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A Study of the Factors Influencing the Financing Gap for the MSME Sector

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ABSTRACT

Micro, Small and Medium Enterprises play a significant role in the socio economic development of a nation. They have a commendable role in generating employment opportunities for the youths of the nation. MSMEs need credit for expansion, modernization, diversification and to manage their day to day activities of the business. Even after making such an enormous contribution to the Indian economy, they are neglected by most of the banks and financial institutions. It is very difficult for a MSME unit to avail long term bank loan at an affordable rate, whereas, large enterprises can easily avail long term bank credit at lower interest rates. It has been well established in the literature that, as the size of the firm increases, its cost of formal credit decreases. The banks and the financial institutions hesitate to some extent in getting involved with the MSMEs because of the adverse selection and moral hazard issues. In most of the cases, banks require transparent information regarding the financial health of the firm and the manner, in which most of the MSMEs operate, makes banks doubtful regarding their financial condition. Majority of the MSMEs do not maintain proper financial statements of their transactions and operate in an opaque manner. The opaqueness of the firms makes it very difficult for them to avail formal credit. Information secrecy maintained by the MSMEs compels the banks to impose credit rationing on the loans being sanctioned to the MSMEs. The imposition of Credit Rationing by the banks further widens the financing gap in the MSME sector. Other major factors that lead to the financing gap in the MSME sector are market Imperfection, Bankruptcy Laws, Property Rights, Issues of Adverse Selection and Moral Hazard. The present paper attempts to identify various factors that influence the Financing Gap in the MSME sector and that lead to the imposition of Credit Rationing approach by the banks. This paper is based on extensive review of literature on Micro, Small and Medium Enterprises and a descriptive survey carried out on the bank officials in the districts of Varanasi and Chandauli. The results from the descriptive survey confirmed that the MSMEs are much more credit constrained than the large enterprises.

Keywords: Financing Gap, Information Asymmetries, MSME, Bank Finance, Credit Rationing.

INTRODUCTION:

Micro, Small and Medium Enterprises play a significant role in the socio economic development of a nation. They have a commendable role in generating employment opportunities for the youths of the nation. Their share in exports is increasing at a rapid pace and they make a significant contribution towards the national GDP. More than 90 percent of the manufacturing units in India come under the purview of the MSME Sector.

Indian economy was primarily an agragarian based economy but the agricultural activities are significantly affected by the monsoons and therefore the return on agricultural activities is highly uncertain. Every year thousands of farmers commit suicide because of the uncertain returns on agricultural activities. The Micro, Small and Medium Enterprises in India employs more than 805 lakh persons (MSME Annual Report, 2016-17) and has become the second largest employment provider after agriculture (As per 4th Census in MSMEs). MSMEs have played a prominent role in transforming Indian economy from an agragarian based economy to an industrialized one.

MSMEs need credit for expansion, modernization, diversification and to manage their day to day activities of the business. Even after making such an enormous contribution to the Indian economy, they are neglected by most of the banks and financial institutions. It is very difficult for a MSME unit to avail long term bank loan at an affordable rate, whereas, large enterprises can easily avail long term bank credit at lower interest rates. It has been well established in the literature that, as the size of the firm increases, its cost of formal credit decreases. The banks and the financial institutions hesitate to some extent in getting involved with the MSMEs because of the adverse selection and moral hazard issues. In most of the cases, banks require transparent information regarding the financial health of the firm and the manner, in which most of the MSMEs operate, makes banks doubtful regarding their financial condition. Majority of the MSMEs do not maintain proper financial statements of their transactions and operate in an opaque manner. The opaqueness of the firms makes it very difficult for them to avail formal credit.

Financial institutions have propensity to fulfill the financing needs of the large enterprises rather than that of the MSMEs. Supply of bank credit towards the MSMEs is far below their demand for the formal credit and it leads to the financing gap in the MSME Sector. Access to timely credit is essential for the growth of the MSMEs in India and its unavailability may impede the development of the MSME sector. Another issue that hinders availability of Bank credit for the MSMEs is the problem of information asymmetries. It basically means that the borrower has more information than the lender on his ability to pay back the loan, the type of projects with the firm and the viability of those projects.

The capital needs of the MSMEs either can be met by internal funds available with the firm or by the use of debt capital from the external sources. MSMEs lack of access to timely credit still remains a major issue and it requires immediate government attention. Unlike the large enterprises, Micro, Small and Medium Enterprises rarely have any access to the capital markets and therefore, the possibility of raising funds through equity is out of question for the majority of the MSMEs. In the absence of the equity capital, MSMEs need to look for support from the banks and financial institutions in order to meet their financing needs. The other informal sources of funds available to the MSMEs are trade credit, private money lenders and borrowing from friends. Private money lenders such as Sahukars, Mahajans and Shroffs charge a very high interest on the credit amount provided to the MSMEs, which usually is exploitative in character. The MSME borrowers are therefore, clutched into the vicious cycle of credit needs and in a number of cases are forced to shut down their units.

Access to external credit is vital in order to ensure flexibility in allocation of resources available with the firm and to minimize the cash flow related problems **(Bigsten et al. 2000)**. Firms, which have proper access to finance can easily pile up inventories and thus, can avoid the risk of stock outs during financial crisis. Availability of external credit increases the probability of survival of the firm during the periods of macroeconomic instability. MSMEs that do not have any access to bank credit are more susceptible to the external shocks of the economy **(Nkurunziza, 2005)**.

