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An exploratory study on microenterprise lending practices in Odisha

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Abstract

Objectives: The study was to acquire updated perspectives on sources of credit for microenterprise in Odisha, India. The study also assesses the demand as well as supply side causes for the persisting inadequacy of credit and dependence of microenterprises on informal channels for their financial needs.
Methods/Statistical analysis: The primary survey was conducted in four districts of Odisha in four different contexts. The research design followed a simultaneous use of quantitative and qualitative research methods. A sample of 813 from these four locations was drawn for representing the different types of microenterprises. The choice of districts was purposive and within districts, the selection of rural/semi-urban and urban sample was also purposive so that the adequate number of rural were covered. The survey dwelt on both the demand and the supply side factors affecting credit flow.
Findings: The study finds that on the demand side, nearly 78% of surveyed micro-entrepreneurs expressed the need for finance for their microenterprises, with the average amount required being close to ₹90,815. The main purpose of the requirement was to procure raw material (including 'saleable' goods for trading enterprises). Surprisingly, only 28% of the surveyed households expressed the need for financing household expenditure for consumption (main purpose), education, health, housing, and social purposes, with the stated average need of ₹65,541. The study reveals that the formal sources accounted for around 60% in terms of both number of loans received and the amount financed.
Application/Improvements: The study points to gender gap in accessing formal credit. Future research and action oriented outputs should focus on studying the gender gap further with the aim of informing policy level changes that could address this.
Keywords: Informal lending, Micro Enterprise, Microfinance institution and MSME.

1. Introduction

The micro enterprises play a crucial role in providing large employment opportunities. Since the merger of the Ministry of Small Scale Industries and Ministry of Agro and Rural Industries into Ministry of MSME, and since the execution of MSME Act, 2006, the scope of microenterprises in India has widened. The Sixth All India Census of MSME provides good insight into the status of MSME in India. The numbers of MSMEs are 512.99 lakhs. The number of employment is 1112.28 lakhs. As per the results of the Sixth Economic Census 2013, [1] non-agricultural enterprises constitute 77.6% or more than three-fourths of establishments in the country. Credit markets in India are characterized by the coexistence of both formal and informal sources of finance and the market is fragmented. It is assessed that the share of informal credit in total outstanding debt has been certainly decreasing over the period due to various financial inclusion initiatives of the Reserve Bank of India (RBI) and legislation of the various state governments to regulate moneylenders. But the inadequate and untimely credit along with procedural hassles from formal institutions has been the major problem of credit access by masses. Although formal microcredit programs exist in India, their scope and impact still remain limited, creating room for a large informal credit market. The National Commission for Enterprises in the Unorganized Sector (NCEUS), 2007, established a Task Force on Credit under the chairmanship Arjun Sengupta [2].

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It showed that in 2001-02, only 4.1% of all enterprises have access to institutional credit, but within them, only 3.1% of the unorganized enterprises had access to institutional credit. The banks in the post-reform period had turned away from lending to small borrowers – the loan amount to borrowers below ₹25,000 declined from 21% of the net bank credit in 1985 to 3.7% in 2005. The study also revealed that despite the RBI guidelines to extend credit to micro-enterprises up to Rs five lakhs without collaterals, commercial banks are not willing to do so. Only 26% of the micro-enterprises who received credit had got credit without collateral security. The cost of credit was high as half of the credit that micro-enterprises were getting was from non-institutional sources, including moneylenders, input suppliers, and output buyers. In April 2015, the Government of India launched the Pradhan Mantri Micro Units Development and Refinance Agency (MUDRA) to develop and refinance all banks and microfinance institutions (NBFC-MFIs) in the business of lending to micro/small business entities engaged in manufacturing, trading, and service activities. Later this was dubbed the Pradhan Mantri MUDRA Yojona and all loans given by banks to microenterprises were brought under its ambit. Thus, based on the existing portfolio of banks and its incremental growth, the numbers looked large, with banks sanctioning 4.81crore loans and disbursing an amount of ₹2,46,437.4 crore in 2017-18 (PMMY website).

2. Microenterprises in India – current status and growth

The very institutional arrangements have posed hurdles to financing microenterprises. Since microenterprises fall in the 'missing middle' category that does not come under the purview of either MFIs or Banks, they have always found it difficult to meet their working capital requirement. The sub-group of the planning commission on MSME estimated the demand and supply of credit for MSME. The projection is for the entire five year period from 2012-2017. The estimation for microenterprises alone, done by GIZ, is shown in the Table1.

Table 1. Estimation for credit demand by microenterprise in India

Year	Working capital demand (₹trillion)	Term loan demand (₹trillion)	Total demand (₹ trillion)
2014-15	8.6	1.9	10.5
2015-16	9.5	2	11.5
2016-17	10.5	2.3	12.8

Source: IFC (2012), MSME Finance in India

In the study published by GIZ India, the demand of microenterprises for credit was about ₹7.9 trillion while the supply of loans from the banks was only estimated to be ₹1.5 trillion for microenterprises. Hence, there is a big gap to be filled with respect to the credit demand from microenterprises. Similar results have been shown in the study by IFC through Intellecap. The debt gap in the microenterprises sector ₹2.3 trillion, a majority share in the total gap of ₹2.9 trillion in MSME sector. The contribution of MSMEs in GDP is 6%, in manufacturing sector 33% and in exports 45% (Table 2).

