



## Bank Finance to Micro, Small and Medium Enterprises

### KEYWORDS

Commercial Banks, Credit, Financial Exclusion, MSMEs, Performance, Sustainable development.

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**ABSTRACT** *Micro, Small and Medium Enterprise (MSME) sector is a vibrant segment of the country which is responsible to promote the industrial growth, employment potential, exports, capital formation, sustainable development and overall inclusive growth. Access to adequate and timely credit at a reasonable cost is the most critical problem faced by MSMEs. Over the years there has been a significant increase in credit extended to this sector by the banks. Despite the increase in credit outstanding to the sector, the financial needs of MSMEs have not been adequately addressed by formal financial institutions. The statistics compiled in the Fourth Census of MSME sector September 2009, revealed that the extent of financial exclusion in the MSME sector is very high. Therefore, MSME sectors should be treated as emerging sectors while providing financial and non-financial assistance.*

### INTRODUCTION

The banking sector is the core segment of the Indian financial system which decides the progress of the economy. An efficient and modern banking system is must for promoting savings and channelizing them into diversified investment and help to achieve a faster rate of economic development. Banks contribute to speed up the economic growth of a country by mobilizing scarce financial resources for productive purposes. Commercial banks constitute the larger part of the total banking system and these banks play an important role in growth and development of economy in general and enterprise sector in particular. They form the most important part of the Indian financial landscape in terms of their role in channelizing credit to the commercial sector and facilitating the process of financial inclusion. The Scheduled Commercial Banks (SCBs) in India comprise 27 Public Sector Banks (State Bank of India and its 6 Associates, 20 Nationalized Banks, 7 New Private Sector Banks, 15 Old Private Sector Banks, 31 Foreign Banks, 86 Regional Rural Banks (RRBs) and 1721 Urban Co-operative Banks (UCBs).

Micro, Small and Medium Enterprises across the world, including India are the vehicles for faster, sustainable and inclusive growth. Globally, MSMEs have been accepted as the engines of economic growth and for promoting equitable development. In India, the MSME sector plays a pivotal role in the overall industrial development of the country. This sector contributes about 8 per cent of the GDP of India, 45 per cent of the manufactured output and 40 per cent of its exports. They provide employment to over 60 million persons through more than 26 million enterprises. There are over 6000 quality products ranging from traditional to high-tech items, which are being manufactured by the MSME sector in addition to providing wide range of services. The labour intensity of the MSMEs sector is much higher than that of the large enterprises. In recent years, the MSMEs sector has consistently registered higher growth rate compared to the overall industrial sector. MSMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country. With its agility and dynamism, the MSME sector has shown admirable innovativeness and adaptability to survive in the recent economic downturn and recession. Thus, MSMEs are important for the fulfilment of national objectives of growth with equity and inclusion.

### DEFINITIONS OF MICRO, SMALL AND MEDIUM ENTERPRISES

In accordance with the provision of Micro, Small and Medium

Enterprises development (MSMED) Act, 2006, the Micro, Small and Medium Enterprises are classified into two categories based on their Investment in plant and machinery and Investment in equipments.

| Manufacturing Sector: |   |
|-----------------------|---|
| Enterprises           | Investment in plant & machinery   |
| Micro Enterprises     | Does not exceed twenty five lakh rupees                                 |
| Small Enterprises     | More than twenty five lakh rupees but does not exceed five crore rupees |
| Medium Enterprises    | More than five crore rupees but does not exceed ten crore rupees        |
| Service Sector:       |   |
| Enterprises           | Investment in equipments  |
| Micro Enterprises     | Does not exceed ten lakh rupees   |
| Small Enterprises     | More than ten lakh rupees but does not exceed two crore rupees          |
| Medium Enterprises    | More than two crore rupees but does not exceed five crore rupees        |

Source: Ministry of MSME

### GROWTH AND PERFORMANCE OF SSI/ MSMEs

Table.1: Growth and Performance of SSI / Micro, Small and Medium Enterprises

| Sl. No. | Year    | Total Working Enterprise (In Lakh) | Employment (In Lakh) | Market Value of Fixed assets (In Crore) | Gross Output (In Crore) | Exports (In Crore) |
|---------|---------|------------------------------------|----------------------|---|-------------------------|--------------------|
| I       | II      | III                                | IV                   | V                                       | VI                      | VII                |
| 1       | 2001-02 | 105.21                             | 249.33               | 154349.00                               | 282270.00               | 71244              |
| 2       | 2002-03 | 109.49                             | 260.21               | 162317.00                               | 314850.00               | 86013              |
| 3       | 2003-04 | 113.95                             | 271.42               | 170219.00                               | 364547.00               | 97644              |
| 4       | 2004-05 | 118.59                             | 282.57               | 178699.00                               | 429796.00               | 124417             |
| 5       | 2005-06 | 123.42                             | 294.91               | 188113.00                               | 497842.00               | 150242             |
| 6       | 2006-07 | 361.76                             | 805.23               | 868543.79                               | 1351383.45              | 182538             |

