
A COMPARATIVE ANALYSIS OF MSME FINANCE IN INDIA

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ABSTRACT

The Micro, Small and Medium Enterprises (MSME) sector is one of the dynamic sectors of the Indian economy in terms of productivity, contribution to GDP, and employment. Their role in nurturing entrepreneurship through innovations and generating employment opportunities has been commendable. Access to financial resources has been a catalyst as well as a challenge to the growth of this sector both in the short-term and long-term. The purpose of the study is to describe the sources of finance available for MSMEs in India and to comparatively analyze the trend in the provision of credit by the Scheduled Commercial Banks (SCB) and Non-Banking Financial Companies (NBFC) to the MSMEs. The findings of the study provide evidence that in India MSMEs look at the informal sources of finance predominantly compared to the formal financial institutions. Among the formal sources of finance, the NBFCs have outperformed the SCBs.

KEYWORDS: *Nbfc, Msme, Scheduled Commercial Banks, Formal Sources, Unorganized Sector.*

1. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) form a fundamental sector of the Indian economy, fostering growth, employment, and business innovations. According to the Report of Expert Committee on MSMEs, RBI, June 2019, the sector contributes about 45 percent to manufacturing output, more than 40 percent of exports, over 28 percent of the GDP and creates employment for about 111 million people, which in terms of volume stands next to the agricultural sector. The share of MSME in All India GDP was 30.27 percent per the Central Statistics Office (CSO) report of 2018-19, indicating that this heterogeneous sector has vast growth potential and serves as a catalyst for creating a wide range of products catering to domestic as well as global markets.

• **National Sample Survey (NSS) 73rd Round Survey 2015-16 on MSMEs**

As per the NSS 73rd round conducted by NSSO, Ministry of Statistics and Programme Implementation during 2015-16, there were 633.88 lakh unincorporated non-agricultural MSMEs in the country engaged in different economic activities (Annual Report of MSME,

2020-21).

TABLE 1 DISTRIBUTION OF MSMEs BASED ON CATEGORY AND AREA OF OPERATION (IN LAKHS)

Category Area	Micro	Small	Medium	Total	Percentage Share
Rural	324.09	0.78	0.01	324.88	51
Urban	306.43	2.53	0.04	309.00	49
All	630.52	3.31	0.05	633.88	100

Source: *Annual Report of MSME, 2018-19, Ministry of MSME, Government of India.*

Table 1 shows the distribution of MSMEs based on their category and area of operation. From the table, it is evident that more than 99 percent of the total estimated number of MSMEs was in the micro sector. 51 percent of the enterprises under MSME were in rural areas compared to urban areas with 49 percent. Concerning employment opportunities provided by the sectors of MSMEs, the micro sector accounted for 97 percent, the small sector with 2.88 percent, and the medium sector with 0.16 percent of total employment, respectively. This sector has motivated entrepreneurs in large numbers due to the ease of doing business and an expanding environment in the past decades in India.

Total registered MSMEs accounted for 74,17,612 Micro Enterprises (88.62%), 9,17,096 Small Enterprises (10.96%) and 35,739 (0.43%) Medium Enterprises as per the report of the Registration of MSMEs in India, Udyog Aadhaar Memorandum, December 2019. The majority of the enterprises of this sector were found to be unorganized and were not registered owing to the challenges of registration and the nature of the household type of enterprises. This does not give them morale during times of crisis as they do not get the benefits of various schemes and support from the government.

- **Government's Impetus to the Sector**

The role of the government of India in promoting the MSME sector is noteworthy mentioning. The government of India enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 to develop entrepreneurship and address various challenges of the MSME sector. This act provided the legal framework for identifying the concept of "enterprise", which includes entities both in manufacturing and service sectors and has categorized the enterprises into three tiers viz., Micro, Small and Medium. Several statutory and non-statutory bodies like the Khadi and Village Industries Commission (KVIC), Coir Board, National Small Industries Corporation (NSIC), National Institute for Micro, Small and Medium Enterprises (NIMSME), and Mahatma Gandhi Institute for Rural Industrialization (MGIRI) are created by the Ministry of MSME to promote growth and development of this sector.

