CHAPTER 2

REVIEW OF LITERATURE

2.1 MSME SCENARIO

'Micro, Small and Medium enterprises' is an area of great interest for many researchers. This is owing to the rising importance of the sector in providing a source of livelihood for a large part of the population. The government and private sector organisations have not been able to meet the growing demands of employment. As such entrepreneurship comes as a relief to millions of jobless people. MSMEs are quite productive, even when compared to larger organisations and they hold a strong ground especially in developing economies (Agyapong, 2010).

However, not all such enterprises have been successful due to many factors. According to the Twelfth Five Year Plan in India, credit is a critical factor in augmenting growth and development of the MSME Sector, particularly the Micro and Small Enterprise (MSE) Sector, because of its limited access to formal sources of finance. A study undertaken by the International Finance Corporation (IFC) and McKinsey and Company has revealed that approximately '45-55 per cent' of the formal MSMEs (11-17 million) in the emerging markets all over the world lack access to formal institutional finance. The credit gap is far bigger if we take into account micro and informal units; '65-72 per cent' of all MSMEs (approximately '240-315 million') in emerging markets lack access to credit. MSMEs as borrowers possess unique characteristics that differentiate them from larger units or individual borrowers. This has been duly recognised by the government in India and hence a range of schemes have been introduced aimed at the sector. MSME sector has been included in the list of 'Priority Sector Advances' for banks to encourage more directed supply of finance to the sector. At the state levels, the Central government had constituted District Industries Centres (DICs) in 1978 as a support system for small, tiny, cottage and village industries. The DICs also maintain data about MSME units registered with them which helps in gaining more knowledge and keeping track of the sector. Owing to the size of MSMEs, it is very difficult to follow the developments of the sector. However, as per the latest MSME Census in 2005-06, less than 10% of total MSMEs were registered with DICs.

There are extensive research works on MSMEs by individual and institutional researchers, private agencies, government organisations, educational institutes and others spanning all over the world. This chapter is a summarised review on selected research works done on the MSME sector which highlights the role played by MSME sector in the economy and the various issues that concern MSME borrowing from the formal sector. It is intended to give a comprehensive and holistic overview on the dynamics of institutional MSME financing, particularly in India, which can serve as bedrock for future research in this area.

2.2 LITERATURE REVIEW

In order to further understand the scenario of MSMEs, a number of research work conducted in the field has been reviewed as listed in Table 2.1.

Table 2.1: List of literature reviewed

AUTHOR (YEAR)	AREA
Abdul Naser (2013)	To evaluate critically the contributions made by the MSMEs to the balanced growth of the economy.
Abubakar Abdullahi Sokoto and Yahya Zakari Abdullahi (2013)	To investigate the growth, characteristics and assess effect of government policies on the development of Small and Medium Enterprises (SMEs) in Nigeria.
A. G. Alamelugeeta (2015)	To study the growth problems and motivation of MSMEs in Madurai district in South India.
A. K. Sharma (2014)	To study role of commercial banks in entrepreneurial development in Hailakandi district, Assam
Alagar K. (2015)	To study the role, functioning and performance of DICs in Sivagangai district in South India.
Allen N. Berger, Aslı Demirgüç-Kunt, Ross Levine and Joseph G. Haubrich (2004)	To present a comprehensive review of related literature on research works on competition among banks.
Allen N. Berger and Gregory F. Udell (2006)	To propose a complete conceptual framework for analysis of SME credit availability issues.
Allen N. Berger, Leora F.Klapper And Gregory F. Udell (2001)	To test hypotheses about the effects of bank size, foreign ownership, and distress on lending to opaque small firms
Allen N. Berger, Marco A. Espinosa-Vega, W. Scott Frame and Nathan H. Miller (2007)	To empirically determine whether a reduction in asymmetric information reduces the incidence of collateral.
Alex Coad and Jaganaddha Pawan Tamvada (2011)	To complement the literature that exists on the nature and performance of small businesses in developing countries.
Ana Kundid and Roberto Ercegovac (2011)	To explore micro economical perspective of credit rationing with special emphasis on the SMEs in the Republic of Croatia.
Anders Nilsson and Peter Ohman (2012)	To examine how application from SME loans can be assessed defensively by Lending Officers (LOs) in Sweden.
Ashish Kumar, Vikas Batra and S.K.Sharma (2009)	To provide an overview of MSME sector in India.

