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# CHALLENGES IN RAISING CREDIT: A STUDY OF MSMES IN PUNJAB REGION

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**Abstract**

*MSMEs in India have emerged as a dynamic sector of economy over years as it plays a crucial role in providing large employment opportunities and industrialization of rural areas. This sector is a major contributor of country's socio-economic development. Despite of this sector's inherent capabilities, MSMEs in India are facing number of problems and raising credit has become their major problem. This study examines various sources of finance that can be used by MSMEs and the obstacles faced by MSMEs in raising finance from such sources. For the purpose of this study, sample of 100 respondents from major cities of Punjab (Amritsar, Jalandhar, Ludhiana, Patiala and Mohali) was interviewed with the help of structured questionnaire. While descriptive analysis was used to identify the common sources for raising capital, factor analysis was used to reduce as well as to identify the major obstacles faced by MSMEs in raising credit. The study indicated bank as most commonly used source of finance over other sources and bureaucratic loan procedure, poor past records and performance of the firm, behavior of bank employees and high cost of financing as the major obstacles faced by MSMEs in raising finance.*

**Keywords:** *MSMEs, Credit, Challenges, Factor Analysis*



## 1. INTRODUCTION

Micro, small and medium enterprises (MSME) sector has emerged as very vibrant and important sector of the Indian economy over the years. Besides providing employment opportunities, development of this sector has also helped in industrialization of rural and backward areas. In Punjab after independence small-scale industries were mainly concentrated in production of consumer goods such as hosiery, handloom spinning and weaving. By the end of 1960 there was shift towards producer goods. Punjab has a predominance of small-scale industry due to indomitable spirit and entrepreneurial skills of people. Engineering goods, hosiery items, pharmaceuticals, leather goods, food and agro products, textiles, electronics, hand and machine tools are some of the prominent range of products of Punjab. The Punjab State Industrial Development Corporation (PSIDC) has developed over 80 industrial estates, growth centers and industrial focal points in the state.

Unregistered sector in Punjab accounts for more than 60% of industrial units and more than 30% of employment, about 19% of investment.

## 2. REVIEW OF LITERATURE

In study of Hyderabad, Rajkot, Delhi and Ludhiana undertaken by UNESCO Research center on Social and Economic Development in Southern Asia (1966), it was found that entrepreneurs had attitude of skepticism toward government policy. In Hyderabad none of surveyed units had borrowed from government or banks, in Okhla 9% had obtained loans from these sources and 45% industries in SME's in Rajkot preferred to raise finance from government subsidy, under its various policiesand from banks.

Mishra (1970)in his study in Saugor district found that industrialist preferred a private moneylender to a cooperative bank for meeting their financial needs because of complicated formalities involved in other sources of finance. Questions were asked from different industries in the district and their preference for raising finance. Majority of them said that they find it easy to approach moneylenders as they do not have to go through long processes of document verification and keeping securities etc. and also time involved is far less comparatively.

Levy (1993) conducted a study on obstacles faced indeveloping indigenous small and medium enterprises. It reports the results of field surveys conducted in Sri Lanka's leather industry and Tanzania's furniture industry. Firm-level interviews in both countries were done to learn about the major constraints on enterprise operation and expansion. The study was conducted on two capital cities. The main objective was to learn how small and medium enterprises (SMEs) perceive the impact of financial, regulatory, technical, marketing, and other input constraints. Lack of access to finance was the major obstacle for small, less established firms in Sri Lanka while in Tanzania firms of adequate size and establishment even, face problem in accessing finance. Regulatory and tax constraints were largest for smaller firms in Tanzania but in Sri Lanka regulatory burden was found to be more for larger firms. Lack of access to finance was leading constraint in both the countries. Constraints in access to physical inputs tend to be sector-specific. Lack of technical skills was not considereda major constraint by SME's in both the countries.

Rao and Revathy (2001) in their research found that lack of access to credit represented a strong restriction of expansion of small scale industrial development, with proprietors themselves perceiving financing as their most pressing input constraint. Different type of enterprises has significantly different needs. As firms grow in size and composition, their financial requirements and relative importance of fixed and working capital changes. Growth not only affects relative importance of formal and informal sources of finance, but also relative contribution to development of firms with various types of financing arrangements.