Bank Client relationship has gained importance in the last few decades. A firm that maintains a good and a long term relationship with a bank or a financial institution indicates that the firm has a formal relationship and it drastically increases the firm's chances of obtaining formal credit from the financial institutions. Credit history of the firm is a major determinant of its chances of availing credit from the banks. A firm with a high credit rating and a good credit history can easily avail bank credit at an affordable rate of interest, whereas, a firm with a poor credit history would find it very difficult to obtain formal credit. MSME owner cannot be separated from the MSME unit and in most of the cases, the credit history of the unit owner may also be as important as the credit history of the firm (**Berger and Udell, 2002, Bass and Schrooten, 2005)**.

MSMEs have become prominent contributors in the Indian economy but at the same time, they keep on facing the various financial constraints which impedes their growth, innovation capability and performance. Lack of access to formal credit has been highlighted as the major barrier by majority of the small entrepreneurs and there are a number of factors that can be identified to explain the severity of this problem. While talking about supply side related factors, it can be pointed out that, most of the banks and financial institutions consider

MSMEs as uncreditworthy borrowers with a very high probability of loan default and therefore, deny or ration their credit needs.

Lack of access to timely credit has been accepted as the major hindrance in the path of the MSMEs and it has been pointed out as the prime reason for their slow growth. Not only in India but throughout the globe, access to finance for the MSMEs has emerged as a major challenge that needs the attention of the policymakers. Small firms are unable to have an access to the formal credit and therefore, are unable to expand their businesses. Most of the financial institutions consider MSMEs as unstable firms and often impose strict lending norms and high risk premiums on the loans sanctioned to the MSMEs **(Atieno, 2009)**.

REVIEW OF LITERATURE:

Murthy (1980) believed that the small scale industries are confronted with various problems but the availability of adequate credit is the major problem surrounding the MSMEs. He agreed that the banks and the financial institutions need to support the small scale industries and act as their friend, philosopher and guide so that the MSMEs can contribute towards employment generation and balanced regional development.

Stiglitz & Weiss (1981) in their article titled “Credit Rationing in Markets with Imperfect Information” stated that the major financial constraint which has an adverse effect on the performance of MSMEs includes high collateral requirements, higher rate of interest on loans and lack of equity capital. The authors further indicated that the relationship between the banks and MSME unit owners is not a very close one and therefore it leads to asymmetric information between them. Lack of adequate information discourages the lenders to determine the real value of the projects and thus it leads to credit rationing. They highlighted that there are three major factors because of which most of the banks are hesitant to lend credit to the MSMEs. The factors include lack of suitable collateral, opaque nature of MSMEs and poor credit history.

Brahmanadam et al. (1981) in their article titled “Financing Small Scale Sector: The Role of Banks” examined the critical role of banks and financial institutions in the growth and development of the micro, small and medium enterprises. Banks have always been hesitant in providing credit facilities to the small scale industrial sector because of their questionable creditworthiness. The authors also reported that the government has come out with several industrial policies to facilitate the flow of credit towards the micro, small and medium enterprises.

Deshpande (1984) conducted a detailed survey of 90 small scale industrial units in Maharashtra. The study focused on the socio-economic background of the entrepreneurs and the major problems surrounding them at the different stages of their career. His study revealed that the socio-economic factors are critical and the caste, family occupation father’s occupational status plays a significant role for the entry into the manufacturing business. The author pointed out that the government support system is necessary to foster the growth of entrepreneurial activities in the country. He further stated that there is need to broaden the government support system so that its benefits can reach to the lower strata of the society effectively.

Manalel (1994) described that the small scale sector faces much more financial problems as compared to the large enterprises. He conducted a study in Kerela and concluded that the banks and financial institutions are a bit hesitant in extending credit to the small scale industrial sector. The author argued that, unless the banks change their attitude towards the small firms, government’s incentive packages for small industries cannot reach the grass root level. He also indicated that the state has a comparable package on record, but the quality of its delivery is ineffective and needs immediate attention of the policymakers.

Lane & Quack (1999) conducted a comparative study on the small industries in the United Kingdom and Germany. The study was aimed to analyze the bank lending norms for the SMEs and risk taking behavior of the entrepreneurs. The authors found that the issue of risk influences the behavior of the entrepreneurs as well as decides the amount of credit sanctioned by the banks. They further stated that the entrepreneurs judge the level of risk with which they are comfortable, whereas banks assess, how risky the entrepreneur is as a lending proposition. Their study concluded that the certain characteristics of small and medium enterprises decide the extent of support it can get from the banking sector and other financial institutions.

