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Role of Financing Policies and Financial Institutions for Micro, Small and Medium Entrepreneurs

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The MSME sector is a significant contributor to the Indian Economy. It has emerged as a highly vibrant and dynamic sector of the Indian Economy over the decades. MSMEs not only play crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialization of rural and backward areas, thereby, reducing regional imbalances, assuring more equitable distribution of National Income and wealth. MSME is a dynamic and highly contributing sector that nurtures entrepreneurial talent besides meeting social objectives including that of providing employment to millions of people across the country. A substantial body of research has established that the MSMEs face severe bank credit constraints, forcing them to look for alternative sources of finance. The paper attempts to explore the major financing policies, especially drafted for MSMEs. Realizing the crucial role played by the MSMEs in the Indian economy, government has initiated various innovative financing policies for encouraging budding entrepreneurs to setup their units. The researcher tries to analyze the contribution of SIDBI in the growth of MSME sector. It has been observed that in promotion and growth of MSMEs, the role of CGTMSE scheme cannot be ignored. Thus, the present paper primarily focuses on the evaluation of CGTMSE Scheme. The paper has been prepared on the basis of extensive review of available literatures on the CGTMSE scheme. The present research paper reveals that SIDBI is playing a very important role in promotion of MSME sector through this scheme.

Keywords: Financial Institution, MSME, SIDBI, CGTMSE

INTRODUCTION

Both entrepreneurship development and MSMEs have been globally acknowledged as instruments for achieving economic growth and development as well as employment creation (Rebecca, 2009). Globally, the micro small and medium enterprises (MSMEs) are contributing a major share in their respective economies and have been accepted as the engine of economic growth and for encouraging equitable development. The main advantage of this sector is that it provides a large employment at a low capital cost. The labour intensity

of the MSME sector is much higher than that of the large enterprises. MSMEs contribute significantly to the economy and are geographically widely spread.

MSMEs are defined in different ways in different parts of the world. In some countries, they are defined in terms of assets, while few countries use employment as a parameter for defining MSMEs. The MSME sector is responsible for about 40 per cent of the exports and 45 per cent of the total manufacturing output of the country (MSME Annual Report, 2012). This sector is the nursery of entrepreneurship and has been recognised as the engine of growth. The MSMEs also have a vital role in the dispersal of industries and generation of employment opportunities. The main advantage of this sector is that it provides a large employment at a low capital cost.

In the last few years, the MSME sector has reflected a higher growth compared to the overall industrial sector. With its quick responsiveness, adaptability and innovative approaches in the recent years, this sector has shown a commendable endurance to survive the effects of recession.

In India too, the role of MSMEs is crucial in the overall industrial growth. In the last few years, the MSME sector has reflected a higher growth compared to the overall industrial sector. With its quick responsiveness, adaptability and innovative approaches in the recent years, this sector has shown a commendable endurance to survive the effects of recession. 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.

REVIEW OF LITERATURE

MSMEs are considered as a driving force of innovation and employment, and thus they are an important factor in fostering general economic performance (Carree and Thurik, 2008). Recent empirical studies suggest that the creation or development of small and medium enterprises was decisive in economic growth (Beck et al, 2005).

Despite their important role in fostering economic growth, MSMEs often face financing difficulties. The theoretical and empirical literature supports the view that, for firms, external financing is more expensive than internal financing. Mach and Wolken (2011) analyzed the effects of credit availability on small firm survivability over the period 2004 to 2008, and

found that credit constrained firms were significantly more likely to go out of business than non constrained ones.

Storey (1994) argued that customer focus was a discriminate variable, explicitly stating that high-growth companies develop strategies that connect them to their customers. These systematic relationships and direct contacts with customers enable the development of differentiation strategies that, in many cases, create custom products and services. Moreover, this strong rapport with customers also allows high-growth companies to proactively meet customer needs by introducing innovations in products and services.

According to Batra and Mahmood (2003), 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.

