

A STUDY ON THE SOURCES AND CHALLENGES IN FINANCE FOR MICRO, SMALL AND MEDIUM SIZED ENTERPRISES WITH SPECIAL REFERENCE TO THE CITY OF BANGALORE

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Abstract

Micro, small and medium-sized enterprise finance (MSMEs) has been a problem for all stakeholders including entrepreneurs', financial institutions and government organizations. The key objective of the study was to identify various sources of funds used by MSMEs for their initial investment, initial working capital and for the expansion of the enterprise. The study also identifies various challenges faced by MSMEs in sourcing of finance from public and private sector. Data was collected through personal interviews using a structured questionnaire from a sample of 50 MSMEs. The survey was conducted mainly in the city of North Bangalore. The study found that micro, small and medium-sized enterprises are expected to rely on their own funds, or loans from friends and family, for money. However, these sources are often insufficient or expensive, and act as a constraint on growth. Based on the conclusion adequate and timely availability of finance is the major constraint for MSMEs due to lack of awareness about the government policies and commercial bank loan for MSMEs, recommendations have been proposed for entrepreneurs, bankers and for the ministry.

Key Words: MSME, finance, entrepreneur

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Introduction

MSMEs play a major role in most economies, especially in developing countries. MSMEs represent the majority of companies around the world and contribute significantly to job creation and global economic development. They account for about 90 percent of businesses worldwide and more than 50 percent of jobs. In emerging economies, formal SMEs contribute up to 40% of national income (GDP).

India's micro, small and medium-sized business sector has been considered the backbone of the national economic structure and has continuously served as the Indian economy's bulwark, providing it with resilience to avoid global economic shocks and adversities. MSMEs are key tools for fostering inclusive regional development, job creation, desirable sustainability, Developing entrepreneurial skills and contribution to export earnings, Gross Domestic Product and innovations.

Over the last five decades, this sector has not only played a crucial role in creating large-scale employment opportunities at comparatively lower capital costs than large industries, but also in helping to industrialize rural and backward areas, thereby increasing regional imbalances and ensuring a fairer distribution of national income and wealth.

An IFC study in 2012 estimated the size of the sector at 29.8 million enterprises in 2010. That number has grown to 55.8 million enterprises in 2017 as per the MSME Ministry's annual report for that year and employs over 110.989 million individuals. Micro, small and medium enterprises are spread throughout urban and rural India. The sector's contribution to the national GDP is eight percent. It contributes about 6.11 percent of the manufacturing GDP, 24.63 percent of the services, and 33.4 percent of India's manufacturing output. It's contribution to exports stand at 40 percent.

Number of MSMEs Category Wise

As per the National Sample Survey (NSS) 73rd round, conducted by National Sample Survey Office (NSSO), MoSPI, during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities excluding the MSMEs registered under (a) Sections 2m(i) and 2m(ii) of the Factories Act, 1948, (b) Companies Act, 1956 and (c) Construction activities falling under Section F of National Industrial Classification (NIC) 2008. Table 1.3 shows the distribution of MSMEs category wise.

Table 1
Distribution of MSMEs (Category Wise)

Number of MSMEs category wise				
Activity Category	Estimated Number of Enterprises (in lakh)			Share (%)
	Rural	Urban	Total	
Manufacturing	114.14	82.50	196.65	31
Trade	108.71	121.64	230.35	36
Other Services	102.00	104.85	206.85	33
Electricity*	0.03	0.01	0.03	0
All	324.88	309.00	633.88	100
*Non-captive electricity generation and transmission and distribution by units not registered with the Central Electricity Authority				

Source: Annual reports of Ministry of MSMEs

MSME Sector – Definition

In accordance with the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified

in two Classes: Manufacturing Enterprises-The enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the industries (Development and regulation) Act, 1951) or employing plant and machinery in the process of value addition to the final product having a distinct name or character or use. The Manufacturing Enterprise are defined in terms of investment in Plant & Machinery. Service Enterprises:-The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment.

Table 2
MSME Sector Definition

Manufacturing Sector	
Enterprises	Investment in plant & machinery
Micro Enterprises	Does not exceed twenty five lakh rupees
Small Enterprises	More than twenty five lakh rupees but does not exceed five crore rupees
Medium Enterprises	More than five crore rupees but does not exceed ten crore rupees
Service Sector	
Enterprises	Investment in equipment's
Micro Enterprises	Does not exceed ten lakh rupees
Small Enterprises	More than ten lakh rupees but does not exceed two crore rupees
Medium Enterprises	More than two crore rupees but does not exceed five core rupees
	exceed five core rupees

Source: Ministry of MSMEs

Review of Literature

Researchers study on “Evaluating access to finance constraints for MSMEs in India”, Focused on the obstacles faced by India's micro, small and medium-sized enterprises

(MSMEs) in accessing finance and government policies to achieve sustainable growth in the sector. The article analyzed data from the World Bank Enterprise Survey (firm level) to understand the main growth constraints faced by Indian firms

'Small and Medium enterprises (SMEs) in Greece - Barriers in Access to banking Services - An Empirical Investigation', The study revealed that not only in the start-up phase, but also in the later growth phase SMEs face financial constraints. Research revealed that companies rely on their primary source of funding, such as their own investments, venture capital during their start-up process, and subsequently on external capital for their investment needs.

