



THE IMPACT OF BANK FINANCING ON THE FINANCIAL PERFORMANCE OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES)

Management

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ABSTRACT

Financing Micro, Small and Medium Enterprises [MSMEs] has received much attention in the present scenario due to the Government policy from 'Made in India' to 'Make in India' and 'Start up India'. This policy has been encouraging entrepreneurs to startup their enterprises. Which helps in development of economy in the way of rural and urban industrialization, generating employment opportunities and entrepreneurial development. Finance is the most important component to run the enterprises. According to research studies stated that lack of adequate access to bank credit is the key factor stifling the growth of MSMEs. The paper sought to determine the adequate bank finance improves the financial performance of MSMEs. The study suggests that commercial banks should develop a credit policies which meets diverse, expected credit and working capital requirements of MSMEs in hassle free manner. The study also suggest the entrepreneurs should formulate financial planning which helps in estimation of finance which required for the business, assess how much funds can be raised through equity and debts and their effective utilizations.

KEYWORDS

1.1 INTRODUCTION: MSMEs mainly relies on bank finance for funding its operation , As per the RBI report 95% of the total advances to MSMEs have been provided by commercial banks in which Public Sector Banks (71%), Private Banks (18%) and foreign Banks (6%). Regional Rural Banks, Urban and State Cooperative Banks comprise remaining 5% of commercial Banks lending. Even though, banking sector is the main intermediary in providing financial assistance to MSMEs but average share of bank financing for MSMEs in India is about 20% and thereby credit flow to the sector is not found to be adequate which is evident from the various studies and Reserve Bank reports. There is a total finance requirement of INR 32.5 trillion in the MSME sector, at present scenario only 22% or 7 trillion of the total MSME debt financing from the formal finance sector, in that 85% or 5.9 trillion of credit supply to MSME sector by scheduled commercial bank and rest of the formal debt flow from Non-Banking Finance Companies, Regional Rural Banks, Urban Cooperative Banks and Financial Institutions (ASSOCHAM). Credit flow to MSMEs has been identified from the empirical evidence that there is a **credit gap** between demands and supply of finance to MSMEs. In order to fill this gap, Government of India and Reserve Bank of India encouraged banks to support MSMEs for meeting their financial requirements in a single window clearance and make provision for adequate finance in the Banking policy. Apart from this Banks can also adopt innovative lending policy and strategies to meet the financial requirements of MSMEs and also help in promoting MSMEs globally competitive.

1.2 An Overview of MSME sector in India:

Micro, Small and Medium enterprises are emerged as a highly **vibrant and dynamic sector** for developing economies like India, over the last five decades this sector is not only playing a crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also by contributing to industrialization of rural & backward areas, thereby, reducing regional imbalances and assuring more equitable distribution of national income and wealth (Ministry of MSMEs).

Definition of Micro, Small and Medium Enterprises as per Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.

Category	Investments[plant & machinery]	Service[turnover]
Micro Enterprises	Less than Rs.25lakh	Less than Rs.10lakh
Small Enterprises	Less than Rs. 5crore	Less than Rs. 2crore
Medium Enterprises	Less than Rs. 10crore	Less than Rs. 5crore

Source: Ministry of Micro, Small and Medium Enterprises (MSMEs). Government of India

1.3 Objectives of the Study:

- To analyze the financial performance of MSMEs by using financial ratios
- To determine the impact of bank financing on the financial performance of MSMEs.

1.4 Research Methodology: the data for the study is secondary in nature. The secondary data has been collected from the financial statement of the MSMEs which borrowed loan from Banks. A sample of 500 companies selected for the purpose of the study. 242 enterprises belonged to Micro, 184 Small enterprises and the remaining 74 are Medium enterprises. In the study T-test used to determine the relationship between financial ratios and MSMEs and ANOVA test was employed for significant difference in Micro, Small and Medium Enterprises with respect to financial performance.

1.5 Conceptual Model and Hypothesis:

Leverage	Leverage represented by Debt to Equity ratio and debt total Assets Ratio.
Profitability	Profitability represented by Return on Capital Employed and Return on Investment
Liquidity	Liquidity represented by Current Ratio
Efficiency	Efficiency represented by Debt to Total Assets, Interest coverage ratio.

Hypothesis Development:

Bank finance significantly impact on the financial performance of MSMEs.

1.6 Literature Review:

'Financing bright ideas' by Angew (2003). The paper focused on the definitions; Bank financing refers to provision of credit facilities by financial institutions for business activities. Financial performance refers to the degree to which financial objectives of a firm are being accomplished.