Winborg & Landstrom (2000) defined that the owners of the small firms have detailed information about their firm but sometimes it becomes a bit complicated to articulate and provide the relevant information about the firm to the lenders. The authors also indicated that in few cases, the small entrepreneurs are a bit hesitant to provide the information to the banks because they feel that the internal information about their firm might get leaked to the competitors. The literature on the small scale industrial sector reveals that it is imperative for the small firms to maintain proper accounts so that they can fulfill the transparency requirements of the lenders. The authors also argued that the majority of the small entrepreneurs are not financially literate and are unable to

understand the credit norms of the formal credit sector.
Bhattacharya (2000) reported that the banking sector in India considers the MSME sector as unprofitable and highly risky investment and therefore, has a conservative approach in extending the credit facilities to the small firms. The author emphasized that the major factors behind this conservative approach of the bank are opaqueness of the small firms, lack of suitable collateral, insufficient assets, low capitalization and high mortality rates.
Alfo & Trovato (2006) highlighted the issues of information asymmetries and agency problem in the SME sector. The authors argued that, the conflict of interests between the shareholders, who are also the owners and the management of the firm, who act as agents on behalf of the owners, leads to the agency problem. They also tried to elucidate the issue of information asymmetries prevalent in the small scale industrial sector. The authors pointed out that only the owners of the small enterprises know about the real financial structure of the firm, the real strength of the investment projects and their intention to pay back the money to the lenders. The SME owners have superior private information about their firm and the bank does not have detailed information about the financial structure and the projects of the SMEs. This leads to the information asymmetries between the SME owners and the lenders and therefore, the bank manager operates under a moral hazard and adverse selection risk. They analyzed the various sources of finance available to the SMEs and how the issues of information asymmetries and credit rationing affects the SME credit market. The approach of Credit Rationing towards the small firms may result in less profitable investments getting financed, while more profitable investments might being left out and thus, resulting in adverse selection and moral hazard risks. The author finally concluded that the information asymmetries can explain asymmetries of credit among the firms with identical characteristics because the lenders are not aware about the exact bankruptcy likelihood for the firms.
Tracy & Tracy (2007) acknowledged that appropriate amount of capital is essential for setting up a unit. The small firms can raise capital by taking help from the family members and friends. Friends and family ensure that the entrepreneur is able to launch his business and sustain it. The business owner mostly uses his own personal savings or puts his credibility on the line to avail credit from his friends and close business associates. His friends and close business associates provide the seed money to the entrepreneur and help him to launch an enterprise. The amount of credit obtained through relatives, friends and close business associates is usually low in value and an entrepreneur requires much more credit for the growth of his business and therefore, is compelled to look for other sources of credit. The authors further pointed out that the second major source of financing available to the MSMEs is the credit obtained from the Private money lenders. The Private money lenders charge a very high rate of interest on the credit provided to the MSMEs and thus lowers the profit margin for the MSMEs. The authors finally concluded that most of the small entrepreneurs approach banks as the last resort when they are unable to arrange credit from the other informal sources but availing the required amount of credit from the bank is a herculean task for the MSMEs.
Sia & Nails (2008) pointed out that the micro, small and medium enterprises usually have a very small capital base and their starting capital for the firm comprises of their personal savings and money borrowed from the relatives. The limited capital base of the firm affects the cash flow of the firm and scale of the business. In the initial phase, most of the MSMEs tend to depend heavily upon the informal sources of credit and lack skills to manage their cash flow.
HongboDuan et al. (2009) stressed upon the fact that the Micro, Small and Medium Enterprises to a large extent are dependent upon the public sector banks and financial institutions in order to meet their financing needs. Their dependence upon the government institutions hampers the growth prospects of the firms due to the lethargic and bureaucratic approach of these institutions. They further argued that, due to the absence of collateral security, MSMEs are unable to access credit from the banks and it limits their contribution in economic development.
Mwarari (2013) argued that the problems faced by the Micro, Small and Medium Enterprises can broadly be classified into three categories as lack of financial support, lack of business opportunities and absence of good business practices. She considered lack of financial support as the most critical problem for the MSMEs and insisted that the banks should come forward so that the MSMEs can realize their full potential. She further asserted that the age and size of the firm plays a major role in determining the capital structure of the firm. She also stressed upon the biased behavior of the financial institutions towards the MSMEs, when compared with those of the large enterprises. She finally urged all the financial institutions to look beyond the need of collateral requirements while evaluating the loan applications of the MSMEs.

METHODOLOGY:

The present study adopted a descriptive survey design and is extensively based upon the literature survey method. A thorough literature review provided the researchers the key variables that lead to the financing gap for the MSMEs. A descriptive survey was further carried out to obtain responses from 115 bank officials in the districts of Varanasi and Chandauli in order to confirm the identified variables obtained from the literature survey. Therefore, the study includes the usage of Primary data as well as the Secondary data. The primary data was collected from the responses obtained from the bank officials regarding the factors that lead to the financing gap for the MSMEs, while the secondary data was collected from the various issues of MSME Annual Reports, SIDBI Annual Reports and Handbook of Statistics on Indian Economy published by the Ministry of MSMEs.

OBJECTIVES:

1. To identify the factors influencing the Financing Gap for the MSME Sector.
2. To analyze the impact of Credit Rationing upon MSMEs Access to Bank Finance.

Factors influencing the Financing Gap for the MSME Sector:

Micro, Small and Medium Enterprises require credit for growth, modernization, diversification, long term sustainability and meeting their day to day business needs. The structure and functioning of the MSMEs is quite different from that of the large enterprises. Banks and other financial institutions consider MSMEs as risky borrowers and therefore, usually refrain from lending long term funds to the MSMEs. Even if the small firms are successful in availing bank credit, they receive lesser amount as compared to the request made by them. This difference between the amount of credit required and the amount of credit actually received is termed as financing gap. MSMEs are forced to look for other sources of informal credit in order to bridge this financing gap. Informal credit is obtained at a very high rate of interest which is exploitative in character. Financing gap has an adverse effect on the performance of the MSMEs as it limits their production capacity, productivity and future growth prospects.