Bedman Narteh (2013)	To investigate the factors influencing bank selection and patronage behaviour of SMEs in the Ghanaian banking industry.
B. P. Bohra (2017)	To study the financing pattern of small business enterprises and traders in Guwahati city
C. Paramasivan & P. Mari Selvam (2013)	To study the growth and prospects of MSMEs in India.
Chandana Goswami (2014)	To find out the credit preference of Micro and Small Enterprises in Assam, India.
Charles Harvie, Sothea Oum and Dionisius A. Narjoko (2010)	To shed some lights as comprehensively as possible on the issue of SMEs' financing in selected East Asian economies.
Charan Singh & K. P. Wasdani (2016)	To identify various challenges faced by MSMEs in sourcing of finance during different stages of their life cycle.
Ciarán Mac an Bhaird and Brian Lucey (2011)	To empirically examine the financing of small and medium sized enterprises (SMEs) through a financial growth lifecycle model in Ireland.
Daniel Agyapong (2010)	Review of literature on MSMEs in Ghana.
Darek Klonowski (2012)	To provide an evaluation of the government's policy instruments towards the SME sector in Poland.
David Irwin and Jonathan M. Scott (2010)	To investigate barriers (esp. personal characteristics) to raising bank finance faced by UK small and medium-sized enterprises (SMEs).
David Pickernell, Paul Jones, Gary Packham, Brychan Thomas, Gareth White and Robert Willis (2013)	To explore associations between e-commerce and internal and external antecedents in UK.
Dilek Demirbas Javed G. Hussain Harry Matlay (2011)	To examine the barriers to innovation faced by Turkish manufacturing SMEs in Turkey.
Doris Neuberger and Christoph Schacht (2006)	To investigate the number of bank relationships of small and medium-sized enterprises in Switzerland.
K. Alamelu and R. Baskaran (2011)	To present an overview of the MSME sector in India.
Urmila Moon (2012)	To examine the trends and performance as well as problems faced by MSMEs in India.
E.C. Gbandi and E. Amissah (2014)	To examine the financing of SMEs in Nigeria and the various financing options available to the SMEs.
Elisabeth Paulet, Mia Parnaudeau and Tamym Abdessemed (2014)	To provide an insight into the profound transformation of banking strategies in Europe in light of 1929 crisis.
Erick Ariel Gonzales Rocha (2012)	To determine if having a larger SME sector is the result of competitive or constraining business environments.
Erik Lehmanna and Doris Neuberger (2001)	To study the lending relationships between banks and SMEs in Germany.
Fatima Vegholm and Lars Silver (2008)	To investigate corporate fairness as a means of achieving customer satisfaction in Sweden.
George McKenzie and Simon Wolfe (2004)	To examine the UK banking sectors problems in assessing and managing credit risks associated with actual or potential environmental damage arising from the activities of borrowers.
Gilda Farajollahzadeh, Abdol Rahman Noorinasab & Babak Yazdanpanaa (2016)	To study the growth, policy support and contribution of the MSME sector.
Goran Skosples (2012)	To investigate how legal extensiveness and legal effectiveness affect availability of bank finance in 21 transition countries.
Govind Sharma (2011)	To find if all small and medium enterprises need to strategize and if tools like ERP are applicable to SMEs in India.

Iraj Hashi and Besnik A. Krasniqi (2011)	To examine the impact of firms' technological and environmental characteristics on the growth of SMEs in Central Eastern and South Eastern Europe at different stages of transition.
Jaskaran & Davinder Singh (2014)	To find out problems related to the financing of small firms in India.
Jeremiah Koshal (2016)	To study entrepreneurship situation in Africa.
Jim Taylor & Steve Bradley (1994)	To study the impact of 1990-92 depression on European countries.
Johnathan A. Scott and William C. Dunkelberg (2001)	To determine the effect of competition on credit availability, loan terms, and service performance by owners of small businesses in US.
K. O. Osotimehin, Charles A. Jegede, Babatunde A. Akinlabi and O. T. Olajide (2012)	To identify the factors influencing MSEs in Nigeria, assess the roles in employment generation and entrepreneurial development and effect of poor financing on MSEs.
K. T. Srinivas (2013)	To study various aspects of MSME sector and their contribution to Indian GDP.
Kevin J. Stiroh Philip E. Strahan (2003)	To examine the impact of increased competition from deregulation on the dynamics of the U.S. banking industry.
Lin Justin Yifu and Sun Xifang (2006)	To show how informal finance with information advantage improves the allocation of funds.
Liz Price, David Rae and Veronica Cini (2013)	To explore perceptions of the recession and recovery by SMEs in Lincolnshire and Rutland.
M. Suriyan (2015)	To evaluate the performances of the SMEs, analyse the role of DIC in the promotion of SMEs in the study area, identify the problems faced by the DIC implementing agencies and beneficiary entrepreneurs.
Mahendra Reddy (2007)	To examine how small businesses have contributed towards rising household income and to identify their various problems in Fiji.
Mitchell a. Petersen and Raghuram G. Rajan (1995)	To provide a simple framework showing that the extent of competition in credit markets is important in determining the value of lending relationships in US.
Mitchell A. Petersen and Raghuram G. Rajan (2002)	To document that the growth in physical distance and dwindling communication between small firms and their lenders in the US.
Moirangthem Biren Singh and N. Tejman Singh (2006)	To analyse and examine the management of inventories, management of cash and management of account receivables in Manipur, India.
N. Shihabudheen (2013)	To make an overview of the MSME Act 2006, examine the awareness level and impact of the MSME Act in the study area and suggest pragmatic measures for the enhanced performance of the Act.
Ngboawaji Daniel Ntea and Otu Ekpenyongb (2014)	Review the nature and Structure of MSMEs in Nigeria, comparative studies of MSMEs in India, review the financing patterns of this sector in both countries and identify innovative financing options that will be beneficial to Nigerian MSMEs.
Nicolaus Lundahl Fatima Vegholm Lars Silver (2009)	To investigate the influence of service management on customer satisfaction in the bank-SME relationship in Sweden.
P. Muruthiah (2015)	To analyse the growth and problems of MSMEs in Thoodukudi district in South India.
Phuong Nu Minh Lee (2012)	To investigate which determinant variables influence Vietnamese small and medium enterprises' access to bank finance which is a typical case of a developing country.
Prasanna Kulkarnia and Abhijit V. Chirputkar (2012)	To analyse the impact of SME Listing on capital structure decisions in India.
Princy Saini (2014)	To focus on MSMEs located in industrial areas and prominent markets of New Delhi.
Rainer Haselmann, Katharina Pistor and Vikrant Vig (2004)	To find out if law promote lending and if all creditors benefit from legal change in the same way.
Rainer Haselmann Paul Wachtel (2010)	To explore how the legal environment affects bank behaviour in 20 transition economies.

