SME FINANCE

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ABSTRACT

SME finance is the funding of small and medium-sized enterprises, and represents a major function of the general business finance market – in which capital for different types of firms are supplied, acquired, and costed or priced. Capital is supplied through the business finance market in the form of bank loans and overdrafts; leasing and hire-purchase arrangements; equity/corporate bond issues; venture capital or private equity; asset-based finance such as factoring and invoice discounting, and government funding in the form of grants or loans. In this research paper focus has been laid down on why is strengthening SME financing in India important to reduce debt gap, what are the Alternate lending platforms for fixing India's financial inclusion problem, becoming enablers for SME funding and the various challenges faced, alternate lending platforms to the rescue, the benefits of financial inclusion for India's MSMEs, innovative early stage financing for SMEs in India and the various MSME finance challenges.

KEY WORDS: Entrepreneurship, social mobility.

Cite this Article: Monica Gupta, Dr. Shashi Shekhar and Dr. Kavita Aggarwal, SME Finance. *Journal of Management*, 6(3), 2019, pp. 134-139.

<http://www.iaeme.com/jom/issues.asp?JType=JOM&VType=6&IType=3>

1. INTRODUCTION

Small scale businesses are a center of innovation, growth, and employment. In India, SMEs constitute 95% of all industrial units and employ 45% of the nation's total labor force. But, lack of growth of SMEs in India is seen as a serious hindrance to social mobility and poverty elimination. The constraints to firm growth include lack of access to efficient and adequately structured financial services, regulatory and legal constraints and limited access to (well-trained) employees as well as lack of infrastructure.

Figure 1 Contribution of SME

2. LITERATURE REVIEW

Equity finance is that capital invested in the firm without a specific repayment date, where the supplier of the equity capital is effectively investing in the business” (Ou & Haynes, 2006, p. 156). Capital can be raised either internally or externally.

There are two situations when SMEs pursue financing from equity capital sources in order to meet expansion needs. The first case is when SMEs face financial distress coupled with a lack of alternative sources of finance. The second is when cash outflows exceed the cash inflows generated from regular sources. Ou and Haynes (2006)

Venture capital is that form of financing in which funds are raised from investors and redeployed by investing in high-risk informationally opaque firms which for the most part are young or start-up firms (Potter & Porto, 2007).

Hellmann (1998) explained that the situation in which a company has a sufficiently large incentive for active monitoring takes place only when the venture capitalist has a concentrated stake invested in that company

3. OBJECTIVE OF THE STUDY

The objective of the study is to see that why is it important to strengthen SME financing in India to reduce debt gap, What are the Alternate lending platforms for fixing India's financial inclusion problem, how to become enablers for SME funding and the various challenges faced, what are the various Alternate lending platforms to the rescue, what are the benefits of financial inclusion for India's MSMEs, to study the Innovative Early Stage Financing for SMEs in India and also study the various MSME Financing Opportunities and Challenges.

4. METHODS OF DATA COLLECTION

PRIMARY DATA: Are those which are collected a fresh and for the first time and thus happen to be original in character and known as Primary data.

SECONDARY DATA: Are those which have been collected by someone else and which have already been passed through the statistical process are known as Secondary data.

5. TYPE OF RESEARCH USED

The research will be conducted by means of descriptive research in which main data is taken from the internet and other journals or books. I.e. mainly secondary data will be used. These are already available i.e. they refer to the data which have already been collected and analyzed.

5.1. Strengthening of SME financing in India to reduce debt gap

India is a country with large population; SMEs are providing employment to a large group of people. SMEs have to look toward Government and many other financial institutions for financial assistance. There is also hindrance in the smooth functioning of the operations as there is inadequate supply of skilled people having degree in the relevant area. SMEs face many difficulties in raising finances from bank and financial institutions as they ask for the resources which are available with them including the infrastructure and the inventory. That is why the financial support needs to be strengthened in order to narrow down the debt gap on the nation. Although the banks are working hard to narrow down this debt gap but it is not making a considerable improvement in the economy. Smart entrepreneurs are tapping the potential of digital technology to make this large eco-system of start-ups based on futuristic ideas to flourish with ease of 2-way transactions, yet financial assistance is something that they urgently need. Of the 200 to 245 million and informal enterprises that need credit but can't avail it, more than 90% are MSMEs. Many of these MSMEs are likely to be Indian, given that India's 51 million MSMEs are facing a credit shortfall of an astonishing \$400 billion.

