

## A Study on Bank Financing to MSME in Ahmadabad city

Dr. Sneha Shukla

Associate Professor

N. R. Institute of Business Management  
Ahmedabad

“The year 2011-12 has been tough with the Indian economy reporting a growth of 6.9%. This is a significant decline as compared to past few years. Despite the slowdown, driven largely by the uncertain global economic scenario, India remains among the frontrunners, globally, in any cross-country comparison. Numerous indicators suggest that the economy is turning around as core sectors as well as manufacturing show signs of recovery. India's GDP growth in 2012-13 is expected to be 7.6% approximately.”

**-In the words of Finance Minister of India**

### Abstract

The MSME sector is an important pillar of Indian economy as it contributes greatly to growth of Indian economy with a vast network of around 30 million units, creating employment of about 70 million, manufacturing more than 6000 products, contributing about 45% to manufacturing output and about 40% of exports, directly and indirectly. This sector even assumes greater importance now as the country moves towards a faster and inclusive growth agenda. Moreover, it is the MSME sector which can help realize the target of proposed National Manufacturing Policy of raising the share of manufacturing sector in GDP from 16% at present to 25% by the end of 2022.

Yet, the sector is continually embattled with intractable issues like limited access to credit and institutional finance, technological obsolescence, limited market access, and skilled manpower shortage. For decades, Indian MSMEs operated in a relatively protected business environment but in a globalised business environment like today they would need sizeable investments to access new technologies, scale up operations and foray into new markets.

To understand the current scenario of MSME Financing by banks, the researcher carried out a study of 100 SMEs belonging to various industries like auto parts and components, machine tools, pharma and cosmetics etc. of Ahmedabad city. This paper then examines their experience regarding obtaining finance from bank in order to draw useful conclusion.

To sum up, the researcher would like to say that in spite of the problems, the MSME sector has grown by leaps and bounds. Micro, Small & Medium Enterprises constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial

production and exports. In India too, the MSMEs play a pivotal role in the overall industrial economy of the country.

### **Keywords:**

Micro Small Medium Enterprise (MSME), Financing, Ahmadabad

### **Introduction**

Micro Small and Medium enterprise, in short MSMEs, is the word coined by MSME act of 2006. It denotes small businesses where investment in Plant and Machinery is not in excess of ten crores (more detailed classification under separate section). Previously it was known as Small Scale Industries, in short SSI. This change brought services sector under the purview of act. It is very significant as service sector contributes 52% to nation's GDP. Majority of service providers are small business, be it a carpenter, blacksmith, hair-dresser or your tax consultant.

MSMEs in India are mostly in the unorganized sector and are the source of livelihood for millions of people. The social contribution made by MSMEs is even more significant than its economic contribution. Within the SME sector, the small sector serves as a seed-bed for nurturing entrepreneurial talent and originating units to grow eventually to medium and large enterprises. The promotion of MSMEs, therefore, becomes a major area for policy focus. Regeneration of MSMEs must receive public support particularly for the village, cottage and micro level enterprises.

### **Products Offered**

The small scale sector produces a wide range of products, from simple consumer goods to highly precision and sophisticated end-products. As ancillaries, it produces a variety of parts and components required by the large enterprises. The sector has emerged as a major supplier of mass consumption goods like leather articles, plastics and rubber goods, fabrics and ready-made garments, cosmetics, utensils, sheet metal components, soaps and detergents, processed food and vegetables, wooden and steel furniture and so on.

More sophisticated items manufactured by the small scale sector now include television sets, electronic desk calculators, microwave components, air conditioning equipment, electric motors, auto-parts, drugs and pharmaceuticals.

