

*In loving memory of my grandfather late Mr. Uma Prasad Gogoi and my
grandmother late Mrs. Bhaba Tara Choudhury*

ABSTRACT

Title of the Thesis: An Evaluative Study on Bank Financing of MSMEs in Assam

Researcher: Maumita Choudhury

Supervisor: Prof. Chandana Goswami

Professor, Department of Business Administration

Tezpur University, Napaam, Assam, India Pin- 784028

Period of research: The study covers a period of 2014 to 2019

Statement of the Problem:

The most imminent problem related to the MSME sector is the lack of availability of authentic data. The informal segment within the SME sector is so vast and, by definition, no authentic information about them is available. A dichotomy exists in the lending scenario to MSMEs. On one hand, more credit flow to MSMEs are needed in order to further accentuate their growth, but on the other hand, commercial banks have reportedly experienced high NPAs from this sector due to which the profitability of the banks are affected. This study therefore aims to find out the problematic factors associated with bank lending to MSMEs and find out various measures to overcome such issues.

Objectives of Research:

The objectives of the study are:

1. To analyse commercial banks' contribution towards financing MSMEs in Assam.

To study the scenario of bank lending in Assam, secondary data has been used.

2. To examine the constraints experienced by MSMEs of Assam in acquiring finance from banks.

To fulfil objective 2, primary data has been collected from MSMEs which were categorised as units that were registered or not registered with DIC during the study period.

3. To identify the obstacles faced by banks in financing MSMEs in Assam.

To find out the perception of banks, primary data has been collected from banks.

Scope and Limitation of the study:

The study concentrates on the function of lending by banks to the MSME sector and the associated problems experienced by both MSMEs and banks in Assam. The three districts with highest number of registered MSMEs in Assam have been selected for the study. MSME units that have borrowed from banks have been included for the purpose of primary research. Both MSMEs that have registered with DIC and those that have not, have been considered for primary survey as during the study period DIC was a prime agency for MSME registration. Also, commercial banks, co-operative banks and regional rural banks operating in the state of Assam which have lent to the selected MSME units have been included for the primary survey.

The study being for academic purpose with a fixed tenure is not without limitations, which can be listed as follows:

- (i) The study has excluded non-commercial banks and non-banking institutions that provide finance to the MSME sector.
- (ii) The study has excluded the role of Khadi and Village Industries Commission (KVIC) and Khadi and Village Industry Boards (KVIB) in MSME financing.
- (iii) The geographical coverage of the study is limited to three districts in Assam (selected based on the concentration of MSMEs).

Research Methodology:

Data was collected from both primary and secondary sources. For Primary sources, data was collected through field visits to MSME units and banks. For secondary sources, RBI reports, SLBC reports, reports and lists by District Industries and Commerce centres, Annual Reports by MSME Development Institutes, journals and articles, data from websites and other published sources were used to find out inferences regarding aspects of commercial bank lending towards MSMEs. The primary data collection was carried

out district-wise, with the help of a structured questionnaire. A structured questionnaire using five point Likert scale was used to measure the selected variables for the study. The study population includes all registered and unregistered MSMEs in Assam which have adequate financial experience in terms of borrowing from commercial banks. 126 MSME units who had not borrowed from banks were also additionally included to understand their side of the issue. The total sample size was 375 (Registered MSMEs) + 375 (Unregistered MSMEs) = 750 units. It is found to be well conforming to sample sizes selected for similar studies. The sample size in case of banks in Assam has been selected as 172. The selected sample size comprises 24% of total number of bank branches which is in tandem with similar studies. For registered MSME units, stratified random sampling method has been used to select samples of MSME units. For unregistered MSME units, snowball and convenience sampling procedure has been used. For banks, judgemental sampling procedure has been used. Samples were selected based on responses of the MSME units.

Findings of the study:

(i) Commercial banks' contribution towards financing MSMEs in Assam

(a) Public sector banks in Assam and all India have a higher number of branch network, however, private banks have surpassed public sector banks and Regional Rural Banks (RRBs) by a huge margin in financing the MSMEs. Average per branch achievement in disbursing credit to MSME is ₹252 lakhs for public sector banks, ₹1,254 lakh for private sector banks and ₹161 lakhs for RRBs for the year 2017-18. Only private sector banks have increased average achievements at a steep year-over-year growth rate compared to public sector and regional rural banks. The proportion of credit to MSME sector to aggregate credit remains low, especially for public sector banks and RRBs.

(b) Public sector, private sector and RRBs have mostly failed in achieving the target of 7.5% of ANBC towards micro enterprises. However, the contribution of private sector banks is comparatively higher. Though the target of 60% of MSME credit to micro sector has been improving for public sector and RRBs over the years, the proportion is comparatively low for private sector banks which imply that the private sector banks have neglected the micro enterprises within the MSME sector.

(c) The absolute proportion of MSME credit by banks in Assam to MSME credit by banks in India remains very low ranging from 0.45% to 1.45%.

(ii) Constraints experienced by MSMEs of Assam in acquiring finance from banks.