Credit Rationing Theory:

Keiding (2013) pointed out that a good proportion of financial institutions are private entities, which are primarily profit oriented but still, it has been witnessed that the majority of the MSMEs are not sanctioned loans from these financial institutions. It clearly signifies that the lending market for MSMEs is not balanced through price mechanism. Many of the small entrepreneurs are denied credit, even if they are willing to pay a high rate of interest.

De Meza & Webb (1987) argued that the market for credit is not similar to the normal markets for goods, which usually is based upon demand and supply. The credit borrowers who are willing to pay higher interest rates may find it very difficult to repay the loan at the time of maturity.

Credit rationing is defined as a situation in which there is an excess demand for commercial loans at the prevailing commercial loan rate (Stiglitz and Weiss, 1981). The authors identified two types of credit rationing that is imposed by the banks. First form of credit rationing is termed as Pure Credit Rationing and it is defined as a situation where two individuals with the identical characteristics apply for a loan but one of them is sanctioned credit, whereas the other is not provided credit by the bank or the financial institution. The second form of credit rationing is termed as Redlining and it is defined as a situation when an identifiable group of individuals are unable to access credit from banks or financial institutions, irrespective of the rate of interest, they are willing to pay, unless the credit supply is increased.

The situation of Credit Rationing arises because the borrower would not be able to repay the loan due to high interest charges (Hodgman, 1960). The cost of borrowing or the cost of capital turns out to be greater than the rate of return generated by the borrower on that borrowed capital and therefore, the MSME borrower is unable to repay the loan availed from the banks. The bank in this case would refrain lending to the MSMEs because of the high rate of interest involved.

Credit Rationing is sometimes exercised by the financial institutions in order to provide them a cushion against the unforeseen circumstances. In few cases, the financial institutions and banks are unable to mitigate the risk arising out of free market principles and therefore decide to ration credit, irrespective of the rate of interest the MSME borrowers are willing to pay. It is a perfect example of market imperfection or the market failure because here the price mechanism fails to bring about equilibrium in the market.

The imperfection here can be understood as the absence of equilibrium condition in spite of the borrowers willing to pay higher rate of interest. It can also be explained as demand exceeding supply at the prevailing market interest rates but the banks and the financial institutions are neither willing to lend more funds to the MSME borrowers nor they are ready to charge higher rate of interest from them on the subsequent loans because they are already maximizing profits. This theory explains the concept of financing gap to a certain extent.

Market Failure Theory:

It is imperative to analyze the role of banks and financial institutions in providing credit to the MSMEs but at the same time it important to highlight the limiting factors that make it difficult for the banks to get associated with the MSMEs. Market Failure Theory tries to justify the reasons behind the inefficient supply of credit towards the MSMEs. Mendes (2004) discussed the private market efficiency theory and stated that under certain circumstances private markets will allocate goods and services among individuals efficiently in the sense that no waste occurs and that the individual tastes are matching with the economy's productive abilities.

As a good number of banks and financial institutions are private entities, they try their best to provide most efficient outcomes for the MSMEs but the atmosphere created by the MSMEs leads to the market failure. It has been witnessed that in most of the cases, the conditions for private market efficiency is violated from the demand side but in few instances, it is also violated from the supply side as well. The supply side violations include factors like information asymmetry and lack of clear risk management policy. Market failure occurs when the financial service providers such as the banks and the financial institutions are unable to allocate services efficiently. The existence of market failure in lending to MSMEs provides a rationale to conclude that the micro, small and medium enterprises lack access to finance and the market failure in lending to MSMEs further leads to the financing gap for the MSMEs.

Information Asymmetry Theory:

Information Asymmetry Theory was first of all introduced by Akerlof in 1970. He argued that every seller uses some predefined market statistics in order to measure the value of the goods that he is selling in the market. In the context of the credit market for the MSMEs, the borrowers try to find out the average prices of the loans available in the market, whereas the lender has a detailed knowledge of each specific loan that the borrower wants to avail. According to Akerlof (1970), this situation provides an upper hand to the lender and puts him in a more advantageous position. The lender or the seller is able to sell goods of less than average market quality. In this situation, the borrowers have complete information about the types of loans being offered by the lender and its characteristics, therefore, the lender offers less than the average quality of goods to the borrower.s

Information asymmetry theory asserts that at least one party involved in the transaction has relevant information whereas the others do not. Due to information asymmetry, a market may break down completely leading to three distinct consequences as Adverse Selection, Moral Hazard and Monitoring Cost. The literature on the MSMEs reveals that the information asymmetries increases the transaction cost for the banks. In order to further reduce the information gap, both the parties involved in the transaction can try to evaluate the various dimensions of product quality at their own ends.

Information Gap between the lender and the MSME borrower leads to information asymmetries. The manner in which most of the MSMEs operate is not very motivating for the financial institutions. Opaqueness of the firms raises a question on their creditworthiness. A bank or a financial institution would refrain from getting associated with a firm which operates in an opaque manner. Opaqueness may point out that a firm has got contingent liabilities and the lender is not sure about the pay back capability of the firm. In this case, banks would hesitate to lend to the MSMEs because of the Moral Hazard and Adverse Selection issues. A MSME unit owner might not have intent to repay the loan back to the bank and it leads to the problem of moral hazard. Banks may sometimes lend projects that are not viable in the absence of adequate information regarding the MSME firm and it leads to the problem of adverse selection.

