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Financing Issues of SMEs: Bankers Perspective

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Abstract

The lack of adequate access to funding is a major obstacle to the growth of the vital Small and Medium-Sized Indian Enterprises (SME) industry. This paper looks at major issues in the financing of Indian SMEs, such as information asymmetry of banking firms, as well as the effectiveness of measures such as credit ratings for SMEs. It also examines the importance of credit rating and risk assessment for the credit rating of SMEs to address the information problem or lending.

Keywords: SMEs • Banking • Lending • Financing • Growth

Introduction

In India, the cyclical reduction appears to be slowing towards development. In fact, India is transiently growing. A substantial part of sustainability is complementing the enormous increase in the population in the workplace with the rapid pace of reforms. Because macro and micro-factor mixes are appropriate, India is positioned to achieve higher corporate and economic growth. India requires a high level of growth. If this sort of development fails in the next generation, it will experience an increasing issue of unemployment, especially among graduates, with all the stresses and hazards implicated. India requires to reinforce one of its key micro-factors, one of which is SME, in India, in order to continue at its present rate. In order to continue, it must reinforce its basis.

In terms of output, exports and employment, small and medium-sized enterprises take a stance of strategic significance in the Indian financial system. According to Jaskaran Singh, et al. [1] The small sector accounts for 40% of the gross added economic value and 50% of the total production exports. Over 3.2 million units are produced throughout the nation, from very fundamental goods to extremely advanced goods. The MSME Ministry states that a small scale industry with a total volume of 29.4 million individuals offers the largest employment In accordance with the MSMED Act, the units that are engaged in the fabrication, manufacture and provision of or the rendering of services have been defined as micro, small and medium based on original investment in machinery and equipment. Opportunities following agriculture (Table 1).

SMEs are Gen-Next engines of economic development, which is responsive to creating the country's employment opportunities and exports. This sector also has enormous bank finance potential for viable development. Since the liberalization of the Indian economy in 1991, the industry is subjected to intensified competition. The LPG scheme, the FDI, the creation of the WTO and national economic reforms have faced the small sector in India with a progressively competitive setting. In specific, Jaskaran Singh, et al. as they are relying on supply agreements from worldwide businesses and other big buyers, must undergo some shift. This puts a lot of pressure on MSMEs to monitor expenses and quality and comply with the various legal demands. This is a significant challenge for them, particularly those who use labour-intensive technology in developing nations where labour costs are a significant problem [1].

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Challenges in access to finance for SMEs

MSMEs face many difficulties when commercial banks and government agencies make use of credit facilities. Financial institutions are asking for plenty of information & data, state financial corporations have been unable to provide the banking industry with a guarantee needed for extending the term credit for the small-scale industry for several months. Even if government agencies can raise tiny credits, the method is so cumbersome that most entrepreneurs who are either illiterate or semi-literate are reluctant to use these facilities by Kadam [2]. When MSMEs are given to external financing, they are charged elevated interest rates as smaller companies are riskier and more likely than larger companies to fail. Many MSMEs are not able to initiate or-worse-complete their innovative thoughts due to the absence of financial resources. Innovation practices were abundant for MSMEs. They have difficulties acquiring loans, as financial institutions often reject (co-)financing of risky development initiatives. The issue of access to government financing for creative thoughts and related red-tape processes is also a financial constraint [3].

Statement of the problem

In India, SMEs will function as an impetus for employment opportunities, manufacturing maturation and the promotion of more exports. Only one side of the coin; in India, the small and medium-sized business industry is having severe issues. Financing issues are, on account of several reasons, a significant constraint for the development of SMEs. This article addresses these problems from the bankers point of view.

Research questions: A research question is a question to answer about a particular problem. In this paper, the researcher-developed constructive question to answer the statement of the problem.

What are the various difficulties faced by banks while financing to the SMEs?

Research objectives: The research project's objective synthesizes what the study is to accomplish. The objective of the research is the particular achievements that the study hopes to accomplish. This study will be carried out with the following objectives.

- To describe key issues in SME financing from the point of perspective of credit suppliers (banks).
- To assess the responses to problems and the associated issues in SME financing from bank officials and to assess the ascertain of the actions proposed to overcome the obstacles.

Scope of the study: The research cramped to the city of Guntur, Andhra Pradesh, India. The results of the research may differ in accordance with the geographical circumstances and internal policies of individual state governments to promote SMEs.

