



THE ROLE OF FINANCIAL INSTITUTIONS IN THE DEVELOPEMENT OF MSME's IN INDIA: A STUDY

Dr.S.Sivasankar

Academic Consultants, Department of Commerce, S.V.University, Tirupati, Andhra Pradesh.

Abstract

Today MSME sector is playing a significant and vital role in the development of Indian economy. A catalyst for socio-economic transformation of the country, the sector is critical in meeting the national objectives of generating employment, reducing poverty and discouraging rural-urban migration. These enterprises help to build a thriving entrepreneurial eco-system, in addition to promote the use of indigenous technologies. The sector has also exhibited consistent growth over the last few years, but it has done so in a constrained environment often resulting in inefficient resource utilization. Of the many challenges impeding the growth and development of MSME's, inadequate access to financial resources is one of the key bottlenecks that make these enterprises vulnerable, particularly in periods of economic downturn. In the overall value chain of different industries various firms are placed in critical positions. It is thus very much imperative to focus on those issues which impact the creation, growth and survival of the firms of the sector. Today in considering the development of MSME sector, role played by credit lending institutions is quite remarkable. Indian financial institutions and government has a crucial contribution in development as well as promotion of MSME sector. The present paper closely analyses the growth and development initiatives of Indian MSME's from opening of the economy in the last few years or so. The other part of the paper looks into the present scenario role of various financial institutions in overall development of MSME's across the nation. Research paper also aims to evaluate possible opportunities and challenges in the sector for raising funds through various financial institutions which should be considered by policy makers for better sustained results ahead.

Keywords: *Financial Institutions, MSME's, Resource, Utilization, Entrepreneurial, Ecosystem.*

Introduction

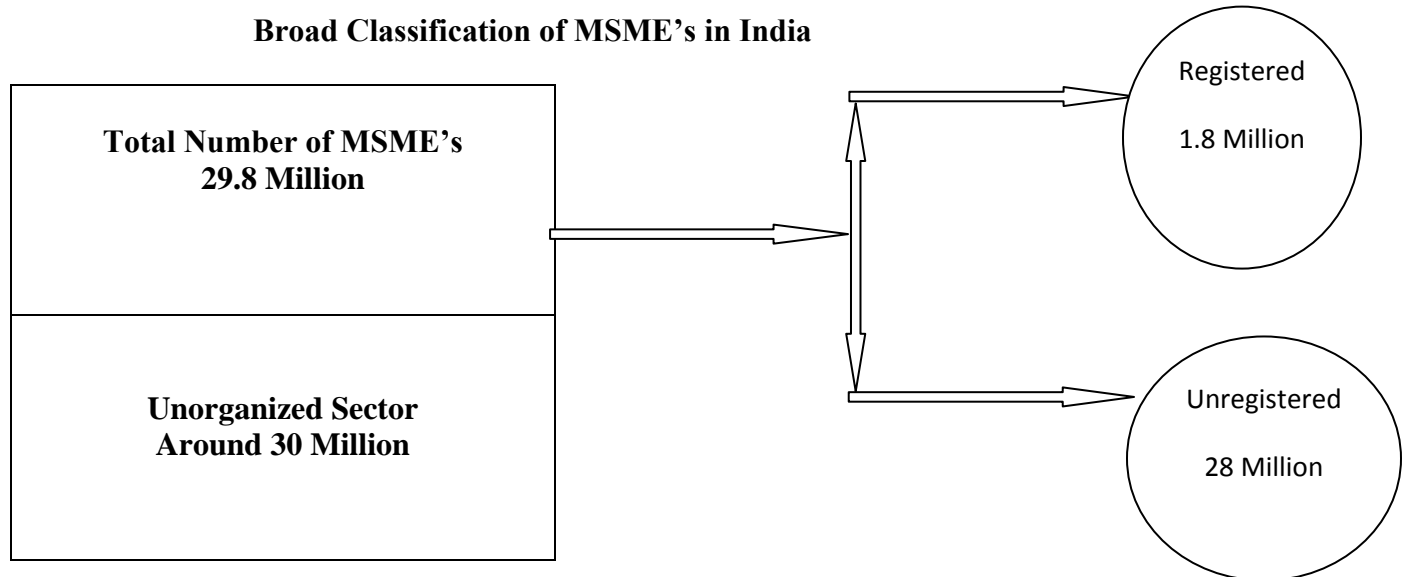
MSME (Micro, Small and Medium Enterprises) sector is very much crucial in Indian economy. There are around 29.8 million enterprises in various industries employing around 69 million people. MSME sector accounts for 45 percent of Indian industrial output and 40 percent of overall exports. Although 94 percent of MSME's are unregistered, the contribution of sector to India's GDP has been growing consistently at around 11.5 percent a year which is higher than the overall GDP growth of 8 percent.