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

Gibb and Lyapunov (1996) suggest that an entrepreneurial culture needs to be nurtured to support MSMEs in areas such as values, beliefs, attitudes and behavioural norms. Gibb also argues that a personal network based on social value constitutes an important variable that influences transactions between firms and customers, marketing channels, suppliers, employees, family, regulatory authorities, banks, accountants, and competitors.

Ha and Swierczek (2003) found that the performance of MSMEs in Vietnam was positively related to entrepreneurial culture. This means that the owners of MSMEs are not willing to take risky business decisions and the presence of a risk avoidance attitude is prominent among entrepreneurs.

Colluzi et al. (2009) confirmed that the probability of facing financing constraints is even larger for small and young businesses. In addition, there is an influence of the industry level: manufacturing and construction are more often constrained than firms in other industries. Bougheas et al. (2006) highlighted characteristics such as firm size, age, level of profitability.

The extensive literature indicates that many industrial enterprises belong to the MSME category and they play a vital role in the economy and are a major source of various economic contributions (Nguyen, Alam, and Prajogo 2009).

Despite the importance of MSMEs for job creation and production, most of the MSME literature points to the fact that small and medium firms face higher barriers to external financing than large firms, which limits their growth and development. Numerous studies that use firm-level survey data demonstrate that access to finance and the cost of credit do not only pose barriers to MSME financing, but also constrain MSMEs more than large firms. Small firms find it difficult to obtain commercial bank financing, especially long-term loans, for a number of reasons, including lack of collateral, difficulties in proving creditworthiness, small cash flows, inadequate credit history, high risk premiums, underdeveloped bank-borrower relationships and high transaction costs (IFC, 2009).

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There is an ongoing debate in the literature on the MSMEs in less developed countries on two issues: the survival of MSMEs in the course of economic development and the importance of government policies for MSME development (Tambuna 2008).

A crucial element in the development of the MSME sector is access to finance, particularly to bank financing, given the relative importance of the banking sector in serving this segment. According to a report of World Bank, access to finance is perceived as one of the main obstacles in doing business. A number of studies have shown that financing is a greater obstacle for MSMEs than it is for large firms, particularly in the developing world, and that access to finance adversely affects the growth of the MSME sector more than that of large companies (Schiffer and Weder, 2001). It is, therefore, unsurprising that the international development community has listed MSME access to finance as an important policy priority.

Stephanou and Rodriguez (2008) analyzed both trend and structure of the MSME financing market in Colombia. They found that banks in the country regarded the MSME segment as an attractive business opportunity though their level of sophistication in terms of business models and risk management tools remains modest. The authors concluded that the market is characterized by a number of institutional and policy constraints, which inhibits further growth of MSME lending.

OBJECTIVES

- To analyze the contribution of MSMEs in Indian economy.
- To analyze the role of Credit Guarantee Schemes in facilitating the credit flow to MSME sector
- To analyze the role of SIDBI in promotion of Micro, Small and Medium Entrepreneurs.

METHODOLOGY

The study is primarily based on qualitative literature survey method. It facilitates in depth analysis of the issues related to financing policies for budding entrepreneurs. Extensive review of the literature provided useful insight about the major schemes undertaken by the government and other bodies for promoting MSMEs. The study is based on secondary data, which has been collected from various MSME Annual Reports and SIDBI Annual Reports. This methodology also helped in providing a direction to the research to an area which is apparently underexplored.

CONTRIBUTION OF MSMEs in INDIAN ECONOMY

MSMEs play a pivotal role in the economy of our country. Table-1 highlights the performance of MSMEs in India over the last decade. It reflects how the MSMEs have grown in the last ten years. It also depicts the major role played by MSMEs in the employment generation.

