

Financing in MSMEs- The Major Issues

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Abstract

Globally Micro, Small and Medium Enterprises (MSMEs) have been accepted as a growth engine of economy for any nation. In India now-a-days MSMEs have become an issue of great interest. There are many financial institutions that provide many types of facilities and services to start MSMEs and for their growth and restructuring. In India MSMEs constitute an important part in its Economic growth and development. Despite this fact, MSMEs are also facing major problems regarding absence of adequate and timely supply of finance, lack of working capital, education, training awareness and lack of suitable technology. The present paper attempts to contribute new knowledge to the existing literature of MSMEs, Financial Management, Banks and Working Capital. The study will be beneficial for Entrepreneurs, Community and other business ventures. The study is based upon the secondary data collected from literature review on the MSMEs. Review of literature revealed that the major problems of MSMEs are how to raise funds from banks and financial institutions particularly timely availability of finance. All these problems may differ from region to region and Business to Business. This paper investigates different types of problems faced by these units in raising finance.

KEYWORDS: MSMEs, Entrepreneurs, Credit, Financial Institutions

Introduction:

India has vibrant and sensitive MSMEs that play a dynamic responsible role in Economic Growth and Development of any country in terms of rising trade, generating highest employment opportunities and creating latest skill development in India with their efficient, effective and innovative entrepreneurial spirit. MSMEs are the pillar of any economy and an engine of economic growth, advancing impartial improvement for all. Therefore, to promote and support MSMEs, the Government of India through Ministry of Micro, Small and Medium Enterprises (MSMED) Act 2006 provides different types of subsidies, plans and incentives for this sector and tries to resolve some major issues related to MSMEs i.e. lack of funds, lack of managerial skills etc. The main objectives of the Act are to manage cluster development, provide training to entrepreneurs, infrastructure development and promote financial access to this sector.

In India, MSMEs in many sectors i.e. agriculture, industry, and service have an effective contribution in national income, value addition, generating employment opportunities, productive utilization of entrepreneurial skill and capital. But this sector is facing many problems i.e. Non-availability of adequate and timely credit, procurement of raw material, high cost of credit, lack of access of global market, unavailability of skilled manpower, low production capacity, small size, infrastructure problem etc. These

problems are killing this sector and pulling it in the list of sick industries. This sector has a weaker financial structure resulting in lower credit rating.

CLASSIFICATION OF MSMEs BASED ON INVESTMENT SLABS

Classification	Investment limit in Plant & Machinery in Manufacturing Enterprises	Investment limit in Equipments in Service Enterprises
Micro	Upto Rs. 25 lakhs	Upto Rs. 10 lakhs
Small	More than Rs. 25 lakhs and upto Rs. 5 crores	More than Rs. 10 lakhs and upto Rs. 2 crores
Medium	More than Rs. 5 crores and upto Rs. 10 crores	More than Rs. 2 crores and upto Rs. 5 crores

Source: Micro, Small & Medium Enterprises Development Act, 2006.

In April, 2015 the government introduced a bill in Lok Sabha to enhance the investment limits for MSMEs. The proposed investment limit in Plant and Machinery for micro enterprises is to be raised from Rs. 25 lakhs to Rs. 50 lakh, small enterprises from Rs. 5 crore to Rs. 10 crore and medium enterprise from Rs. 10 crore to Rs. 30 crore.

Related Literature:

Various studies have been conducted on MSMEs to highlight the issues. Few important studies have been coated here.

Garg, N. (2014) highlighted the growth of MSMEs sector and analyzed various problems and challenges faced by this sector in India in general. **Nishanth and Zakkariya (2014)** conducted a survey in Kozhikode district in Kerala. They revealed that MSMEs faced a problem in accessing finance from banks and financial institutions and also revealed that this sector faced various barriers in raising finance and also tried to identify various sources of finance other than banks.

Padmasani, S., and Karthika (2013) conducted a study in Tripura and Coimbatore District in Textile Exports on Problems and Prospects of MSMEs. The main objective of this paper was to examine the problems of MSMEs in the era of global economy and also identified the factors affecting MSMEs. The survey revealed that MSMEs could be overcome the problems if it focused on standardization of the business process and also improved the productivity by adopting latest technology. To fulfil this objective bank could support the MSMEs sector by providing credit at low cost and Government and Institutions should take effective measure to improve the export performance of MSMEs for economic development. Another study done by **Harif, et al. (2010)** on financial management practices of SMEs in Malaysia. They concluded that lack of working capital which accounted for 93.6 percent was the most common weakness in the area of financial management. A survey was conducted by **Thiripurasundari and Gurumurthy (2009)** to highlight the challenges of Indian MSMEs. They found that one side globalization was a big opportunity for MSMEs but on the other hand it was a big challenge for indigenous

MSMEs because this sector in India was facing a great problem due to large production of foreign manufacturing concern. Only those MSMEs which were financially strong would survive at globalized platform. **Wanjohi (2009)** conducted a study to explain the working capital practices of SMEs in Kenya. He surveyed 113 SMEs and found that working capital practices were low amongst SMEs as majority had not adopted formal working capital routines.