The Micro, Small and Medium Enterprises sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. MSMEs not only play significant role in providing employment opportunities at comparatively lower cost of capital than large scale industries but also help in establishment of industrialization of rural and backward areas, which leads to reduce regional imbalances and assure equitable distribution of national income and wealth. MSMEs are complementary to large industries as ancillary units and contribute enormously to the socio-economic development of the country. MSMEs of India have to face many challenges and utilize the opportunities in the fast changing global markets. Now, MSMEs are required to make use of consultancy services to upgrade their competencies in various fields like marketing, finance, business development operations, technology etc. MSMEs are having significant contribution in the country's industrial output, employment, exports and consistent growth in employment followed by agriculture.



The MSME sector not only providing employment but also helped rural development which was the biggest challenge in front of the Government as in initial phase of industrialization which has attracted rural population towards urban region. It has provided balanced regional development of the country and proved as a key success factor for rural development.

Broad Classification of MSME's in India



Source: MSME Census, NCEUS

Some of the Major highlights of the MSME sector are as follows:

1. Number of MSME units: Around more than 45 million units in various sectors
2. Production: 45% of Industrial manufacturing output
3. Exports: 40% of India's total overall export
4. Employment: Providing employment to almost more than 100 million people creating Approximately 2 million job opportunities every year
5. Products: More than 8000 products

Major objectives of the study:

The major objectives of the present study are as follows:

1. To know and analyse the contribution of MSME's in the Indian Economy
2. To examine the growth and performance of MSME's
3. To analyse the role of financial institutions in development of the Indian MSME's
4. To analyse various challenges and opportunities available for the Indian MSME's

Research Methodology Adopted in the Study

The data required for the present study has been collected from secondary sources. The data collected for the study includes i). Annual reports of MSME's ii). SIDBI's reports on MSME reports iii). Ministry of MSME releases iv). RBI Annual reports v). Various websites relevant to topics

MSME- Considered As Backbone of Indian Economy

MSMEs in the India are continuously gaining importance due to their significant contribution towards key factors of the Indian economy. MSME units contribute more than 90% of total industrial units in India. To promote national economy Government is taking several steps to boost manufacturing



sector. Government's intention towards industrialization can be analysed through formation of various institutions for policy designing and allocation of funds through Five Year Plans. Formation of National Manufacturing Competitiveness Council by Government suggests ways to enhance competitiveness in the manufacturing sector to make sector globally competitive. Government has announced National Manufacturing Policy for raising the share of manufacturing to 25% of GDP by 2022. Make in India announced in September 2014 by New Government aims at to make India a Global Manufacturing hub.

Sources of Financing for MSMEs

The MSMEs in India largely depend on self-finance. As per the fourth census of MSME sector 87.23% of all enterprises were found in the category of taking "Self-finance/No finance". This high percentage of units depending on "Self-finance/No finance" can be a result of high proportions of units falling in "Micro enterprises" category. Micro enterprises comprise 94.94% of all the MSME units in India, whereas the share of small enterprises is 4.89% and that of medium enterprises is only 0.17%.

Without much adequate financing opportunities MSME's face the problem of receivables management through factoring services. The delayed payment by the purchasers from larger enterprises has always been an issue of great concern for the MSMEs. Financial Institutions in India have to be more proactive in providing finance against the receivables factored. Globally, factoring is a preferred route of accessing working capital for SMEs. The enactment of Factoring Regulation Act in 2011 in India is expected to give boost to factoring services. Factoring offers benefits like open account facility which means credit limit increases as sales grow, provided the firm has a satisfactory record of payments.