Table-1

Growth of MSMEs in the last decade

Sl. No.	Year	Total Working Enterprise (In Lakh)	Employment (In Lakh)	Market Value of Fixed Assets (In Crore)	Gross Output (In Crore)
1	2001-02	105.21	249.33	154349.00	282270.00
2	2002-03	109.49	260.21	162317.00	314850.00
3	2003-04	113.95	271.42	170219.00	364547.00
4	2004-05	118.59	282.57	178699.00	429796.00
5	2005-06	123.42	294.91	188113.00	188113.00
6	2006-07	361.76	805.23	868543.79	1351383.45
7	2007-08	377.37	842.23	917437.46	1435179.26
8	2008-09	393.70	881.14	971407.49	1524234.83
9	2009-10	410.82	922.19	1029331.46	1619355.53
10	2010-11	428.77	965.69	1094893.42	1721553.42
11	2011-12	447.73	1012.59	1176939.36	1834332.05

Source: Annual Reports of MSMEs (2012)

It displays an increase in number of units from 105.21 lakh in 2001-02 to 447.73 lakh in 2011-12, reflecting an increase of 325.55% over the last decade. This sector has shown an immense increase in the numbers in last ten years. The growth in numbers may be associated to various schemes offered by government to promote entrepreneurship and in MSME sector.

Table-1 highlights the increase in the total number of employments that comes under the MSME sector. The contribution towards employment by this sector also increased from 249.3 lakh in 2001-02 to 1012.59 lakh in 2011-12, reflecting an increase of 306.17% over the last decade. This sector has now become the second largest source of employment in our country just after agriculture.

Table-1 reflects the increase in total market value of fixed assets of the MSME sector. The market value of fixed assets of MSMEs increased from Rs. 154349 crore in 2001-02 to Rs. 1176939.36 crore in 2011-12, reflecting an increase of 725.57% over the last decade. MSME no longer are operated through handlooms or small machines. Science and technology had a

deep impact on MSMEs as well and slowly they have started using heavy machines for the production process.

Table-1 depicts the increase in gross output of the MSME sector over the last ten years. The gross output by MSMEs increased from Rs. 282270 crore in 2001-02 to Rs. 1834332.05 crore in 2011-12, reflecting an increase of 549.85% over the last decade. Due to the support provided by the government and use of heavy equipments for production, the gross output by MSME sector has shown a tremendous increase over the last ten years

CREDIT GUARANTEE FUND TRUST FOR MICRO AND SMALL ENTERPRISES (CGTMSE)

Bank extends loan facilities for the budding entrepreneurs. But usually one has to face the problems of Collateral or third party guarantee in order to avail credit from banks. Realizing this constraint, Government of India and SIDBI started with a trust known as Credit Guarantee Fund Trust in year 2000. This trust runs a scheme known as Credit Guarantee Fund Trust for Micro Small Enterprises. Under this scheme, loans are provided to the budding entrepreneurs without the hassles of collateral or third party guarantee. The purpose of this scheme is to strengthen the credit flow to the MSME sector and encourage the entrepreneurs to achieve their dreams. The main objective is that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. The Credit Guarantee scheme assures the lender (Bank) that, in case the MSE unit which has availed collateral free credit from the lender fails to pay back the amount, the trust will make up for the losses to the bank. The trust will compensate up to 75 % to 85% of the losses depending upon the gender of the entrepreneur who availed the credit and the region to which he/she belongs. A maximum credit cap of Rs 100 lakhs (Rupees Hundred lakhs only) are eligible to be covered under this scheme.

EXTENT OF THE GUARANTEE

Table - 2 highlights the extent of the guarantee. It reflects the amount that is covered and would be compensated by the trust in case the MSE unit fails to discharge its liabilities.

Table-2
Extent of the Guarantee

CATEGORY		MAXIMUM EXTENT OF GUARANTEE WHERE CREDIT FACILITY IS	
Micro Enterprises	Up to Rs.5 Lakh. 85% of the amount in default subject to a maximum of Rs.4.25 lakhs.	Above Rs.5 lakh up to Rs.50 lakh. 75% / Rs.37.50 lakh.	Above Rs.50 lakh Up to Rs.100 lakh. Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh.
Women entrepreneurs/ Units located in North East Region (incl. Sikkim) other than credit facility up to Rs.5 lakh to micro Enterprises	80% of the amount in default subject to a maximum of Rs.40 lakh.		Rs.40 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.65 lakh.
All other category of borrowers	75% / Rs.37.50 lakh.		Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh.