(a) Attitude of banks' whole lending to MSMEs is the broad area with the highest difficulty reported. Specific areas of difficulty identified to be dominant in obtaining finance from bank by MSMEs are details demanded in the application procedure, unreasonably high collateral security requirements, insufficient promotional drives inviting MSMEs, negative overall attitude towards MSMEs and unreasonably high time gap between submission and sanction.

(b) The demographic, financial and borrowing characteristics that seem to have significant influence over difficulty experienced by MSMEs are gender, type of unit, age of unit, registration status (with DIC), capital invested, annual income, amount of loan applied and type of scheme availed. Male borrowers were found to experience more difficulty with regard to documentation, attitude, post sanction and terms and policies while obtaining loans from banks. Comparatively older borrowers (age more than 50 years) are observed to have faced higher difficulty with documentation and sanction process. Medium units faced more difficulty with documentation and sanction process, while small units experienced more difficulty with application, attitude and support services. Businesses that were 6-10 years old faced highest difficulties while businesses up to 5 years old faced the least difficulty with application. Unregistered units experience higher difficulties with application, documentation, sanction, attitude, support service and terms and policies. MSMEs with comparatively higher investments in capital seem to have experienced greater difficulty. MSMEs with comparatively higher annual income faced highest difficulties with application, documentation, attitude and terms and policies. Highest difficulty was experienced by borrowers applying for micro loans. Borrowers under MUDRA scheme face more difficulty with attitude, support service, staff support and terms and conditions, followed by borrowers minus any scheme who face the highest difficulty with sanction, documentation and application.

(c) MSMEs that have not borrowed from bank is because of lack of awareness, fear of inability to repay in time, documentary requirements, perceived high rate of interest charged by banks or have access to alternate source of finance and they do not approach bank even after believing that borrowing from banks can help the business

improve. Some dominant reasons behind MSMEs getting rejected by banks for loans are lack of adequate collateral and non-feasibility of project although in many cases the borrowers were not provided with a clear reason for rejection.

(d) The trend of registration of MSMEs is growing on a yearly basis but the proportion of registered units in Assam to registered units in India is very negligible at marginally less than 2% during 2007-18. Out of total 79,52,491 registrations through the portal from 2015 till 2019, only 11,913 registrations were from the state of Assam, accounting for approximately only 0.15%. Unregistered borrowers were primarily either unaware of benefits from DIC registration, were of the perception that getting registered meant too much documentary requirements or did not feel the requirement among other factors that refrain them from registering.

(e) Registering with DIC was found to marginally influence the borrowers' satisfaction with the amount sanctioned by banks in the districts of Nagaon and Dibrugarh in Assam. However, there was no such influence observed in the district of Kamrup in Assam.

(f) Unregistered borrowers ordinarily faced higher difficulty in application process when compared to registered borrowers, with the exception of those unregistered borrowers who had a postgraduate degree. All unregistered units faced comparatively more difficulties in terms of attitude and support service from the bank in comparison to registered units.

(iii) Obstacles faced by banks in financing MSMEs in Assam.

(a) Dominant problems encountered by banks while lending to MSMEs are identified to be new and unfamiliar customers (perceived as riskier due to information asymmetry), high average cost on loans made to MSMEs, hassles with repayment, difficult to recover a loan from MSME in case of default and scarcity of adequately trained manpower to handle MSME clients.

(b) Co-operative banks faced highest the difficulty associated with MSME borrowers which were referred by DIC.

(c) Important factors that were considered by banks in sanctioning loans to MSME borrowers are proper documents, proper financial records, third party guarantor, long and close relationship with the lending bank, good social interaction/relationship with loan officer, reference by DIC, good quality business project/plan, size of the unit, size of loan requests, age of the unit, NPAs associated with the sector, borrower

pledging more collateral compared to other applicants and credit score as calculated by the bank.

(d) Banks' requirements considered in sanction of MSME loan were higher compared to perceived difficulties with the sector.

(e) Government policies for MSME sector were the main driver behind investment in the sector by banks. Only a handful of bankers felt that investment in MSME sector could counter increased competition from rival banks.

(f) Banks were found to provide better service when borrowers have reference of influential person or a credit rating by agency.

(g) Banks were also facing manpower shortage to handle government schemes. There is lack of adequate support from the government to implement the PMEGP scheme. The scheme policies for capital subsidy schemes were perceived to be inappropriate by banks.

Suggestions:

Some specific findings and observations from current study which has been conducted in the state of Assam are as follows:

- (i) Banks in Assam, especially public sector banks, have been struggling and in effect, failed to accomplish credit directives over the years. The negligence is magnified in case of the micro units within the MSME sector. To address this issue and curtail the over dependence of MSME financing on banks, major schemes, especially for micro enterprises, can also be implemented through institutions other than commercial banks, so as to deflect some strain from banks.
- (ii) A credit rating, in theory, addresses the information asymmetry between the MSME borrower and the lender. It will very beneficial if a unique ID containing credit rating information for each MSME is created linked with the online portal launched by Ministry of MSMEs, particularly in the Northeast India.
- (iii) Many unregistered MSMEs are unaware of the benefits that registration provides. Ministry of MSMEs must go for more effective promotional strategies that can raise awareness especially in rural areas. The MSMEs must be ensured full security and support which will encourage them to register and inhibiting factors behind registration must be addressed.