Concerns Involved in Providing Finance to MSME'S

The growth in providing finance to MSMEs cannot be achieved without addressing the concerns of formal financial institutions like banks in lending to this sector. MSMEs are considered as high risk borrowers due to factors such as insufficient assets and low capitalization. The firms being highly vulnerable to economic and marketing fluctuations have high mortality rates. According to Reserve Bank of India (RBI) data, the number of sick units in MSME sector has increased by 16% to 90,141 units in March 2011 from 77,723 units in March 2010. As per current definition, a unit is considered sick when any of the borrower account of the unit remains substandard for 6 months or there is erosion in the net worth due to accumulated cash losses to the extent of 50% of its net worth during the previous accounting year and the unit has been in commercial production for at least two years. For the financial year 2011-12, the share of Micro and Small Enterprises in banking system credit was 9.8% whereas the share of these firms in banking system Non-Performing Assets (NPA) was as high as 17.9%. Large number of MSMEs turning sick units and the rising trend of NPA pose a significant risk for the banks.

The information asymmetry that exists in lending to MSMEs act as an obstacle in ensuring credit flow to the sector. The credit information about small enterprises is not easily available and it is not cost effective for the banks to collect information on large number of small enterprises. This often results into lending rates being loaded with the cost of information asymmetry. Information asymmetry makes it difficult for the lenders to distinguish between bankable projects and doubtful projects. As per the 4th census of MSME sector 90.08% of the enterprises are of proprietary in nature. Such a large proportion being dependent on the proprietors and without having succession planning in most cases make the sector unattractive for the lenders. The inability of smaller firms to hire appropriate manpower means that they rely on the proprietors too heavily. In the absence of adequate collateral



offered by the most MSMEs, financial institutions depend on the technical, managerial and marketing skills of borrowers to service the loan which increases the risk profile of these firms. The other problems that lenders find in dealing with MSMEs are lack of transparency and reliability of data, lack of financial discipline and inability to provide sound financial track record.

Contribution of MSMEs in Production and GDP

More than 45 million units accounting for more than 90% of industrial units are playing key role in boosting economic growth of the country. MSMEs production has consistently grown over the period of last few years and stood at Rs.671910 crore i.e. 37.52% of total industrial output at the end of FY12. MSME has also proved them as engine of employment creation and total number of employment at the end of FY12 stood at 1011.8 lakhs generating approximately 1.5 million employment opportunities every year.

MSME's financing Strategy

Finance is believed as the lifeblood of business. Majority of Indian MSMEs are falling in unorganized sector and hence struggling for regular credit flow. For start-ups, entrepreneurs are managing finance through informal sources as they used to struggle for seed funding. MSMEs require timely and adequate capital infusion through term loans and working capital loans basically in the early and growth stages. Majority of Indian MSMEs have relied on following sources for their financing need:

1. Personal savings, ancestral capital, loan from relatives and also loan from unregulated markets
2. Retained earnings, fundings through sale of major assets
3. Institutional financing from scheduled commercial banks
4. Venture capital funds/ seed funds

In respect of MSME contribution, there are so many organizations that which have set up by the central governments, state governments and also banks to support development of MSME's. Some of the major list of institutions set up for MSME development is as follows:

A. Central government

1. Central board for Micro, Small and Medium enterprises
2. Small Industries Development Organization
3. National Institute for MSME's
4. National Small Industries Corporation Ltd
5. Entrepreneurship Development Institute of India Ltd

B. State Government:

1. District Industry Centres
2. Khadi and Village Industries Commission (KVIC)
3. State Financial Corporations
4. State Small Industries Development Corporation
5. State Industries Development Corporations/State Industrial Investment Corporation

C. Banks

1. Major Commercial Banks
2. Regional Rural Banks
3. Small Industries Development Corporations of India (SIDBI)
4. Co-Operative Banks
5. National Bank for Agriculture and Rural Development (NABARD)



Apart from the above stated major forces there are also other sources of finance which MSME's choose as an easy viable source. These sources are own funds, funds from relatives or funds, credit obtained from suppliers and other such informal sources.

Major Role of Financial Institutions in the Development of MSME'S In India

Indian MSMEs have proved themselves as key factor for overall economic development. Considering the role of MSMEs government has taken time to time initiatives for development and promotion of the sector. After analysis it is found that Government has made huge investments through five year plans for product, skill and competitive development of MSME sector. In the country like India where economy is in its developing phase has to give due consideration for key success factors. The same happened to Indian MSMEs which has attracted the attention of policy makers and researchers.