Source: CGTMSE Circulars

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CGS- OPERATIONAL HIGHLIGHTS

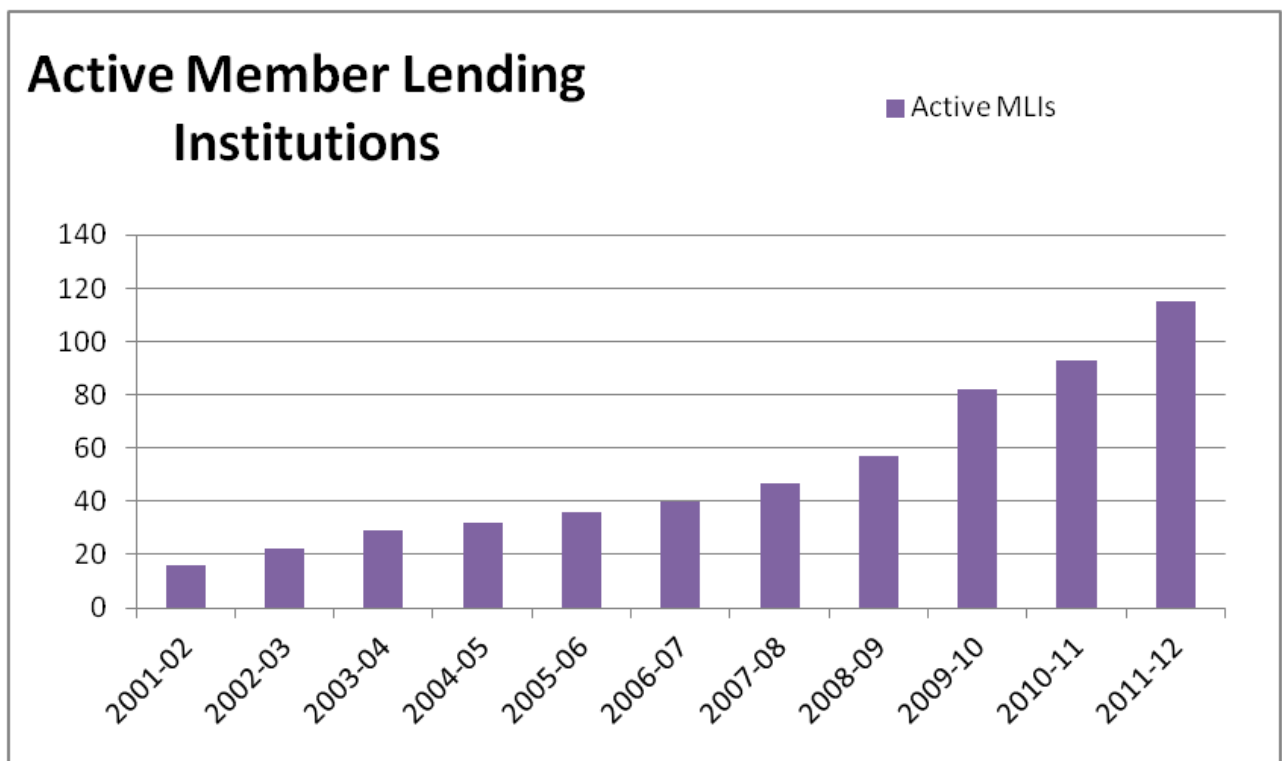
Table-3
CGS Operational Highlights

Period	Active MLIs	Number of Proposals Approved	Credit Amount Approved (Rs. in Crore)
FY 2000-01	9	951	6.06
FY 2001-02	16	2296	29.52
FY 2002-03	22	4955	58.67
FY 2003-04	29	6603	117.60
FY 2004-05	32	8451	267.46
FY 2005-06	36	16284	461.91
FY 2006-07	40	27457	704.53
FY 2007-08	47	30285	1055.84
FY 2008-09	57	53708	2199.40
FY 2009-10	82	113029	5110.09
FY 2010-11	93	137645	6234.67
FY 2011-12	115	178453	7865.87

Source: SIDBI Annual Report (2012)

Table- 3 highlights the trend of the CGS scheme over the last decade. The table depicts how the scheme has shown tremendous improvement over the years and benefited thousands of budding entrepreneurs.