|    |          |        |         |            |             |        |
|----|----------|--------|---------|------------|-------------|--------|
| 7  | 2007-08# | 377.37 | 842.23  | 917437.46  | 14351383.45 | 202017 |
| 8  | 2008-09# | 393.70 | 881.14  | 971407.49  | 1524234.83  | N. A.  |
| 9  | 2009-10# | 410.82 | 922.19  | 1029331.46 | 1619355.53  | N. A.  |
| 10 | 2010-11# | 428.77 | 965.69  | 1094893.42 | 1721553.42  | N. A.  |
| 11 | 2011-12# | 447.73 | 1012.59 | 1176939.36 | 1834332.05  | N. A.  |

Source: Ministry of MSMEs Annual Report 2012-13 # Projected N. A: Not Available

The above Table 1 explains the annual growth of working MSMEs, employment generated, investment, production and exports in India from 2001-02 to 2011-12. The data up to the year 2005-06 represents the Small Scale Industries (SSIs) and from the year 2006-07 relates to MSMEs which include manufacturing and service enterprises. It can be observed from Table 1 that in the year 2001-02, there were 105.21 lakh units which created employment opportunities for 249.33 lakh persons with fixed investment of `154349 crore. Total production of this sector was worth `282270 crore and contribution to the India exports was to the extent of `71244 crore. There was a steady growth up to the year 2005-06. After the

passing of the MSME Act 2006, there has been increase in the number of enterprises, employment, investment, production and exports. The above table shows that number of MSMEs have increased from 105.21 lakh units in 2001-02 to 447.73 lakh units in 2011-12. The employment in MSMEs increased from 249.33 lakh in 2001-02 to 1176.93 lakh during 2011-12. The investment and production increased from `154349 crore and 282270 crore in 2001-02 to `1176939.36 crore and 1834332.05 crore in 2011-12 respectively. Exports have increased from `71244 crore in 2001-02 to `202017 crore in 2007-08.

### OUTSTANDING CREDIT TO MSE SECTOR

Finance is the life-blood of an enterprise. For the promotion, development and effective running of an industry, adequate and timely finance is a prerequisite. Financial access is critical for MSMEs growth and development. The MSMEs primarily rely on bank finance for their operations and as such ensuring timely and adequate flow of credit to the sector has been an overriding public policy objective. Advances extended to the MSE sector are treated as priority sector advances. Over the years there has been a significant increase in credit extended to this sector by the banks.

Table 2: Outstanding credit to MSE Sector by SCBs (No of A/Cs in millions) (Amount- Rs. in billions)

| Year                       | Public Sector Banks |                      | Private Sector Banks |                     | Foreign Banks      |                     | All Scheduled Banks   |                      |
|----------------------------|---------------------|----------------------|----------------------|---------------------|--------------------|---------------------|-----------------------|----------------------|
|                            | No of A/Cs          | Amt O/s              | No of A/Cs           | Amt O/s             | No of A/Cs         | Amt O/s             | No of A/Cs            | Amt O/s              |
| Last Friday of March 2008* | 3.967               | 1511.374             | 0.819                | 469.118             | 0.065              | 154.892             | 4.851                 | 2135.386             |
| March 2009                 | 4.115<br>(3.73%)    | 1914.083<br>(26.64%) | 0.678<br>(-17.21%)   | 466.563<br>(0.54%)  | 0.058<br>(-10.78%) | 180.634<br>(16.61%) | 4.0851<br>(No change) | 2561.280<br>(19.94%) |
| March 2010#                | 7.217<br>(75.38%)   | 2763.189<br>(44.36%) | 1.131<br>(66.81%)    | 648.247<br>(38.94%) | 0.157<br>(170.69%) | 211.470<br>(17.07%) | 8.0505<br>(75.32%)    | 3622.907<br>(41.44%) |
| March 2011                 | 7.398<br>(2.51%)    | 3694.30<br>(33.70%)  | 1.718<br>(51.90%)    | 881.16<br>(35.93%)  | 0.186<br>(18.47%)  | 209.81<br>(-0.78%)  | 9.302<br>(9.37%)      | 4785.27<br>(32.08%)  |

Source: Address by Dr. K.C. Chakrabarty, Deputy Governor, Reserve Bank of India at the 'SME Banking Conclave 2012' organized by SME Chamber of India, February 4, 2012, Mumbai.