Analysis of Bank Credit Against MSME'S Fixed Investments and Production

Indian MSME's performance is showing excellent growth in production over the period of time. Production contributing towards 45% of industrial output and 40% in export has attracted the attention of policy makers and financial institutions. Various initiatives jointly by Government of India and Small Industrial Development. Bank of India (SIDBI) led to financial inclusion and growth of MSME's sector in recent years. The growth percentage of bank credit against fixed asset investment and production of MSME's is increasing at 33% and 22% respectively. The increase in credit flow is indication of policy makers concern towards growth of MSME sector for economic development of the nation.

Increase in credit flow from formal sector to MSME is due to GOI and SIDBI initiatives which include:

- ❖ Inclusion of Micro and Small Enterprises in Priority Sector Lending
- ❖ Funding support to Credit Guarantee Fund Scheme to enhance unsecured financing
- ❖ Financial support to increase penetration of credit rating
- ❖ Promotion of Cluster Development
- ❖ The Nair Committee Recommendations
- ❖ Priority Sector Lending Norms
- ❖ Prime Ministers Task Force on MSMEs recommendations
- ❖ Policies to facilitate multi prolonged support to-Skill Development, market linkages, technology adaptation and infrastructure

Product and service portfolio through which financial institutions offering credit to MSME sector are as follows:

Banks offering loans to MSME's sector can be categorized are as follows:

- Fund based products and
- Non fund based products like Letter of Credit

Bank Guarantee, Current Account, Saving Account and Remittance. The overall support from government and competitive legal and regulatory environment has given boost to credit supply to MSMEs from financial institutions. The increased credit supply will certainly make MSME sector stronger and enhance their competitiveness in global market. Technology up-gradation, tool room facilities, incubators and entrepreneurial training facilities will surely enhance the capabilities of MSME to increase contribution in GDP and to achieve the goal of government by 2022 of 25% manufacturing contribution in GDP.



Some of the Major Challenges Faced By MSME Sector

Irrespective of the efforts taken by the government of India and the Reserve bank of India in credit supply to MSME's sector there is a huge gap between credit supply and demand by the sector. Not only the credit but there are others things too which are hindering the growth of the sector.

Some of these challenges are as follows:

A. Financial exclusion:

Access to adequate and timely credit at a reasonable cost is the most critical problem faced by MSMEs. The statistics compiled in the fourth census of MSME's sector revealed that only 5.18% of the units had availed finance through institutional sources, 2.05% through non-institutional sources and 92.77% of MSME's units dependent on self-finance of informal sources. These problems need to be addressed to make MSME's sector globally competitive and to achieve GDP targets or expectations from the sector. Government needs to play a catalytic role to cater the needs of this sector.

B. Infrastructure:

India is aiming at the best in class infrastructural facilities for MSME's. Infrastructural problems restrict private initiatives in this sector. Therefore creation of better infrastructural facilities for MSME's must receive priority

C. Marketing:

After the revolution in IT sector, assumed market for MSME products is no more in existence. To enhance MSME's competitiveness due consideration should be given to various application of IT based products for use for the purpose of marketing should be promoted.

D. Technology:

Due to high initial cost of technology up-gradation, MSMEs are lagging behind in adaptation of technology and unable to be cost efficient. Sustainable Business Model approach should be promoted with various attractive packages to MSMEs.

E. Need for Skilled Labour:

The major constraint of MSME's sector is availability of skilled labour force. For this government should develop integrated model for integration of educational institutes with industries. This practice will enhance the ability of students to get practical knowledge and skill set required by industry along with theory.

Contribution of MSME'S Towards Employment Generation

The contribution of the Micro, Small and Medium enterprises to the economic growth of a nation is well recognized. In developing countries, as some authors argue the contribution of MSME's towards employment generation is significant because they:

1. Tend to use more labor intensive production processes than large enterprises, boosting employment and leading to more equitable income distribution
2. Provide livelihood opportunities through simple, value adding processing activities in agriculturally based economies
3. Nurture entrepreneurship and Support the building up of systemic productive capacities and the creation of resilient economic systems, through linkages between small and large enterprises