Banks also need to spend much in the form of high monitoring costs in case, it has a large number of MSMEs as its clients in order to protect itself from the risk of NPA's. Bankruptcy Laws and Property Rights are in the favor of the borrower in most of the cases and therefore, banks need to think wisely before sanctioning credit to the opaque firms. Informality of the MSMEs makes it very difficult for them to avail formal credit. All these factors compel banks and financial institutions to impose credit rationing on the loans made to the MSMEs, which in turn increases the financing gap for the MSME Sector.

Table – 1 gives a glimpse of the condition of MSMEs in India and their access to the institutional credit. Credit rationing imposed by the banks has only widened the financial gap in the MSME Sector.

Table 1: Percentage Split of MSMEs by Sources of Finance

	No Finance/Self Finance	**Through Institutional Sources**	**Through Non Institutional Sources**
Percentage of Enterprises	92.8%	5.2%	2.1%

Source: MSME Census 2007

Table – 1 reveals that only 5.2% of the MSMEs have access to institutional sources of credit while 2.1% of the units raise funds through non institutional sources. The Census on MSME conducted in 2007 further highlighted that 92.8% of the MSMEs do not have any access to external finds and they use their own savings to operate their businesses. Informal nature of the MSMEs makes it very difficult to avail external credit.

Impact of Credit Rationing upon MSMEs Access to Bank Finance:

A descriptive analysis was carried out by distributing a questionnaire to 120 bank officials from the 20 Public Sector Banks in the districts of Varanasi and Chandauli. Out of 120 distributed questionnaires, 115 filled questionnaires were received and were ready for analysis. The results of analysis are as follows:-

Table 2: Major Products

Major Products offered by the Banks to the MSMEs	Number of Responses
Short Term Loans	53
Overdrafts	72
Working Capital Loan	17
Long Term Credit	27
Total	**169**

Graph 2: Major Products

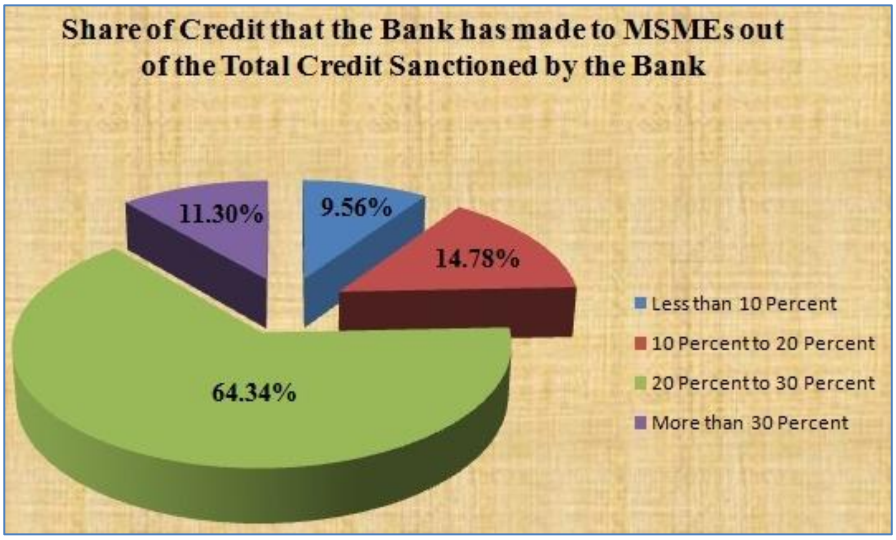
Source: Survey Data

Table - 2 states that 72 surveyed Bank officials considered Bank Overdrafts as a major financial product offered to the MSMEs, whereas 53 respondents believed that short term loans play an important role for MSMEs growth. Obtaining Long term bank credit is comparatively tougher for the MSMEs. The table highlights most of the banks are a bit hesitant in sanctioning long term loans to the MSMEs and it can be seen that only 27 responses were received out of a total of 169 responses where the banks were interested in offering long term credit to the MSMEs.

Table 3: Share of MSME Credit

Share of Credit that the Bank has made to MSMEs out of the Total Credit Sanctioned by the Bank	Number of Responses	Percentage
Less than 10 Percent	11	9.56%
10 Percent to 20 Percent	17	14.78%
20 Percent to 30 Percent	74	64.34%
More than 30 Percent	13	11.30%
Total	**115**	**100%**