Literature Review

A variety of studies on financing SMEs have been performed. Carbo, et al. [4] pretend that for two reasons the bank rivalry and accessibility issues could be the most important for small- and medium-sized enterprises. Firstly, small and medium-sized enterprises are more vulnerable to problems. Secondly, small and medium-sized enterprises are more dependent on the bank than large companies. Meuleman, et al. [5] conclude that R&D grants give a favorable sign to improving access to long-term debt with regard to MSME outcomes and quality. Banerjee, et al. [6] discover that companies that freshly arrived on the preferential lending criteria were prepared to acquire more loans that would, therefore, have a positive effect on their sales growth, using a 1998 rise to the investment limit as a criterion of eligibility for preferential bank credit for SMEs in India, indicating that these companies were earlier credit restricted. Manan, et al. [7] addressed the study's attempt to explore the resemblance between the stylized patterns of MSMEs funding in other areas of the globe with Malaysian MSMEs. One interesting feature of the research is the fact that many small and medium-sized enterprises have been working towards Islamic methods of funding such as Murabahah, Bai Bithaman and Ajiland Ijaraha. It may give the Islamic financial institutions a favorable signal to offer MSMEs greater services. In the SME portfolio research of two Swedish banks, Jacobson, et al. [8] have no proof to show that SME lending portfolios are constantly less dangerous or less cost-effective than commercial lending. The theoretical model of the technological innovation engineering is provided in the document by Liu et al. [9] on the financial effects and the impact on leadership in Small and Medium Enterprises (SMEs). The empirical findings demonstrate that the model works well and is highly converging. In research covering the period 1995-2004, Ghosh [10] states that since liberalization the cash flow has become less essential for the investment of the company, thereby improving the access to foreign finance for financially restricted businesses, thereby facilitating finance for smaller firms. While it is possible that SMEs in India are not financially restricted too soon to conclude, financial sector reform and enhanced lending facilities definitely have enhanced access to finance for tiny businesses. The legal environment also influences the Bank's inclination to lend to small businesses [11].

Methodology

Research Design

A descriptive research design was used in this study. The small and medium-sized industry depends primarily on bank finance to finance their activities involving a large amount of financial and non-financial problems. The research undertaken in this subject area has an analytical nature. A structured questionnaire is used to collect the primary data. The data instrument reliability was tested by Cronbach's alpha technique and it's meet the requirement of 75.

Sample of the study: In Guntur town, there is a total of 41 banks. The population of the study is 41. The questionnaire was sent to all the population. 41 questionnaires were returned out of 41 and found 38 questionnaires to be applicable.

Research instruments: Statistical techniques *viz.* ratio analysis and comparative growth analysis used to draw inferences.

Results and Discussion

This section presents the results of the survey relating to the facts about why bankers are not willing to offer borrowing facilities even government instructed provide loans to SMEs. The following percentage tables are explaining various factors which are blockades to SMEs finance from the bankers.

Factors that trigger the credit rates of SMEs to be slow

The different factors leading to slow banker development in lending to SMEs are presented in Table 2. Most bankers (26 per cent) believe that small and medium-sized firms have no powerful financial facilities. This declaration is supported by the above-noted ranking, which was followed by many managers (22 per cent) arguing that the absence of expertise in small and medium-sized enterprises is a significant limitation in refusing credit to the enterprises. The lack of infrastructure and the failure of a mortgage also create a slow development in credit for small and medium-sized companies.

Reasons for not preferring lending to SMEs by banks

Table 3 explicitly states that most bankers think that it requires a high credit score for anybody to get the loan. Fortunately, the powerful credit rating does not exist for SMEs. On this basis, bankers are not able to give small and medium-sized enterprises borrowing facilities. This view was articulated by 31% of bank executives, which meant it was a serious consideration for

Table 1. Investment in machinery and equipment.

S. No	Type of Enterprise	Manufacturing Industry (Investment in Plant and Machinery)	Service Industry (Investment in Equipment)
1	Micro	Does not exceed Rs. 25 Lakh	Does not exceed Rs. 10 Lakh
2	Small	Exceeds Rs. 25 Lakh but does not exceed. 5 Crore	Exceeds Rs. 10 Lakh but does not exceed Rs. 2 Crore
3	Medium	Exceeds Rs. 5 Crore but does not exceed Rs. 10 Crore	Exceeds Rs. 2 Crore but does not exceed Rs. 5 Crore

Table 2. Factors that trigger the credit rates of SMEs to be slow.

Statistics						
		Slow Growth F1	Slow Growth F2	Slow Growth F3	Slow Growth F4	Slow Growth F5
N	Valid	38	38	38	38	38
	Missing	0	0	0	0	0
Mean		3.82	3.97	3.34	3.84	3.42
Std. Deviation		0.926	0.822	0.994	0.945	1.13
Rank		3rd	1st	5th	2nd	4th

Note: F1: Being small size of loans, the transaction cost is very high hence not preferred;
F2: SME borrowers do not have strong financials;
F3: These borrowers do not have collaterals to secure banks' loans;
F4: Most of the SME borrowers are first-generation entrepreneurs don't have business experience and own contribution towards projects or business;
F5: Lack of infrastructure in backward areas

Table 3. Reasons for not preferring lending to SMEs by banks.