Conclusion

Micro, Small and Medium Enterprises (MSMEs) have emerged as an engine of growth in several developed and developing economies of the world. In India also, they have emerged as a vibrant and dynamic component of the economy by virtue of their significant contribution to GDP, industrial production and exports. However, the most important contribution of this sector is towards



employment generation which is second only to agriculture. The experience of recent years shows that while employment in agriculture sector has been declining, large industries are also experiencing jobless growth. In such a situation, the main responsibility for job creation rests with unorganized sector including small and medium enterprises and the service sector. Considering its potential and ability, the MSMEs sector has been assigned a target of 12 per cent annual growth and additional employment of 4.4 million persons. In India MSME's will certainly contribute towards the role and ambiguity of development of overall economy of the country at large. Unemployment and poverty are addressed by MSME's by providing jobs to youths thus minimizing the challenges faced in providing jobs. It has provided scope for regional development and demolishing imbalances. Worldwide MSMEs are considered as development engine for economy. So policy makers should give due consideration for designing good policies for the sector and equally for policy implementation. So far Financial Institutions have played an important role in support and development of MSMEs, focus should be given for more financial inclusion of MSMEs. Government should act on the recommendations of various committee reports appointed for MSME sector analysis.

There are few challenges which are hindering the growth of the sector. By addressing these challenges government can achieve best of its expectation from MSMEs performance in industrial output, export and most important GDP. MSMEs are best vehicle for inclusive growth to create local demand and consumption. The contribution of these firms demands that the bottlenecks in getting credit be removed. It is true that a large number of enterprises becoming sick units increases risk perception of the lenders. The NPA of banks resulting from lending to this sector is also very high. The setting up of Credit Information Bureau of India Limited (CIBIL) can strengthen the credit information infrastructure. This can enhance the confidence of the lending institutions in extending the credit to the MSMEs. It is important to increase the level of awareness about MSMEs about the policy measures and institutional measures aimed to facilitate credit flow to the sector. The MSME sector can evolve to be more competitive and contribute more significantly towards India's goal of sustainable and inclusive growth with the greater access to finance. The MSMEs of today will be large corporates and MNCs of tomorrow and hence will be giving strength to economy. So banks and other agencies should take pride while serving MSMEs as they are playing key role formation of such corporate and MNCs of Indian future of global industrial manufacturing hub in days to come.

References

1. Ravindra Gowda K, Shivakanth Shetty A (2010) SME's Contribution to Inclusive
2. Growth and Employment Opportunities in India. Southern Economist 1: 9-12.
3. Annual Report 2008 - 2009 (2009) Government of India Ministry of SSIs.
4. MSMEs Annual Report 2009-2010 (2010).
5. Pandiyan S (2008) Rural Industrial under Liberalization.
6. Radha J, Markkandeyan (2009) The Role of DICs in Promotion and Development of SSIs in Dindigul District. Unpublished PhD Thesis of MaduraiKamaraj University.
7. LaghuUdyogSamachar (2003) Government of India.
8. Annual Report on Development Banking in India (IDBI) (1999) 1: 17-18.
9. Annual Report on Development Banking in India (IDBI) (1999) 1: 32-33.
10. Datt R, Sundaram KPM (2006) Indian Economy. S. Chand & Company Ltd, New Delhi 53: 892.
11. Tamil Nadu-An Economic Appraisal (1997) Evaluation and Applied Research Department. Government of Tamil Nadu.



12. Report of Prime Minister's task force on Micro, Small and Medium Enterprises, Govt. of India, January, 2010.
13. Vision 2020: Implications for MSMEs (2011), Grant Thornton, FICCI.
14. Chakraborty K.C. (June, 2010). Bank Credit to MSMEs: Present status and way forward, RBI monthly Bulletin.
15. Annual Report, (2010-11). Ministry of Micro, Small and Medium Enterprise, Government of India. Badulescu Daniel. SMEs Financing: The extent of Need and the Responses of Different Credit Structures.
16. Final Report (Edition: April, 2011) 4th All India Census of MSME, 2006-07: Registered Sector. Risk Capital and MSMEs in India (A SIDBI Publication).
17. RBI Report on 'Empowering MSMEs for Financial Inclusion and Growth-Role of Banks and Industry Associations.
18. MSME Finance in India, 'A Research Study on Needs, Gaps and Way Forward, International Finance Corporations, November' 12