'The effect of bank financing on the financial performance of small and medium – sized enterprises in Nairobi country' by Akinyi Susan Irene (2012). The study recommended that the Commercial Banks reform the term of bank financing to increase SMEs access to access credit from financial institutions and Management of SMEs should intensify SMEs size so as to enhance their financial performance.

'Voluntary disclosure of Financial Ratios; CNX Nifty Companies' by CMA Dr. M. Sriram (2016). The paper highlighted on Financial Ratios are considered as one of the important tool of analysis. The inclusion of which in the annual report shall reduce the information asymmetry. Investors and Analysts use ratios for comparability purposes, standardization of the method of calculations will help them compare the performance of the companies sector-wise and decide the best investment vehicle.

'Credit impact on performance of Micro, Small and Medium Enterprises in Telgana' by Prabhakar Gampala (2018). The study concludes that the credit programs formulated by state and central government has to consider field level reality and financial institutions which are serving these programs have to treat MSEs as medium and large enterprises. Then only the introduced credit programs can get success and influence more on performance oriented development of the MSEs.

2.1 Analysis and Interpretation: An analysis has been made to understand the adequate bank finance improves the financial performance of MSMEs by using financial tool viz. Ratios.

Financial Ratios	Output	Enterprises			Total	Test statistics	
		Micro	Small	Medium			
Debt to Equity	<2:3	F	89	75	24	188	X ² =101.296 p=.000; CV=.064 p=.397
		%	36.8%	40.8%	32.4%	37.6%	
	=2:3	F	35	18	13	66	
		%	14.5%	9.8%	17.6%	13.2%	
	>2:3	F	118	91	37	246	
		%	48.8%	49.5%	50.0%	49.2%	
Debt to Total assets	<1:3	F	85	75	21	181	X ² =684.52 p=.000; CV=.095 p=.059
		%	35.1%	40.8%	28.4%	36.2%	
	=1:3	F	35	30	20	85	
		%	14.5%	16.3%	27.0%	17.0%	
	>1:3	F	122	79	33	234	
		%	50.4%	42.9%	44.6%	46.8%	
Return on capital employed	<20%	F	50	36	17	103	X ² =81.424; p=.000; CV=.094 p=.182
		%	20.7%	19.6%	23.0%	20.6%	
	20%-40%	F	111	69	32	212	
		%	45.9%	37.5%	43.2%	42.4%	
	40%-60%	F	47	34	14	95	
		%	19.4%	18.5%	18.9%	19.0%	
	>60%	F	34	45	11	90	
		%	14.0%	24.5%	14.9%	18.0%	
Return on Investment	<20%	F	52	40	22	114	X ² =15.472 p=.000 CV=.095 p=.169
		%	21.5%	21.7%	29.7%	22.8%	
	20%-40%	F	59	38	16	113	
		%	24.4%	20.7%	21.6%	22.6%	
	40%-60%	F	57	34	19	110	
		%	23.6%	18.5%	25.7%	22.0%	
	>60%	F	74	72	17	163	
		%	30.6%	39.1%	23.0%	32.6%	
Current Assets to Current Liabilities	<2:1	F	147	92	19	258	X ² =79.876 p=.000; CV=.195 p=.000
		%	60.7%	50.0%	25.7%	51.6%	
	=2:1	F	53	63	25	141	
		%	21.9%	34.2%	33.8%	28.2%	
	>2:1	F	42	29	30	101	
		%	17.4%	15.8%	40.5%	20.2%	
Net profit to Turnover	<10%	F	185	116	18	319	X ² =519.872 p=.000; CV=.280 p=.000
		%	76.4%	63.0%	24.3%	63.8%	
	10%-20%	F	46	59	54	159	
		%	19.0%	32.1%	73.0%	31.8%	
	20%-30%	F	11	8	2	21	
		%	4.5%	4.3%	2.7%	4.2%	
	>30%	F	0	1	0	1	
		%	0.0%	0.5%	0.0%	0.2%	
Interest on Debt to Net profit	<10%	F	21	9	3	33	X ² =29.140 p=.000; CV=.203 p=.000
		%	8.7%	4.9%	4.1%	6.6%	
	10%-20%	F	67	36	8	111	
		%	27.7%	19.6%	10.8%	22.2%	
	20%-30%	F	104	89	23	216	
		%	43.0%	48.4%	31.1%	43.2%	
	>30%	F	50	50	40	140	
		%	19.8%	27.2%	54.1%	27.6%	

When we verified the association between return on capital employed to MSMEs, it revealed a non-significant association (CV=.094; p=.182) due to a similarity in evaluated results of return on capital employed ratio range between 20%-40% in MSMEs.

