CHAPTER 8

PROBLEMS FACED BY BANKERS' IN LENDING TO MSMEs

8.1. INTRODUCTION

A primary survey was conducted among banks in the selected three districts. The research instrument was a questionnaire designed to find out the perception of bankers' towards the MSME sector. The banks were selected based on the overall mean difficulty score assigned to the banks (elaborated in Chapter 6). Responses were sought from MSME respondents with regard to their experience of borrowing from the bank (refer Question 12, Appendix 1). The responses to 37 variables were converted into one mean score. Thus there is a difficulty score for the bank against each respondent. The sample was grouped as per the three selected districts. Then district wise the banks were sorted in descending order of the mean difficulty score. From this, the top 50% were named as 'High Scoring' banks (meaning comparatively more difficulties faced) and the bottom 50% were named as 'Low Scoring' banks (meaning comparatively less difficulties faced). A total of 172 banks were thus included for the study, 92 banks were from Kamrup, 54 from Dibrugarh and 26 from Nagaon. The list of selected banks along with the mean difficulty scores has been demonstrated in Appendix 7. In order to gain more insight into the issues influencing banks' lending behaviour, it has been attempted to find what influences the difficulty levels as perceived by MSME borrowers.

8.2 ORGANISATION OF THE BANKS

The organisation type (public, private, co-operative or RRB) of banks were found to constitute as follows:
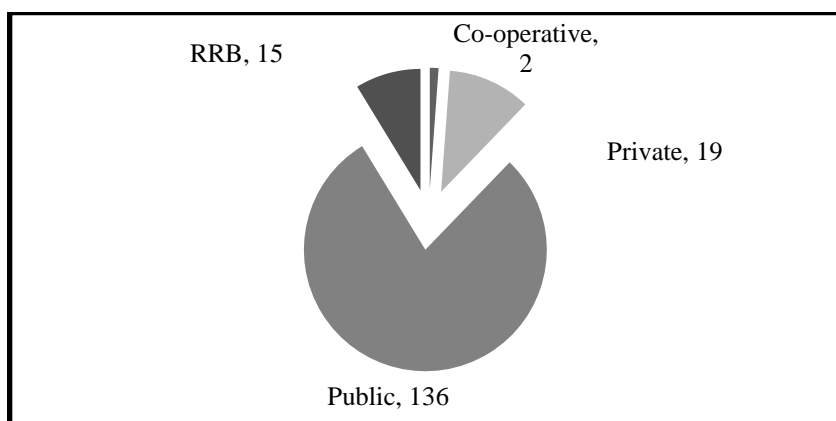