### **Major Export Products**

- Readymade Garments
- Chemicals and pharmaceuticals
- Engineering goods
- Processed foods
- Leather products
- Marine products

### **SMEs in India**

India has a vibrant SME sector that plays an important role in sustaining economic growth, increasing trade, generating employment and creating new entrepreneurship in India. In keeping in view its importance, the promotion and development of SMEs has been an important plank in our policy for industrial development and a well-structured programme of support has been pursued in successive five-year plans for SMEs in India have recorded a sustained growth during last five decades. The number of SMEs in India is estimated to be around 13 million while the estimated employment provided by this sector is over 31 million. The SME sector accounts for about 45 per cent of the manufacturing output and over 40 per cent of the national exports of the country.

India embarked on the path of opening up its economy and integrating it with the global economy in 1991. The liberalization of economy, while offering tremendous opportunities for the growth and development of Indian industry including SMEs, has also thrown up new challenges in terms of fierce competition. The very rules which provide increased access for our products in the global markets also put domestic industry under increased competition from other countries. In today's world, access on a global basis to modern technology, capital resources and markets have become the most critical determinants of international competitiveness.

### **Defining SMEs**

In India, the enterprises have been classified broadly into two categories:

- (i) Manufacturing; and
- (ii) Those engaged in providing/rendering of services.

Both categories of enterprises have been further classified into micro, small and medium enterprises based on their investment in plant and machinery (for manufacturing enterprises) or on equipments (in case of enterprises providing or rendering services). The classification on basis of investment is as under:

**Table 1 Classification of Micro, Small and Medium Enterprises**

Classification	Investment Ceiling for Plant, Machinery or Equipments	
	Manufacturing Enterprises	Service Enterprises
<b>Micro</b>	Upto Rs.25 lakh	Upto Rs.10 lakh
<b>Small</b>	Above Rs.25 lakh & upto Rs.5 crore	Above Rs.10 lakh & upto Rs.2 crore
<b>Medium</b>	Above Rs.5 crore & upto Rs.10 crore	Above Rs.2 crore & upto Rs.5 crore

([http://www.dcmsmc.gov.in/ssiindia/MSME\\_OVERVIEW.pdf](http://www.dcmsmc.gov.in/ssiindia/MSME_OVERVIEW.pdf))

## Research Methodology

### Scope of the study

The MSME sector is an important pillar of Indian economy as it contributes greatly to growth of Indian economy with a vast network of around 30 million units, creating employment of about 70 million, manufacturing more than 6000 products, contributing about 45% to manufacturing output and about 40% of exports, directly and indirectly. This sector even assumes greater importance now as the country moves towards a faster and inclusive growth agenda. Moreover, it is the MSME sector which can help realize the target of proposed National Manufacturing Policy of raising the share of manufacturing sector in GDP from 16% at present to 25% by the end of 2022.

Yet, the sector is continually embattled with intractable issues like limited access to credit and institutional finance, technological obsolescence, limited market access, and skilled manpower shortage. For decades, Indian MSMEs operated in a relatively protected business environment but in a globalised business environment like today they would need sizeable investments to access new technologies, scale up operations and foray into new markets.

The researcher thus focuses to understand the current scenario of MSME Financing by banks.

### Objectives of the study

The objectives of the research are as follows:

- To understand various options offered by banks for MSME financing.
- To identify the mode and purpose of financing preferred by MSMEs.
- To know the preference for public vis-à-vis private sector banks for financing.

- To determine the factors in favor and against getting finance from banks.
- To know the level and degree of satisfaction of MSMEs with respect to various parameters of raising finance from public sector banks.
- To know the awareness of MSMEs regarding Private Equity financing and their preference for bank financing vs. PE financing.
- To identify the factors in favor of PE financing.

### Approach to the study

The approach to the study was descriptive. The research was aimed at collecting information by approaching 100 small and medium scale enterprises and knowing their experience regarding obtaining finance from bank in order to draw useful conclusion.

### Sources of data

The data sources used for the project were both primary and secondary. The secondary data is based on the past surveys and research work published in magazines and journals. The primary data was collected from respondents of Ahmedabad city only.

### Methods of the data collection

The information from the end users was obtained using the survey method. A structured questionnaire was administered. The questions were closed ended.

