ARE MSMES GOOD ASSETS? - A BANKERS' PERSPECTIVE

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ABSTRACT

The study has attempted to address the predicaments in the lending scenario to Micro Small and Medium Entrepreneurs. More credit flow to MSMEs is needed but commercial banks reportedly shy away from lending to the sector due to various issues. In light of the covid-19 relief economic packages announced by government of India for the sector, how to ensure that MSMEs are welcomed by banks. The aim of the research is to examine the influential factors that determine the difficulties experienced in lending to MSMEs by banks. This is the first study in the state of Assam in India that compares between MSMEs that have availed assistance of District Industries Centres and MSMEs that have not in getting finance from banks. Information asymmetry, high average cost on loans, hassles with repayment, difficulty in recovery and scarcity of trained manpower are factors that are found to deter banks from lending to the sector.

Key words: MSME funding, Banks, SME finance, Bank loans, Entrepreneurial finance

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1. INTRODUCTION

Micro, Small and Medium enterprises are known by different names and definitions over the world (Small and Medium sized Enterprises in US and Europe). Known as MSMEs (Micro, Small and Medium Enterprises) in India, the sector has been an area of great interest for many researchers. According to the Twelfth Five Year Plan in India, credit is a crucial input for promoting the growth of the MSME Sector, particularly the Micro and Small Enterprise (MSE) sector, in view of its limited access to alternative sources of finance. Formal finance is

imperative to the growth of MSMEs because of the shortfalls and risks associated with informal financing. However, reports suggest that various schemes by government have barely managed to uplift the sector (Sharma, 2020; Vijayasathy, 2020; “Government's Guarantee-Free Loan Scheme”, 2020) and also banks are seen struggling to meet the target (Unnikrishnan, 2020; Shankar, 2020; Soni, 2020). Under such circumstances it is essential to understand what is stopping or hindering banks from selecting or promoting MSME borrowers. The study, therefore, aims to find out the problematic factors associated with bank lending to MSMEs as perceived by the bankers. The key contribution made to the body of knowledge by the study are, this is the first study in Assam that compares the commercial bank borrowing experience between MSMEs that have borrowed from banks with the assistance of DICs [1] and MSMEs that have borrowed without the assistance of DICs.

2. REVIEW OF LITERATURE

Mukherjee (2018) feels though the MSME sector in India is currently at a global level in terms of competition and quality, government intervention is important to help the sector to raise finance, minimize costs, assist in market capturing, development and expansion of infrastructure, etc. Cull et. al. (2006) was one of the researchers who laid the groundwork of the modern theory that suggested a causal relationship between financial development and the viability of MSMEs. Sambrani and Pol (2016) noted that rural entrepreneurs preferred to borrow from informal sources such as Zamindars (landlords) or local rural banks because of their lack of financial knowledge or training. Moreen et al. (2016) found that low levels of financial literacy among micro-entrepreneurs expose them to economic shocks as they depend on informal sources. It has also been observed that although overall credit to the sector by banks has improved, it has still a long way to go to meet the total demand of the sector (Kumar et. al., 2016). Berger and Udell (2006) have proposed that lending technologies are the key conduit through which government policies and national financial structures affect credit availability and that lending infrastructures have important effects on SME credit availability. An analysis of the Eleventh Five Year Plan by Alamelu et. al. (2011) revealed inadequate access to credit as one of the core challenges of. Similarly, lack of access to proper finance has been found to negatively affect growth of MSMEs by numerous studies [Tambunan (2011), Coad and Tamvada (2012) and Paulet et. al (2014)].

Sohns et. al. (2017) said that “the mere existence of a bank in the village is not sufficient for starting a micro-enterprise and it is important that the bank provides affordable microloans to the enterprises”. Singh (2006) from his study in Manipur observed that banks and financial institutions have financed the SSIs indiscriminately to achieve their targets either under pressure or with over-enthusiasm. Kumar, Batra & Sharma (2009) from their analysis of reports of Ministry of MSMEs reasoned how due to their weak financial strength, unclear information of business plans and accounting statements, the creditworthiness of MSMEs cannot be ascertained and as such are considered as high-risk borrowers by investors and banks. Moon (2012) based her study on secondary sources of data like books, journals, articles, reports, etc, stated that the inherent weakness of small enterprises and lack of transparency in the financial data make the process of rating difficult for MSMEs.

From the review, it has been observed that a well-developed MSME sector can generally be linked to well-structured lending institutions. However, banks shy away from lending to the sector because of information asymmetry, lack of credit rating, lack of collateral assets, and smaller size of loans.

3. RESEARCH GAP

The majority of the studies have focused on the problems of MSMEs and the bankers' viewpoint has not been assessed adequately. Assam as a study area for analyzing MSME lending has not been researched extensively. The study, therefore, attempted to examine the influential factors that determine the difficulties experienced in lending to MSMEs by banks in Assam.