Figure 8.1: Organisation type of banks

8.3 IMPORTANCE OF MSMEs ACCORDING TO BANKERS

Five statements validating the importance of MSMEs as an investment for banks were presented to bankers and the responses collected were as follows:
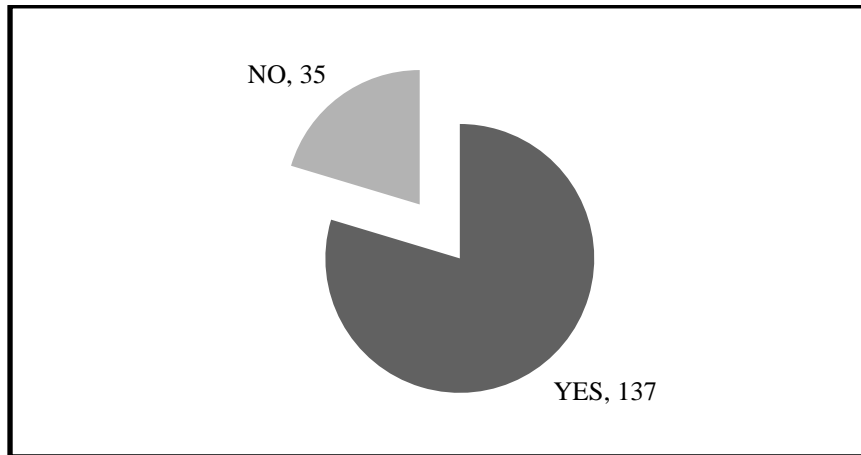
Figure 8.2: Responses on the statement 'MSME is an important sector for economic growth of the country'
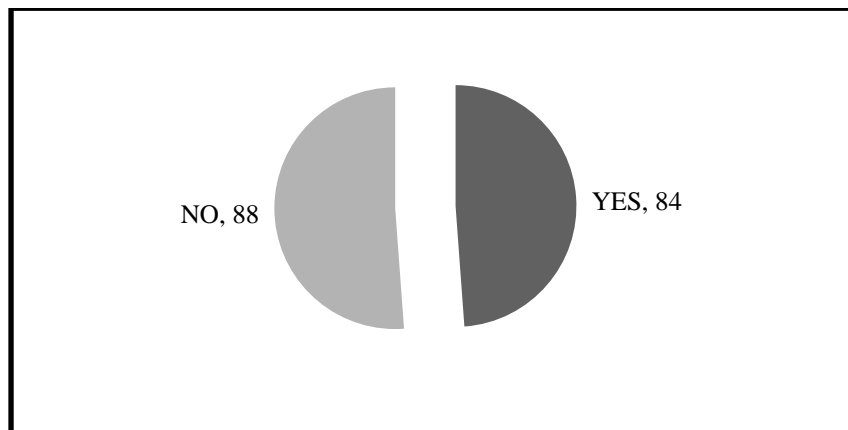
Figure 8.3: Responses on the statement 'MSME sector has good credit worthiness reputation'
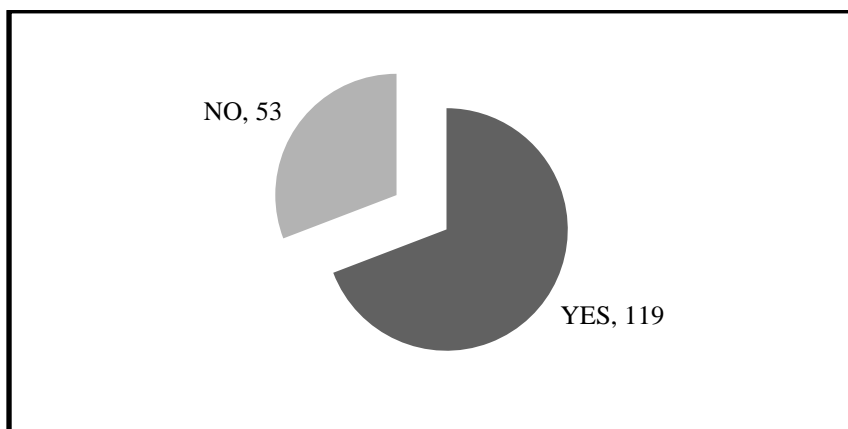
Figure 8.4: Responses on the statement 'MSMEs serve social objectives of banks'
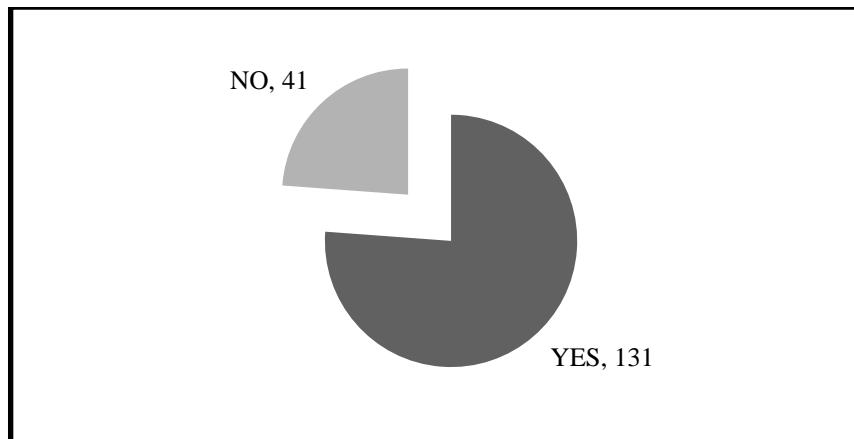
Figure 8.5: Responses on the statement 'Are government policies directed towards MSME sector, the reason behind investing in the sector'
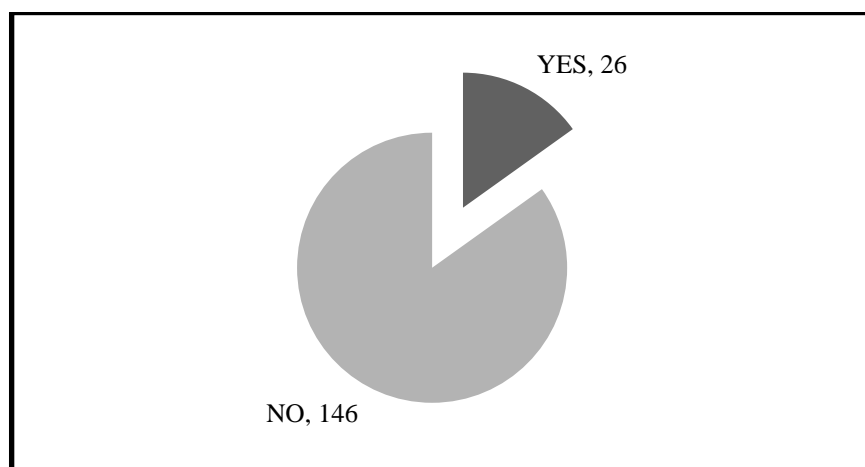