Table 2. Share of MSME sector in GDP and total manufacturing output

Manufacturing output at current Price			Share of GDP		
Year	MSME manufacturing output(₹. In crores)	Share of MSME manufacturing output in total manufacturing output (%)	MSME Manufacturing Sector	MSME Service Sector	Total
2011-12	2167110	33.12	6.16	23.81	29.97
2012-13	2385248	33.22	6.27	24.13	30.40
2013-14	2653329	33.27	6.27	24.37	30.64
2014-15	2783433	33.40	6.11	24.63	30.74

Source: Annual Report 2016-17, Ministry of MSME (msme.gov.in)

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Table 3. Summary results fourth all India census of MSME

Sl No	Characteristics	Establishments (6th EC)	Employment (6th EC)	Establishments (5th EC)	Employment(5th EC)
1	Total	58495359	131293868	41253630	95054007
2	Rural	34795754	67895421	25146177	16107453
3	Urban	23699605	63398447	50374053	44679954

Source: Fourth All India Census of MSME 2006-07: Unregistered Sector, DC-MSME, Govt. of India

The table gives the number of establishments and employment in the last two economic censuses and inter census growth rate of establishments in respect of rural, urban and combined over the period 2005-13. The numbers of MSMEs as on date are 584.95 lakhs throughout the country and provide the employment to1312.93 lakhs (Table 3). It is seen that the overall compound annual growth rate (CAGR) of establishments per year during 2005-13 was 4.66% per annum in urban areas was slightly more than the growth rate in rural areas (Table 4). The total growth in number of establishments during 2005-13 was 28.97%. As far as employment is concerned, the overall CAGR of 4.12% was observed during 2005-13. The total growth in number of workers during 2005-13 was 28.85% (Table 4). The status of Micro enterprises in India, in general, has been discussed based on the available data from the reports of the Ministry of MSME. The unregistered category is the majority, within which the rural enterprises are lagging behind in registering their enterprises. This may be due to both lack of information and unwillingness of entrepreneurs, as they don't want to reveal details about their enterprises to avoid tax and regulatory process.

Table 4. Growth rates of non-agricultural establishments and employment

Sector	Item	5th EC(2005)	6th EC(2013)	CAGR (%)	Total Growth (%)
Rural	Establishments	19437178	22710545	1.96	16.84
	Employment	40198855	46838101	1.93	16.52
Urban	Establishments	15736469	22653241	4.66	43.95
	Employment	43941551	61573266	4.47	40.13
Combined	Establishments	35173647	45363786	3.23	28.97
	Employment	84140406	108411367	4.12	28.85

Source: Annual Report 2017-18, Ministry of MSME, Govt. of India

3. Review of some past studies

In [3] study, the sector's total finance demand, including debt and equity is estimated to be INR 32.5 trillion ($ 650 billion in 2009-10), with 80% of the demand originating from the informal sector. Micro and small enterprises have limited access to equity and, in many cases their ownership structure prevents infusion of external equity. Information from sector associations suggests a debt-equity structure of 4:1. The total finance gap in the sector, including debt and equity, but excluding the entrepreneur's equity contribution, is INR 20.9 Trillion (USD 418 Billion). This is split between Micro (INR 16.25 Trillion; USD 325 Billion), Small (INR 3.9 Trillion; USD 77 Billion) and Medium (INR 0.78 Trillion; USD 15.4 Billion) enterprises. Following the exclusions already highlighted, the debt gap that is immediately addressable by formal financial institutions is estimated at INR 2.9 trillion ($ 58 billion) and the equity gap at INR 1.9 trillion ($ 38 Billion). The Micro Enterprises Debt Gap was estimated to be INR 2.3 trillion ($ 46 Billion) in 2009-10 by the IFC. In [4] in its study entitled "Finance for Micro, Small, and Medium-Sized Enterprises in India: Sources and Challenges" tried to identify the factors that encourage financial access for start-up stage enterprises. It found that enterprises highlighted the need for loans without collateral, affordable interest rates, and loan guarantees provided by the government. They also reported the need for guidance by personnel from the financial institution and the need for a paradigm shift by which financial institutions view MSMEs as prospective customers rather than as interference. A few entrepreneurs emphasized that financiers should have faith in lending to businesses that had continued to operate in the same place for generations. In [5] reveals that Indian households continue to have high levels of unsecured debt from informal sources like moneylenders, putting them at risk of falling into a debt trap, a study by a central bank-appointed panel has found.