According to **McNamara et al. (1988)** there were four reasons for the failure of small enterprises. These reasons were: a) to enable management to respond quickly to changing conditions, b) to train lenders in recognizing the important factors involved in determining an enterprise's likelihood of failing, c) to assist lending organizations in their marketing by identifying their customer's financial needs more effectively, d) to act as a filter in the credit evaluation process. **Meredith, (1986)** revealed that financial management has been one of several functional areas of management but it was central to the success of any small business.

UNIDO (1969) found that the small enterprises with a lower level of investment per worker tend to achieve a higher productivity of capital than do the larger, more capital intensive enterprises. According to **Jain (1956)** the assistance to small scale industrial sector has been grossly inadequate and the agencies have developed a preference of investing their funds in the medium and large scale units and the bigger ones among the small scale units. **Suneetha, K., and Sankaraiah, T.** survey revealed the Problems of MSMEs and Entrepreneurs in Kadapa District. The study was conducted on 156 enterprises in divisions of Kadapa, Jammulamadugu and Rajampet. The surveys revealed that majority of enterprises (103) were facing financial problems and among them 62.8 per cent are from Micro enterprises. On the other hand 23 percent found as inadequate assistance from government agencies.

Need of Finance:

India is the second largest populated country in the world after China. India is rich in natural resources and has human capital in bulk. But still the growth rate of country is quite lower because of lack in capital formation. Although procurement of funds is very necessary for any business concern, MSMEs are facing problems in procuring finance. If we go through the past studies, we would be able to know that the percentage contribution of MSMEs is increasing day by day in development of the country through providing employment opportunities, rising trade and introducing innovative entrepreneurial spirit. This sector generally requires two types of funds: long term funds and secondly working capital or short term funds. Long term funds are needed for investment in fixed assets for setting up new business and restructuring/ expansion/ modernization of existing business units. On the other hand short term fund or working capital is very important to manage day-to-day activities of the business. Because of increasing competition, Indian MSMEs are finding it difficult to sell their products in national as well as international markets. Sometimes the product is not good enough to enter in global market because of its bad quality. Finance plays an important role in every sector and it is the backbone of the industries. It helps in production, advertisement, growth and development. Not only MSMEs sector but all the sectors require finance for

pre-seed, seed and start-up. In this competitive world every sector wants to be globalized and wants to sell its products in domestic as well as in international market. To fulfil this objective they need to adopt advanced technology, skilled man power, raw material in bulk and adequate working capital which can't be possible without sufficient and timely finance.

Procurement of Finance for MSMEs Sector:

MSMEs contribute an important part in growth of Indian economy and play a dynamic role for the development of the country. In spite of its importance, this sector is facing major problem in raising funds from the banks and other financial institutions. The Government of India is recognizing the potential of this sector for the country's development and taking important steps to enhance it. So, to promote this sector Government is planning to increase financial assistance for micro, small and medium enterprises to 80 per cent of their capital requirements in the 12th plan. The government through its various agencies has taken many key steps to strengthen and promote innovation and capacity building in this sector. To boost this sector government introduced various schemes and policies i.e. credit rating scheme for Micro and Small Enterprises which were formulated in consultation with Indian Banks Association (IBA) and Rating Agencies. With the help of this scheme the MSMEs sector can get credit at attractive rate of interest and can raise funds for start-up and for day to day activities. The government of India has implemented the Micro and Small Enterprises-Cluster Development Program for the holistic development of these enterprises. This program is being implemented in clusters for enhancing productivity and competitiveness of this sector through soft interventions, hard interventions and infrastructure up gradation. Forty three new clusters have been taken up for various interventions during the year 2014-15. The government has introduced around 966 clusters and 171 infrastructure development programs. The Credit Linked Capital Subsidy Scheme is also introduced by government of India. Through this scheme technological up gradation of MSMEs is possible. The other program of Ministry of MSME is National Manufacturing Competitiveness Program which tries to equip this sector with technology-based tools in the areas of quality up gradation, productivity, design development, energy efficiency and marketing. Another program named Indo-German Manager Training Program (IGMTP) is running with the support of government of both countries India and Germany. The aim of this program is to enhance the international business and economic potential of Indian enterprises by bringing them in contact with German enterprises. The Confederation of Indian industry is operating a training program on Production Management for Manufacturing in India in partnership with Overseas Human Resources Development Association (HIDA), Japan to achieve the objective of "Make in India" through Japanese-style. This program will be helpful to enhance production management capability in the Indian manufacturing industry. Prime Minister **Shri Narendra Modi** launched an ambitious movement named '**Startup India**' to boost digital entrepreneurship at the grassroots level. In a major announcement, he provided income tax exemption for the first three years to start-ups and also promised faster patent registrations and quicker exits for companies. Banks have been directed to achieve a 20 per cent year-on-year growth in

credit to micro and small enterprises and a 10 per cent growth in the number of micro enterprise accounts.