Beck et al. (2005)conducted a study in Ghana to find out the financial preference of small firms in raising finance from banks. A comparative study of small and large firms was made. Equal number of both categories was taken and interview was done with owners. It resulted in small firms raise less finance from banks as compared to large firms. Among other sources used by various firms, large firms finance major portion of their investment from equity while small firms depend on informal sources such as money lender, family, friends etc.

Martínez and Schmukler (2010) studied relationship between banks and small and medium enterprises. In this study both nationalized and commercial banks were taken. Interviews were taken from relation managers of respective banks regarding their behaviour toward SME's and their preference in serving financial needs of SME's. It was viewed that large and foreign banks were generally not interested in serving SMEs, at the same time small and niche banks had an advantage because they can overcome SME opaqueness through relationship lending.

Daskalakis, Jarvis and Schizas (2013)explored how SME's finance themselves and what are their preferences ofSMEs for three main sources of finance, that is, equity, debt and grant financing. An important objective of the research was to capture all SME's operating in Greek economy, so the Hellenic statistical authority was contacted to obtain data. A telephonic survey method was adopted. From a list of 2,327,567 firms gave responses to the questions asked through a structured questionnaire. It was found that in terms of equity financing firms rely heavily on their own funds and there is reluctance in using new outside equity. In case of debt financing they would use more debt (long term) than they currently do if there are no constraints. It also explored that safer, quick loan and less collateral was reason firms go for micro-finance. And in debt finance SME's consider high loan rates as major obstacle in going for other source of finance.

## 3. OBJECTIVE OF THE STUDY

a. To identify key obstacles faced by MSME's in raising credit in Punjab region.

## 4. RESEARCH METHODOLOGY

The study is exploratory one based on both primary and secondary sources of information to achieve the proposed research objective of finding the financial challenges faced by SMEs in Punjab. Information from primary sources has been collected through a questionnaire and personal discussion with owners, officials of the units financed by various financial institutions.

**4.1 Sampling**

The selection of SME's is done through convenience sampling due to low response rate from these firms in pretesting, when chosen through random sampling. Our sample includes 25 micro, 49 small and 26 medium firms. It includes both manufacturing (66) and (34) services firms. Sample of SME's is geographically spread throughout Punjab covering 100 entrepreneurs from five major cities Ludhiana, Amritsar, Patiala, Jalandhar and Mohali. Sample consists of private limited company (29), partnership (27), sole proprietor (39), and family owned business (5) firms.

**4.2 Data collection**

Information from primary sources is collected through a questionnaire. First pretesting of questionnaire was done to see if questionnaire prepared is easy to understand for firms and to confirm it includes all constructs and necessary options for all questions. After this pilot testing of questionnaire was done to see reliability of questionnaire.For pilot testing 10% of sample size 100 i.e.10 were collected from different cities Ludhiana (3), Amritsar (3), Jalandhar(2), Patiala(2).Cronbach alpha was calculated which came out to be 7.8.

**5. ESTIMATING RESULTS**

This study deals with finding out the main problems faced by MSME's in raising finance from banks. To find out the main problems twenty constructs were taken based on previous studies and firms were asked to respond based on applicability of problem to their firm on 5-point likert scale from very high to very low. For reducing data, factor analysis is applied to find out main factors/obstacles to firms in accessing finance from bank. Factor Analysis is data reduction toolthat represents correlated variables with a smaller set of "derived" variables.

**5.1 Factor Analysis**

**5.1.1 KMO and Bartlett's Test**

Bartlett's test of sphericity checks the null hypothesis that original correlation matrix is an identity matrix that is the variables are uncorrelated in the population. It is indicated in the results that correlations between items are sufficiently large for Principal Component Analysis and it is not an identity matrix so we can proceed with factor analysis. The Kaiser-Meyer-Olkin measure verified the sampling adequacy for the analysis. This was done basically to compare the magnitudes of observed correlations to the magnitudes of partial correlation coefficients.Value of 0.78 was obtained, thissignified that the correlations between pair of variables can be explained by other variables and that factor analysis isappropriate.