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Such a dependence on unsecured loans leads to higher costs and traps households in a long cycle of interest repayments. It noted that this phenomenon has been well-documented over the decades, but nevertheless remains stubbornly persistent. The reason why these households prefer informal sources of funding is because they have a low nuisance factor, according to the committee. The average Indian household associates the formal banking system with high administrative burden and complicated paperwork, it said. According to observations made in the report, Indian households need customized and cost-effective financial products. These products would need to be made available without any issues surrounding incentives to those providing it. The report also recommended that complicated paperwork and bureaucratic impediments be reduced, by ensuring that the terms and conditions of financial products are made simple and intuitive to the intended customers [6] finds that only 31.4% of all households had access to credit. Access to credit rose along with the asset ownership class. The lowest five deciles had access less than the average, which itself was low enough. The access to credit from formal institutions was lower, with only 17.2% of all rural and 14.8% of all urban households getting access to formal institutions.

4. Database and Methodology

The study focused on understanding various sources of credit used by Microenterprises and micro entrepreneurs from both formal and informal sources. A special focus was given to understand the informal sources of credit including, why entrepreneurs availed loans from informal sources, despite having a choice of taking more cheaper loans from formal financial institutions like banks. The study also reviewed credit features including interest rates, repayment conditions, documentation, processing time etc. The study examined both the supply side and demand side causes for the dependency of the micro entrepreneurs on informal channels for credit. From the supply side, the study also scanned various alternative channel/model of credit which is currently meeting the credit requirements of the microenterprises and their key features. The study aims at suggesting the possible way to formalize/ regulate the informal sources in India based on the primary survey and secondary research and finally come out with recommendations required for policy interventions and corrective measures for designing the policy/act for institutionalizing/mainstreaming the informal credit sources.

4.1. Objectives of the study

1. To study the various sources of finance for microenterprises and micro entrepreneurs in India and understand the difficulties in accessing the credit from different sources.
2. Understand the reasons for the persistence of overall inadequacy of credit to micro-enterprises.
3. Understand the role of informal credit sources including moneylenders, input suppliers and output buyers in meeting the credit requirements of microenterprises and micro-entrepreneurs.
4. Assess the extent to which alternative channels such as NBFCs, MFIs, BCs, and SHGs are meeting the credit requirements of microenterprises and micro-entrepreneurs and the possibility of enhancing their role.
5. To make required policy recommendations/corrective measures so as to help policymakers and regulators for designing the policy.

4.2. Sampling design

The microenterprise survey was conducted in four districts i.e., Cuttack (Rural), Ganjam (Urban), Sudargarh (Tribal) and Puri (Coastal) of Odisha in four different contexts. The districts were also selected for different levels of penetration of microfinance institutions, which have become a significant alternative channel of formal financing. The research design followed a simultaneous use of quantitative and qualitative research methods. A sample of 813 from these four locations was drawn for representing the different types of microenterprises. The detailed characteristics of the respondents are at Table 5.

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The choice of districts was purposive and within districts, the selection of rural/semi-urban and urban sample was also purposive so that an adequate number of rural were covered. Thereafter, in each location, the surveyed microenterprises were selected through systematic random sampling.

Table 5. Characteristics of the respondents

S. No	Variable	Particulars	N	%
1	Gender	Male	506	61.63
		Female	307	38.37
		Total	813	100
2	Religion	Hindu	689	84.5
		Muslim	120	15.0
		Christian	4	0.5
		Total	813	100
3	Area	Rural	293	36.62
		Urban	317	38.00
		Semi-Urban	203	25.38
		Total	813	100
4	Social Category	SC	116	14.51
		ST	93	11.62
		OBC	252	29.87
		Gen	330	41.25
		Others	22	2.75
		Total	813	100
5	Economic Category	APL	403	50.37
		BPL	390	47.13
		Others	20	2.50
		Total	813	100
6	Literacy Level	Illiterate	97	12.12
		Primary (1-7)	281	33.50
		Secondary (8-10th)	107	13.37
		Higher Secondary (11th-12th)	132	16.50
		UG and PG	102	12.75
		Vocational/Technical	94	11.75
		Total	813	100
7	Types of Micro Enterprises	Manufacturing	320	40.00
		Trading	276	34.50
		Processing	58	7.25
		Servicing	133	16.63
		Mixed	26	1.62
		Total	813	100
8	Asset Category of Micro Enterprises	0-50,000	251	31.37
		50,001 - 2,00,000	246	29.12
		2,00,001 - 5,00,000	134	16.75
		5,00,001 - 10,00,000	103	12.88
		10,00,001 - 50,00,000	71	8.88
		Above 50,00,000	8	1.00
		Total	813	100

Source: Authors' calculation based on field study

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5. Key findings of the study

The findings of the study presented as; (i) Financial needs of micro entrepreneurs/enterprises, (ii) Actual borrowing pattern of the micro entrepreneurs/enterprises, (iii) Access to various sources of finance by the micro entrepreneurs/enterprises, (iv) Key features of the financing sources used by micro entrepreneurs, (v) Factors considered by micro entrepreneurs to choose a formal source of finance, (vi) Factors considered by micro entrepreneurs to choose an informal source of finance, etc.

5.1. Financial Needs of Micro entrepreneurs (ME)/enterprises

Out of the total micro entrepreneurs interviewed, 6.6% of the entrepreneurs need loan for both personal and business need as shown in Table 6.