Has done study on Issues, challenges and prospects of Small and Medium scale enterprises (SMEs) in Port-Harcourt City, Nigeria. The paper focused on determining whether poor financing, inadequate social infrastructure, lack of managerial skills and multiple taxation create major challenges in the performance of SMEs. The authors had adopted a descriptive study using 120 randomly selected registered operators of SMEs in Port-Harcourt City. The paper concluded that the above mentioned four factors were the major challenges faced by the SMEs in Port-Harcourt City. The authors also suggested few recommendations to address the major challenges of SMEs like provision of soft loans, long term loans by government should be guaranteed to SMEs, establishment of funding agency.

Has done study on Challenges of Financing small and medium enterprises in equity Bank branches in Kenya. The study aimed in determining the challenges faced by equity bank (k) Limited branches in financing SMEs and examining how these challenges are addressed. 50 branches were selected as sample for the study. The study revealed that SMEs lack banking history, credit history, they don't have Collateral to act as security, non-registration of business, lack of financial statements required for financing. The

securities provided by SMEs Has done paper on “**The Role of Government in SME Development in Transition Economies**”. From empirical evidence from Ukraine, Belarus and Moldova, it showed that most Small Enterprises are survived and develop due to their successful resource utilization and adaptability of creative techniques that suit the external environment. Although many companies remain just small businesses and their economic contributions are minimal. Government must therefore take a number of steps to promote and grow small and medium-sized enterprises. Similarly, improving the advance market level and enabling the banking system to introduce new financial products as well as expanding the infrastructure Public Private Partnership.

Statement of the Problem

Despite the various policies and measures taken by authorities to cater financial needs of the MSME Sector, Lack of adequate access to finance has been the major challenge for MSMEs for growth and scaling up of business. This study is to check the various sources of finance used by MSMEs and to check various challenges faced by the MSMEs.

Objectives of the Study

The following are the objectives of the present study:

1. To identify the sources of funds available to MSMEs.
2. To identify the specific challenges in finance faced by MSMEs in Bangalore.

Scope of the Study

The scope of the present study has been classified into two categories which are as follows,

Periodic Scope: The scope of the present study is confined to micro, small and medium sized enterprises which are defined under MSME Act (2006) and registered with the

District Industry and Commerce (DIC) or Karnataka State Small Scale Industrial Development Corporation (KSSIDC), who has been in operation for minimum of five years.

Geographic Scope: The present study is limited to micro, small and medium sized enterprises located in the taluk of North Bangalore, which comprises of four Industrial Estates, namely, Rajajinagara, Peenya Phase I, Peenya Phase II and Peenya Phase III, of Bangalore Urban district.

Research Methodology:

This paper is conducted based on descriptive research basis. To meet the objectives of the study and to test the hypothesis framed, primary data have been collected. The primary data required for the study was collected by using structured questionnaire from Micro, small and medium sized enterprises located in the taluk of North Bangalore. Relevant information was gathered through discussions with different entrepreneurs.

Sample Size:

A sample of 50 micro, small and medium sized enterprises is selected to conduct the study. The present study covers four Industrial Estates of North Bangalore, namely, Rajajinagara, Peenya Phase I, Peenya Phase II and Peenya Phase III.

Sampling Technique:

Simple random sampling technique was adopted by the researcher. Each and every item in the population has an equal chance of inclusion in the sample and each one of the possible samples, in case of finite universe, has the same probability of being selected.

Table 3
Sources of initial investment

Source	Frequency	Percentage
Personal funds and loan from family and friends	9	18
Personal funds and banks	27	54
Personal funds, loan from family and friends and banks	11	22
Personal funds and others	1	2
Personal funds, loan from family and friends and others	2	4
Total	50	100

Source: Computed from Primary data

The above table3 depicts that all the micro, small and medium sized enterprises in the sample have pooled in their personal funds in the business as their initial investment, which ranks the highest. 38 micro, small and medium sized enterprises in the sample have chosen banks for financing their initial investment, which ranks the second highest. On the other hand 2 of the sample MSMEs have chosen government MSME Schemes for their initial investment and 1 have issued shares. It is interpreted that all the MSMEs in the sample have used their personal funds for the initial investment and only 2 have gone for Government MSME Schemes for initial investment.