### Sampling Elements

The sample elements for the respondent survey were SMEs belonging to various industries like auto parts and components, machine tools, pharma and cosmetics etc.

## Sampling Design

Simple Random Sampling was used to collect the data.

## Sample Size:

Sample of 100 Respondents from Ahmedabad city were taken for the study.

## Findings of the Study

- From the survey it was found that respondents use multiple sources for financing their enterprises. The study shows that most of, i.e. 94 percent of the respondents rely on their own funds. Additionally, 82% respondents' use bank financing as well along with the other sources of capital (both long as well as short term). (Details in Table 2)
- The study also shows that as much as 50 percent of respondents use financing for the purpose of increasing production capacity. Other purposes were construction & improvement (34%) and flooring of inventory & working capital (30%). However it shows that enterprises use less finance for modernization and up gradation of technology (18%) and real estate acquisition (18%). (Details in Table 3)
- It was found that enterprises use public sector banks more as compared to private sector banks for financing their businesses. SBI (and its subsidiaries) are the leading financiers with 34 percent of respondents favoring it among all other public sector banks where as private banks are less preferred with a total of 14 percent responses. (Details in Table 4)
- Analyzing the advantages of MSME financing schemes, various factors like better service, single window dispensation, attractive financing conditions, easy access & low rate of interest were asked to respondents. From the weighted average score method, it can be interpreted that 'Low Interest Rates' factor (with the highest score of 38) was highly appreciated by the respondents. They also preferred better service, attractive financing conditions, and easy access to obtain MSME financing schemes. (Details in Table 5)
- Enterprises normally face many issues while raising finance from public sector banks. While asking them which were the most common issues, the major ones were insufficient collateral; delay in the sanction of loan; lengthy process and poor documentation. Sometimes such factors discourage SMEs to get finance from the public sector banks and force them to go for private sector banks and other convenient sources. (Details in Table 6)
- It was found out that out of 100 enterprises, 10 enterprises have been rejected loan application previously. Upon interaction with the owners of those enterprises they have stated that the main reason for rejection was inability on their part to provide enough guarantees. The other reasons because of which application was rejected were unprofitable ventures, incorrect application etc. (Details in Table 7)
- Table 8 reflects the level and degree of satisfaction of MSMEs with respect to various parameters of raising finance from public sector banks. The survey results show that out of 100 enterprises, 68 enterprises have sourced finance from public sector banks. Likert scale method has been used to draw out the true picture. By applying this method it was found that maximum number of the enterprises has shown high level of satisfaction with regard to simplicity of the application form. Some enterprises have shown satisfaction with regards to interest rates charged to them in the process of raising finance from bank. On the other hand, 24 enterprises have shown concerns and huge level of dissatisfaction with regard to delay made by public sector banks in sanctioning the loans. Service fees and charges was also the cause of level of dissatisfaction among the enterprises. Some enterprises were also dissatisfied by the behavior of the bank staff and guarantees required by the bank. (Details in Table 8)
- Upon interaction with various owners of various enterprises it was found out that 70% of the enterprises expect the schemes and incentives from the government side that can lead to saving of taxes. 58% of the respondents seek for such incentives that can provide assistance and support for revival of their sick units along with innovative and technological support. Many enterprises also expect the government to create such policies and incentives that favor and encourage entrepreneurship. (Details in Table 9)
- It was found out that 74% of the total enterprises were aware of private equity financing. The main reason stated by them was they were approached by many private equity investors who were ready to provide technical and financial assistance in their projects. (Details in Table 10)
- It is further found that 30% of those enterprises who were aware of private equity financing have shown their optimism towards private equity venture as opposed towards bank financing. Those enterprises that have showed positive sign for private equity finance have had unpleasant experience while availing finance from the bank. (Details in Table 11)

- While asking about the factors that encourage the SMEs for PE financing, timely approval, guarantee required and less documentation hassles were motivating factors. Now a days PE investors are entering in the market with lucrative features giving stiff competition to the other financiers, including government organization and public sector banks. (Details in Table 12)

### Conclusion

In spite of the problems, the MSME sector has grown by leaps and bounds. Micro, Small & Medium Enterprises

constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, the MSMEs play a pivotal role in the overall industrial economy of the country.