Table 6. Financial needs of micro entrepreneurs (ME)/enterprises

Personal Financial needs		Need of finance for business	
% of ME expressed need for personal loans	Average amount needed (INR)	% of ME expressed need for business loans	Average amount needed (INR)
22%	65,541	78%	90,815

Source: Authors' calculation based on field study

Nearly 78% of micro-entrepreneurs interviewed, expressed need for finance for their microenterprises, with the average amount required stated to be ₹90,815. The main purpose stated to be buying raw material (including saleable goods for trading enterprises) purchase. 22% of the micro entrepreneurs expressed the need of finance for household expenditure with average need being ₹65,541. The extent of finance accessed was ₹69, 000 on an average, which was 75% of the average need of ₹90,815 for business purposes stated above.

Table 7. Personal financial and business needs

Personal Financial Needs											
District	meeting HH Consumption Needs	Buying durable items	Educational Expenses	House repair/ Extension/ purchase	Medical Expenses	Social expenditure	Buying crop inputs/irrigation of land for cultivation	Buying livestock/fodder	Total for Personal	% of ME who expressed need for personal loans	Average amount needed (Rs)
Cuttack	11	1	0	1	2	2	5	17	39	18.30	60,059
Ganjam	16	2	2	10	6	7	3	0	46	23.00	93,460
Sudargarh	22	0	11	10	3	8	2	2	58	29.00	1,01,750
Puri	38	0	2	2	21	2	1	22	88	44.00	18,855
Total	87	3	15	23	32	19	11	41	231	22.40	65,541
Percentage	38	1	6	10	14	8	5	18			

Business Financial Needs										
District	Giving advance to get finance or subsidy	Buying tools/equipment	Buying machinery	Other long term	Other short term	Buying raw materials for micro enterprises	Building a work shed	Total for business	% of ME who expressed need for business loans	Average amount needed (Rs.)
Cuttack	7	13	18	81	3	63	1	186	87.3	65,890

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Ganjam	1	14	16	1	6	106	2	146	73.0	1,71,000
Sudargarh	2	6	23	10	3	129	14	187	93.5	1,21,260
Puri	0	4	10	0	8	88	4	114	57.0	60,010
Total	10	37	67	92	20	386	21	633	77.9	90,815
Percentage	2	6	11	15	3	61	3			

Source: Authors' calculation based on field study

The micro-enterprises targeted in the study don't require huge capital investment. The establishment is primarily within the premises of their own house. It starts with a low investment in buying the raw materials and need fund to increase the raw material on up surging the demand. About 22% of the micro-entrepreneurs reported to avail small size loan to meet the upfront fee and cost for availing the bigger loan. About 38% of the total micro entrepreneurs interviewed reported the need of finance for consumption purpose as shown in Table 7.

1. Working capital to stock raw material when it is cheap

The entrepreneurs tend to buy and stock the raw material when it is cheap to increase the margin. At the same time, the market is erratic and the price of the raw material fluctuates. During the interview with the micro-entrepreneurs, it was reported that the urgency of immediate finance when the price of the raw material falls. At this situation, they buy the raw material in credit. For some of the cases when the raw material is not available on credit, they approach informal sources mainly moneylenders for a quick loan. Availability of cheaper and quick loans from banks to stock raw material when it is cheap would generate an additional income for them; however, entrepreneurs reported that banks take a long time for processing loan application.

2. Working capital to stock finished goods before peak demand

The Micro entrepreneurs interviewed who were involved in the production were selling their produce to the output buyers or in the market immediately after production at a lower price due to unavailability of capital to stock the finished goods. Invariably, they are losing money. The other reason highlighted by the respondents as to why they sell the finished good immediately is to arrange money for buying input. If they stock the finished goods, either they have to avail loan from informal sources or to buy input on credit. In either case, they will lose a good margin.

3. Need to extend credit sales to expand the customer base

Micro-entrepreneurs are also facing a challenge in the expansion of their business as they cannot provide material on the credit. Some of the grocery shop owners shared that they know their customers are creditworthy as they live in the same neighborhood but unable to provide material to their customers on credit as they have limited investment capacity. Due to this, they are unable to expand their customer base. Some of the enterprises having investment up to INR 200,000 reported to operate in a rolling business manner. They need immediate cash to buy raw material and hence they do not sale the finished goods on credit despite they know it will enhance their customer base.

4. Capital for equipment to improve quality or increase production

Most of the micro entrepreneurs of manufacturing industry interviewed are still using conventional technologies for the production of goods through latest technologies is available. For e.g. the craft workers in Puri districts reported the availability of equipment for carving and engraving but it is costly and they cannot effort to procure. This leads to low production and some of the flour mill owners interviewed reported that buying a packing machine will enhance their business as they can supply a variety of flour to the retail shops.

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5.2. Actual borrowing patterns

1. Borrowing analyzed by purpose

Out of total 1,232 loans taken by 347 respondents (28.2%) were for personal purpose; out of which 26.7% were for agriculture & allied activities, and 36% for household consumption need (Table 8).