Table 4
Sources of initial working capital

Source	Frequency	Percentage
Banks	27	54
Personal funds and money lenders	10	20
Personal funds and banks	10	20
Personal funds and loan from family / friends	1	2
Banks and money lenders	2	4
Total	50	100

Source: Computed from Primary data

The above table 4, depicts that most of the MSMEs i.e. 39 MSMEs chose banks for their initial working capital, which ranks the highest. 12 MSMEs in the sample have used money borrowed from money lenders, which ranks the third. On the contrary, none of the MSMEs have gone for NBFCs or financial institutions or government schemes for their initial working capital. It is interpreted that most of the MSMEs go for banks when it comes for initial working capital than any others.

Table 5
Sources of fund used for expansion

Source	Frequency	Percentage
Banks	15	41.67
Industry specific schemes of government or MSME	6	16.67
Others	12	33.33
Money lenders and others	1	2.78
Industry specific schemes and others	1	2.78
Banks and industry specific schemes	1	2.78
Total	36	100

Source: Computed from Primary data

From the 50 MSME samples, 36 of the MSMEs have gone for expansion. The above table depicts that MSMEs in the sample chose bank loans for their expansion, which ranks one, followed by the others option, which are profits from the business and personal funds together ranks second. Only 7 of the total MSMEs have utilized industry specific schemes of Government or MSME development institute for their expansion, which ranks third and followed by industry specific schemes of SIDBI or NSIC, where only one MSME has availed it. It can be interpreted that most of the MSMEs use bank loans and profits from the business operation for expansion. And only few enterprises go for government schemes.

Table - 6
Challenges faced by MSMEs of manufacturing sector in availing finance from Government source

Challenges	Frequency	Percentage
Institutional delays	7	8.0
Difficulty in providing business plan	10	11.5
Inflexible repayment terms	12	13.8
No transparency	23	26.4
No formal accounting system	6	6.9
Lack of knowledge about the schemes	15	17.2
Difficulty in providing collateral and documents	14	16.1
Total	87	100

*Source: Computed from Primary data *multiple responses were allowed*

The above data depicts that 26.4% of the sample enterprises expressed that there is no transparency in lending funds from the government. 17.2% of the sample enterprises expressed that they lacked knowledge about the schemes. 16.1% face difficulty in providing collateral and documents for availing financial assistance from the government. On the other hand 11.5% of the sample enterprises faced difficulty in providing Business plan for the loan and 6.9% of the enterprises couldn't avail finance from government sector as they had not maintained proper accounting system. It is interpreted that enterprises face difficulty in providing collateral and necessary documents and a small size of the sample face difficulty in providing the business plan and by not maintaining proper accounting system.

Table -7
Challenges faced by MSMEs of service sector in availing finance from Government source

Challenges	Frequency	Percentage
Difficulty in providing business plan	4	13.8
Inflexible repayment terms	4	13.8
No transparency	7	24.1
No formal accounting system	3	10.3
Lack of knowledge about the schemes	6	20.7
Difficulty in providing collateral and documents	5	17.2
Total	29	100

*Source: Computed from Primary data *multiple responses were allowed*

The above data depicts that 24.1% of the sample enterprises expressed that there is no transparency in lending funds from the government, 20.7% of the sample enterprises expressed that they lacked knowledge about the schemes. 17.2% face difficulty in providing collateral and documents for availing financial assistance from the government. On the other hand 13.8% of the sample enterprises faced difficulty in providing Business plan for the loan and inflexible repayment terms. 10.3% of the enterprises couldn't avail finance from government sector as they had not maintained proper accounting system. It is interpreted that enterprises expressed that there is no transparency in lending funds from the government and a small size of the sample face difficulty in providing the business plan and by not maintaining proper accounting system.

Table 8
Challenges faced by MSMEs of manufacturing sector in availing finance from Private Source

Challenges	Frequency	Percentage
Processing of loan	19	23.8
Difficulty in providing collateral	18	22.5
High rate of interest	37	46.3
No formal accounting system	6	7.5
Total	80	100

*Source: Computed from Primary data*multiple responses were allowed*

The above data depicts that 46.3% of the sample enterprises expressed that the interest rate was high when they lend from private source. 23.8% of the sample enterprises expressed that they had to pay high service fees for processing of loan. 22.5% face difficulty in providing collateral and documents for availing financial assistance. It is interpreted that enterprises expressed that interest rate was high and enterprises expressed that they had to pay high service fees for processing of loan.