Figure 8.6: Responses on the statement 'MSMEs sector are a good investment due to increased competition from rival banks'

Majority bankers believe that MSME is an important sector for economic growth of the country. Majority bankers determine that MSME sector has good credit worthiness reputation. Majority bankers opined that social objectives of bank needed to be fulfilled by investing in the sector. Majority bankers felt that government policies directed towards focusing on MSME sector were the reason behind investing in MSMEs. Only 15.1% bankers assert that investment must be made in MSMEs in order to counter the increased competition from rival banks.

8.4 FACTORS THAT INFLUENCE SELECTION OF LENDING PROPOSALS (SPECIFICALLY MSMEs)

From literature review, 17 factors that were considered as influential in obtaining credit from bank by MSMEs were identified. The bankers were asked to respond to the statements by assigning a score to them from 1 to 5 according to their importance in

sanctioning loan request by MSME borrowers (Questionnaire attached in Appendix 2). A higher score would imply that the bank demanded more evidence and other requirement to sanction a loan. The responses were assigned scores using the following formula,

$$\frac{[N(HU) \times (1) + N(NI) \times (2) + N(N) \times 3 + N(I) \times 4 + N(HI) \times 5]}{N(R)}$$

Where,

N(HU) = No. of respondents selecting 'Highly Unimportant'

N(NI) = No. of respondents selecting 'Not Important'

N(N) = No. of respondents selecting 'Neutral'

N(I) = No. of respondents selecting 'Important'

N(HI) = No. of respondents selecting 'Highly Important'

N(R) = Total no. of respondents

After calculating the aggregate scores we arrive at the following:

Table 8.1: Aggregate scores on factors influencing selection of lending proposals

STATMENT	WEIGHTED MEAN
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*
NPAs 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*
Risk ratings as calculated by third party agencies	3.34
Adequate collateral security	3.19
Market reputation of borrower	3.17
Reference of some influential person	2.67

From Table 8.1, it is found that good quality business project/plan, size of the unit, borrower pledging more collateral compared to other applicants, third party guarantor, proper financial records, credit score as calculated by the bank, age of the unit, NPAs associated with the sector, long and close relationship with the lending bank, proper documents, reference by DIC, good social interaction/relationship with loan officer and size of loan requests are 'important' (highlighted*) factors for bank in selecting borrower (Refer Para 6.2, Chapter 6 for Likert scale cut-off). A Good quality business project/plan was found to be the ***most important factor***, while reference of some influential person was found to be ***least important factor*** in sanctioning a MSME borrower by the bank. The following are the top five most important factors that are considered by banks in sanctioning loans to MSME borrowers:

(i)   Good quality business project/plan.

(ii)   Size of the unit.

(iii)   Borrower pledging more collateral compared to other applicants.

(iv)   Third Party Guarantor.

(v)   Proper financial records.