Table 8. No of ME wise actual purpose of borrowing – Personal purpose

District	meeting HH Consumption Needs	Buying durable items	Educational Expenses	House repair/ Extension/ purchase	Medical Expenses	Social expenditure	Buying crop inputs/irrigation of land for cultivation	Buying livestock/fodder	Total for Personal	% of ME who expressed need for personal loans	Average amount needed (Rs)
Cuttack	9	0	1	4	3	3	0	22	42	15.50	33286
Ganjam	10	3	3	8	4	3	0	0	31	16.40	110000
Sudargarh	43	0	9	16	5	23	0	29	125	29.70	56000
Puri	78	0	4	0	49	1	6	53	191	41.90	20150
Total	140	3	17	28	61	30	6	104	389	31.70	50400
Percentage	36.0	0.8	4.4	7.2	15.7	7.7	1.5	26.7			

Source: Authors' calculation based on field study

Table 9. No. of ME wise actual purpose of borrowing - Business Purpose

District	Giving advance to get finance or subsidy	Buying tools/equipment	Buying machinery	Other long term	Other short term	Buying raw materials for micro enterprises	Building a work shed	Total for business	% of ME who expressed need for business loans	Average amount needed (Rs.)
Cuttack	9	14	22	107	6	71	0	229	84.50	30,650
Ganjam	0	21	9	3	10	117	1	161	85.20	156,000
Sudargarh	1	7	9	5	12	164	1	199	63.60	68,520
Puri	0	4	13	0	18	232	0	267	58.60	57,100
Total	10	46	53	115	46	584	2	856	69.70	76,700
%	1.2	5.4	6.2	13.4	5.4	68.2	0.2			

Source: Authors' calculation based on field study

Out of the total loans used for business purpose, 68.2% were to buy raw material, 5.4% to buy tools/equipment, 6.2% to buy machinery and build a work shed (Table 9 and 10). The extent of finance accessed was ₹76,700 on an average, which was 85% of the average need of ₹90,815 for business purposes stated above. If we also take into account the household need, of ₹65,541, then the availability was only 43% of the expressed need, showing a severe shortfall in access to finance. As manufacturing enterprises require higher capital investment, the average loan requirement for these enterprises is more. Manufacturing enterprises emerge as the highest type for the fund requirement and inflow. And the demand-supply mismatch is smallest in this category. However, it may be observed that the highest demand-supply mismatch is in trading (Table 11)

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Table 10. Average borrowing across type of Microenterprises

Type of ME	Mean	N	Standard Deviation	Total	% of Amount	% N units
Processing	54,726	58	56634.31	3,174,100	3.7%	7.1%
Manufacturing	133,020	320	301373.55	42,566,350	50.1%	39.4%
Trading	92,767	276	142571.83	25,603,820	30.1%	33.9%
Services	94,699	133	145531.29	12,595,005	14.8%	16.4%
Mixed	42,760	13	31488.46	1,069,000	1.3%	3.1%
Total	104,561	813	216634.99	85,008,275		

Source: Authors' calculation based on field study

Table 11. Demand-supply mismatch – By ME type

Microenterprise Type	Average amount needed (Rs)	Average amount borrowed (Rs)	Mismatch
Processing	71524.07	58779.6	17.80%
Manufacturing	131826.6	124786.7	5.30%
Trading	88903.63	57724.5	35.10%
Services	105911.7	97635.7	7.80%
Mixed	101708.3	44541.7	56.20%

Source: Authors' calculation based on field study

The majority, 52.7% of the loans were from informal sources, accounting for 32% of the amount financed. Moneylenders play a dominant role as within the informal sources they lent 44% of total loans for financing enterprises, followed by 33% by family, friends and neighbors and 17% by input suppliers and output buyers. The service-based MEs are not borrowing much and they are predominantly (72.18%) dependent on formal banking sources for borrowings (Table 12).

Table 12. Access to various sources of finance

S.No	Source of Finance	Processing	Manufacturing	Trading	Services	Mixed	Total
I	Formal Sources						
1	Bank (Public + Private + SFB+RRB)	13	88	79	49	3	232
2	Cooperative Bank and Society	1	6	7	7	1	22
3	NBFC/NBFC-MFI/NGO-MFI/FI	18	22	33	33	6	112
4	SHG	9	52	47	7	7	122
	Total	41	168	166	96	17	488
II	Informal Sources						
1	Moneylenders	4	40	39	11	5	99
2	Chit funds	0	1	1	1	0	3
3	Traders	2	32	19	4	1	58
4	Family and Friends	6	29	30	15	1	81
5	Others	0	5	4	3	0	12
	Total	12	107	93	34	7	253
	No Loan	5	45	17	3	2	72
	G.Total	58	320	276	133	26	813

Source: Authors' calculation based on field study

Table 13. Quantum of Loan by ME type

S.No	Micro Enterprises	No Loan	Upto 10,000	10000-50000	50001-1 lakh	Above 1 Lakh	Total
1	Processing	5	1	34	11	7	58
2	Manufacturing	44	55	91	52	78	320
3	Trading	15	13	139	52	57	276
4	Services	3	4	87	17	22	133
5	Mixed	2	2	15	4	3	26
	Total	69	75	366	136	167	813
	%	8.49	9.23	45.02	16.73	20.54	100