Chart 3: Share of MSME Credit



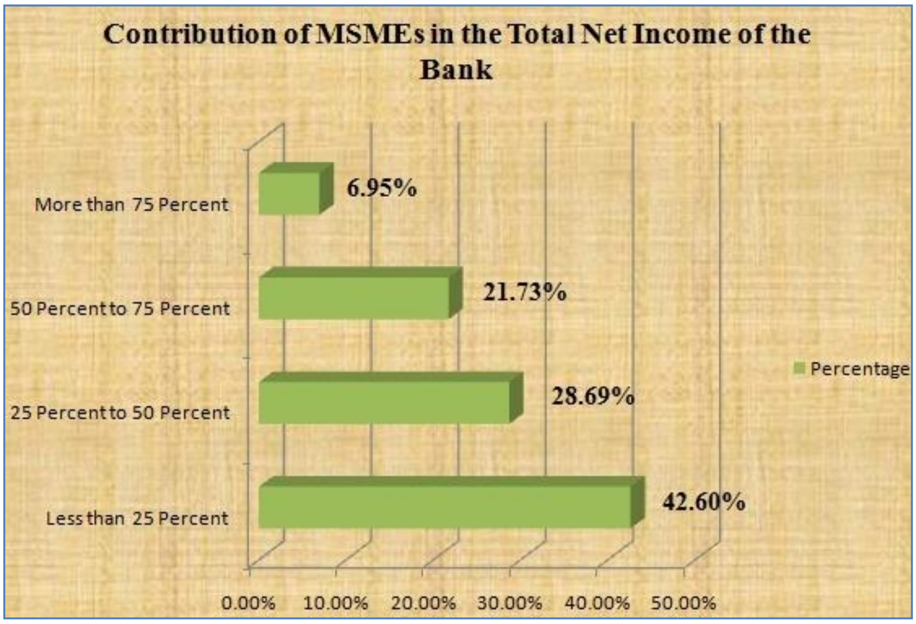
Source: Survey Data

Table - 3 reflects that 64.34% of the surveyed banks have sanctioned 20 to 30 percent of credit to the MSMEs out of their total credit sanctioned. Only 11.30% of the surveyed banks have disbursed more than 30 percent of credit to the MSMEs out of their total credit sanctioned. The table clearly reveals that the banks are a bit hesitant in sanctioning credit to the MSMEs as only 11.30% of the surveyed banks agreed that they have sanctioned more than 30% of credit to the MSMEs.

Table 4: Contribution of MSMEs

Contribution of MSMEs in the Total Net Income of the Bank	Number of Responses	Percentage
Less than 25 Percent	49	42.60%
25 Percent to 50 Percent	33	28.69%
50 Percent to 75 Percent	25	21.73%
More than 75 Percent	8	6.95%
Total	**115**	**100%**

Graph 4: Contribution of MSMEs



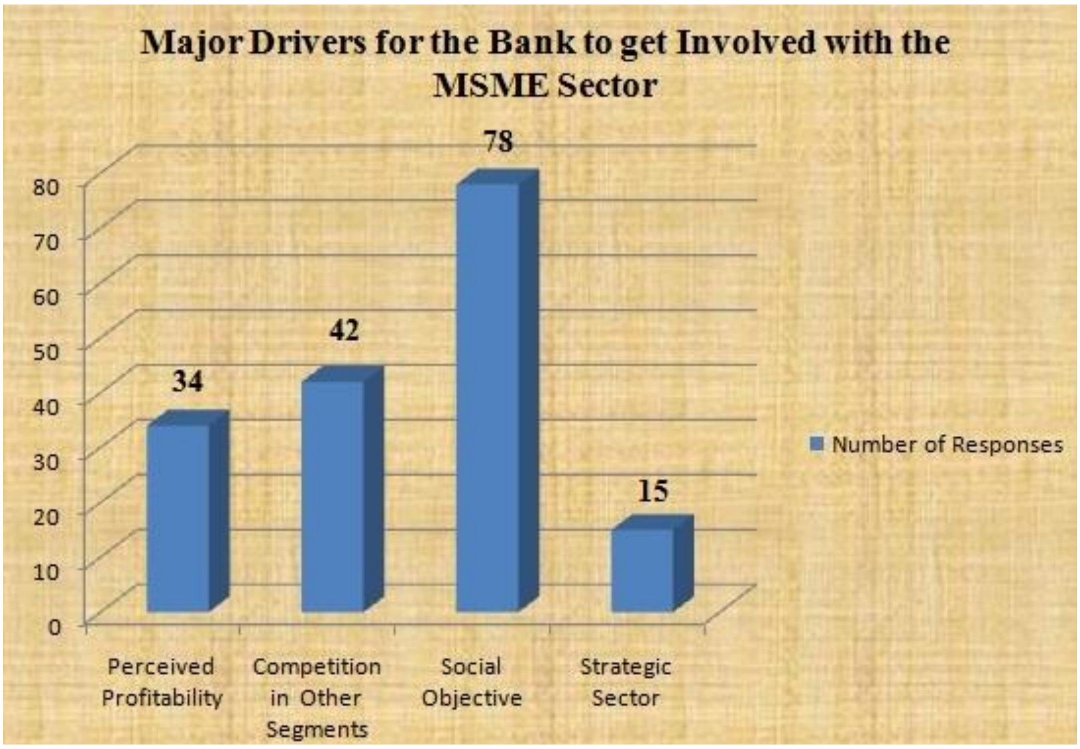
Source: Survey Data

Table - 4 reveals that 64.34% of the banks agreed that MSMEs do not contribute a major share in the Total net income of the banks and only 28.68% of the banks consider that the MSMEs have a substantial role in the Total net income of the banks. The table indicates that the MSMEs are not the prime customers for the banks and they do not contribute a major share in the bank's total income as only 6.95% of the banks agreed that MSMEs contribute more than 75% in the bank's total income.