Statistics						
		Not Leding F1	Not Leding F2	Not Leding F3	Not Leding F4	Not Leding F5
N	Valid	38	38	38	38	38
	Missing	0	0	0	0	0
Mean		4	4.13	3.53	2.74	2.42
Std. Deviation		0.838	0.811	1.109	1.005	1.081
Rank		2nd	1st	3rd	4th	5th

Note: R1: It is highly risky because of higher delinquency;
R2: These beneficiaries do not have the credit rating or have a very low credit rating;
R3: Fail to bring own contribution to the business;
R4: Do not have proper accounting and books of transactions;
R5: Inverse relationship between the number of account and volume of business, hence higher man-hours in processing and monitoring.

Table 4. Factors contributing default in banks' loan by SMEs.

Statistics						
		Loan Default F1	Loan Default F2	Loan Default F3	Loan Default F4	Loan Default F5
N	Valid	38	38	38	38	38
	Missing	0	0	0	0	0
Mean		3.84	4	3.42	2.55	3.68
Std. Deviation		0.973	0.9	0.919	0.645	0.989
Rank		2nd	1st	4th	5th	3rd

Note: F1: Promoters' failure to bring their own contribution;
F2: Diverting/Siphoning off funds;
F3: Low technology innovation and cost inefficiency;
F4: Lack of professionalism;
F5: Under finance by banks, hence over private borrowings.

failing to give banker loans. And they also said that offering to lend to small businesses is extremely risky because many small and medium-sized enterprises approached banks with poor projects. 23 per cent of bankers has indicated this reason, following the opposing component for sanctions loans to SMEs most of the time, that they can not fulfil their ROI perspective.

Factors contributing default in bank's loan by SMEs

In comparison to large companies, reasons for defaults by SMEs differ and reactions to default by bankers are presented in SMEs. Table 4 denoted that, one of the major arguments by the bankers (29%) while they need to provide credit facility to SMEs that, SMEs will utilize the loan amount for non-business operations. So funds are going to be miss utilize, this will be directly reflecting the NPAs volume. This was the bigger failure by the SMEs. One more reason for default in banks' loan by SMEs was that they are not contributing their own amount into the business. Therefore there is a delay in repay bank loan, 26% of bankers support this one. One more important factor was that according to 25% of the respondents when the time will come to repay the loan amount, SMEs are giving first priority to settle private borrowings rather than Banks loan. Low technology, lack of systematic administration in the organization are also caused to default in banks' loan by SMEs.

Conclusion and Recommendations

A substantial aspect of the economy is the SME industry in India, comprising micro, small and medium-sized businesses. The availability of a sufficient quantity of funds is nevertheless a significant problem for the SMEs. The Government has acknowledged the main function of the SME segment to build fresh businesses and provide jobs for a large section of the population and has embraced a number of public policy measures to improve loan flows to the industry. Despite important variations in lending procedures, business models, drivers, and barriers in SME finance, the SME industry is seen as a profit-making undertaking for banking enterprises. Many SME finance problems were evaluated in the research based on impressions by bank officials in their own right.

First-generation entrepreneurs and family enterprises are the special features of small and medium-sized enterprises; they do not have a credit rating or a lower score for lack of consciousness; Cooperate is, therefore, advisable to provide data and comply with the Bank rules. Financing alone won't assist SMEs to compete and expand their capabilities. Banks should advise entrepreneurs on problems linked to finance and non-financing, such as advantages from adequate account books, retention of profits in the enterprise rather than tax avoidance, and loan guarantee information. To achieve more credit feasibility through appropriate financial practice to construct a powerful credit rating. The style of company and life has altered with technology. Innovation is no synonym nor technology replacement, but it foresees and adopts changes in the future, with a future taste and demand of consumers. Developing products for SMEs by themselves is a challenging job for them because of the absence of brand name and quality of packaging. It requires regulatory and financial assistance based on the empirical findings of the research as suggested. For getting such financial assistance by SMEs from the banks, they need to develop good projects. When plans are competitively effective banks will give financial assistance.

Limitation of the study

Study work on the basis of primary data with intrinsic limitations has been carried out. In the context of the surveys,respondents either hesitate to answer questions or do not have sufficient time to discuss and to provide disto orted information, which does not produce realistic conclusions. However, sincere attempts have been rendered to achieve study objectives without the adverse effects of restrictions.

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