



A STUDY ON CONSTRAINTS FACED BY MSMES IN ARRANGING FINANCE

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INTRODUCTION

Micro, Small and Medium enterprises form the core of Indian manufacturing sector in terms of their contribution to GDP, manufacturing output, employment generation, export performance, ancillary support to large industries and a host of other parameters. Ever since 1991, as a part of liberalization compulsions, Indian small scale industries ceased to enjoy the protective cover and benefits of reservation of production of notified products exclusively by SSI sector. Small scale industries had to either compete in the market along with big players or just perish. Government's new policy of liberalizing imports and easing quantitative restrictions in the wake of economic liberalization and later WTO dictates, made the things worse for MSMEs (earlier SSIs) to stay put in the ruthless competitive world. Notwithstanding several measures taken by government of India for enhancing MSME sector's competitiveness, the problems and constraints of MSMEs continued unabated.

Among various constraints faced by MSMEs, lack of adequate and timely institutional finance was found to be a major issue confronting them. Banks in India have played a role becoming of them, in financing small and medium enterprises but the same is found to be cumbersome and time consuming. It is a known fact that small enterprises are underfinanced by banks more often than not. To make the matters worse, banks in India insist on collaterals and third party guarantee even where RBI put a caveat on such practices. Hindu Business Line dated August 14, 2017, notes that out of 26 lakh crore outstanding credits to MSME sector, only 40% of funding was made by formal banking sector. NBFCs have made their presence felt in financing SMEs more out of business perspective than service to this nation building sector.

To address the issues of MSME sector more specifically, government announced a flagship program known as NMCP (National manufacturing Competitiveness program) during the year 2006-2007. Even though NMCP has been in vogue for well over a decade, no evaluation on implementation of nine components of this program has taken place.

Keeping the contribution by MSME sector and their potentiality vis-s-vis problems and constraints faced a field level survey on NMCP implementation and its impact on MSME sector was undertaken covering 200 select manufacturing and service oriented units in prime industrial locations in Karnataka State. One of the objectives of this study was to assess the problems and constraints in availing bank finance and to suggest suitable steps for easing such finance related constraints of this sector.

RESEARCH METHODOLOGY

In order to analyze the constraints faced by SMEs in availing institutional financial support, a set of statements related to the constraints were formulated based on both literature review as well as personal interaction with financial experts and SMEs during the pilot study. These inputs were taken and a final list of 19 statements reflecting the various constraints related to availing institutional financial support that might be faced by SMEs were formulated. The structured questionnaire with these 19 statements was given to respondents from 200 organizations. The respondents were asked to rate their agreement with the statements on a Likert Scale. The responses were the tabulated and prepared for analysis.

RESULTS OF T-TEST AND DISCUSSION

A t-test was conducted to check the significance of the agreement or disagreement with the statement. The null hypothesis was formulated as the mean value is equal to 3, which indicates that "The SMEs do not have a clear idea about their constraint expressed in the statement." If the mean value is greater than 3, then the SMEs are constrained by the area expressed in the statement and if the mean value is less than 3, then the SMEs do not face any constraint by the area expressed in the statement. The t-test was carried out for each statement using R and the results are tabulated below in Table 1.

S.NO	Var	Labels	Mean	p-Values	Alternative Hypothesis	Test Result
1	A	Pre- sanction appraisal is repetitive	3.525	1.4282E-12	SMEs' are constrained in this area	Null hypothesis rejected
2	B	Demand for collaterals is difficult to meet	3.765	4.7209E-26	SMEs' are constrained in this area	Null hypothesis rejected
3	C	Fund release is not timely and inspection at every stage of release is irritating	3.095	0.1020	SMEs' are are not clear about their constraint	Null hypothesis accepted
4	D	Counseling and nurturing is lacking	3.31	2.0092E-05	SMEs' are constrained in this area	Null hypothesis rejected
5	E	It is generally much lower than our needs	3.085	0.1301	SMEs' are are not clear about their constraint	Null hypothesis accepted
6	F	Emergent credit needs are generally ignored or met with reluctance	3.55	8.7355E-15	SMEs' are constrained in this area	Null hypothesis rejected
7	G	Working capital assessment is not need based. It is linked to term finance	2.575	0.0001	SMEs' are not constrained in this area	Null hypothesis rejected
8	H	Long term loan requirements do not find favour	4.025	6.0904E-79	SMEs' are constrained in this area	Null hypothesis rejected
9	I	The present system of NPA recognition system is too harsh for MSMEs	3.805	1.0136E-38	SMEs' are constrained in this area	Null hypothesis rejected
10	J	Closure certificate issued by banks in respect of settled loans carries a stricture. MSME units find it difficult to approach for subsequent dose of finance	2.81	0.0008	SMEs' are not constrained in this area	Null hypothesis rejected
11	K	The application forms for MSME loans are lengthy	3.905	3.6492E-52	SMEs' are constrained in this area	Null hypothesis rejected