Table 5: Major Drivers for the Bank

Major Drivers for the Bank to get Involved with the MSME Sector	Number of Responses
Perceived Profitability	34
Competition in Other Segments	42
Social Objective	78
Strategic Sector	15
Total	**169**

Graph 5: Major Drivers for the Bank



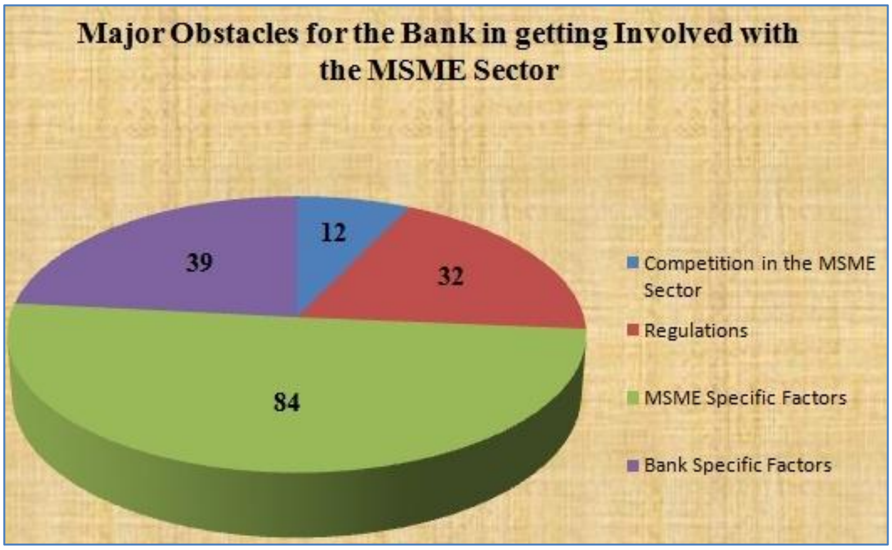
Source: Survey Data

Table - 5 indicates that 78 surveyed Bank officials considered Social Objective as the major driver for the bank to get involved with the MSME sector, whereas 34 respondents believed that perceived profitability is the major driver for the bank to lend credit to the MSMEs. The table concludes that the banks are not much interested to serve MSMEs. They do not consider MSMEs as profitable sector but they serve MSMEs to fulfill the social objectives as 78 responses out of 169 responses of the bank officials prove the same.

Table 6: Major Obstacles for the Bank

Major Obstacles for the Bank in getting Involved with the MSME Sector	Number of Responses
Competition in the MSME Sector	12
Regulations	32
MSME Specific Factors	84
Bank Specific Factors	39
Total	**167**

Chart 6: Major Obstacles for the Bank



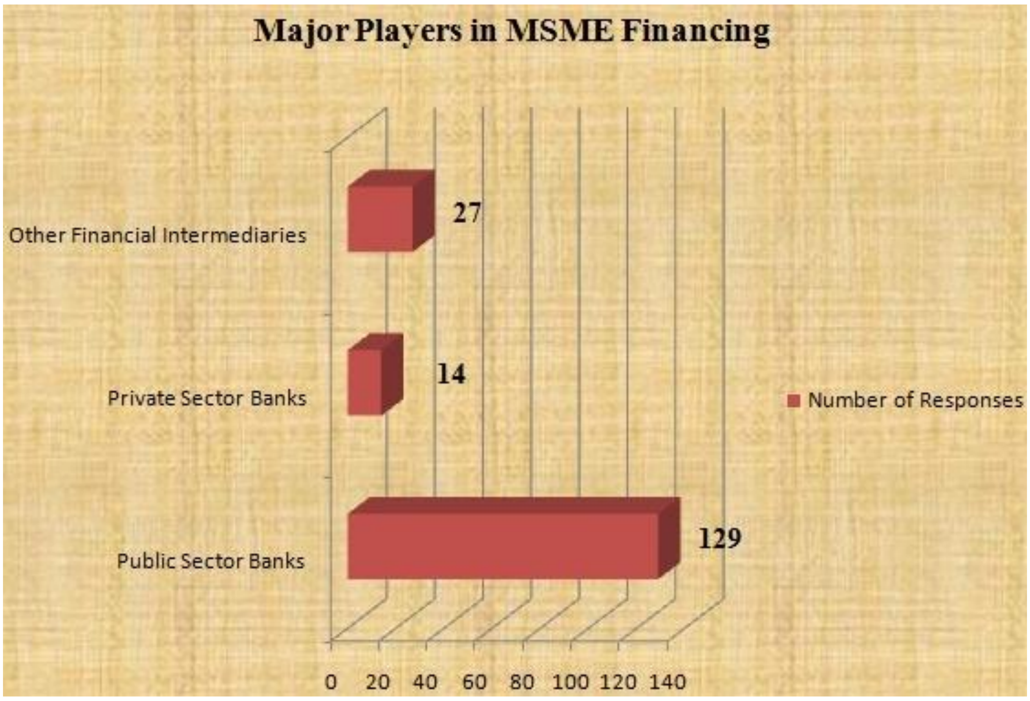
Source: Survey Data

Table - 6 highlights that 84 surveyed Bank officials considered MSME Specific Factors as the major obstacle for the bank in getting involved with the MSME sector, whereas 32 respondents believed that Government Regulations and norms affect bank's lending to MSMEs. The table indicates that the banks shy away from getting associated with the MSMEs because of the MSME Specific factors such as their age, size and working. 84 responses out of 167 responses of the bank officials assert the same.