5.2. The challenge

The SMEs have limited access to finance because of two major reasons. First is the lack of a comprehensive credit score and the second is the difficult application filing process to get a loan. Banks and other lenders in India use the credit ratings to determine the creditworthiness of the applicant and most of the borrowers are not able to get the loan as they do not fulfill the minimum eligibility criteria.

5.3. Alternate lending platforms

The new and upcoming startups are taking help of technology-driven solution which are helping them to access credit very easily. NBFCs are already providing 16% of credit to MSMEs. The share of NBFCs in money lending are expected to raise to 22-23% by March 2022. The companies also use cutting-edge AI-driven algorithms to create a credit score for applicants. These credit scores are more holistic, provide a more detailed perspective, and are likely to be substantially more accurate than existing credit scores. The documents of Aadhaar and India Stack, deploying e-KYC are also being used to make application and approval a process that is quick and convenient.

5.4. The benefits of financial inclusion for India's MSMEs

According to a Morgan Stanley report, India's e-commerce market is set to hit \$200 billion by 2026, growing at 30% annually. In large part, this amazing growth is attributed to the greater adoption of technology by consumers in India's tier 2 and tier 3 cities. Further, a BCG report projected that by 2025, these cities will account for 45% of India's consumption.

Figure 2 Types of SMEs Loans

6. Innovative Early Stage Financing for SMEs in India

The World Bank has been working with the Small Industries Development Bank of India (SIDBI, the apex development bank for MSMEs), providing a credit line of \$500 million and supporting SIDBI's efforts in direct and indirect financing, leveraging SIDBI's role as a "market making" institution to boost private sector financing.

As of March 2017, the MSME project—one of the largest disbursing project in the India portfolio—has disbursed \$265.38 million in facilitating financing to MSME. Enterprises today are busy expanding product lines, updating technology, improving marketing campaigns and hiring new talent to add to their bottom line. Small business loans for MSME/SME provide a simple and low-cost way to borrow for commercial ventures. They help entrepreneurs to plug the sudden gaps in finance and cover a variety of expenses without delays.

Figure 3 MSME Lending

7. MSME FINANCE: CHALLENGES

The MSME (Micro, Small and Medium Enterprises) sector is called the backbone of the Indian economy. Also known as the SMEs, this sector is growing at a rapid pace and has, in fact, emerged as one of the fastest growing in the past decade. A report from the Ministry of Micro, Small and Medium Enterprises states that the sector accounts for 45% of manufacturing output, contributes more than 40% to exports and is responsible for 8% of India's GDP. These are impressive statistics, but the SMEs can do much more. India ranks low in World Bank's Ease of Doing Business Index and a lot of things can be done to help small businesses achieve their full potential. Here are some of the challenges that need to be addressed on a war footing for further development of SMEs and subsequently, improve their financing.

MSME Finance: Challenges	
Outdated Technology	Poor Customer knowledge
Lack of Skilled Labor	SME skills & Literacy
Access to Credit	Low Profitability
Government Policies	Lack of credit data
Priority Sector Lending	Lack of collateral or capital
Digital India	Poor business enablers

Figure 4 MSME Finance: Challenges

8. FINDINGS

- SMEs constitute 95% of all industrial units and employ 45% of the nation's total labor force.
- There is need for strengthening the financial support for the SMEs so as to narrow down the debt gap on the nation. Although various banks in India are making all the possible efforts in bridging this gap, however, their approach is restrictive only.
- The two biggest reasons for the financial exclusion of MSMEs were their lack of a comprehensive credit score, and the long-winded and difficult application process to get a loan.
- Today, several MSME founders and owners are leaning on these platforms for credit, with NBFCs already accounting for more than 16% of the credit extended to MSMEs. The share of lending by NBFCs to MSMEs is projected to rise to 22-23% by March 2022.
- Companies have managed to overcome the credit gap because instead of a bureau and bank account-based credit score, they collect data from other sources and use cutting-edge AI-driven algorithms to create a credit score for applicants.
- India's e-commerce market is set to hit \$200 billion by 2026, growing at 30% annually.
- There are various types of MSME loans which are available now days.
- There are various MSME finance challenges which are being faced and which need to be overcome.

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