The following are the five least important factors that are considered by banks in sanctioning loans to MSME borrowers:

(i)   Reference of some influential person,

(ii)   Market reputation of borrower

(iii)   Adequate collateral security,

(iv)   Risk ratings as calculated by third party agencies

(v)   Size of loan requests

8.5 DIFFICULTIES ASSOCIATED WITH MSME BORROWERS AS PERCEIVED BY BANKERS

It was found from literature survey that there are some unique problems which are faced by the bankers in lending to MSMEs. A list of 14 such potential problems that could pose an obstruction in lending to MSMEs were presented to the bankers. The bankers were asked to respond to the statements by assigning score to them according to their importance in sanctioning loan request by MSME borrowers. The responses were assigned scores using the following formula,

$$[N(HD) \times (1)+N(D) \times (2)+N(U) \times (3)+N(A) \times (4)+N(HA) \times (5)]$$

$$\overline{}$$

$$N(R)$$

Where,

N(HD) = No. of respondents selecting 'Highly Disagree'

N(D) = No. of respondents selecting 'Disagree'

N(U) = No. of respondents selecting 'Undecided'

N(A) = No. of respondents selecting 'Agree'

N(HA) = No. of respondents selecting 'Highly Agree'

N(R) = Total no. of respondents

After calculating the aggregate scores we arrive at the following:

Table 8.2: Difficulty scores associated with MSME borrowers

STATEMENTS	WEIGHTED MEAN
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*
MSME as a lending sector is inconsistent with banks' lending requirements and targets	3.38
MSMEs are a very risky sector	3.34
There are many competitors in the market who draw away potential borrowers	3.31
Lack of proper credit ratings for MSMEs	3.17
Some of the govt. policies hinder in improving lending to MSMEs	3.06
The MSMEs referred by DIC are usually not very credible	3.02
Information from DIC is insufficient	2.83
It is difficult to obtain requisite information on MSMEs due to limited managerial ability	2.78
MSMEs produce unreliable information on purpose	2.74

It is found that the variables which are perceived by bankers as difficult (highlighted*) 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 (Refer Para 6.2, Chapter 6 for Likert scale cut-off). 'MSMEs which are not existing bank customers' (and perceived to be comparatively riskier) was found to be the *most important problem*, while 'MSMEs producing unreliable information on purpose' was found to be *least important problem* in sanctioning loans to MSME borrowers. The following are the top five *most important problems* encountered by banks while lending to MSMEs:

(i)   MSMEs which are not existing bank customers are comparatively riskier.

(ii)   Average cost on loans made to MSMEs is high.

(iii)   Most of the MSME borrowers create a lot of hassles with repayment.

(iv)   In case of default it is comparatively more difficult to recover a loan from MSME.

(v)   There is a scarcity of adequately trained manpower to handle MSME clients.

The following are the five *least important problems* encountered by banks while lending to MSMEs:

(i)   MSMEs produce unreliable information on purpose.

(ii)   It is difficult to obtain requisite information on MSMEs due to limited managerial ability.

(iii)   Information from DIC is insufficient.

(iv)   The MSMEs referred by DIC are usually not very credible.

(v)   Some of the govt. policies hinder in improving lending to MSMEs.

8.6 GOVERNMENT SCHEMES FOR MSMEs

There are a host of government schemes directed at improving credit availability to MSMEs. But many of these schemes have not been able to perform adequately. The bankers' responses were sought on four parameters of selected schemes. Schemes have been selected as per their relevance towards financing MSME sector and feedback from bankers during pilot survey. A brief description of the schemes that have been included under this category is as follows:

(i) **PMEGP: '**Prime Minister's Employment Generation Programme' is a credit linked subsidy programme for generation of employment through setting up of micro enterprises in rural and urban regions of the country ("PM Employment Generation Program and other Credit Support Schemes", Ministry of MSMEs).

(ii) **PMMY: '**Pradhan Mantri MUDRA Yojana' is a scheme by Central Government of India to provide small loans (up to ₹ 10 lakhs) to micro and small enterprises ("MUDRA Offerings").

(iii) **Collateral Free Loans:** 'Collateral free loans' refer to credit schemes for MSMEs where the borrowers do not require pledging any asset or collateral in order to avail credit.

(iv) **Capital Subsidy:** 'Credit Linked Capital subsidy' is a scheme of financial assistance by providing a certain margin of up front capital subsidy to Micro and Small Enterprises, including tiny, khadi, village and coir industrial units, on institutional finance availed by them. This scheme is available to those MSEs who propose technology up gradation by purchasing plants, machineries or equipment with the help of institutional loans. Subsidy is transferred to beneficiary's account by disbursing agency after three years if the unit fulfils the conditions. The scheme has been discontinued as on 31st March, 2020 ("CLCSS, Development Commissioner, Ministry of MSME").