Source: Authors' calculation based on field study

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Table 14. Factors considered by micro entrepreneurs to choose a formal source of finance

Preferences wise desired factors for financing		
Ranking	Factors	% of ME preferred
1	Easy physical accessibility	67.40%
2	Less processing time	64.70%
3	Lower interest rate	57.10%
4	Less paper work and formalities	50.20%
5	Friendliness of financier	46.70%
6	Adequate amount of finance	33.10%
7	No need for land title for mortgaging	31.90%
8	Repayment schedule which suits your cash flow	25.70%
9	Duration of finance suits you	24.00%
10	Lesser requirement of collateral security for finance	23.50%
11	Less cost of financing (other than interest)	20.70%
12	Flexibility of end use – the financier does not ask what we used the finance for	8.60%
13	Availability of subsidy	7.60%
14	Chances of loan being waived	6.00%
15	Is the financing like a partnership with profit sharing or is it a finance to be returned	3.10%

Source: Authors' calculation based on field study

6. Factors for choosing a formal source of finance by microenterprise

1. Easy physical accessibility: Refers to distribution and making sure that the product/service is available where and when it is wanted. This includes such options as field officers, Business Correspondents, local persons hired by banks to help them with the local community (for e.g. Bank Mitra who is a liaison between SHGs and Banks) working with the informal sector financial services etc. Entrepreneurs prefer the availability of the loan within their neighbourhood so that they need not lose their work and also expressed the contact person to be approachable for e.g. know their local language, local conditions, explain the services available with patience etc.
2. Less processing Time: Microenterprises prefer loans that can meet their immediate demand. For banks and other financial institutions, the loan processing time is similar in length and complexity regardless of the size of enterprise or credit requirement. Even the loan sanctioning process is centralized for these institutions that require a longer period.
3. Lower interest rate: Microenterprises prefer lower interest rate on loans. It was reported by the micro-enterprises that the interest rate of banks are less and are the preferred source for a loan but the opportunity cost is high due to the lengthy process of banks.
4. Less paperwork and formalities: Micro entrepreneurs prefer less paperwork to avail loan. Field insights reveal that banks require legal documents such as shop establishment certificate, trade license, business plan, bank statement, cash flow details, and tax filing documents. Majority of microenterprises interviewed prefer to avail loans under the Sishu category because it is easier and quicker (only requires documents such as Aadhaar, Election card, Ration Card and KYC), despite the inadequacy of the loans for their microenterprise.
5. Friendliness of financier: Friendliness of financier is the 5th desired factor indicated by the microenterprises. Micro entrepreneurs are scared to face and confront the bankers and felt microenterprise is not a priority sector for the bank rather a target oriented exercise. Micro entrepreneurs express social humiliation on availing loans from MFIs and moneylenders due to forced recovery.
6. Adequate amount of finance: Micro entrepreneurs want the required amount of credit from the single source so that they need to approach many people/ institutions to meet the financial requirements of their enterprise. Under finance will lead to entrepreneurs unable to provide the required range of services/products to their clients. Loans from other institutions except banks are of little assistance because of the inadequacy of loan amounts. This hasn't reduced their dependence on the informal credit sources, especially for the one-time-expenditures like weddings.

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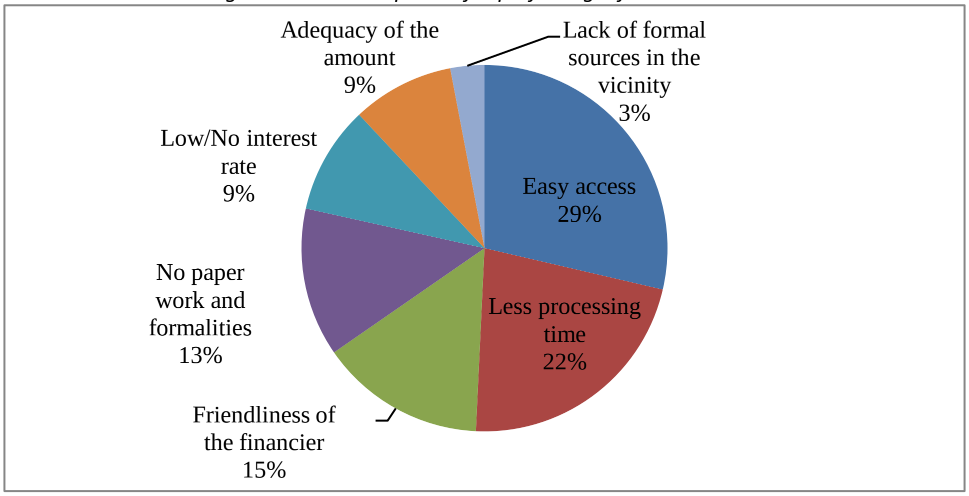
7. Factors considered to choose an informal source of finance

Based on the data analysis, we found that following are the top five desired factors Micro entrepreneurs consider when choosing a financier as shown in Figure 1.

