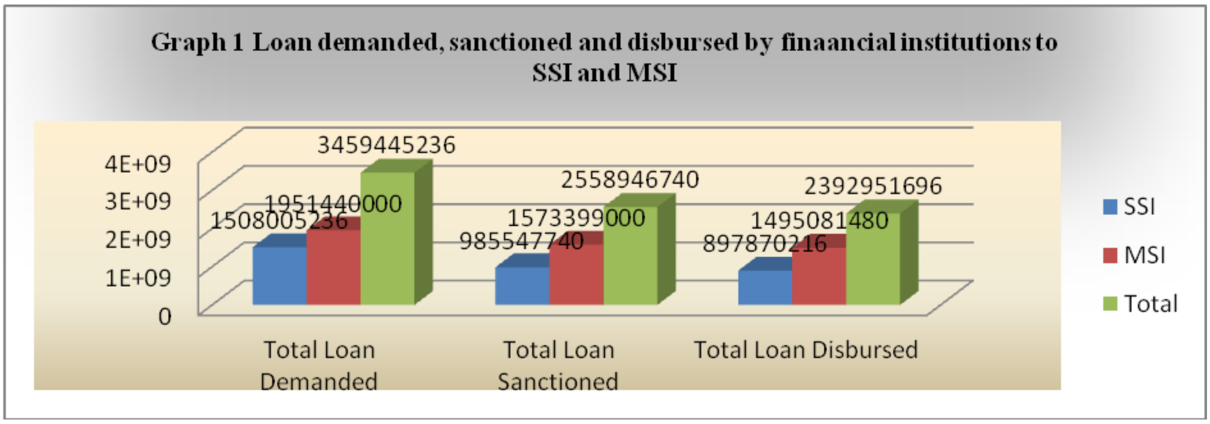
Table 1 Loan demanded, sanctioned and disbursed by financial institutions

Industry	No. of units	Total Loan Demanded	Total Loan Sanctioned	% of loan demanded to sanctioned	Total Loan Disbursed	% of loan disbursed to loan sanctioned	% of loan disbursed to loan demanded
SSI	78	1,50,80,05,236	98,55,47,740	65.35	89,78,70,216	91.10	59.54
MSI	34	1,95,14,40,000	1,57,33,99,000	80.62	1,49,50,81,480	95.02	76.61
Total MSMEs	112	3,45,94,45,236	2,55,89,46,740	73.96	2,39,29,51,696	93.51	69.17

Source: Primary data

The disparity in the total funds demanded and sanctioned for the SSI units reveals that total credit demanded by 78 SSI units was Rs. 1,50,80,05,236, credit sanctioned by financial institutions was Rs. 98,55,47,740 which is 65 per cent of the amount demanded. The amount disbursed was Rs. 89,78,70,216 which is 91 per cent of the amount sanctioned. The percentage of amount disbursed to amount demanded is 60 per cent which is less than the total average of 69 per cent as shown in Table 1.

The information of sample MSI enterprises reveal that the requirements of 34 MSI units was Rs. 1,95,14,40,000, whereas the amount sanctioned was Rs. 1,57,33,99,000 which is 80 per cent of the amount demanded and the amount disbursed was Rs. 149,50,81,480 which is 95 per cent of the amount sanctioned. The percentage of amount disbursed to amount demanded was 77 per cent. (Table 1) The insistence for 100 per cent or more of collateral security for the loan amount is the principal reason for this disparity. Wide disparity was also found between amount demanded by SSI and MSI units.



The Graph 1 clearly points out the difference in the amount demanded, sanctioned and disbursed to SSI and MSI. To know whether there is any difference between the loan demanded and sanctioned by financial institutions, statistically t test for equality of means is applied.

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Table 2 Group Statistics about loan demanded, sanctioned and disbursed					
Category		N	Mean	S.D	Std. Error Mean
Loan Demanded	SSI	78	19333400	28791387.712	3259983
	MSI	34	57395294	42584201.585	7303130
Loan Sanctioned	SSI	78	12635227	23915895.888	2707942
	MSI	34	46276441	42102420.614	7220506
Loan Disbursed	SSI	78	11511157	23748112.962	2688944
	MSI	34	43972984	41468618.637	7111809
Source: Primary data					

Testing of Hypothesis

To know whether there is any significant difference between amount demanded and sanctioned by financial institutions among MSMEs the hypothesis is tested with the help of t test.

H_o : There is no variation between loan demanded and disbursed by financial institutions among MSMEs.

H_a : There is variation between loan demanded and disbursed by financial institutions among MSMEs.