Rajib Lahiri (2012)	To examine the changing pattern of definition of the MSMEs in India and critically analyse the impact of MSMED Act, 2006.
Ram Jass Yadav (2012)	To examine the reasons why banks shy away to lend to the sector and possible remedies.
Ramzi Benkraiem and Calin Gurau (2013)	To study the influence of various corporate characteristics on the capital structure of French SMEs.
Regan Lam, Suzan Burton and Hing-Po Lo (2009)	To demonstrate a method for estimating the trade-offs that banking customers make between different attributes of a service in Hong Kong.
Robert Cull, Lance E. Davis, Naomi R. Lamoreaux and Jean-Laurent Rosenthal (2006)	To focus on the economies of the North Atlantic Core during the 19th and early 20th centuries.
Robert DeYoung, Dennis Glennon, and Peter Nigro (2008)	To explore how the legal environment affects bank behaviour in 20 transition economies.
S. K. Baral (2013)	To study role of MSMEs in developing India.
Sanjeeb Kumar Dey (2014)	To evaluate growth, performance and challenges of MSMEs in India.
Shalunkhe (2016)	To analyse the effects of PEMGP in rural area of Kolhapur district in India and evaluate the performance of the Programme.
Shannon Mudd, (2013)	To produce evidence for a non-linear relationship between competition and the use of bank financing by small firms.
S. Sharma (2014)	To understand the effects of formal registration on microenterprises in India.
Shigehiro Shinozaki (2012)	To focus on regional cooperation and integration in the areas of infrastructure, software, trade, investment, money, finance, and regional public goods in Asia.
Stephen Korutaro Nkundabanyanga, Denis Kasozi and Irene Nalukenge (2014)	To investigate the relationship between commercial bank lending terms, financial literacy and access to formal credit by small SMEs in Uganda.
Steve Mercieca & Klaus Schaeck & Simon Wolfe (2009)	To find how concentration and competition in the European banking sector affect lending relationships between SMEs and their banks.
Sudha Venkatesh and Krishnaveni Muthiah (2012)	Importance and performance of MSMEs.
Sunildro L.S. Akoijam (2013)	To analyse the issues and concerns of Indian rural credit.
Suwastika Naidu & Anand Chand (2012)	To examine the financial obstacles faced by MSMEs.
Thorsten Beck and Asli Demirguc-Kunt (2006)	To study the access to finance by small and medium-size enterprises.
Thorsten Beck Asli Demirguc-Kunt Luc leaven Ross Levine (2008)	To present empirical evidence on current policy disputes about the cross-firm distributional effects of financial development in Nigeria.
Tulus Tahi Hamonangan Tambunan (2011)	To examine recent developments of SMEs in Indonesia.
V. Sobia (2014)	To review the progress, performance, satisfaction, perception level of proprietors on various aspects of institutional financing by MSME sector in Coimbatore, India.
Vlasdilav, Maksimov (2017)	To improve efficiency of SMEs in LDC countries.
W. Scott Frame, Aruna Srinivasan and Lynn Woosley (2001)	To shed some lights as comprehensively as possible on the issue of SMEs' financing in selected East Asian economies.

2.2.1 Methodology

The literature reviewed has been retrieved from journal portals, organisational reports, government reports, conference and seminar publications and other websites. The key words used to retrieve these research works are 'MSME', 'Small and Medium Enterprises (SME[3])', 'small entrepreneurs', 'MSME finances' and 'bank financing to MSMEs'. The literature review has been done for the period 1994 to 2018. The literature review has covered 68 journals papers, 3 working papers, 8 doctoral thesis, 3 research report, 2 articles in a book and 2 conference proceeding. The portals from which the journals, articles, thesis and others have been collected are listed as follows:

Table 2.2: List of portals

Journal Portal	No. of Papers
Emerald Insight	20
Elsevier	8
Jstor	3
Springer	6
Taylor and Francis	1
Wiley	3
Bonfring	1
Oxford Academic	1
SIBR	1
Shodhganga	8
Others	32

The types of research work covered are both theoretical and empirical. The percentage of theoretical research and empirical research are 6% and 94% respectively. The geographical coverage of the research work reviewed for the study can be segregated as follows:

Table 2.3: List of geographical areas covered by the study

GEOGRAPHICAL AREA	NO. OF STUDIES.
North Atlantic Core	2
Europe	18
Africa	9
Asia (Excluding India)	8
India	31
United States	4
Not area specific	12

[3] The abbreviation 'SME' for small industries is used in the European Union and by international organizations such as the World Bank, the United Nations and the World Trade Organization.

2.2.2 Importance of MSMEs

Agyapong (2010) emphasized that MSME's "contribution to the economy and employment in Nigeria is significant" as they provide a "stimulus to economic growth, fosters backward and forward linkages, develops human assets and develops entrepreneurial skills in the society". Demirbas et al. (2011) emphasized that the development of a "sustainable and competitive SME sector in Turkey depend upon innovative practices in this type of firms. For innovation to take place there is a need for appropriate government infrastructure, policy and supporting networks to be in place". Ntea et al. (2014) mentioned that it is an immutable fact that,

> *"MSMEs have remained the bed rock for economic growth and development not just in the developing economies but in advanced economies as well. In Nigeria, this sector has remained pivotal and must be sustained for economic growth and survival".*

Benkraiem et al. (2013) said that

> *"Small business financing is of capital importance for the French economy, since SMEs represent more than large corporations, major vectors for innovation and employment". Rocha (2012) suggested that in order to improve opportunities for the poor MSME sector must be encouraged to grow.*

Dey (2014) added that MSMEs in addition to contributing significantly to GDP, output and employment, also facilitates availability of goods and services to the economy at affordable costs and offers innovative solutions. Venkatesh et al. (2012) also found that in recent years the role of small industries are growing rapidly with the growth of Indian market especially in various industries like "manufacturing, food processing, textile and garment, retail, precision engineering, information technology, pharmaceuticals, agro and service sectors". Koshal (2016) emphasized how with focus on entrepreneurship, business growth and good governance Africa has managed to rise commendably from its never-ending poverty, unemployment and other ills. They added that many African countries are making strides not only economically but also through leadership and governance. In his study conducted on "1273 manufacturing SMEs from seven LDCs in Africa, Asia, and the Middle East", it was discovered that "SMEs that can secure government contracts, export to foreign markets, or have female ownership are more likely to achieve greater efficiency and pay higher wages to their employees and ultimately helps in reducing poverty in the least developed countries" (Maksimov et al., 2017).