(v) **Interest Subsidy:** 'Interest Subsidy' is a scheme where a certain margin of interest relief is granted to eligible MSMEs.

Table 8.3: Bankers' perception on selected schemes for MSMEs

SCHEMES	Are there adequate applicants		Are the scheme policies appropriate		Is there adequate support from government		Is there adequate manpower to handle the scheme	
	Yes (In %)	No (In %)	Yes (In %)	No (In %)	Yes (In %)	No (In %)	Yes (In %)	No (In %)
PMEGP	90 (88.24)	12 (11.76)	84 (82.35)	18 (17.65)	35 (34.31)	67 (65.69)	41 (40.20)	61 (59.80)
PMMY	124 (95.38)	6 (4.62)	85 (65.38)	45 (34.62)	82 (63.08)	48 (36.92)	48 (36.92)	82 (63.08)
Collateral Free Loans	82 (80.39)	20 (19.61)	76 (74.51)	26 (25.49)	60 (58.82)	42 (41.18)	24 (23.53)	78 (76.47)
Capital Subsidy	60 (73.17)	22 (26.83)	39 (47.56)	43 (52.44)	42 (51.22)	40 (48.78)	32 (39.02)	50 (60.98)
Interest Subsidy	90 (100)	0 (0)	64 (71.11)	26 (28.89)	56 (62.22)	34 (37.78)	36 (40.00)	54 (60.00)

From Table 8.3, it is clear that majority of bankers agree that there is a manpower shortage to handle all the schemes that are being introduced by the government. Also, majority of bankers feel that there is lack of adequate support from the government to implement the PMEGP scheme. Majority bankers also felt that the scheme policies for capital subsidy schemes were not appropriate.

8.7 FACTORS INFLUENCING SANCTIONING OF LOANS TO MSMEs

The factors which influence whether or not a loan application will be sanctioned have been tested on various parameters to find out what influences the factors.

8.7.1 Factors influencing sanctioning of loans to MSMEs and type of bank

Since assumption of normality could not be assumed and the sample size being not adequate, a Kruskal-Wallis test which is more suitable for non-parametric data has been conducted to find out whether the average individual factor scores were similar across the various types of banks, i.e., public, private, co-operative or RRB. The hypothesis was framed as follows:

H_0 = Average factor scores do not differ significantly across type of bank organisation.

H_1= Average factor scores differ significantly across type of bank organisation.

Table 8.4: Kruskal-Wallis Test for Mean Factor Scores across different types of bank

FACTORS	p-value
Adequate collateral security	0.983
Proper Documents	0.807
Proper financial records	0.913
Third Party Guarantor	0.696
Long and close relationship with the lending bank	0.486
Good social interaction/relationship with loan officer	0.536
Reference by DIC	0.935
Reference of some influential person	0.681
Good quality business project/plan	0.128
Size of the unit	0.717
Size of loan requests	0.767
Age of the unit	0.855
NPAs associated with the sector	0.389
Borrower pledging more collateral compared to other applicants	0.430

Market reputation of borrower	0.920
Credit score as calculated by the bank	0.760
Risk ratings as calculated by third party agencies	0.329

The result of the Kruskal-Wallis test from Table 8.4 is that the hypothesis cannot be rejected. It means that there is no difference between the average Mean Factor Scores for various types of bank organisations. In simple words, type of bank, i.e., public sector bank, private sector banks, RRB or co-operative bank, does not influence the factors determining selection of borrowers by bankers.

8.8 DIFFICULTIES EXPERIENCED IN SANCTIONING LOANS TO MSMEs

The perceived difficulties experienced in sanctioning loans to MSMEs by banks have been tested on various parameters to find out what influences the difficulties.

8.8.1 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 hypothesis was framed as follows:

H_0 = Average difficulty scores do not differ significantly across type of bank organisation.

H_1= Average difficulty scores differ significantly across type of bank organisation.