- **Financial Resources – The Lifeline of MSMEs**

Financial resources to the MSMEs have remained a major factor contributing to the success or failure of the enterprise. The factors such as dependence on informal sources of finance, high cost of credit, lack of reliable credit information, lack of access to institutional finance rates, the problem of delayed payments by large buyers to the MSMEs have hindered their growth in the long run. In India, access to financial resources by MSME entrepreneurs has been predominantly by "self-finance" or "informal sources" Formal sources of finance remained a minor contributor to this sector owing to the regularities, difficulty of access to timely credit, and the large scale unorganized nature of

the sector. The performance of banks in MSME lending has also been inadequate in India despite the measure of including MSMEs in the priority-sector lending. The government of India is also actively engaged in boosting financial resources to the MSME sector by the introduction of timely schemes, programs, and incentives."The International Finance Corporation (IFC Report 2018) [1] revealed that formal sources of finance cater to only 16 percent of the total MSME debt financing - the rest is either self-financed or availed from informal sources - down from 22% in 2012".

The significance of the MSME sector is therefore a vital force to the economy and there is a pressing need to visit the key challenges and requirements of this sector to tap its potential to ensure inclusive and sustained growth. In this backdrop, the present study is a novel attempt to examine the accessibility of financial resources to the MSME sector and compare the credit provided by the Scheduled Commercial Banks (SCB) and Non-Banking Financial Companies (NBFC).

2. REVIEW OF LITERATURE

Earlier studies reviewed to identify the need for the study are presented in this section. Ghatak (2010) [2] discussed MSMEs and their role in economic growth and employment generation in the Indian context. Further, this paper highlighted how the policy environment for promoting MSMEs changed from 'protectionism' during the pre-1990s to 'export orientation' during the post-1990s. Access to credit plays an important role for enterprises to scale up the operation and participate in larger value (supply) chains of activities which may help them to grow in the long run. Furthermore, access to formal credit played an important role in influencing the decision of entrepreneurs to become a formal entity (De Paula and Scheinkman 2010 [3]; Araujo and Rodrigues, 2016 [4]).

Singh and Wasdani (2016) [5] found that the source of funding utilized by an MSME depends on its current stage in the enterprise life cycle, i.e., start-up, survival, growth, and sustenance. Patnaik, Satpathy and Rachayeeta (2016) [6] identified the various challenges faced by MSME were issues as a credit facility, issues of equity capital, issues of infrastructure, issues of government support, issues related to technology, and issues related to skill gap after critical examination by visiting various MSME units.

Banerjee, Breza, Duflo and Kinnan (2017) [7] in their study suggested that access to formal credit by the MSME sector can have long-lasting positive impacts, but it would take some time to accumulate these credit benefits. Behera and Wahi (2018) [8] assessed the recent credit dynamics and export performance of MSMEs in India. The study found that the microcredit to MSMEs, including loans by banks and NBFCs, showed a particularly healthy rate of growth in recent quarters. Further, MSME exports appeared to be affected more by GST implementation vis-à-vis demonetization.

Devi (2018) [9] emphasized the availability of the financial facility and sources of finance and finance accessing techniques to establish an enterprise for new and existing women MSME entrepreneurs. Sarma, Gupta and Colaco (2020) [10] studied the growth scenario of the MSMEs in India as well as evaluated the effects it had on rural India. The study found that MSMEs contributed significantly to skill acquisition, entrepreneurial development, and an increasingly diverse workforce specifically in the rural areas.

NEED FOR THE STUDY

The recent literature surveyed revealed that studies have analyzed the MSMEs using various parameters. The sources of finance are considered as an engine of growth for the MSMEs and therefore it is necessary to periodically review the sources, their accessibility,

and performance for policymakers, researchers, and entrepreneurs. This ensures the removal of constraints of financial inclusion to MSMEs, and also facilitates shifting the bulk of enterprises from unorganized to the organized sector. In this regard, the study identified the need to comparatively examine the credit provided by the major financial institutions in India, which would enable policymakers to look at the specific reasons for the differences in credit provided by the financial institutions and thereby enhance financial inclusion in the sector.