12	L	It is extremely difficult to get a bank guarantee in time	3.58	4.4353E-16	SMEs' are constrained in this area	Null hypothesis rejected
13	M	Banks do not generally favour us with information on subsidy support, debt waiver matters.	3.195	0.0047	SMEs' are constrained in this area	Null hypothesis rejected
14	N	A separate loan counter with a dedicated credit officer for MSME loans at branches is required	2.955	0.2879	SMEs' are not clear about their constraint	Null hypothesis accepted
15	O	Bank branches should help improve the literacy of MSME units in all relevant matters	3.505	5.8978E-13	SMEs' are constrained in this area	Null hypothesis rejected
16	P	Special support services for matters on implementation of NMCP components	3.02	0.4013	SMEs' are not clear about their constraint	Null hypothesis accepted
17	Q	Delivery of credit should be timely and adequate	4.065	1.2139E-80	SMEs' are constrained in this area	Null hypothesis rejected
18	R	RBI should intervene in the credit delivery system of banks and make way for credit extension without delay or hassle	1.87	2.7091E-43	SMEs' are not constrained in this area	Null hypothesis rejected
19	S	Exclusive lending target for financing NMCP components can be fixed as a part of priority sector lending of commercial banks	1.87	2.7091E-43	SMEs' are not constrained in this area	Null hypothesis rejected

Table 1: Results of t-test for hypotheses related to constraints faced by SMEs

DISCUSSION

A: The following table shows the variables in which there is no clarity of whether it is a constraint or not for MSME units. The result maybe because of mixed experiences across SMEs and perhaps it depends on the way specific bank/institutional branches deal with the situation. It may also be influenced by the institutions attitude, position and orientation in this area.

S.NO	Var	Labels	Mean	P-Values
1	C	Fund release is not timely and inspection at every stage of release is irritating.	3.095	0.1020
2	E	Funds made available are generally much lower than our needs.	3.085	0.1301
3	N	A separate loan counter with a dedicated credit officer for MSME loans at branches is required.	2.955	0.2879
4	P	Special support services for matters on implementation of NMCP components.	3.02	0.4013

Table 2: Areas where there is no clarity about the constraints

B: The following table (Table 3) shows the areas where the SMEs do not experience a constraint in availing institutional financial support.

S.NO	Var	Labels	Mean	P-Values
1	G	Working capital assessment is not need based. It is linked to term finance	2.575	0.0001
2	J	Closure certificate issued by banks in respect of settled loans carries a stricture. MSME units find it difficult to approach for subsequent dose of finance	2.81	0.0008
3	R	RBI should intervene in the credit delivery system of banks and make way for credit extension without delay or hassle	1.87	2.7091E-43
4	S	Exclusive lending target for financing NMCP components can be fixed as a part of priority sector lending of commercial banks	1.87	2.7091E-43

Table 3: Areas where the respondents said they experience a constraint

Institutions for Financial Support are providing need based working capital assistance. Since this has been a long term government supported initiative in terms of short-term lending, the SMEs do not face problems in this area. However, other variables indicate that SMEs have a struggle with long-term loans that aid in capital formation. This can also be seen through finding 3.2.7 where the CLCSS scheme was the only better utilized scheme among all NMCP components. There we had highlighted the role banks play, and this fact corroborates with the same.

Variables J and R clearly indicate that the existing banking and financial support system adequately supports in closure, refinancing and credit delivery processes. Thus, the SMEs find working in these areas is not a constraint. Variable S indicates that except for CLCSS banks do not come into the picture for financing NMCP implementation.

C: The remaining variables are indicators of the areas where the SMEs experience constraints. A critical examination of these variables is hence required. However, it would be extremely useful to analyse them together in some coherent groups rather than independently. Thus, the following tables present these variables in groups that are related and further analysis is carried out.

S.NO	Var	Labels	Mean	P-Values
1	B	Demand for collaterals is difficult to meet.	3.765	4.7209E-26
2	H	Long term loan requirements do not find favour.	4.025	6.0904E-79
3	L	It is extremely difficult to get a bank guarantee in time.	3.58	4.4353E-16
4	Q	Delivery of credit should be timely and adequate.	4.065	1.2139E-80

Table 4: Group of variables that are constraints related to long-term borrowing from banks

This grouping of variables in the above table (Table 4) is indicative of the difficulties SMEs face in getting long term loans for capital formation. Variable H, specifically points this out. The mean value of 4.025 indicates strong agreement and the low p-value makes this statistically significant. Similarly variables B and L, though indicating moderate agreements with means of 3.75 and 3.58, their low p-values once again make the observation stronger statistically. Thus, arranging for collaterals and bank guarantee are major challenges in availing financial support. Hence we conclude that the problem doesn't lie with short-term borrowings such as work capital loans, but it lies with long-term borrowings which help in capital formation. This further strengthens the argument for proactive implementation of CLCSS and its success so far.

Variable Q indicates that there is a delay in disbursement of loan proceeds even after the MSMEs have followed the necessary procedures. Further, whatever credit is released is not adequate to meet the financial requirements of their business. This highlights the instances of underfinancing, which is a great impediment to the implementation of not only NMCP but also any other program.

We can conclude, therefore, that, SMEs that are already entangled in financial crisis may not be in a position to look at availing the benefits of NMCP schemes. Even though bank financing is beyond the scope of NMCP, ministry of MSME may need to supplement this through some other means.