Figure - 1
Active Member Lending Institutions

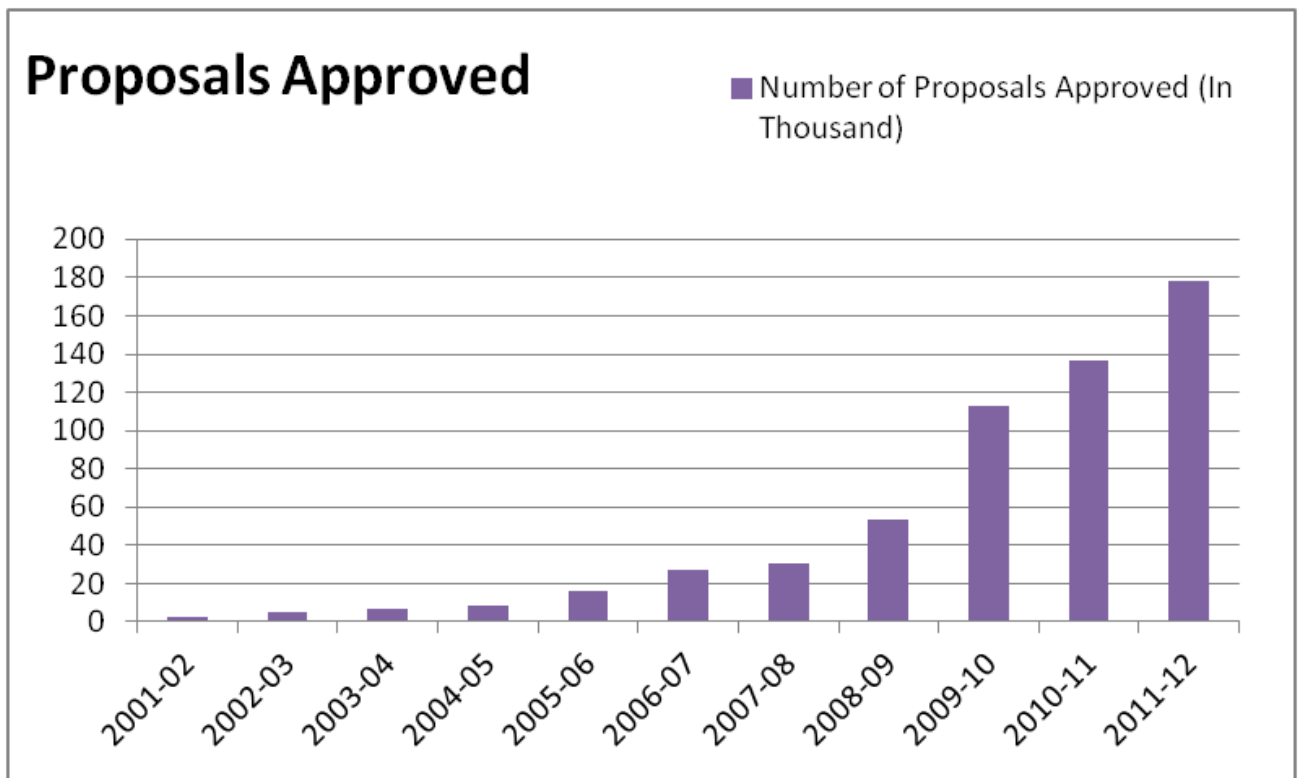


Source: Compiled from SIDBI Annual Report (2012)

Member Lending Institutions comprise of various commercial banks and Regional Rural Banks that are involved in sanctioning the loan under the CGS scheme of CGTMSE.

Figure-1 highlights the increase in the total number of Member Lending institutions that sanction collateral free loans to the budding entrepreneurs. The number of MLIs increased from 9 in 2001-02 to 115 in 2011-12, reflecting an increase of 1177.77% over the last decade. Almost all the private sector and public sector banks are covered under this scheme.