4. METHODOLOGY

The study is based on primary data collected from commercial banks, co-operative banks, and regional rural banks operating in the state of Assam in the three districts of Assam with the highest concentration of MSMEs. A total of 172 banks were included for the study, out of which 92 banks were from Kamrup, 54 from Dibrugarh, and 26 from Nagaon. The bankers were asked to respond to the statements by assigning scores from 1 to 5 according to their relevance. The responses were assigned scores using the following formula,

$$[N(R_1) \times (1) + N(R_2) \times (2) + N(R_3) \times 3 + N(R_4) \times 4 + N(R_5) \times 5] / N(R_0) \quad (1)$$

$N(R_1)$ = No. of respondents selecting "Highly Unimportant/ Highly Disagree", $N(R_2)$ = No. of respondents selecting "Unimportant/ Disagree", $N(R_3)$ = No. of respondents selecting "Neutral/ Undecided", $N(R_4)$ = No. of respondents selecting "Important/ Agree", $N(R_5)$ = No. of respondents selecting "Highly Important/ Highly Agree", $N(R_0)$ = Total no. of respondents

Further, the cut off score for a 5-point Likert scale has been calculated in the following manner:

$$(\text{Maximum} - \text{Minimum}) / \text{Group} = (5-1)/5 = 0.8.$$

Thus the verbal description has been converted into an interval of means of equal difference (0.80 in case of a 5-point scale) in order to give interpretations for the weighted mean. 1 to 1.80 (Highly Unimportant/ Highly Disagree), 1.81 to 2.60 (Unimportant/ Disagree), 2.61 to 3.40 (Neutral/ Undecided), 3.41 to 4.20 (Important/ Agree), 4.21 to 5 (Highly Important/ Highly Agree).

5. ANALYSIS AND DISCUSSIONS

The primary data was collected and the results collected and summarised as follows:

5.1. Factors that Influence the Selection of Lending Proposals from MSMEs

After calculating the aggregate scores on factors influencing the selection of lending proposals as explained in the methodology section, the significant factors were identified as follows:

Table 1 Aggregate scores on factors influencing the selection of lending proposals

Statement	Mean Score[2]
Good quality business project/plan	4.11*
Size of the unit	3.85*
Borrower pledging more collateral compared to other applicants	3.79*
Third-Party Guarantor	3.65*
Proper financial records	3.55*
Credit score as calculated by the bank	3.55*
Age of the unit	3.51*
NPA's associated with the sector	3.51*
Long and close relationship with the lending bank	3.42*
Proper Documents	3.41*
Reference by DIC	3.41*
Good social interaction/relationship with loan officer	3.4*
Size of loan requests	3.4*

Source: Data collection

5.2. Difficulties Associated with MSME Borrowers as Perceived by Bankers

After calculating the aggregate scores of difficulty in lending to MSME borrowers as perceived by bankers, we arrive at the following significant factors:

Table 2 Difficulty scores associated with MSME borrowers

Statements	Mean Score[3]
MSMEs which are not existing bank customers are comparatively riskier	4.06*
Average cost on loans made to MSMEs are high	3.9*
Most of the MSME borrowers create a lot of hassles with repayment	3.68*
In case of default it is comparatively more difficult to recover a loan from MSME	3.44*
There is a scarcity of adequately trained manpower to handle MSME clients	3.41*

Source: Data collection

It is found that the variables which are perceived by bankers as difficult (highlighted* in Table 2) are MSMEs which are not existing bank customers, high average cost on loans made to MSMEs, hassles with repayment by MSME borrowers, comparatively more difficulty in recovering a loan from MSME in case of default and scarcity of adequately trained manpower to handle MSME clients.

5.3. Difficulties Experienced and Type of Bank

A Kruskal-Wallis test has been conducted to find out whether the average individual difficulty scores were similar across the various types of banks, i.e., public, private, co-operative, or RRB. The significant factor was found to be “The MSMEs referred by DIC are usually not very credible (p-value .037).

Table 3 Mean of Difficulty score for “MSME referrals by DIC” for the type of bank

Bank Organization	Mean
Public	3.08
RRB	2.47
Private	2.84
Co-operative	4.5

Source: Data collection

Pairwise Comparisons of Bank Organisation

Each node shows the sample average rank of Bank Organisation.

Sample1-Sample2	Test Statistic	Std. Error	Std. Test Statistic	Sig.	Adj.Sig.
RRB-Private	16.611	16.082	1.033	.302	1.000
RRB-Public	25.319	12.668	1.999	.046	.274
RRB-Co-operative	89.900	35.050	2.565	.010	.062
Private-Public	8.709	11.404	.764	.445	1.000
Private-Co-operative	-73.289	34.614	-2.117	.034	.205
Public-Co-operative	-64.581	33.165	-1.947	.052	.309

Each row tests the null hypothesis that the Sample 1 and Sample 2 distributions are the same. Asymptotic significances (2-sided tests) are displayed. The significance level is .05.