Table 3 Independent samples t test					
		t - test for equality of means			
		t	df	Sig (2 tailed)	Result
Loan Demanded	Equal variance assumed	-4.365	110	0.000	Significant
Loan Sanctioned	Equal variance assumed	-5.005	110	0.000	Significant
Loan Disbursed	Equal variance assumed	-4.879	110	0.000	Significant
Source: Primary data					

As shown in Table 3. the ‘P’ value is 0.000 at 110 degrees of freedom with 5 per cent significance level for loan demanded, loan sanctioned and loan disbursed by financial institutions between SSI and MSI. The calculated ‘P’ value is less than 0.05 and the value for t test 4.365 for loan demanded, 5.005 for loan sanctioned and 4.879 for loan disbursed is higher than the table value of 1.645, hence it is concluded that there is significant difference in the amount demanded, sanctioned and disbursed by financial institutions to SSI and MSI. It is viewed that the credit requirements, sanctioning and disbursements are different for SSI and MSI.

Hence the null hypothesis that there is no variation between the loan demanded and disbursed by financial institutions among MSMEs is rejected and the research hypothesis that there is significant variation in the amount demanded and disbursed by financial institutions among MSMEs is accepted.

Sector wise Disparity in amount demanded, Sanctioned and Disbursed

Sector wise analysis is prepared further in Table 4 to know whether there exists a significant difference among different sectors in terms of loan demanded, sanctioned and disbursed by financial institutions among

ISSN: 2348 9510
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different sectors.

Testing of Hypothesis

To know whether there is any significant difference between amount demanded and sanctioned by financial institutions among different sectors the hypothesis is tested with the help of ANOVA one way

H_o : There is no variation between loan demanded and disbursed by financial institutions among different sectors

H_a : There is variation between loan demanded and disbursed by financial institutions among different sectors

Table 4 Showing ANOVA results on difference among the sector between amounts demanded, sanctioned and disbursed

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Loan Demanded	Between Groups	18925119922882800	7	2703588560411829.0	2.229	.038
	Within Groups	126163104579319900	104	1213106774801153.0		
	Total	145088224502202700	111			
Loan Sanctioned	Between Groups	17225093235253970	7	2460727605036282.0	2.355	.028
	Within Groups	108660496327933700	104	1044812464691670.0		
	Total	125885589563187700	111			
Loan Disbursed	Between Groups	16661536872306580	7	2380219553186655.0	2.353	.028
	Within Groups	105193901196693600	104	1011479819198977.0		
	Total	121855438069000200	111			

With a view to examine whether there is any significant difference between the loan demanded and disbursed by financial institutions among different sectors analysis of variance test is applied. Table 4 shows the calculated value of 'F' and 'P' at 5 per cent significant level. The calculated value of 'P' is 0.038 for amount demanded, 0.028 for amount sanctioned and 0.028 for amount disbursed. As all 'P' values are less 0.05 it is concluded that there is significant variation in the amount demanded and disbursed by financial institutions to different sectors. Hence the null hypothesis that there is no variation between the loan demanded and disbursed by financial institutions among different sectors is rejected and the research hypothesis that there is significant variation in the amount demanded and disbursed by financial institutions among different sectors is accepted.

Improving Credit Health for MSMEs

New channels of financial aid Access to equity capital through SME exchanges

There is a general lack of awareness among MSMEs about equity capital, stock markets and funding options, other than banks. So far, there have been only debt-financing options, without any access to alternative equity options. The small and medium exchanges for MSMEs listing norms unlike the regular listing on a MSME platform through an IPO are a major introduction. Meant for MSMEs with a paid-up capital of less than 25 crore INR, it empowers them to tap into the capital markets by getting listed on the exchange without having to make any initial public offering. To enable MSMEs to get over the liquidity crisis that they continue facing, regulators have mandated market making in the MSME Exchange platform, to ensure that liquidity is generated. The handholding of the company by the merchant banker in the form of market making will create the liquidity on the MSME Platform. Moreover, the sector is highly unorganised and fragmented, and the new MSME exchange will facilitate the creation of a financial ecosystem for MSMEs in India. Financial support from venture capitals MSME private equity and venture capital funds are also some available options.

V. CONCLUSION

An analysis of the pattern of industrial credit reveals that availability of credit is not only inadequate, but is unevenly distributed among different sectors, and among different size of enterprises. Thus the study concludes that there is significant variation among the different sectors in terms of amount demanded, sanctioned and disbursed from financial institutions. The entrepreneur's irrespective of sufficiency of credit are repaying the amount to different financial institutions. It is suggested that the financial institutions should improve the loan monitoring, reduce the cost of credit, supply sufficient credit which will facilitate develop the business of MSMEs, have ripple effect on the economy and reduce the borrower's attitude to not pay back their loans and help them to enhance their business

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