Figure - 2
Number of Proposals Approved

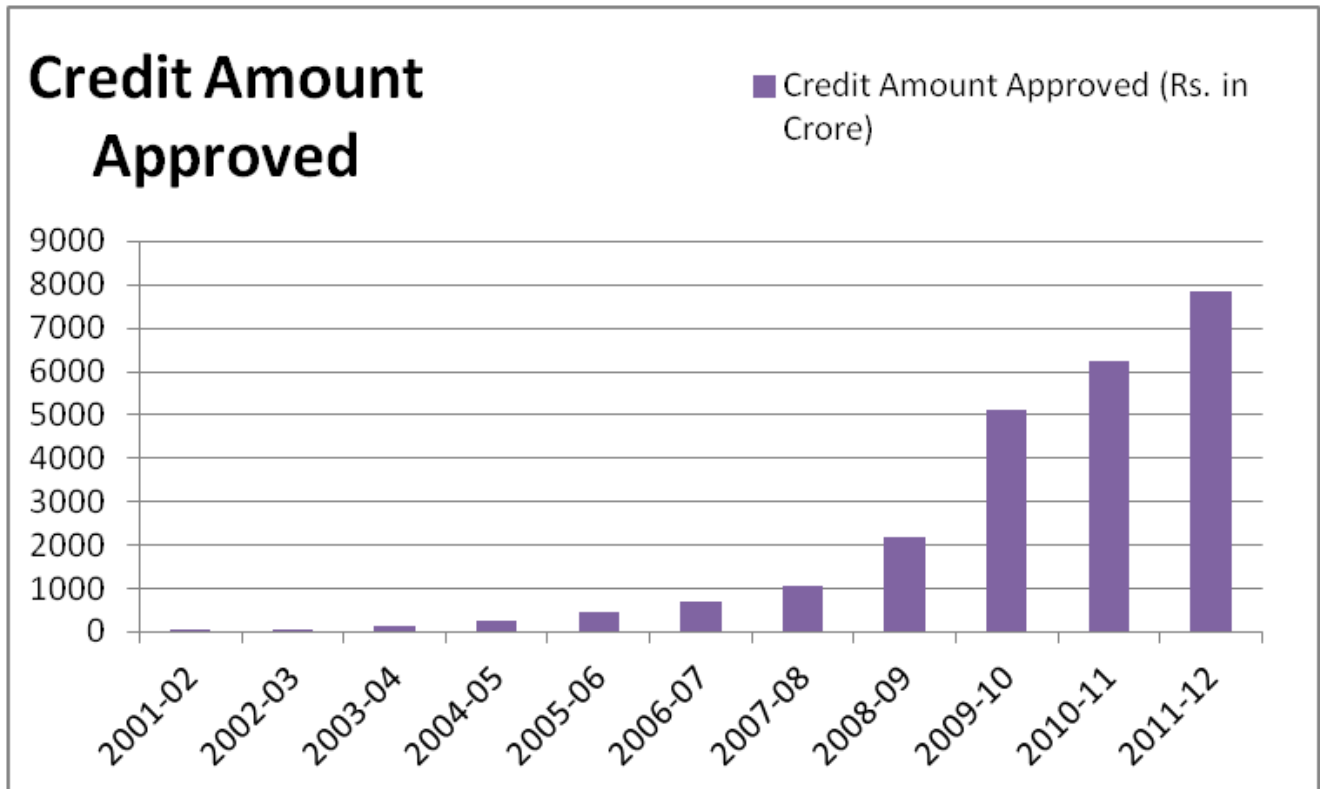


Source: Compiled from SIDBI Annual Report (2012)

Initially when the CGS scheme was launched in the year 2000, very few people were aware about the scheme. But slowly this scheme became so popular among the budding entrepreneurs that the number of proposals approved under this scheme has increased many folds.

Figure-2 reflects the increase in the total number of proposals that have been approved under this scheme by various MLIs over the last ten years. The number of proposals approved under this scheme increased from 951 in 2001-02 to 1, 78,453 in 2011-12, reflecting an increase of 18664.77% over the last decade.