In recent years the MSME sector has consistently registered higher growth rate compared to the overall industrial sector. With its agility and dynamism, the sector has shown admirable innovativeness and adaptability to survive the recent economic downturn and recession.

### Annexures

**Table-2 Sources of finance used**

Sources of Finance	No. Of Responses
Owners Financing	94
Private financial institutions	44
Equity finance	18
Bank financing	82
Venture capital	8
Hire purchase and leasing	24
Business angel financing	28
Others	4

**Table-3 Purpose of loan**

Purpose of Loan	No. of Responses
Real estate acquisition to house the business	18
Increase the production	50
Construction, renovation or leasehold improvements	34
For flooring of inventory and working capital	30
For modernization and up gradation of technology	18

**Table-4 Banks from where finance is raised**

Public Sector Banks	No. of Responses	Private Sector Banks	No. of Responses
Punjab National Bank	16	ICICI Bank	4
Union Bank Of India	16	HDFC Bank	8
State Bank of India	34	AXIS Bank	2
IDBI			8
Bank of Baroda			10
SIDBI			12
Canara Bank			4
Bank of India			6

**Table 5 Rating of Benefits of MSME Financing**

Parameters	5	4	3	2	1	Weighted Average Score
Better Service	95	48	18	8	0	33.8
Single Window Dispensation	25	44	57	4	1	26.2
Attractive Financing Conditions	55	56	30	8	2	30.2
Easy Access	55	68	9	14	3	29.8
Low rates of interest	145	28	15	2	0	38

**Table 6 Problems faced in raising finance from public sector banks**

Problems Faced	No. Of Responses
Insufficient collateral	23
Poor documentation	21
Delay in the sanction of loan	22
Complicated Procedure	19
Lengthy Process	22
Biasness	16
High rate of interest	15
Any Other	5

**Table 7 Reasons for rejection of loan application**

Reasons	No.Of Respondents
The management team is too inexperienced	0
The application did not meet the criteria	2
The application was not correctly completed	2
Poor credit history	0
The enterprise could not provide enough guarantees	4
Not a profitable venture	2
Total	10

**Table 8 Level of satisfaction from a public sector bank**

Various Aspects	Strongly Satisfied	Satisfied	Neutral	Dissatisfied	Strongly Dissatisfied	Likert score
The amount granted by the bank relative to the amount requested	10	10	0	-4	-6	10
The simplicity of the application form	24	14	0	-3	-2	33
Interest rate	14	10	0	-3	-4	17
Service fees	4	4	0	-10	-10	-12
Time to obtain approval	4	4	0	-12	-12	-16
Guarantees required by the institution	6	5	0	-8	-10	-7
Behaviour of the bank staff	6	7	0	-9	-12	-8



**Table 9 Preference for various government initiatives**

Various Initiatives	No. Of Respondents
Decrease the amount of taxes	72
Support innovative technological companies	56
Guidance for upgrading skills & knowledge of entrepreneurs	50
Assistance and support for revival of sick units	58
Introduce a Single Window concept for helping SMEs	38

**Table 10 Awareness about Private Equity (PE) Financing**

Awareness	No Of Respondents
Yes	74
No	26
Total	100

**Table 11 Preference for PE financing against bank finance for long term finance**

Preference	% Of Respondents
Yes	30
No	70
Total	100

**Table 12 Factors considered for Private Equity finance**

Factors	No. of responses
Avoiding regulatory reporting	2
Guarantee required by PE investors	10
Time to obtain approval	10
Less documentation hassles	8
Negotiable interest rates	14
Any Other	2
Total	44

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