3. OBJECTIVES

The objectives of the study are:

- To describe the financial resources available to the MSME sector in India.
- To comparatively analyze the credit provided by the Scheduled Commercial Banks (SCB) and Non-Banking Financial Companies (NBFC) to the MSME sector.

4. METHODOLOGY

Secondary data from sources such as the Ministry of MSME and the RBI database on "Statistics of the Indian Economy" and "Time Series Publication of Statistical Tables relating to Banks in India" were used to comparatively analyze the provision of credit by SCBs and NBFCs using the trend approach by calculating the Compound Annual Growth Rate (CAGR) for the period 2015 to 2019.

5. FINDINGS AND DISCUSSION

The findings and observations regarding the financial resources to MSMEs are discussed in this section of the study.

• Financial Sources to the MSMEs

Given the deep penetration of MSMEs [11] across India, the government, RBI, SEBI, and other agencies have come forward to create institutions to cater to the specific financial needs of this sector. In the last few decades, institutional financing has been induced during all budgets both by the Central Government and State Governments to enable ease of access to finance and promote more entrepreneurs in the MSME sector. Major schemes by the Ministry of MSME to provide financial assistance include Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship (ASPIRE); Scheme of Fund for Regeneration of Traditional Industries (SFURTI); Credit Linked Capital Subsidy Technology Up gradation Scheme (CLCS-TUS); Market Development Assistance to Khadi Artisans (MDA); MSME - Micro and Small Enterprise Cluster Development Programme (MSE-CDP); National SCST Hub; and Coir Udyami Yojana.

• U K Sinha Committee Recommendations 2019 to boost institutional credit to MSME

An Expert Committee was constituted under the Chairmanship of Shri U K Sinha in 2018 by the RBI to propose long-term economic and financial solutions to the MSME. The significant recommendations of the committee included (i) the creation of a distressed asset fund of Rs. 5,000 crores for providing relief to small business hurt by demonetization, GST and the current ongoing liquidity crunch, (ii) expanding the role of SIDBI (the apex body to develop MSME) to deepen the credit markets in remote regions, (iii) greater adoption of technology to solve problems of MSME sector and forming a government-sponsored Fund of Funds of Rs. 10,000 crores to support venture capital and private equity firms in the sector.

- **Informal Sources – The Bane of the Sector**

The availability of timely, low-cost, and adequate finance with greater repayment modes and methods motivates the entrepreneurs in the MSME sector in the long run. In India, for decades, it has been observed that the "household and micro nature" of the MSME enterprises has created challenges in access to finance from institutional sources. The perspective of the entrepreneur is that of the immediate availability of funds for day-to-day operations and management of debt already procured. This factor has induced large-scale penetration of informal sources of finance to this sector. The 4th All India survey of MSMEs states that close to 90 percent of MSMEs are dependent on informal sources; RBI (2016). The informal sources of credit include family, friends, and relatives, while institutional sources comprise moneylenders, chit funds, crowd funding, angel investors. The informal financial sources have penetrated so deep into the MSME sector owing to the fact that they do not involve processing factors such as paperwork, the guarantee of security, long waiting periods, and fixed tenure and interests. [12]

- **Formal Sources – The Boon to the Sector**

With regard to the formal sources, the SCBs serve as a major provider of finance to the MSME sector, with the credit flow to the MSME sector being treated as priority sector lending. RRBs and cooperative banks with their vision of rural development form the next level approach by the MSMEs for credit facilities.

The NBFCs have been increasingly turning to MSMEs as an avenue for growth based on the higher margins of the sector since their emergence in the 1990s. Today MSMEs are willing to pay higher interest rates to the NBFCs because of the quick and efficient delivery of loans. NBFCs also have tailor-made products to suit entrepreneurs of various activities and their marketing campaigns have made them very close to this sector than the banks.