Figure - 3
Credit Amount Approved (Rs. in Crore)



Source: Compiled from SIDBI Annual Report (2012)

Availability of timely credit is the biggest challenge for the MSME sector. A decade back, Banks were a bit reluctant in sanctioning loans to MSME because of the high amount of risk involved but since the inception of CGS scheme and the norms of the government towards priority sector lending, banks have started showing much more interest in MSME sector as well.

Figure-3 highlights the increase in the Credit amount approved under this scheme over the last ten years. The total amount approved under this scheme increased from Rs 6.06 crore in 2001-02 to 7865.87 crore in 2011-12, reflecting an increase of 1, 29,699.83% over the last decade.

ROLE OF SIDBI IN PROMOTING MSMEs

SIDBI plays a role in the growth and development of a country as it provides required infrastructure for economic development of the country. In our country a large population

lives in villages and small cities. The world has become a global market. The impact of globalization, privatization and liberalization has totally changed the style of banking sector in India. In India banking sector is entering in several new activities in the MSME sector.

Small Industries Development Bank of India (SIDBI) has been consistently involved with promotion, financing and development of the MSME sector since its inception in 1990. Going beyond finance, SIDBI has adopted a 'Credit Plus' approach for promotion and capacity building of the MSME sector. Its flagship programme 'Rural Industries Development' in 120 districts have resulted in setting up of 37,000 micro enterprises in rural areas, thereby providing employment to more than 1 lakh persons. SIDBI also supports various entrepreneurship development and skill development programmes.

Cluster Development is another thrust area of the Bank. So far, the Bank has supported more than 100 Cluster Development Programmes (CDPs) in the areas of marketing support, IT training, skill development, regulatory compliance, awareness programmes, testing facilities, business information and Counselling Centres for micro enterprises, promotion of energy efficiency measures, etc. SIDBI's endeavour towards holistic development of the MSME sector is greatly supported by Government of India for providing special refinance support of 4,000 crore in FY 2011. With the support of Government of India, Reserve Bank of India, foreign partners and more importantly, the dedicated staff, SIDBI could achieve 21% growth in its credit outstanding to MSME sector. With a cumulative credit disbursement of 2, 03,126 crore, SIDBI has benefited more than 320 lakh persons in the MSME sector. The dedicated services of SIDBI towards the Nation at large and the MSME sector in particular was also facilitated by its subsidiaries and associates.

CONCLUSION

The study reveals that there is a vast prospect for developing nations to harness the opportunity by developing MSME sector. The study further identifies the policy changes necessary for enhancing the role of MSMEs. This study concludes that the MSMEs with effective use of networks, associations and government supports become more sustainable and make a greater contribution to the economy. Policy measures such as a loan guarantee scheme, microfinance fund and credit register should help to mitigate the adverse effects of recession somewhat, but it is clear from the extensive literature review presented here that challenges will remain in the medium term.

Literature reveals that across countries, banks perceive serving MSMEs as a profitable endeavour and almost all banks have MSME clients. Though, there is significant difference in exposure, lending practices, business models, drivers and obstacles of MSME finance for banks operating in developed vis-a- vis developing countries.

Different studies have indicated that MSMEs act as an engine for growth of any economy and their role in the development of nation cannot be overlooked. The study reveals that there has been a drastic increase in the number of MSME units over the last ten years. The

employability of the MSME sector has also increased tremendously and it has now become the second largest employer after agriculture.

The Credit Guarantee Scheme has emerged out as one of the most popular schemes for the MSME sector over the last decade. Almost all the banks today sanction loans through that scheme and the volumes keeps on increasing day by day.

SIDBI is playing a very crucial role in the overall development of the MSME sector by providing various schemes especially designed for catering the needs of MSME sector.

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. More steps are to be taken to popularize this movement to make the people aware of the advantage, scope and programmes of MSMED Act. Thus we can face the problem of poverty and unemployment by promoting MSMEs, supplementing it with government support in its managerial, technical and financial requirements and popularizing the same among the masses.

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