According to report of 'Small and Medium Enterprises (SME)' chamber of India,

> *"Small and medium enterprises play a vital role for the growth of Indian economy by contributing 45% of the industrial output, 40% of exports, 42 million in employment, create one million jobs every year and produces more than 8000 quality products for the Indian and international markets. As a result, MSMEs are today exposed to greater opportunities for expansion and diversification across the sectors".*

The MSME sector has been rightfully termed "engine of growth" by economists. The latest MSME Census of 2006-07 in India has reported that the total employment in the registered sector was 93.09 lakhs. The data for unregistered sector is only an estimate, but it is exponentially higher than employment in registered sector. Srinivas (2013) compared the data over the years and concluded that "the contribution of the MSME sector to Indian GDP is progressively increasing". Paramasivan et al. (2013) focused on progress and performance of MSMEs and found that the sector meets the local and global demands with its unique offerings of goods and services. The sector has performed very well in India even after globalisation and has the potential to achieve sustainable development of the country with its self-reliance aspects. More authors adds that,

> *"MSMEs contribution should be seen not only in terms of output, employment, income, investment or exports but also in terms of qualitative indicators such as their synergies with large industries, contribution towards balanced regional growth, participation in nurturing the entrepreneurial spirit, innovation and in producing skilled and trained manpower".* (Farajollahzadeh et al.,2016)

As echoed by India Brand Equity Foundation (2013), it is reported that,

> *"While a key achievement of MSMEs over time has been their talent in utilising available domestic resources to deliver quality products and services, these firms have made their presence felt across India's key sectors as well as in prominent export markets. MSMEs have made an impact on a range of issues, from industrial*

progress to entrepreneurship and from job creation to economic empowerment. The inclusiveness of the MSME sector is highlighted by the fact that around 50 per cent of MSMEs in India are owned by underprivileged groups. Due to its low capital structure, coupled with high labour absorbing power, the sector has played a noteworthy role in achieving rural industrialisation as well. The MSME sector remains a key driving force for India's complete transition from an agrarian economy to an industrialised one".

Baral (2013) further agrees with the theory and adds that,

> *"SMEs form the foundation of manufacturing sector in large manufacturing countries and they not only generate employment but contribute to the country's exports. SMEs adopt latest technologies and improve their productivity most effectively within industrial clusters around larger enterprises preferably linked with technology institutes".*

MSMEs contribution to country's industrial production is additionally corroborated by Naser (2013) reports,

> *"Over the year MSME reached at a level on the optimum utilization of available domestic resources and produces quality products and services. The sector contributes much to the industrial growth of the country and has an impact on various issues of the economy such as industrial progress, entrepreneurship, job creation, economic empowerment etc. MSME made possible an inclusive and balanced growth".* He also adds that *"around 50% MSME are owned by rural people and hence increases the standard of living of people".*

Thus these studies have effectively highlighted the contribution of the MSME sector to the economy, adding special focus on its role in developing countries. The small sized units as a whole have contributed greatly in decreasing the dependence on government and large sized industries for employment and development. Therefore the role played by MSMEs particularly in development of an economy cannot be undermined.

2.2.3 Major Problems Affecting MSME Growth across the World

Beck and Kunt (2006) in their article have compiled recent cross-country firm-level database in which they have summarized recent empirical researches which show that, *"Access to finance is an important growth constraint for SMEs, and that financial and legal institutions play an important role in relaxing this constraint, and that innovative financing instruments can help facilitate SMEs access to finance even in the absence of well-developed institutions".*

Cull et al. (2006) stated that "a common explanation for the comparative absence of SMEs in poor countries today is that they cannot obtain access to capital".

A survey conducted by the World Bank among the countries of 'Northern and Western Europe and North America' confirms "large firms everywhere generally have more access to bank credit, both local and foreign, than small firms, whereas the latter rely heavily on internal funds and retained earnings". Alamelu et al. (2011) analysed the Eleventh Five Year Plan and accordingly believed "one of the core challenges of MSMEs is inadequate access to credit and working capital". Tambunan (2011), Lahiri (2012), Coad and Tamvada (2012) and Paulet et al (2014) have confirmed "lack of access to proper finance" as one of the main setbacks. Secondary data reveals that the "annual growth rate in terms of Net Bank Credit, Credit to MSMEs and Percentage of Net Bank Credit offered to MSMEs shows a fluctuating trend. In 2002-03, the annual growth rate of credit to MSMEs showed a negative result". However, literature reveals that,

"At the same time, access to finance for SMEs is often limited by the imperfections and constraints of supply and demand of credit. During a time of financial crisis where their capacity to invest depends generally on banking loans, SMEs cannot finance their projects. For this reason, they believed that the stability of the global banking system and not economic growth has been the regulators' top priority" (Klonowski, 2012).

The most dominating problem that seems to stunt the growth of MSMEs is the lack of access to finance. In any economy an adequate system of financing is indispensible for the good health of its MSMEs.

2.2.4 Importance of Institutional Lending

Gbandi and Amissah (2014) emphasized that "access to finance by the SMEs is very critical to the success of the SMEs in Nigeria" but at the same time "the informal finance sector provides more than 70% of the funds to the SMEs". They feel that "the government should find out the factors that make this possible and incorporate such factors into its policy for improving SMEs access to finance". "Countries in which SMEs have access to external sources of finance are those with more advanced financial systems, suggesting there may have been a causal relationship between financial development and the viability of SMEs", as suggested by Cull et al. (2006). Berger et al. (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". Vegholm and Silver (2008) stated how, "it is apparent that there is a certain level of discontent among customers, both SMEs and consumers, concerning the practices of financial institutions. The crucial question is whether it is advantageous for financial institutions to treat these kinds of initiatives as if they are in their own best interest". In a research covering Central Eastern Europe and South Eastern Europe, Hashi and Krasniqi (2011) found that "a major adverse feature of the environment, recognised by many studies, is the poor supply of external finance for new businesses". Furthermore, they added,

> *"Small firms are also likely to be subject to credit rationing because of the information asymmetry in the capital markets and therefore, according to him banks are more likely to meet the credit needs of larger firms whose ability to provide track record and collateral is greater than smaller firms, thus offsetting the information asymmetry effect. Small firms are less able to provide the required collateral, and less likely to access finance"* (Hashi and Krasniqi, 2011).