\*change in definition of the sector as per the MSME Act 2006 advised to banks in 2007

# Retail trade included in service sector

Note: Figures in Parentheses indicates Y-O-Y growth/decline

The above Table 2 reveals the outstanding credit to MSE sector by SCBs. As at the end of March 2011, the total outstanding credit provided by all Scheduled Commercial Banks (SCBs) to the MSE sector stood at `4785.27 billion as against `3622.907 billion in March 2010 was registering an increase of 32.08%. Despite the increase in financing to the MSME sector there is still a considerable credit gap which needs to be bridged.

### ESTIMATED OUTSTANDING CREDIT DEMAND AND SUPPLY OF MSMEs

Table 3: Estimated Outstanding Credit Demand and Supply of MSMEs (₹ Crore)

| Year    | Total Demand | Total Supply | Credit Gap in absolute terms | Credit Gap as per cent of Total Demand |
|---------|--------------|--------------|------------------------------|--|
| 2010-11 | 20,92,500    | 7,37,161     | 13,55,339                    | 65                                     |
| 2011-12 | 23,08,384    | 8,74,482     | 14,33,902                    | 62                                     |
| 2012-13 | 25,41,574    | 10,38,948    | 15,02,626                    | 59                                     |
| 2013-14 | 28,03,628    | 12,37,539    | 15,66,089                    | 56                                     |

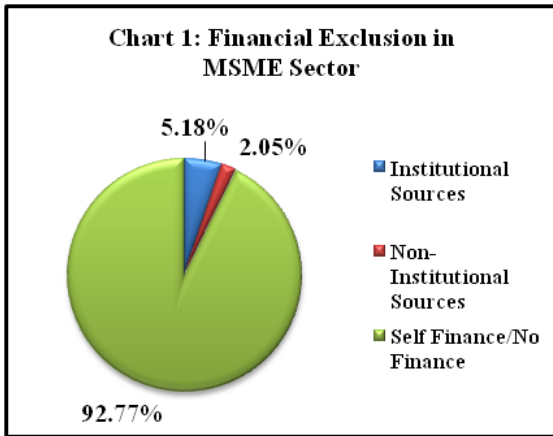
|         |           |           |           |    |
|---------|-----------|-----------|-----------|----|
| 2014-15 | 30,89,863 | 14,77,928 | 16,11,935 | 52 |
| 2015-16 | 34,05,845 | 17,66,659 | 16,36,186 | 48 |
| 2016-17 | 37,57,755 | 21,24,644 | 16,33,111 | 43 |

Source: RBI Monthly Bulletin, December 2013

The above Table 3 shows the estimated outstanding credit demand and supply of MSMEs. In terms of the Report of the Private Sector Investment for MSME sub group under Working Group for the 12<sup>th</sup> Five Year Plan (2012-2017) the credit gap as a percentage to total demand is estimated at 52 per cent in 2014-15 at `16,11,935 crore for the MSME sector. Meanwhile, in 2016-17 the credit gap will be of 43 per cent at `16,33,111 crore.

### FINANCIAL EXCLUSION IN MSME SECTOR

Access to adequate and timely credit at a reasonable cost is the most critical problem faced by MSMEs. Despite the increase in credit outstanding to the sector, the financial needs of MSMEs have not been adequately addressed by formal financial institutions.



Source: RBI Monthly Bulletin, December 2013

The statistics compiled in the Fourth Census of MSME sector September 2009, revealed that only 5.18% of the units (both registered and unregistered) had availed of finance through institutional sources, 2.05% had availed of finance from non-institutional sources; the majority of units i.e., 92.77% had

not availed finance or depended on self-finance. (Chart 1) Thus, the extent of financial exclusion in the MSME sector is very high. However, this is not entirely unexpected because if one looks at the financial exclusion in our country in general, then Micro, Small and Medium Enterprises cannot remain unaffected by it. Hence, there is a need to bridge this gap through enabling policies and the Government of India needs to play catalytic role to cater the needs of this sector.

#### CONCLUSION

MSMEs play a very significant role in the balanced and sustainable growth of the economy. The contribution of micro, small and medium enterprises to GDP, industrial production, employment and exports of the country is quite significant. Over the years, there has been a significant increase in credit extended to this sector by the banks. Despite the increase in financing to the MSME sector there is still a considerable credit gap which needs to be bridged. Therefore, MSME sectors should be treated as emerging sectors while providing financial and non-financial assistance. The government should also take necessary steps to promote the MSMEs product in the market by arranging trade fair, export shows etc. There is need for the Government, banks or financial institutions to promote MSME development by providing policy support, adequate and timely finance and other required facilities to address the issue of poverty, unemployment, financial inclusion and inclusive growth.

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