- (iv) MSMEs are required to register separately with different organization for various purposes which are a waste of time and resource. It is recommended to maintain one single point registration system for MSMEs which must be done electronically. It is recommended that DIC be appointed the nodal agency for monitoring MSME registration because of its widespread reach and resources.
- (v) The DIC officials follow a traditional rule of thumb technique in accepting or rejecting proposals to be forwarded to banks. DIC must encourage MSMEs to avail the Performance and Credit Rating Scheme being implemented through NSIC to improve the acceptance rate.
- (vi) It is suggested that banks use alternatives like personal guarantee, bank statement, GST data, standardized score cards to evaluate credit worthiness of MSME borrowers instead of heavily relying on collateral security closes the door to many potential MSME borrowers. Schemes directed to the sector must be launched under a single nodal agency, i.e. the Ministry of MSME to address the issue of lack of awareness.
- (vii) Introduction of a standardised and minimal application or documentation approach specifically for MSME sector could ease the difficulties associated with borrowing process. DIC can be entrusted the duty to come up with such a uniform documentation system which can be applicable for all banks and all MSMEs.
- (viii) There should be strict penalty for wilful defaulters which will discourage them from misusing the relaxations offered. It is important to ensure that credit flow is directed to deserving borrowers and not wilful defaulters.

A Committee was constituted on Micro, Small and Medium Enterprises for proposing long term solutions for the economic and financial sustainability of the MSME sector. The suggestions of the Committee which supplement the findings and observation of the current study, and also some additional observations and suggestions have been listed as follows:

- (i) The Sinha Committee recommended an online portal in similar lines as mentioned in suggestions above which can be synergized with banks as well as Goods and Service Tax Network¹ so that all borrowing information of the borrowers can be uploaded and the creditworthiness of the borrower can be assessed accordingly on the website.

¹ Goods and Services Tax is an indirect tax imposed in India on the supply of goods and services.

- (ii) As per the Committee reports, reasons for lack of registration are many and varied. For nano/household type of enterprises, in their view, not obtaining registration is an escape from official machinery, paperwork, costs and rent seeking. Registration offers them little by way of tangible benefits.
- (iii) In line with the suggestions above, the Sinha Committee has recommended NSIC as the nodal agency for all purpose registration of MSMEs. However, NSIC as the nodal agency could be inefficacious as NSIC has limited resources and limited reach compared to DICs.
- (iv) The study is in agreement with the Sinha Committee recommendation that the Ministry of MSME should be the Nodal Ministry for all interventions pertaining to the MSME Sector, rather than multiple schemes being run by different Ministries for promotion of MSMEs in their respective domain.
- (v) The committee has recommended increase in the limit for non-collateralised loans to ₹20 lakh and revision in loan limit sanctioned under MUDRA to ₹20 lakh from ₹10 lakh. Such a step would definitely give a boost the MSMEs in Assam and supplements suggestions above.
- (vi) The Committee recommends that the RBI facilitate the creation of additional information sources from where a financial institution may download a report which includes a score for the entity based on additional factors including business risk, industry risk, management risk, and financial risk. As recommended in suggestions above, these information can be stored in the unique ID allotted to each MSME borrower.
- (vii) Uniformity in and simplification of various loan application formats and assessment process has been recommended by the Committee as concurred in suggestions above.

Contribution to the body of knowledge:

The present study has attempted to evaluate the scenario of commercial banks' lending to MSMEs. The key contribution made to the body of knowledge by the study are, this is the first study that compares the commercial bank borrowing experience between MSMEs that have borrowed from banks with the assistance of DICs and MSMEs that have borrowed without the assistance of DICs. The research gap identified was that unregistered and informal sector, which are comparatively much higher in prevalence but also unaccounted for, remains mostly off the radar. The study reveals the influential factors that determine the borrowing experience of MSME borrowers as well as banks.

In addition the status of lending to the MSME sector by banks in Assam has been investigated and the findings accordingly discussed.

It has been observed that the Northeastern part of the country is lagging behind in most aspects related to development of MSMEs. Though Assam comparatively has a higher presence compared to the other Northeastern states, it is still substantially much behind at an all India level as evident from the study. There is no question about the government's effort in trying to uplift the MSME sector. But it has not been very effective in ensuring that the schemes and policies benefit the target groups. Development is not ensured by merely implementing schemes but also taking appropriate measures to ensure that the schemes are being well implemented and reaches and benefit the target groups.

Scope for further research:

The research can be extended to problems faced by MSME units in other states in India. Problems experienced by financial institutions other than banks in financing MSMEs are another area that can be explored. Government funded organisations which were set up with the aim of assisting the MSMEs such as DIC, NSIC, KVIB etc. can be evaluated for their roles and functions. Further research can be undertaken on government's role in MSME development. The performance of schemes for MSMEs can also be evaluated so that it can be found whether the schemes have been achieving its objectives.