Bhaird and Lucey (2011) found in Ireland that "firms in the nascent stages of development are largely dependent on resources of the firm owner, friends and family". Shinozaki (2012) emphasized that "with indirect financial systems dominant in Asia, enhancing the efficiency of bank lending for SMEs is a priority policy issue". He further adds that "the number of growth-oriented SMEs is expected to increase and they will seek increased access to the formal financial system. Thus, enhancing financial accessibility through diversifying financing instruments and infrastructure is critical to supporting growth-oriented SMEs". Saini (2014) found that commercial banks are not the primary supplier of finance for most of the MSMEs in New Delhi as owners find the application process cumbersome and tedious. Also, they do not qualify for loans due to lack of both collateral and positive balance sheets. The author concludes that "not only does it discourage aspiring entrepreneurs but also plays a huge role in holding back the growth of existing firms". Osotimehin et al.(2012) revealed from their study that "a vast majority of the respondents indicated that lack of financial support from the government and financial institutions are problems hindering the establishment of small and medium enterprise in many states in Nigeria. Lack of capital has been identified as the most serious problem of establishing small and medium enterprises". Based on the findings of the study, they recommended that "the government should re-introduce the small business credit scheme so that beneficiaries can use them to run the micro, small and medium enterprises". Pickernell, Jones, Packham, Thomas, White and Willis (2013) assessed "the association between business finance sources ranging from finance provided by friends and family to British government sourced finance and e-commerce as a trading activity. Positive associations between e-commerce trading activity and own personal finance and government finance were identified". However, Yadav (2012) in his study reports that bank finance has been observed as the "most preferable source of funding by SMEs with the highest weightage of 94 per cent followed by retained earnings at 81 per cent". It was also found in the study that "79 per cent of SMEs reported bankers were unwilling to provide loans whereas out of bankers' 21 per cent were observed to be indifferent to help SME firms". Data analysis of information collected from medium-sized enterprises in France indicates that "they have more leverage than the small ones". Some findings also indicate that high growth in SMEs is associated with debt component in capital, especially long term debt (Benkraiem and Gurau, 2013).

From the review it has been observed that well-developed MSME sector can generally be linked to well-structured lending institutions. This is because the structures of lending institutions seem to greatly affect the performance of MSMEs.

2.2.5 Difficulties Faced by MSMEs with Respect to Institutional Lending

Singh and Singh (2014) observed that,

"Small scale entrepreneurs face a lot of problems while availing loan facility from commercial banks and Government agencies. Financial institutions ask for a lot of information and data, State Financial Corporation takes several months to take decision on extending term loans and small-scale sector is not in a position to offer guarantee required by the banking sector. Even when small loans are raised from Government

agencies, the procedure is so cumbersome that most of the entrepreneurs who are either illiterate or semiliterate, hesitate to make use of these facilities".

Yifu et al. (2006) stated that in comparison to large enterprises, SMEs face more difficulty in providing collateral security requirements and guarantors required for institutional finance. They further found that "financial institutions have to collect and deal with soft information about the potential SME borrowers and therefore, they felt that in dealing with SME lending, informal lenders may have a great advantage over formal financial institutions". Reddy (2007) from his study at Fiji found that lack of security, insecure environment, lack of experience and lack of capital are stated as a major threat to credit procurement by small firms. The financial sector also is quite biased towards more developed firms. Irwin and Scott (2010) conducted a study on Barclays Bank customers in Great Britain and found that "education made little difference to sources of finance". The survey further confirmed that "ethnic minority businesses, particularly black owner-managers, had the greatest problem raising finance and hence relied upon bootstrapping as a financing strategy". Price, Rae and Cini (2013) stated that during times of recession in Lincolnshire and Rutland, "as indication of the long-term consequences of the credit crunch, the banks are not promoting the availability of finance for business, nor making finance easy for SMEs to access". These findings are supported by the conclusions of Taylor and Bradley (1994), who stated that "the smaller size of SMEs means that they are perceived as a greater investment risk by finance providers". Banks generally do not go out proactively to invite this segment of customers. Nkundabanyanga et al. (2014) suggests that access to formal credit varies with type of business and turnover. The authors further explained how the most important observed variable for commercial lending terms is interest rates, which, together with literacy levels, explains 31 per cent of the variances in access to formal credit by SMEs in Uganda. Sobia (2014) concludes from her research at Coimbatore that there is a general feeling among the proprietors of MSME units that they have not been provided loans from the lending institutions with operational flexibility in the terms of lending. Narteh (2013) stated how, most SMEs in Ghana cannot meet the rigid collateral demands (viz. landed property) of the banks as a pre-condition for accessing bank credit. Similarly, pricing was also an essential bank selection criterion by the SMEs in Ghana. Naidu and Chand (2012) reported that "MSMEs find it difficult to compete with their large counterparts and access the various financial services on offer which constrains their growth and survival". Goswami (2014) in her study conducted on SMEs in Assam reveals that 75 per cent respondents used their own fund for initial investment, while 93 per cent stated using bank loans. It also found that majority sought cash credit meant for working capital, but after availing the loan majority of the SMEs had utilised the fund for starting the business. It was also found that banks generally do not go out to woo this segment of customers and majority of the respondents stated that it took longer than the stipulated time for the credit to be sanctioned. Further, Singh and Wasdani (20 reported from their working paper for the World Bank, banks took on an average one and-a-half times longer than NBFCs in processing loan requests for existing MSMEs. Difficulty with collateral security or guarantee demanded by bank, procedural complications, lack of knowledge about available schemes are also some problems reported by the same study. Sharma A. K. (2014) conducted a study on 148 entrepreneurs in Hailakandi district in Assam and found that at least 30% of the entrepreneurs faced problems while lending from banks. Bohra (2017) conducted a study on 572 small business enterprises in Guwahati city and found that at least 63% of the respondents preferred to obtain funds from friends, relatives and at least 61% preferred informal moneylenders who were charging high interest rates. The primary reasons behind not preferring formal sources were unwillingness to register with District Industries Centre and lack of awareness.