Figure 1. Reason reported for preferring informal sources



1. Easy physical accessibility: Refers to distribution and making sure that the product/ service is available where and when it is wanted. This includes such options as field officers, Business Correspondents, local persons hired by banks to help them with the local community. Entrepreneurs prefer the availability of the loan within their neighborhood so that they need not lose their work and also expressed the contact person to be approachable for e.g. know their local language, local conditions, explain the services available with patience etc.
2. Less processing time: Includes the way or system in which or through the credit is delivered: how the transaction is processed and documented, the waiting period involved, the forms to be filled etc. Customers want the loans to be sanctioned in a short period of time so that they can get a timely loan to procure required raw material to produce the products and deliver to the customers who ordered.
3. Friendliness of Financer: The non-formal source financers leave in the vicinity of micro-entrepreneurs. They know the micro-entrepreneurs more than the people from formal financial institutions. Whenever the micro-entrepreneur meets the non-formal source financer at least they ask them how the business is going on and how their children are doing. But this doesn't happen with formal financial institutions though there is reason for it. Only transaction happens between financers and the micro-entrepreneurs. The financers in formal financial institutions serve more number of people than the informal source financer. As per the banking policy, the person from formal financial institution keeps on changing on every three years. We found some of the people from formal financial institutions who were able to build the relationship with micro entrepreneurs in the three years of their duration and micro entrepreneurs are missing them. But it has not gone into the system rather it is person specific.
4. Less paperwork and formalities: Micro entrepreneurs want the number of documents to be filled should be less and they should not be asked to bring too many documents from various sources one of the respondents from Cuttack said that he was asked to get "No objection certificate" from all most all the banks in that area and it has consumed a lot of his time in addition to spending time. Most of the time entrepreneurs and guarantors hesitate to give their signatures on many documents as simply they do not understand the purpose of giving so many signatures. Some institutions also ask for the license/registration of their enterprise, collateral documents for providing loans which is another reason why entrepreneurs hesitate to approach formal financial institutions.

5. Interest rate: Entrepreneurs are comfortable only for one fee to access the credit which includes the interest rate, processing fee, prepayment penalties, transaction costs etc. They don't mind to pay more at the cost of their time, hurdles and uncertainty to get the loan.

8. Recommendations of the study

The financing gap in the microenterprise sector is a combined result of demand-side challenges such as lack of awareness, documentation requirements, inability to provide margin money, collateral and mixing up of household and enterprise cash flows, and supply-side issues, such as lack of translation of high level credit policies into appropriate processes for microenterprise borrowers, and incentives for field bankers to lend to micro entrepreneurs. Superficial understanding about microenterprise business among bankers is persistent, and due to their branch and desk-based orientation, they find it difficult to identify the right borrowers and instead lend to those who come to them, often through middlemen or recommendations of influential persons and who can at least on paper, meet the various requirements. Project appraisal, loan monitoring, and default management is more for the purpose of reporting "action taken" rather than to actually do it in spirit.The study recommends policy interventions suitable to address the difficulties faced by micro entrepreneurs in accessing credit from their choice preference and to address the persistence of overall inadequacy of credit.

1. Enhancing awareness through information dissemination, training, hand-holding, mentoring and establishment of a network for facilitating cross-learning and mutual help. The RBI has already taken many steps towards this through various banks but the outreach is extremely limited and perfunctory. This because most programs of financial literacy are based on holding face-to-face training programs in rural areas and low-income urban areas which are too labour intensive for the trainers and takes too much time for the participants. Instead, mobile phone-based training short videos, mobile phone games and mobile apps like Haqdarshak which indicate the eligibility of a person for a government program or loan, should be used. These can be supplemented by web-based e-learning modules such as www.dhangyan.com, Rupaya Paisa series of books developed by Pratham Books for children of classes 6 to 8. Vocational training courses to become Household Financial Advisors and Microenterprise Business Advisors should be offered as a part of the National Skill Qualification Program from class 9 to 12 so that eventually India has lakhs of young people engaged in these professions.
2. Reducing the complexity in documentation by replacing it with simple procedures, increased periodical monitoring, and further strengthening of DICs etc. In its movement towards digital India, the GoI should eliminate the need for any paper-based loan application and a physical visit by the borrower to a branch. Loan applications for loans up to the Shishu category should be fully digitized using mobile phone apps and tabs. These can be uploaded by anyone having access to the internet. If they need assistance in filling the application, the lakhs of BC and CSC operators should be trained and authorised to do this for a fixed fee. If the mighty LIC could digitise its insurance policy application and issuing of cover notes, through a nationwide network of Common Service Centres in rural areas, there is no reason why the banking system should lag behind. Already significant sized pilots are being conducted in Rajasthan by the United Bank of India and Sub-K (a BC company) for originating and approving microenterprise loans in a paperless manner using electronic tablets (Tabs). Another effort worthy of mention in this regard is Streenidhi, (https://www.sthreenidhi.ap.gov.in) [7] a wholesale lending institution for SHGs and SHG Federations, established by the Govt of Andhra Pradesh in 2012. The operations of Streenidhi are fully digitised and a woman applying for a loan to her SHG in rural AP gets a decision within three days and if the loan is approved then she gets the money credited in her bank account by the fifth day.
3. The gap between policy pronouncement on credit to small borrowers and actual flow needs to be bridged differently than issuing more circulars by the RBI and the bank's head offices. The processes that a borrower has to go through should be subjected to detailed scrutiny by business process reengineering professionals. Banks must be mandated to make all applications up to Shishu loans completely digital and paperless and not requiring any branch visit. Once an application is digitally uploaded, its appraisal, approval, disbursement, and repayment must be digitally tracked. This must include mandatory use of