Government institutions such as SIDBI and SFCs also contribute significantly to the financial needs of MSMEs by enabling the operation of various government schemes to promote this sector. SIDBI was set up in 1990 as an apex body for tiny and small industries. The recent initiatives by SIDBI, such as the PSBLoansIn59Minutes, publications such as MSME Pulse, Micro Finance Pulse, MSME Sentiments Index, etc., have induced new ways of lending to reach the vast and unreached enterprises in the MSME sector. SIDBI, SFCs, and NBFCs cater to the long term financial requirements of MSMEs, while the scheduled commercial banks, RRBs and Cooperative Banks cater to the working capital requirements of the sector.

Figure 1 presents the classification of various financial sources to the MSMEs in India.

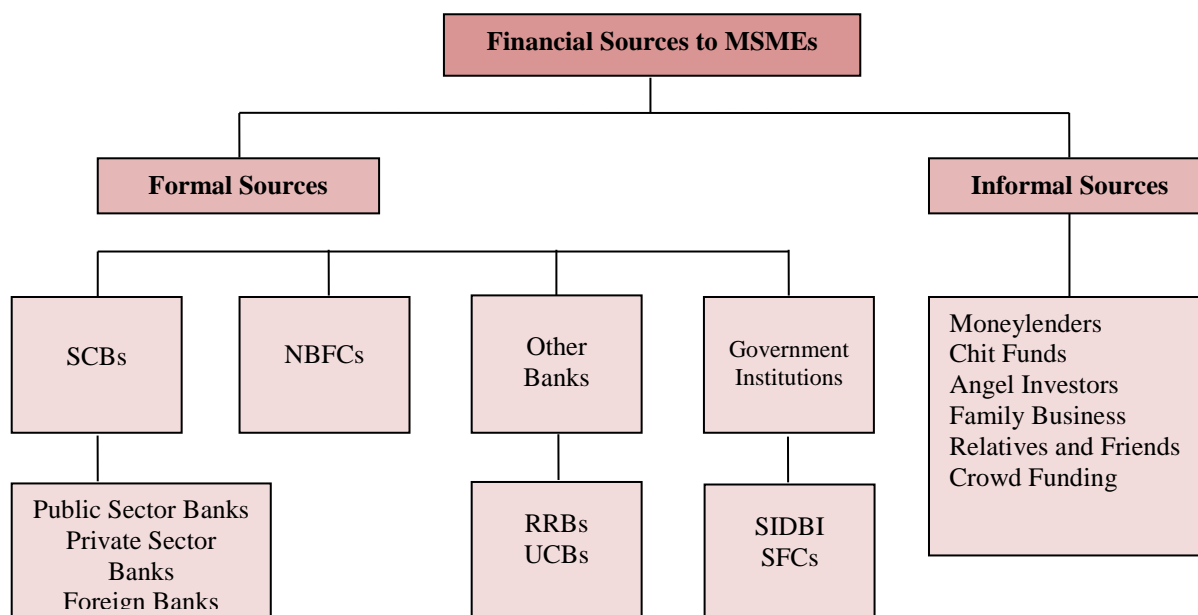


Fig 1. Financial Sources to MSMEs

Provision of credit by SCBs and NBFCs: A Comparative Analysis

In the formal source of credit to the MSMEs in India, the SCBs and the NBFCs have come a long way in providing sustained credit over the last decade. The institutions lending to MSMEs in India regulated by Reserve Bank include SCBs (Public Sector Banks, Private Sector Banks including Small Finance Banks, Foreign Banks, Co-operative Banks and Regional Rural Banks) and NBFCs including NBFC- MFIs. In addition to this, the Securities and Exchange Board of India (SEBI) regulates the institutions engaged in providing or mediating capital to MSMEs such as SME Exchanges, Angel Investors, Venture Capital and Private Equity (Report of the Expert Committee on Micro, Small and Medium Enterprises, RBI; 2019) The provision of credit by the two major institutional forms via; SCBs and NBFCs has been comparatively analyzed in this section. Table 2 provides the annual provision of credit by the SCBs to the MSMEs based on their category of enterprise.