MSMEs have unique characteristics when compared to other borrowers as result of which they find it difficult to clear the norms fixed by banks in extending credit. Banks also deem MSMEs as an unprofitable sector because of the smaller size of the loans along with inadequacy in providing collateral.

2.2.6 Difficulties Faced by Banks in Lending to MSMEs

Singh et al. (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 and most of the times feasibility report is not prepared by many units and even if prepared depicts a rosy picture to satisfy requirements of lending institutions. 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 credit worthiness of MSMEs cannot be ascertained and as such are considered as high-risk borrowers by investors and banks. Lam, Burton and Lo (2009) found that "majority of the SMEs in

Hong Kong appear to actively choose not to use one bank exclusively, and a large proportion of the SMEs appear to be willing to switch to other banks that offer better services, which suggests that banks face a challenging task in aiming to retain the loyalty of SMEs". Lundahl, Vegholm and Silver (2009) in their study in Sweden have found that "the basic assumption that SMEs want banks to provide support primarily during difficult times is still valid. Because most banks focus on the same issues and offer practically identical products and services, these findings give some guidance to banks striving simultaneously to differentiate themselves from competitors in the financial sector and to strengthen the relationship with their SME customers". Similar studies by Lehmann and Neuberger (2001) have agreed to the same. 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". The author further adds that "in spite of promotional measures of RBI, there has been high rate of NPAs in this sector leading to further hindrances in flow of credit to the sector". Nilsson and Ohman (2012) have noted in Sweden that "in a risk-averse banking environment, Lending Officers can be prone to assessing SME loan applications defensively to a noteworthy extent". They suggested that "for business owners and managers seeking bank financing, it would be highly important to back up a loan application with financial facts that can be processed internally by a bank and presented to its credit committee in order to obtain a loan approval". Akoijam (2013) analysed in details and stated that,

> *"In the field of credit delivery, the financial institutions are under stress, particularly since the financial sector reforms of 1992-1993. They added that the credit policy should continue to emphasize on small borrowers. They believed that commercial banks are wary of lending to the agricultural sector and rural poor and therefore the provisions of mandatory lending for the priority-sector and agricultural activities should continue".*

Sharma A. K. (2014) interviewed 13 banks in Hailakandi district in Assam where he found that all the banks reported shortage of staff.

It can be concluded that banks are not keen in lending to the sector because of varying reasons out of which the most recurring are "information asymmetry", "lack of credit rating agencies", "lack of proper collateral assets" and "smaller size of loans" which in turn increases the cost.

2.2.7 Towards Greater MSME Growth

Kundid and Ercegovac (2011) in their study at Croatia suggested that 'SMEs' access to financial resources may be unfavourable, but policy response should still be targeted to specific areas of concern, rather than provide financial support to any enterprise just because of its size'. Sharma G. (2011) reported from various news articles, government reports etc. that,

> *"Government of India is announcing number of measures to provide credit to MSME. Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has entered into memorandum with major banks such as State Bank of India, Punjab National Bank, Canara Bank to cover the risk of loans provided to micro and small enterprises in case of collateral-free credit".*

Kulkarni et al. (2012) from their analysis of government reports, news articles, journals etc. has suggested that "banks have many tasks on hand and hurdles to overcome which, when completed and constraints overcome, will certainly lead to strengthen the banker-borrower relationship". Sokoto and Abdullahi (2013) feel that "there should be urgent and pragmatic effort to address lack of funding and weak infrastructure, which are some of the constraints facing SMEs in Nigeria. In this regard government should be apt and consistent in its policies pertaining to SMEs and avoid policy summersaults". N. Shihabudheen (2013), after his research in Kerala, opined that "the strategic approach in promoting SSIs in reducing regional disparities in industrial development, in creating employment opportunities especially in rural areas and in developing entrepreneurship is successful especially after the MSME Act of 2006". However, Klonowski (2012) found that,

> *"Government-support programs are not effective in helping the sector close the liquidity gap as majority of the government programs aimed at closing the liquidity gap are concentrated at the lower end of the financial needs for the SME. In spite of this target concentration of the government, smaller firms from the SME sector experience difficulty in accessing finance at this range".*

Government has introduced a number of schemes and other measures which aims at development of the sector. But the success rates of such MSMEs are still uneven through various geographical locations and sectors. Lack of awareness about such sectors has been seen in many areas. It is very important to perform adequate follow-ups of such schemes.

2.2.8 Factors Determining MSME Lending

From the inference gathered from related literature, a number of factors are recorded which are likely to influence MSME lending. Mercieca et al. (2009) have found that competition increases bank-SME relationships while concentration decreases bank-SME relationships. Some more theoretical frameworks have also identified "competitiveness as an important factor that affects banks' lending behaviour" (Petersen & Rajan, 1995). "Competition may also bring about easier access to a wider range of bank services" (Neuberger et al., 2006) "or a shield against credit rationing caused by a sole lending bank" (Berger et al. 2001). Along similar such line, Berger et al. (2004) "provides evidence for the role of competitiveness by analysing data from 74 countries. He used a method to measure competitiveness through a concentration ratio, which reported that a higher concentration in the banking sector will pose stronger impediments for SMEs from accessing formal finance". Beck et al. (2008) have claimed that "legal framework has a greater impact on SME compared to firm size or bank ownership". Skosples (2012) tried to analyse and found,