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Aadhaar for e- KYC check and Credit Bureau for credit history check of applicants, conveying of approval or rejection of loan application, including causes thereof by mobile SMS, and disbursement as well repayment through their bank accounts electronically linked to the core banking system.

4. Banks should be encouraged to use alternative channels – like SHGs, MFIs and BCs who are already engaged in cash-in and cash-out transactions for bank accounts. Banks are using these channels but reluctantly and tend to do so when they get a government mandate and an operating subsidy for the channel costs (as in case of the SHG loans). In case of MFIs as well as loan-originating BCs, banks tend to keep a much larger share of the net interest income that their proportion of operating costs plus risk. To correct this situation the RBI should establish an Expert Committee to determine the efficiency level cost structure (including operating and risk costs) for each channel and the channels should then be paid accordingly. Banks should be allowed to price products in line with cost structures. PSU banks currently hesitate to mark-up the price to accommodate for BC costs thus ending up underpaying BCs.
5. Banks need to innovate greatly on product features. The standard term loans with quarterly or monthly repayment instalments, do not take into account the seasonality of microenterprise cash flows nor of the varying requirements of micro-entrepreneurs' households. Thus "cash-credit" products should be offered but with digital operations, so that deposit or drawl or small amounts frequently need not to mean the micro-entrepreneur has to go to a bank branch or ATM. Term loans should be only given for the purchase of equipment, machinery or other lumpy fixed assets and should be at least four-year duration with a one-year moratorium or three years with ballooning of instalments (higher amounts in the latter years). Even though they may be below the GST registration floor, microenterprises taking bank loans may be encouraged to use apps like GR4GST (get ready for GST) to channel as much of their input purchase and utility payment transactions through bank accounts as possible. Sale proceeds may be mostly still in cash but the bank must insist on a daily deposit of proceeds and a reminder should go out by SMS if it does not happen by 11 am every morning. Even cash collection from the shop is now being offered as a reliable digitally recorded service by, for example, Indepay (www.indepay.com) [8] and SBI is partnering with them for a pilot in the Delhi NCR.
6. Banks need to innovate greatly on product features. The study recognizes that for microenterprises, the business cash flows and the household cash flows are mixed up, and often entrepreneurs are forced to use business loans to meet other financing needs medical care, children's education, housing, and social expenditure. In the case of very low-income households, part of the loan is even used for consumption. Thus it is important to offer a range of different products to meet these needs and allow one person or one household to have multiple, simultaneous loans (within overall repayment capacity) for different financing needs, with different interest rates and repayment terms.
7. In [9] had recommended a selective and careful use of moneylenders, to enhance access to credit by micro-borrowers, and even drafted model legislation for the regulation of moneylenders who would then be linked with banks for wholesale finance, not much progress happened on it. The reasons for this are from both sides – moneylenders are reluctant to be brought under any formal controls, and banks are unwilling to lend to them in case the scheme backfires. Instead, banks are more willing to use alternative channels like MFIs, SHGs, and BCs, as they are more prone to being supervised. The study found that wherever the outreach of these channels was dense, the dependence on moneylenders was getting reduced. In summary, therefore, our recommendation is that informal channels should be allowed to slowly wither away as the alternate channels spread their outreach.

9. Conclusion

It is obvious from the study that the formal institutions have made a significant impact on microenterprises through financing that led to the reduction of dependency on informal sources but at the same time the informal sources are the vital players for the microenterprises that cannot be completely replaced from the market due to their unique service proposition. The study also points out that there is a huge finance demand-supply gap for microenterprises that compel them to approach informal sources.

The latest government schemes focusing on financial services to microenterprises proved to be very effective in terms of reaching out. Going forward, the formal financial sources have to focus on

1. Efficient distribution system backed with technology, customized product and services, and good relationship management, reduce the transaction cost and risk profile of micro enterprises
2. Leveraging local distribution channel added with a non-conventional way to acquiring business detail result in scaling up the business
3. Increasing ability of the financier to evaluate and manage business risks and offer a customized product. Cash flow based appraisal & future cash flow of the enterprises would be estimated to derive the credit requirement and installment. Examination of the special peculiarities of the business like seasonality, business margin, selling pattern, buying pattern, trend analysis to arrive at the conclusion.
4. Customized underwriting procedures backed with technology result in faster and effective loan processing through anticipating cash flow of the enterprise & their overall participation in the value chain
5. Integrating into the supply chain of the micro enterprises would help the financier to evaluate the client effectively.

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