Table 5 includes variables that are related to the processes and systems related to banks. Attention should be paid to the mean values. All of them fall between 3 and 4 which indicate a moderate agreement with the statement. This may indicate a mild resignation on the part of the

SMEs in that they put up with the system as they cannot wield any influence in their change. Also, the banking sector has gone through many reforms and the SMEs maybe waiting for a time when the banks would be free from these hassles. All variables except M have low p-values that indicate the statistical strength in the agreement expressed.

S.NO	Var	Labels	Mean	P-Values
1	A	Pre- sanction appraisal is repetitive	3.525	1.4282E-12
2	D	Counseling and nurturing is lacking	3.31	2.0092E-05
3	I	The present system of NPA recognition is too harsh for MSMEs	3.805	1.0136E-38
4	M	Banks do not generally favour us with information on subsidy support, debt waiver matters.	3.195	0.0047
5	O	Bank branches should help improve the literacy of MSME units in all relevant matters	3.505	5.8978E-13

Table 5: Group of variables that are constraints related to the procedures and systems of the banks

Among all the variables, the mean value for the harshness of the NPA recognitions system is very high and is also statistically significant. The present system usually focuses on the performance of the banking industry rather looking at the MSME unit’s performance and potential business on a case to case basis. The system may have been so designed keeping in mind the financial indiscipline of the entrepreneur. However, despite some business potential and growth, MSMEs may fail to repay loans on time due to several reasons other than insolvency. Such units, when supported adequately during such periods, by allowing their accounts to be “special NPAs” or “NPAs under monitor” may help them in availing further finances to overcome temporary setbacks,

In the case of variable M, the relatively high p-value (0.0047) and the closeness of the mean to 3 (which is the neutral/zero of the scale) indicates that the agreement is quite weak, even though it is statistically significant in a technical sense. This shows that if the banks support with subsidy information and information on debt waivers, it would be much appreciated by the SMEs.

Variables A and O deal with the communications processes related to credit facilities provided by banks. Since MSMEs represent only a small fraction of the business generated by banks, it may not be possible for the banks to provide that degree of attention as expected by MSMEs. However, it can be noticed that special MSME branches have been created by many banks to address such issues in the future.

SUMMARY OF FINDINGS AND CONCLUSION

From the analysis of data it is clearly seen that MSME units are constrained in the following areas.

- Availing long-term financial support from banks
- Arranging collateral for availing long-term lending facilities
- Even when credit is sanctioned, Inadequacy of the funds to meet their requirements
- Cumbersome and time consuming procedures for availing loans
- Rigid NPA classification system, deterring availing of refinance.

However, SMEs do not find any constraints in availing working capital and issues of closure certificate during settlement of loans.

From the above we can conclude that availing long-term finance from banks and other financial institutions is a major constraint faced by MSME units. SMEs failing to get timely financial support may result lack of capital formation for procuring plant and machinery, expansion and upgradation, introduction of new products and processes and quality upgradation. SMEs that are mired in such problems may not be in a favourable position to appreciate and avail the benefits of NMCP schemes. Though NMCP is needed and relevant, its success may depend on some other government interventions related to bank financing for their long-term financial requirements. At present only those SMEs which are financially sound maybe in a position to avail the benefits of NMCP subject to the user-friendliness of the schemes as well as ministry of MSME as discussed in the previous chapter.

SUGGESTIONS TO IMPROVE FINANCIAL ASSISTANCE THROUGH BANKS

Through our study we are clear that the CLCSS scheme, because of the involvement of banks, has seen quite a success compared to any other scheme. This is primarily due to the promotional role the banks have played through their network. This success story highlights the role banks can play in the implementation of other schemes.

- A.** To address the long-term financial constraints the ministry can work with identified public sector banks based on the following outline:
- a.** As soon as a beneficiary is identified as a potential implementer of a given NMCP scheme and due diligence has been carried out by ministry of MSME to whet the implementation project report, the bank can be authorized to offer financial assistance in the form of a loan on the guarantee given by the ministry to repay it post-implementation.
 - b.** Such a loan can be disbursed in a phase wise manner as directed by the ministry of MSME linked to the successful implementation of the scheme as envisioned in the original project document. This reduces the financial burden to the entrepreneur and the cost is limited the

amount of interest payable to the bank, that too spread over the term of implementation.

Such an arrangement may make the scheme more attractive to the entrepreneur.

- c. Even the 10% to 15% investment as required to be invested by the entrepreneur to avail the benefit, maybe brought under the line of credit as a soft-loan, based on the discretion of the bank.
- B. For micro enterprises, that too in priority sector, the 10 to 15 percent investment requirement from the beneficiary can be waived off on successful implementation of the given scheme. If needed such a waiver can be held in trust as a fund to kick start the next set of scheme implementation. However, this can be left to the discretion of both the entrepreneur and the ministry of MSME. This waiver maybe a booster for the “MSME Technology Incubator Scheme”, where most of the beneficiaries are budding entrepreneurs, who have interesting and useful ideas, but may not have access to funds to arrange even for 10 to 15% of investment which is mandatory promoter’s contribution.

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