Table 8.5: Kruskal-Wallis Test for Difficulty Scores across different types of bank

PERCEIVED DIFFICULTY	p-value
MSMEs produce unreliable information on purpose	0.767
Information from DIC is insufficient	0.257
Lack of proper credit ratings for MSMEs	0.398
Some of the govt. policies hinder in improving lending to MSMEs	0.660
MSME as a lending sector is inconsistent with banks' lending requirements and targets	0.811
MSMEs are a very risky sector	0.573
Most of the MSME borrowers create a lot of hassles with repayment	0.472
MSMEs which are not existing bank customers are comparatively riskier	0.520
There is a scarcity of adequately trained manpower to handle MSME clients	0.550
The MSMEs referred by DIC are usually not very credible	**0.037**
It is difficult to obtain requisite information on MSMEs due to limited managerial ability	0.351
In case of default it is comparatively more difficult to recover a loan from MSME	0.138
There are many competitors in the market who draw away potential borrowers	0.146

The result of Kruskal-Wallis test is that the assumption of equality of means cannot be rejected except in case 'MSME referrals by DIC'. It means that there is a difference between the average difficulty scores for 'MSME referrals by DIC' among various types of bank organisations. A Dunn post-hoc (Appendix 6H) reveals significant difference between private and co-operative, RRB and co-operative, public and co-operative and RRB and public. From Table 8.6, it is seen that co-operative banks faced highest difficulty associated with MSME referrals by DIC followed by public sector banks.

Table 8.6: Mean of Difficulty score for 'MSME referrals by DIC' for type of banks

	Bank Organisation	Mean
	Public	3.08
The MSMEs referred by DIC are	RRB	2.47
usually not very credible	Private	2.84
	Co-operative	4.5

8.9 BANK REQUIREMENTS AND PERCEIVED DIFFICULTY FACED BY BANKS

A high factor score would indicate that the bank has more requirements to sanction a loan. In other words to obtain a loan from the bank, borrower will have to provide comparatively more evidence. A high difficulty score would indicate that the bank perceives that there are comparatively more problems in lending to the sector. It has been attempted to find out if a relationship exists between the two scores, i.e., whether the average factor scores and difficulty scores were similar. The means of the individual factors and individual difficulties were considered for the test. Wilcoxon signed rank test has been used as an alternate to paired sample test to test the hypothesis as normality could not be assumed and sample size is not adequately large. The hypothesis is framed as follows:

H_0 = There is no difference between average factor score and average difficulty score.

H_1 = There is significant difference between average factor score and average difficulty score.

Table 8.7: 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)	**0.031**

a. Wilcoxon Signed Ranks Test

b. Based on negative ranks.

From the results in Table 8.7 we can see that the null hypothesis is rejected, indicating that there is significant difference among average factor score and average difficulty scores.

Table 8.8: Wilcoxon signed ranks

		N	Mean Rank
	Negative Ranks	114[a]	79.20
Mean_difficulty -	Positive Ranks	58[b]	100.84
Mean_factor	Ties	0[c]	
	Total	172	

a. Mean_difficulty < Mean_factor

b. Mean_difficulty > Mean_factor

c. Mean_difficulty = Mean_factor

From Table 8.8, after comparing the mean ranks between the two variables, it is seen that in 114 cases (66%) average factors were higher than average difficulties. It implies that irrespective of whether the banks perceived high difficulty in lending to MSMEs or not, the sample banks had high requirements in selecting borrowers.

8.10 CATEGORY OF BANK AS RANKED BY BORROWERS (HIGH DIFFICULTY AND LOW DIFFICULTY)

In Chapter 6, it has been explained in details how borrowers scored their banking experience in relation to difficulty level. The selection method of banks for primary data collection has been explained in Chapter 3 and elaborated in current chapter. Now the banks were grouped under two bases, i.e., high difficulty and low difficulty as ranked by borrowers. It has been attempted to find out whether average factor scores and average difficulty scores significantly varies across the two categories of banks. Since normality could not be assumed and sample size is inadequate, a non-parametric alternate to

independent samples t-test has been used. The results of Mann Whitney U tests are summarised below:

8.10.1 Category of bank and average factor scores

The hypothesis framed is as follows:

H_0 = There is no significant difference in average factor scores across categories of bank

H_1 = There is significant difference in average factor scores across categories of bank

Table 8.9: Mann Whitney test for category of banks and factor score

FACTORS	p-value
Adequate collateral security	0.462
Proper Documents	0.977
Proper financial records	0.967
Third Party Guarantor	0.941
Long and close relationship with the lending bank	0.066
Good social interaction/relationship with loan officer	0.065
Reference by DIC	0.273
Reference of some influential person	**0.004**
Good quality business project/plan	0.158
Size of the unit	0.565
Size of loan requests	0.563
Age of the unit	0.908
NPAs associated with the sector	0.751
Borrower pledging more collateral compared to other applicants	0.852
Market reputation of borrower	0.852
Credit score as calculated by the bank	0.573
Risk ratings as calculated by third party agencies	**0.002**

The results from the test reveal there the null hypothesis is rejected in two cases, reference of influential person and risk ratings calculated by third party agencies, where significant differences exists between categories of bank.