Table 7: Major Players in MSME Financing

Major Players in MSME Financing	Number of Responses
Public Sector Banks	129
Private Sector Banks	14
Other Financial Intermediaries	27
Total	**170**

Graph 7: Major Players in MSME Financing



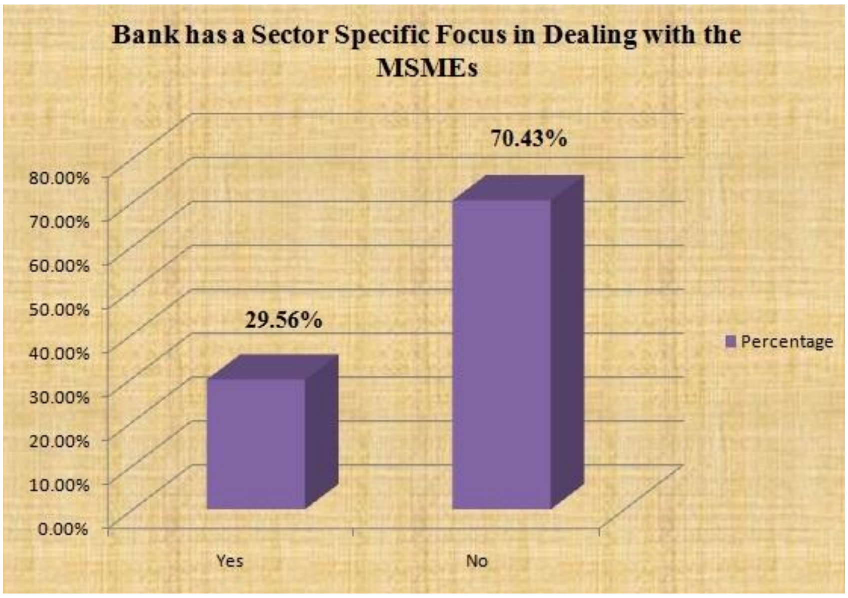
Source: Survey Data

Table - 7 points that 129 surveyed Bank officials considered Public Sector Banks as the major player in MSME financing, while 14 respondents believed that Private Sector Banks play a key role in MSME financing. The table reveals that the major player in the MSME financing is the Public Sector Banks because they have a social objective to improve the industrial environment of the country and are also bound by the priority sector lending norms. 129 responses out of 170 responses of the bank officials confirm the same.

Table 8: Bank's Sector Specific Approach

Bank has a Sector Specific Focus in Dealing with the MSMEs	Number of Responses	Percentage
Yes	34	29.56%
No	81	70.43%
Total	**115**	**100%**

Graph 8: Bank's Sector Specific Approach



Source: Survey Data

Table - 8 states that 70.43% of the surveyed Banks have a Sector specific focus in dealing with the MSMEs, while 29.56% of the banks do not have a Sector specific focus in dealing with the MSMEs. The table highlights that the majority of the banks do not have a Sector Specific Approach in dealing with the MSMEs because they do not consider MSMEs as profitable investments and lend them just to fulfill social objective norms. 70.43% of the surveyed banks agreed on the same.

CONCLUSION:

Micro, Small and Medium Enterprises in India have evolved at a rapid pace since the MSMED Act was implemented in 2006 to make the MSME sector much more competitive. MSMEs have become a significant part of the Indian economy as they make a major contribution in the national GDP and provide ample employment opportunities in the economically backward areas of the country. They have a major share in exports and constitute more than 90 percent of the manufacturing enterprises of the country.

The Indian government has also acknowledged the contribution of MSMEs in the Indian economy but even after making such a significant contribution, MSMEs are much more credit constrained as compared to the large enterprises. The literature on MSMEs reveals that, they find it very difficult to access credit from the formal sources. MSMEs need credit for their growth, modernization, technology up gradation and managing their day to day business affairs. Lack of access to timely credit makes it very difficult for the MSMEs to survive in this era of globalization and liberalization.

Banks and the financial institutions usually require transparent information regarding the financial position of the firm in order to sanction credit. They ask for audited balance sheets in order to analyze the financial health of a firm before taking a loan sanctioning decision. Most of the MSMEs operate in an informal environment and

behave in an opaque manner. Their opaqueness leads to the information asymmetries between the borrower and the lender. Lack of adequate information about the firm's financial health, projects and contingent liabilities poses a question mark on the firm's creditworthiness.
Information secrecy maintained by the MSMEs compels the banks to impose credit rationing on the loans being sanctioned to the MSMEs. The imposition of Credit Rationing by the banks further widens the financing gap in the MSME sector. Other major factors that lead to the financing gap in the MSME sector are market Imperfection, Bankruptcy Laws, Property Rights, Issues of Adverse Selection and Moral Hazard.
The descriptive survey conducted on the 20 Public Sector Banks in the districts of Varanasi and Chandauli further confirms that the banks do not consider MSMEs as profitable investments and lend them only to fulfill social objective obligations and priority sector lending norms.
Therefore, it is imperative for the MSMEs to reduce information asymmetries between the borrower and the lender by operating in a transparent manner and thus, increasing their probability of availing formal credit and reducing the financing gap in the MSME sector.

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