**Table 1 - KMO and Bartlett's Test**

| | | |
|---|---|---|
| **KMO measure of sample adequacy** | | **0. 78** |
| Bartlett"s test of sphericity | Approx.Chi-Square | 1924.464 |
| | Df | 210 |
| | Sig. | .000 |

**5.1.2Communalities**

Next is a table of estimated communalities (i.e.estimates of that part of the variability in each variable that is shared with others, and which is not due to measurement error or latent variable influence on the observed variable). According to this table variance explained by variables is >=4 for all variables. Output shows the table of communalities before and after extraction. Communality is the proportion of common variance within a variable. Principal component analysis works on the initial assumption that all variance is common; therefore, before extraction the communalities are all 1 (see the column labelled Initial). In effect, all of the variance associated with a variable is assumed to be common variance.Once factors have been extracted, it gives better idea of how much variance is, in reality, common. So, for example, we can say that 43. 5% of the variance associated with question 1 is common, or shared, variance.

**Table 2 - Communalities**

| | **Variables** | **Initial** | **Extraction** |
|---|---|---|---|
| 1 | High interest rate | 1. 000 | .745 |
| 2 | Bureaucratic loan procedure | 1. 000 | .889 |
| 3 | High collateral | 1. 000 | .395 |
| 4 | Less beneficial schemes | 1. 000 | .400 |
| 5 | High cost of financing | 1. 000 | .731 |
| 6 | Complex after loan procedure | 1. 000 | .870 |
| 7 | Poor book keeping | 1. 000 | .787 |

| | | | |
|---|---|---|---|
| 8 | Default on previous loan | 1. 000 | .479 |
| 9 | No asset to mortgage | 1. 000 | .782 |
| 10 | Low capitalization | 1. 000 | .613 |
| 11 | Improper collateral valuation | 1. 000 | .702 |
| 12 | Small size of firm | 1. 000 | .690 |
| 13 | Poor past performance | 1. 000 | .751 |
| 14 | Long disbursement period | 1. 000 | .650 |
| 15 | Long approval period | 1. 000 | .652 |
| 16 | Stringent process | 1. 000 | .866 |
| 17 | Mindset of bankers | 1. 000 | .843 |
| 18 | Lengthy paper work | 1. 000 | .712 |
| 19 | Small repayment period | 1. 000 | .616 |
| 20 | Employees in bank not friendly | 1. 000 | .849 |

**5.1.3Total variance explained**

An initial analysis was conducted to obtain eigenvalues for each component in the data. Four components had eigen values over Kaiser's criterion of 1 and together they explained 70% of the variance. The scree plot showed inflexion at four factors.

**5.1.4Component factor matrix**

Four factors have been found in this study. Output shows the rotated component matrix thatcontains the same information as the component matrix, except that it is calculated after rotation. There are several things to consider about the format of this matrix. First, factor loadings less than 0.4 have not been displayed because we asked for these loadings to be suppressed. Second, the variables are listed in the order of size of their factor loadings. The original logic behind suppressing loadings less than 0.4 was based on Stevens (2002) suggestion that this cut-off point was appropriate for interpretative purposes (i.e. loadings greater than 0.4 represent substantive values).

The next step is to look at the content of questions that load onto the same factor to try to identify common themes. The questions that are highly loaded on factor 1 are all related to bureaucratic loan procedure. The questions that are highly loaded on factor 2 are all related to poor past records and performance of the firm.The questions that are highly loaded on factor

3 are all related behavior of bank employees and questions highly related to factor 4 are related to high cost of financing. So we come up with four main factors that are named as **bureaucratic loan procedure,poor past recordsand performance of the firm, behavior of bank employees, high cost of financing.**