> *"The level of difficulty in obtaining loans considering legal extensiveness and legal effectiveness for all firms in transition economies shows various results. Diverse effects on firms were found of different sizes. Small firms significantly encounter financing barriers caused by legal effectiveness in terms of consistency of regulations, efficiency of contract enforcement and treatment in the courts. The European Bank for Reconstruction and Development (EBRD) standards can be observed in which legal extensiveness refers to how easy it is to create, register, and enforce movable assets as collateral, transparency of bankruptcy laws and its effectiveness. Legal extensiveness covers creditor rights and legal effectiveness captures transparency and consistency of laws, administrative and judicial procedures".*

Some authors add that “credit policies are being identified as another channel through which the Government affects credit availability and affordability” (Berger & Udell, 2006). “Credit regulations help to relax rigid financial conditions from lenders by offering incentives such as interest subsidies and credit guarantee schemes, to name a few” (Harvie et al. 2010). Another “key constraint that lending banks are facing is lack of information about opaque SME borrowers” (Frame et al., 2001). “It lowers bank’s confidence in making approvals or can also distort their decisions towards demanding more collateral” (Berger et al. 2007). “Social relationship between loan officer and firm manager (Lehmann & Neuberger, 2001) is regarded as another important factor”. It is also said that “bank relationship serves as a proxy for an effective protection from credit rationing” (Berger et al., 2001) “because long lasting relationships with customers helps banks address asymmetric information and share risks with them” (Stiroh & Strahan, 2003). Some researchers have proposed “factors that are consistent with hard information of borrowers (Petersen & Rajan, 2002). They could be financial ratios from their financial statements, such as cash flow and profitability (McKenzie & Wolfe, 2004) or loan amount used” (Mercieca et al., 2009). Some authors have also considered “collateral as a determinant after considering banks that adopt asset-based lending technologies” (Berger et al. 2006; Haselmann & Wachtel, 2010). “Factors that involve firm characteristics are also widely used, for example, management (McKenzie & Wolfe, 2004) or being a new firm” (De Young et al., 2008). “Firm size” is also popularly considered to be an “important determinant of credit availability to SMEs” (Scott & Dunkelberg, 2001; Neuberger et al., 2006). Nu et al. (2012) in their study has found that the bigger the Vietnamese SMEs are in size, the greater the proportion of bank loan that has been obtained by them which are inconsistent with previous studies reviewed by them.

The key determinants identified that affect lending towards MSMEs have been identified as “size”, “competition”, “legal structure”, “credit policies”, “information asymmetry”, “collaterals” and “age of firm”.

2.2.9 Role of District Industries Centre

The ‘District Industries Centre (DIC)’ programme was started by the central government in 1978 with the objective of providing a focal point for promoting small, tiny, cottage and village industries in a particular area and to make available to them all necessary services and facilities at one place. The DIC website states that,

> *"District Industries Centre is the institution at the District level, which provides all the services and support facilities to the entrepreneur for setting up Micro, Small and Medium Enterprises. This includes identification of suitable schemes, preparation of feasibility reports, arrangements for credit facilities, machinery and equipment, provision of raw materials and development of industrial clusters etc."* (District Industries Centre, Department of Commerce and Industries, Government of Manipur).

The PMEGP scheme implemented through DIC at the urban areas was found to play a vital role in rural development in Kolhapure district in Maharashtra (Shalukhe, 2016). However though numerous schemes are available for MSMEs it is clear that majority do not have access to those schemes. More awareness must be created for those schemes so that it reaches the intended sections (Alamelugeeta, 2015). According to Alagar (2015), there are some inherent weaknesses in the relationship between DICs and MSME units. The vision and mission of DIC needs to be updated to reach out more to MSMEs. At the same time DIC needs to be accompanied by adequate support system in order to be more successful. A study conducted on MSMEs in Thoothukudi district in Tamil Nadu by Suriyan (2015), reported that MSMEs found the heavy bureaucratic procedure for registration of MSMEs as cumbersome and it hinders their relationship with DIC. Also the units complained of lack of flexibility in the banks recommended by DIC. Suriyan (2015) further compared between investments in industries before and after DIC's assistance in Tirunelveli district in Tamil Nadu and listed significant increases in average investments. He further surveyed the DIC officials and listed some problems as narrated by them viz. poor publicity about schemes, lack of co-ordination between DIC and other promotional agencies like banks and Khadi and Village Industries Commission, invariable rejection of project reports formulated by the experts of DIC by the banks, frequent transfer and failure to fill up vacant posts, complex procedures to be followed to satisfy the regulations and interference of political leaders, and the lack of adequate training facilities for junior officers. Another problem frequently experienced by MSME units, as found by Muruthiah (2015), was the lack of cooperation by the designated banks. Banks have their own norms and goals to achieve and hence may not adhere to DIC's requirements. Though DIC encourages collateral free loans, banks insist on collaterals. A study conducted by Sharma S. (2014) found that there were considerable gains from registering with DIC for small urban manufacturing enterprises. But surprisingly, there was still very low percentage of registered firms in India. He further added that as per the third All India census in 2002-03, the reasons for not registering with DIC was "not aware of such a provision (53%)", "not interested (40%)" and about 4% responded as "complicated procedures". Based on such responses, it is obvious that information asymmetry is a major constraint which leads the units to outweigh the costs and undervalue the benefits. A study conducted in Guwahati city, Assam found that out of 572 respondents (small traders), only 18.8% were registered with DIC while the rest preferred to register with Guwahati Municipal Corporation (GMC). The reason behind not preferring DIC was stated as "lengthy and cumbersome process of registration and huge number of documentation" (Bohra, 2017).

2.3 SUMMARY OF LITERATURE REVIEW

This review summarizes recent empirical research where the role and performance of MSME units all over the world has been highlighted. The importance of MSMEs is undermined by the fact that they provide the stimulus to economic growth, foster linkages and develops assets and entrepreneurial skills. Development of transitional economies like Poland depends on MSME growth. The MSMED Act of 2006 in India has been found to be very successful in developing the MSMEs. They are found to be the bed rock of economic growth and development not just in the developing economies but in advanced economies as well. MSMEs have been revolutionary in many developing countries.