Table 9
Challenges faced by MSMEs of service sector in availing finance from Private Source

Challenges	Frequency	Percentage
Processing of loan	5	17.2
Difficulty in providing collateral	8	27.6
High rate of interest	13	44.8
No formal accounting system	3	10.3
Total	29	100

*Source: Computed from Primary data*multiple responses were allowed*

The above data depicts that 44.8% of the sample enterprises expressed that the interest rate was high when they lend from private source. 27.6% face difficulty in providing

collateral and documents for availing financial assistance. 17.2% of the sample enterprises expressed that they had to pay high service fees for processing of loan.

Table 10
Chi-Square Test Results on Source of Funds used for Initial Investment of different Business Activities

Particulars	Value	df	Asymp. Sig. (2 sided)
Pearson Chi-Square	1.315	4	.859
Likelihood Ratio	2.054	4	.726
Linear-by-Linear Association	.845	1	.358
N of Valid Cases	50		

The above table exhibits the chi-square results on Source of Funds and Initial Investment of different Business Activities. Pearson Chi-square P-value (2 sided) has .859, since the P-value lies more than 0.05 (5%), we cannot reject the null hypothesis, and we can conclude that there is no significant association between sources of funds used for initial investment of different business activities.

Table -11
Chi-Square Test Results on sources of funds used for initial investment and type of business firm

Particulars	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	52.217	8	.000
Likelihood Ratio	12.707	8	.122
Linear-by-Linear Association	1.628	1	.202
N of Valid Cases	50		

The above table exhibits the chi-square results on sources of funds used for initial investment and type of business firm. Pearson Chi-square P-value (2 sided) has 0.000, since the P-value is less than 0.05 (5%), we reject the null hypothesis, and we can conclude that there is significant association between sources of funds used for initial investment and type of business firm

Suggestions

MSMEs could take orientations from banks and other consulting firms to understand the variety of financing options available to MSMEs. MSMEs should establish efficient lines of communication with commercial banks and government agencies to have knowledge about Government schemes and policies of commercial banks. MSMEs should explore various other sources of finance like NBFCs, private investor, angel investors and venture capital instead of using personal funds, loan from family/friends. MSMEs should maintain proper books of accounts, which helps the government and banks to evaluate the viability of the enterprises, so that they can avail finance from government schemes or banks.

For Government and Ministry

Strong finding of the study is the lack of awareness among MSMEs on the financial schemes of the Government, hence special awareness programs and awareness drives should be initiated by the government. Though the policies of the government are encouraging for MSMEs, it is not reaching the MSM entrepreneurs effectively; in this direction government should make efforts to reach its policies to entrepreneurs. Special consultation centers in industrial areas could be established. Awareness should be created on the services of business development institutions like National Small Industrial Corporation of India (NSIC), Technology Business Incubation (TBI), Council of Scientific Research (CSIR), Indian Institute of Technology (IIT), National

Research and Development Corporation (NRDC), National Institute Design (NID) and other institutions. Government may need to create transparent and less cumbersome ways of financing MSMEs, since the study reveals lack of transparency in lending to MSMEs. A designated cell could be linked to DIC to collect and analyze relevant data in assessing the performance of assisted units.

For Bankers

Strong finding of the study is that there is a time lag between application of loan and disbursement of loan, hence banks could simplify the procedure of sanctioning of the loan. The banks should collect feedback from the MSM entrepreneurs, in order to understand and cater to the financial needs of MSMEs. The banks should educate the bank officials at the ground level regarding specially designed MSME loan and subsidized Government loan for MSMEs, since the study reveals that MSMEs are unaware about these schemes.

Conclusion:

MSMEs play an important and vibrant role in stimulating economic growth and fostering balanced regional development, rural and backward area industrialization by growing regional imbalances and ensuring a fair distribution of national income. In India, the MSME sector continues to show remarkable resilience in the face of trialing global and domestic economic conditions. Although it has emerged as a highly vibrant and competitive economy market, it has played a crucial role in providing large job opportunities at a comparatively lower cost of capital compared to large industry. Realizing its capacity and significance in economic development and its tremendous contribution to the country's socio-economic development, the Government has formulated policies and acts for the sector's progress by invoking a slogan of 'make in India' 'start up' have been launched to promote and develop MSMEs.

Despite several government policy initiatives and RBI guidance, MSMEs still face financial, marketing, technology and skilled workforce problems. The critical problem for business growth and development is amongst finance. There still exist demand and supply mismatch in the availability of finance. Adequate and timely availability of finance is the major constraint for MSMEs due to lack of awareness about the government policies and commercial bank loan for MSMEs. Government and commercial banks should understand the need of finance and other services to MSMEs. RBI and Government have to take steps in formulation and implementation of policies towards development of MSMEs.

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