**Table 3 – Factor loadings on variables**

| Factors | Questions/Variables | Factor loadings |
|---|---|---|
| **Bureaucratic loan procedure** | Bureaucratic loan procedure | . 928 |
| | Stringent process | . 922 |
| | Complex after loan procedure | . 920 |
| | Lengthy and complex paper work | . 824 |
| | Time period between application and loan approval is long | . 700 |
| | Period between sanction and disbursement of loan is long | . 585 |
| **Poor past records and** | No proper financial reports/ poor book keeping | . 802 |
| **performance of the firm** | No asset to mortgage land and building. | . 789 |
| | Small size of enterprise. | . 787 |
| | Low capitalization. | . 781 |
| | Default on previous loans | . 664 |
| | Poor past financial performance of company | . 658 |
| | High collateral required | . 450 |
| **Behavior of bank employees** | Mindset of bankers is not to provide loan to small scale | . 872 |
| | Employees in bank are not friendly | . 870 |

| | | |
|---|---|---|
| | Improper collateral valuation | . 711 |
| **High cost of financing** | High interest rates | . 757 |
| | Small repayment period | . 724 |
| | High cost of financing | . 713 |
| | Less beneficial schemes for MSME"s | . 582 |

## 6. INTERPRETATION OF SIGNIFICANT FACTORS

### Factor 1: Bureaucratic loan procedure

Banks adopt a proper procedure and carry out strict assessments while sanctioning loans to MSMEs. ROIs are calculated only after assessment; hence it varies from case to case.An applicant has to disclose the company registration number, balance Sheet of one to three years, business type, location of this manufacturing facility, business projections for next two years etc. Paper and documentation are pre- requirement for loan as it acts as physical evidence of business transactions. Paper formalities are generally treated more cumbersome in public sector banks. Higher factor loading of Bureaucratic loan procedure, stringent process, lengthy and complex paper work,time period between application and loan approvaland period between sanction and disbursement of loan shows that these variables are related to a common factor which is named as Bureaucratic loan procedure. *Yadav (2013*) also found out bureaucratic loan procedure of banks as major impediment to growth of SMEs, in his study on small and medium enterprises of India. Banks should make processing and documentation process simpler. Technology up gradation can be done and Management Information System need to be used for this purpose.

### Factor 2: Poor past records and performance of the firm

This factor includes variables that are related to past performance of the firm with highest loading on no proper financial reports or book keeping. Other variables it includes are capitalization of firm for determining the proportion of debt firm has already taken from other banks or other organized sources. It also includes assets firm has to mortgage land and building. Next is poor past performance or default on previous loans.

*Gangata, Hudson and Matavire (2013)* in his study found that banks require past records of firms as importantrequirement before sanctioning loan and firms with poor past record face problem in getting loan. But in our study thisfactor is not considered as major obstacle because may be they maintain proper financial reports etc., due to which they do not face any such problem.

**Factor 3: Behavior of bank employees**

MSMEs lack awareness about various schemes available to them. Banks seem to be redundant in disclosing details about various schemes introduced by NSIC (National Small Industrial Corporation). Employees in some banks fear providing loan to these MSME's owing to mindset that these firms because of their small size may not be able to return their money so they prefer to give loans to large corporations. Banks sometimes do not disclose the schemes available with them just to avoid hassles involved in getting funds released from third party. However banks need to change this mindset because the small firms are building blocks of our economy. With MSME being accorded status of priority sector for lending by banks, many institutions now have set up specialized branches to deal with the requirements of such units. This factor includes mindset of bank employees for giving loan to MSME's, their behaviour towards these firms and collateral valuation of their assets, property etc.

**Factor 4: High cost of financing**

The high cost at which credit is made available to small and medium enterprises (SMEs) is the one of the impediment to enhance their growth and competitiveness in the domestic and global market, and also drives them to sickness.This factor includes high interest rate and high cost of financing. Other variable included in the factor is small repayment period of loans. *Nkuah, Tanyeh and Gaeten (2013)* in his study quoted high cost of financing as one of important factor due to which MSME's go for other sources of finance like friends, relatives etc.

## 7. CONCLUSION

Summing up we can say that due to insufficient loan provided by banks and stringent loan procedure and delays in sanctioning loan, MSMEs has to obtain loan from other sources like friends, relativesetc.for meeting their financial needs. Firms find these sources convenient and easy to approach, as they do not require any complex paper work, collateral etc. Some demographic characteristics of owner like age, education qualification of owner, nature of firms does affect the credibility of firms and helps in getting loans from banks.Owners must work on making their firms credit worthy by working on these characteristics and also banks should come up with customized solutions as different type of firms have different needs and banks should provide solutions to them differently.

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