The review further found the most prominent problem hindering institutional financing of MSMEs. MSMEs reportedly have not been able to succeed due to lack of finance. It has also been reported by the review of related literature that institutional finance is believed to be more important for their growth in comparison to informal finance. But survey reports in India have suggested that proportion of institutional finance in comparison to informal finance is very negligible. From the extensive literature review on the related areas it has been found that the availability of timely credit affects their daily activities and ultimately their profitability. Medium-sized enterprises in France are found to have more leverage than the small ones. Small-scale entrepreneurs face a lot of problems while availing loan facility from commercial banks and Government agencies as they ask for a lot of information and data, and usually take several months to decide on extending term loans. The research summarized here suggests that access to finance is a dominant growth constraint for SMEs and financial and legal institutions play an important role in relaxing this constraint. Therefore the comparative absence of SMEs in poor countries can be explained by the fact that they cannot obtain access to capital. Financial limitation is mainly caused by limited access to formal sources of credit. During times of financial crisis where their capacity to invest depends generally on banking loans, SMEs in Europe cannot finance their projects. Lending infrastructures have important effects on SME credit availability and better lending infrastructures may significantly improve SME credit availability. Small firms are also likely to be subject to credit rationing because of the information asymmetry in the capital markets. Bank finance has been observed as the most preferable formal source of funding by SMEs. In another contrasting study banks are found to be not the primary source of finance for most of the MSMEs in New Delhi as borrowers find the application process cumbersome and tedious. Enhanced financial accessibility, through diversified financing instruments and infrastructure, is critical to support growth-oriented SMEs. It is also seen that SMEs face difficulty in providing collateral security requirements and guarantors required for institutional finance. In dealing with SME lending, informal lenders may have a great advantage over formal financial institutions because of more access to soft information. The financial sector also is quite biased towards more developed firms. Smaller size of SMEs means that they are perceived as a greater investment risk by finance providers.

The review also tries to determine what influences credit disbursements towards MSMEs. It suggests that banks and financial institutions have financed the SSIs indiscriminately to achieve their targets either under pressure or with over-enthusiasm leading to failures. MSMEs are considered as high-risk borrowers by investors and banks. A large proportion of the SMEs appear to be willing to switch to other banks that offer better services, which suggests that banks face a challenging task in aiming to retain the loyalty of SMEs. There has been reportedly high rate of NPAs from this sector. Furthermore, it is found that Government support to the SME sector should take various forms apart from financial availability. Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has entered into memorandum with major banks such as State Bank of India, Punjab National Bank, Canara Bank to cover the risk of loans provided to micro and small enterprises in case of collateral-free credit.

From literature, the important factors that influence institutional lending towards MSMEs are:

Competition among the banks to increase borrowers has a positive effect on MSMEs as more banks become willing to provide credit to them (Mercieca et al., 2009; Petersen & Rajan, 1995; Neuberger et al., 2006; Berger et al., 2001; Berger et al., 2004).

Legal framework implemented by the government such as priority sector lending are important in credit rationing towards comparatively weaker MSME borrowers (Singh, 2006; Akoijam, 2013; Sharma, 2011; Beck et al., 2008).

Credit policies being followed by banks also determine magnitude of credit towards the sector. Whether it is sensitive to specific needs of MSME firms and also whether it requires information and supporting documents that MSMEs find it difficult to comply determines the ease of procurement of loans by MSMEs (Singh and Singh, 2014; Nkundabanyanga et al., 2014; Sobia, 2014; Berger & Udell, 2006; Harvie et al., 2010).

The problem of lack of information about SME borrowers also lowers credit directed towards the sector (Kumar, Batra & Sharma, 2009; Moon, 2012; Frame et al., 2001). On the other hand, if borrower shares personal relationship with lender, it helps the lender address the problem of asymmetric information about the borrower (Lehmann & Neuberger, 2001; Berger et al., 2001; Stiroh & Strahan, 2003).

Firm characteristics like age and management also affect borrowing behaviour of MSMEs (Irwin and Scott, 2010; McKenzie & Wolfe, 2004; De Young et al., 2006)

Firm size also play an important role as smaller sized firms find it more difficult to provide collateral requirements and guarantors and perceived as a "greater investment risk by finance providers" (Yifu et al., 2006; Taylor and Bradley, 1994; Skosples, 2012; Scott & Dunkelberg, 2001; Neuberger et al., 2006; Nu et al., 2012).

The literature suggests that the gap in MSME financing by banks is two-sided. There are problems faced by the entrepreneurs in availing finance from banks. On the other hand banks are shying away from lending to this sector. Various government institutes and schemes have been implemented to address this problem. But it has not been able to reach a majority section of MSMEs. Considering all the aspects to the problem further research is very essential in order to reach a comprehensive and sustainable solution to the problem.

2.4 RESEARCH GAP

A number of significant and comprehensive studies have been conducted on various aspects of MSMEs but some issues are still not adequately addressed. The study has identified the following research gaps:

i. Unregistered MSMEs are a segment which has a comparatively higher prevalence, but remains significantly unexplored. Due to scarcity of data on the unregistered sector, the area propounds potential new findings.

ii. As literature has suggested, there is a large financing gap in case of institutional finance to MSMEs. In order to analyse this gap, problems being faced by both the banks' and MSMEs are required to be identified and corroborated. 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 borrowing experience has not been researched extensively.

iii. Though it has been observed from literature that lack of registration with DIC had hindered many enterprises from obtaining finance, the author has not come across any study in Assam that emphasizes the impact of registration with DIC on MSME borrowing experience. DIC, being one of the nodal agencies for many of the government schemes, plays an important role in the development of the sector.