Table 8.10: Mean ranks for factor and category of bank

	Category of Bank	Mean Rank
Reference of some influential person	High Score	75.87
	Low Score	**97.13**
Risk ratings as calculated by third party agencies	High Score	75.12
	Low Score	**97.88**

Looking at Table 8.10 and comparing mean ranks of low scoring and high scoring banks, we find that banks that have a low difficulty score from MSMEs, give comparatively more importance to reference of some influential person and risk ratings as calculated by third party agencies.

8.10.2 Category of bank and average difficulty scores

The hypothesis framed is as follows:

H_0 = There is no significant difference in average difficulty scores across categories of bank

H_1 = There is significant difference in average difficulty scores across categories of bank

Table 8.11: Mann Whitney test for category of banks and difficulty score

PERCEIVED DIFFICULTY	p-value
MSMEs produce unreliable information on purpose	.911
Information from DIC is insufficient	.636
Lack of proper credit ratings for MSMEs	.854
Some of the govt. policies hinder in improving lending to MSMEs	.661
MSME as a lending sector is inconsistent with banks' lending requirements and targets	.987
MSMEs are a very risky sector	.683
Most of the MSME borrowers create a lot of hassles with repayment	.958
MSMEs which are not existing bank customers are comparatively riskier	.774
There is a scarcity of adequately trained manpower to handle MSME clients	.208
The MSMEs referred by DIC are usually not very credible	.434
It is difficult to obtain requisite information on MSMEs due to limited managerial ability	.987
In case of default it is comparatively more difficult to recover a loan from MSME	.393
There are many competitors in the market who draw away potential borrowers	.966
Average cost on loans made to MSMEs are high	.551

Since null hypothesis cannot be rejected in any of the parameters of difficulty, it is concluded that there is no significant difference in average difficulty scores across categories of bank (high or low difficulty).

8.11 SUMMARY OF FINDINGS

Majority bankers believe that MSME is an important sector for economic growth of the country, MSME sector has good credit worthiness reputation, and social objectives of bank needed to be fulfilled by investing in the sector and government policies directed towards focusing on MSME sector were the reason behind investing in MSMEs. However, only 15.1 % bankers assert that MSMEs must be serviced in order to counter increased competition from rival banks. Type of bank had no influence over mean factor score or mean difficulty score. Bankers who have higher requirements in selecting a borrower do not necessarily have experienced higher difficulty in lending to the MSME sector.

The top five most factors that are considered by banks in sanctioning loans to MSME borrowers are good quality business project/plan, size of the unit, borrower pledging more collateral compared to other applicants, third party guarantor and proper financial records. The following are the top five most problems encountered by banks while lending to MSMEs: MSMEs which are not existing bank customers are comparatively riskier, average cost on loans made to MSMEs is high, most of the MSME borrowers create a lot of hassles with repayment, in case of default it is comparatively more difficult to recover a loan from MSME and scarcity of adequately trained manpower to handle MSME clients..

Majority of bankers agree that there is a manpower shortage to handle all the schemes that are being introduced by the government. Also, majority of bankers feel that there is lack of adequate support from the government to implement the PMEGP scheme. Majority bankers also felt that the scheme policies for capital subsidy schemes were not appropriate.

There is a significant difference between the average difficulty scores for 'MSME referrals by DIC' among various types of bank organisations. Co-operative banks are found to have faced highest difficulty associated with MSME referrals by DIC followed by public sector banks. Banks that have a low difficulty score from MSMEs, give comparatively more importance to reference of some influential person and risk ratings as calculated by third party agencies. Also, irrespective of whether the banks perceived difficulty in lending to MSMEs or not, banks had high requirements in selecting borrowers.