Finance as a major problem of MSMEs:

In spite of the tremendous contribution of MSMEs in the growth of Indian economy, this sector is facing serious and major problems of not getting timely and adequate finance for start-up, growth and development. The scheduled banks do not prefer to give credit to MSMEs sector because banks consider it as a risky area for investment because of its low growth rate, high processing cost, low creditworthiness and poor flow of information. Providing loan by bank is a very lengthy and formalistic process and cost of credit is also very high. The owners of MSMEs have to present different types of documents before banks to prove their worthiness. Because of these difficulties MSMEs show less trust on financial institutions and banks for raising funds and therefore mostly depend on its internal sources i.e. personal savings, loan from relatives, and loan from local money lenders. The small size is also a big problem for this sector. This sector has a poor infrastructure that's why the production capacity is very low and production cost is very high. Thus, this sector can't enjoy large production and because of the increasing NPAs, they tried to avoid granting loan to MSMEs. The other problems like poor technology, lack of skilled manpower, marketing problems, delayed payments etc are also faced by this sector and these problems negatively affect it.

In the financial year 2005 the total credit to MSMEs sector was Rs.833 billion and it has grown at a compounded average growth rate of 25 % to Rs. 7.9 trillion in the financial year 2014. There is still a huge demand of Rs. 32.5 trillion credits in MSME sector, which comprises of Rs. 26 trillion of demand debt and Rs. 6.5 trillion of equity demand. According to the provisional data for year ended March 2016, the total credit availability is Rs. 11.10 trillion for this sector against the demand of Rs. 26 trillion. To get financial assistance in MSMEs becomes an issue of great interest. There is a huge demand of fund in MSMEs for start up, infrastructure development, procurement of raw material etc. but most of the MSMEs are facing huge problem to get funds from banks and other institutions. Despite some increase in the credit to MSMEs, this sector continues to experience problems in accessing credit. Higher interest rate is also killing this industry and pulling it in the category of sick unit. Collecting receivables for SMEs is also a major problem. Both Centre and state government are responsible for this. The problem starts with the government (Centre and State), which holds back payments to public sector units (PSUs) and the PSUs, in turn, hold back payments to large and medium industry. These large and medium industries hold back payment to the smaller units. Thus, government indirectly shifts the burden to MSMEs and this sector suffers the most.

Results:

The development and growth of any nation is not fully dependent on the growth of the large industries, MSMEs are also the backbone of any country and contributing tremendous to the economic development, growth of the nation. According to Ministry of MSME, Government of India, MSMEs sector generates huge employment opportunities around 117.1 million jobs through over 51 million units. This sector plays a vital role in

social and economic restructuring of India with 38% contribution to the nation's GDP and 40% and 45% share of the overall exports and manufacturing output, respectively, it is easy to comprehend the salience of the role they play in social and economic restructuring of India. Apart from these services provided by this sector, it is engaged in the manufacturing of over 6,000 products ranging from traditional to hi-tech items. Small and Medium Enterprises (SMEs) play vibrant and dynamic role in economic growth in various ways such as generating employment opportunities for rural and urban population, generating innovative ideas, providing goods & services at affordable costs etc. But apart from this importance MSMEs in India are facing a number of problems i.e. absence of adequate and timely banking finance, high cost of credit, lack of suitable technology, ineffective marketing due to limited resources and non availability of skilled manpower at affordable price. The government of India is showing strong commitment towards this sector to its start-up, growth and promotion but still the financial conditions of this sector are not satisfactory and this sector is not getting timely and adequate finance from the banks and financial institutions. The policies and high rate of interest of the financial institutions are killing this sector. Accordingly Prime Minister's Task Force has recommended and RBI has mandated scheduled commercial banks to achieve, among others, 20% year-on-year credit growth to MSME sector. Mainly this sector is facing a major problem of unavailability of working capital because the government holds back payments to public sector units (PSUs) and the PSUs, in turn, hold back payments to large and medium industry. This holds back payment process has negative effect on MSMEs funding position. The Indian MSME sector provides best employment opportunities for both self-employment and wage-employment outside the agricultural sector and contributes an important part in building an inclusive and sustainable society in innumerable ways through creation of non-farm livelihood at low cost, balanced regional development, gender and social balance, environmentally sustainable development, etc.

Conclusion

MSMEs are the major contributor towards growth of Indian economy and development. MSMEs are the back bone of any nation and play an important role in employment generation, developing latest skills etc. At present this sector is becoming an area of great interest. But despite its importance this sector struggles with a number of problems like unavailability of adequate and timely finance, high credit cost, ignorance of banks and financial institutions, lack of skilled human capital, unawareness of government schemes, lack of modern technology, suitable marketing and infrastructure facilities etc. This sector is facing difficulty in selling its products in domestic and international markets. Indian MSMEs need to upgrade their technology and put more focus on innovation strategies. On the other hand, government is paying more attention towards strengthening of this sector and introducing many policies and schemes but most of the entrepreneurs are not aware of it. Banks and Financial institutions need to improve their rules and regulations to provide funds on high rate of interest to the MSMEs so that they can raise funds easily and play more contributory role in country.

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