Figure 1 Dunn's Post hoc analysis

A Dunn post-hoc (Figure 1) reveals significant differences between private and co-operative, RRB and co-operative, public and co-operative, and RRB and public. From Table 3, it is seen that co-operative banks faced the highest difficulty associated with MSME referrals by DIC followed by public sector banks.

5.4. Bank Requirements and Perceived difficulty Faced by Banks

A high factor score would indicate that to obtain a loan from the bank, the borrower will have to provide comparatively more documentations. A high difficulty score would indicate that the bank perceives that there are comparatively more problems in lending to the sector. Wilcoxon signed-rank test has been used as an alternate to paired sample test to test the relationship as normality could not be assumed and the sample size is not adequately large.

Table 4 Wilcoxon signed-rank test between factor score and difficulty score

Aggregate score assigned to each factor - Aggregate score assigned to each problem	
Asymp. Sig. (2-tailed)	.031
a. Wilcoxon Signed Ranks Test	
b. Based on negative ranks.	

Source: Data collection

From the results in Table 4, we can see that the null hypothesis is rejected, indicating that there is a significant difference among average factor score and average difficulty scores. Wilcoxon signed ranks also reveals that in 114 cases (66%) average factors were higher than average difficulties.

6. CONCLUSION

Information asymmetry seems to be a major obstacle hindering banks' lending to MSMEs. A DIC referral is observed to be perceived as important by banks. However data from DIC office in Guwahati, Assam revealed that the rate of rejection of MSME borrowers referred by DIC under PMEGP[4] scheme in Assam was 63.21% in 2016-17, 76.43% in 2017-18 and 78.26% in 2018-19. In the case of MSME borrowers which were referred by DIC, co-operative banks faced the highest difficulty in disbursing loans. Despite being one of the major contributors to MSME credit, co-operative banks are not covered under Credit Guarantee Scheme[5] by the government. This is a major issue behind co-operatives facing more difficulties with the sector (Thaver, 2020). Veiga et. al. (2019) highlighted how a guarantee scheme benefits in two ways, reducing the risk premium charged by the banks and helping micro units qualify for bank loans. It was seen that in 66% of the cases average factors were higher than average difficulties. It implies that banks' requirements considered in the sanction of MSME loans were higher compared to perceived difficulties with the sector. Banks are therefore observed to be adopting a pre-emptive strategy in providing credit to MSME sector.

A credit rating, in theory, addresses the information asymmetry between the MSME borrower and the lender. However, adoption of ratings continues to be low and most MSMEs being exempted from GST, are clear of the tax network. An online portal called MSME data bank has been launched by the Ministry of MSME where MSMEs can log in and update information about the enterprise. Out of close to 2 crore registered units, only 1,61,181 had registered in the portal till 2019. A one-stop online portal with information about all available schemes and related information such as tax exemption etc. will encourage more MSMEs to come into the fray. This recommendation is echoed by Expert Committee (Report of the Expert Committee on Micro, Small and Medium Enterprises, 2019) report by RBI under the Chairmanship of Shri U. K. Sinha as an outcome of which MSMEs in India can now be

registered through Udyam portal under the Ministry of MSMEs which will require mandatory requirement to file GST registration number from April, 2021. The problem of high average cost on MSME loans as well as lack of trained manpower can be addressed through more MSME specialised branches or a MSME specialised counters at every major branches. Kärnä (2019) in a study on a public bank in Sweden and found that larger number of local bank offices increases the local credit supply, and decreases the credit constraints of nearby SMEs. An innovative cost minimising strategy is being adopted in China by a public private partnership (PPP) so that the agency cost between SMEs and the government reaches zero (Luo et. al. 2019). Such branches or counters can minimise time and cost of loan process. A high rejection rate decreases the trust of banks towards DICs. The DIC must be held credible and responsible to screen applicants for minimum preliminary requirements (35% of rejections had non-viable projects and 7% did not possess requisite documents!) before referring to banks.

KEYNOTES

- 1] District Industries Centres were the nodal agency for registration of MSMEs in India
- 2] Calculation of mean score has been explained in Methodology section through (1)
- 3] Calculation of mean score has been explained in Methodology section through (1)
- 4] Prime Minister's Employment Generation Programme (PMEGP) is a credit linked subsidy programme by Government of India mainly through District Industries Centres.
- 5] The Credit Guarantee is administered by Government of India to safeguard lending institutions providing credit to MSMEs.

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