- Credit by the Scheduled Commercial Banks (SCB)

TABLE 2 PROVISION OF CREDIT BY SCBS BASED ON CATEGORY OF ENTERPRISE (IN RS. CRORES)

Year	Micro and Small	Medium	Total
2015	380028	124536	504564
2016	371467	114821	486288
2017	369731	104806	474537
2018	372999	103680	476679
2019	375505	106395	481900
CAGR**	-0.24	-3.09	-0.91

Source: Reserve Bank of India, ** Estimated by the Authors

It can be seen that from 2015 to 2019, the amount of credit provided to the "Micro and

Small" and "Medium" categories of enterprises by SCBs has declined. This can be attributed to the fact that SCBs have not yet penetrated the grass root levels, due to the presence of large scale unorganized sector, poor banking network, high cost-to-serve MSMEs in case of defaulters, lack of information of formal credit among the MSMEs, and high risk in case of Non-Performing Assets (NPA). The CAGR of the provision of credit from 2015 to 2019 to the "Micro and Small" and "Medium" enterprises was found to be -0.24 percent and -3.09 percent, respectively. This implies a decline in the provision of credit to the MSME by 0.24 percent and 3.09 percent. The total provision of credit to MSMEs by SCBs also declined by -0.91 percent, which implies that the SCBs were not facilitating inclusive and the required credit to the MSME sector, despite the fact that lending to this sector was allowed to be treated as priority sector lending by the Government of India. In addition, the emergence of NBFCs and even the introduction of Small Finance Banks by RBI have led to the shift in approach by the enterprises towards NBFCs and Small Finance Banks for credit in recent years.

- **Credit by the Non-Banking Financial Companies (NBFC)**

NBFCs have been significant credit providers to MSMEs, especially at the grass-root levels. This is attributed to the established regional players, who have developed an in-depth knowledge of micro markets and low-cost distribution. They provide access to credit to MSMEs beyond the tier I cities while focusing on credit underwriting tailored to informal and smaller MSMEs (The Economic Times, July 2019). Table 3 shows the provision of credit by NBFCs to MSME enterprises based on their category. [13]

TABLE 3 PROVISION OF CREDIT BY NBFCs BASED ON CATEGORY OF ENTERPRISE (IN RS. CRORES)

Year	Micro and Small	Medium	Total
2016	32208	15206	47414
2017	48133	17645	65778
2018	64455	28311	92766
2019	54597	22979	77576
CAGR**	14.10	10.87	13.09

Source: Reserve Bank of India, ** Estimated by the Authors

It is evident from the RBI report on financial institutions that the provision of credit to the MSME sector by the NBFCs has increased considerably from 2016 to 2019. The credit provided to the "Micro and Small" enterprises has increased from Rs. 32,208 crores in 2016 to Rs. 54,597 crores during 2019. The estimated CAGR was found to be 14.10 percent year-on-year, implying the fact that NBFCs significantly have taken measures to penetrate the lower segment of enterprises. The CAGR for credit provided to "Medium" enterprises indicated an increase in the provision of credit by NBFCs with 10.87 percent annually. The total credit provided to the MSME from 2016 to 2019 also increased from Rs. 47,414 crores to Rs. 77,576 crores with CAGR being 13.09 percent. This reveals the fact that NBFCs have paved the way for increased liquidity to the MSME sector by way of tailored financial products and innovative marketing campaigns. It is evident from the comparative analysis that the NBFCs outperformed the SCBs in the provision of credit to MSMEs in India.

6. CONCLUSION

The MSME sector is considered the "growth engine" for driving the Indian economy in today's global competitive scenario. Financial needs serve as the fulcrum point for the efficient working of the MSME sector. The findings of the study provide evidence that in India MSMEs look at the informal sources of finance predominantly compared to the formal financial institutions. Among the formal sources of finance, the NBFCs have outperformed the SCBs, despite their long-term presence. The NBFCs have emerged and created a niche in the short period of penetration with an in-depth micro-level understanding of the need and functioning of the enterprises in the MSME sector. The SCBs must relook their financing strategies to the MSME sector and make provisions of tailor-made products and innovative marketing to reach the unreached in this sector. The government also has to enable the reach of various financial schemes to the appropriate and needy MSMEs by way of direct channels to promote financial inclusion in this sector.

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