Return on Investment: Another parameter to measure % of net profit to fixed assets was return on investment, wherein 30.6% of the Micro enterprises and 39.1% of Small enterprises have higher ratio of return on investment than Medium enterprises, which expressed that assets are being utilized properly (X²=15.472; p=.000). The association between return on investment and types of enterprises is observed, wherein we find that there is a non-significant association (CV=.095; p=.169), indicating >60% of return on capital employed ratio was more in Small enterprises followed by Micro enterprises and least in Medium enterprises.

Current assets to Current Liability ratio: It is a most widely used ratio. Around 71% of the Micro and 50% of Small enterprises have the current ratio of <2:1 whereas 40.5% of the Medium enterprise have the

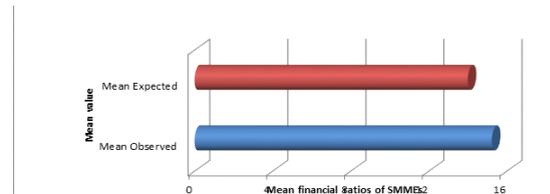
current ratio of >2:1 which expressed that there is no adverse effect on business operations when the payment of current liabilities is made (X²=79.876; p=.000). When Cramer's value was applied and verified to determine the association between current assets to current liabilities and different types of enterprises, it was found that there is a significant association (CV=.195; p=.000), considering as much as 41% of the Medium enterprises have current ratio of >2:1 than Small and Micro enterprises.

Net Profit ratio reveals the overall profitability of the concern. An analysis has been made to know the profitability of 500 sample units of which 76.4% and 63% of Micro and Small enterprises respectively have <10% of N/P to Turnover and 73% of Medium enterprises have the profitability ranging between 10%-20%, which give an idea of improving in the efficiency of the concern (X²=519.872; p=.000). Coming to the Cramer's value (CV=.280; p=.000), it indicated a significant association between N/P ratio and MSMEs. 63.8% of MSMEs profitability belong to >10% followed (31.8%) by 10%-20% and least (21%) by 20%-30%.

Interest on debt to N/P or Interest coverage ratio: A total of 500 MSMEs have been targeted to know the efficiency of the concern towards payment of interest charges against debt, wherein 43% of Micro and 48.8% of Small enterprises were utilized 20-30% of their earnings to make the payment of interest against debts. In case of Medium enterprises 54.1% of total were utilized >30% of their earnings towards interest on debts. To know the correlation between interest coverage ratio and different types of enterprises, we can find a significant correlation (CV=.203; p=.000), considering 43.2% of MSMEs utilize 20-30% of their earnings towards payment of interest. Similarly 27.6% of the enterprises spent >30% of their earnings for payment of interest, the range between 10%-20% of their profitability for interest paid by 22.2% of MSMEs and only 6% of MSMEs have spent their earnings <10%.

2.2 T-test: Results of one way T test Scores of financial ratios of Micro, Small and Medium Enterprises.

Financial Ratios	N	Mean Observed	Std. Deviation	Mean Expected	Differences	T value	P value
	500	15.2340	3.36599	14	1.2340	8.198	.000



When an implication of financial performance was verified, a mean score of 15.2340 was found as against the expected mean value of 14. The difference of 1.2340 having higher implications on the financial performance of MSMEs and it was found to be significant at .000 levels.

One way ANOVA: Results of One way ANOVA scores of financial performance of Micro, Small and Medium Enterprises.

Types of enterprises	Numbers	Mean	Std. Deviation	Minimum	Maximum
Micro Enterprises	242	14.7851	3.20712	8.00	22.00
Small Enterprises	184	15.3967	3.67538	7.00	24.00
Medium Enterprises	74	16.2973	2.78317	11.00	23.00
Total	500	15.2340	3.36599	7.00	24.00

Groups	Sum of square	Differences	Mean Square	Frequencies	Significances
Between	137.298	2	68.649	6.185	.002
Within	5516.324	497	11.099		
Total	5653.622	499			

Scheffe

	Category	Number	Subset for alpha = .05
		1	2
Micro Enterprises	242	14.7851	

Small Enterprises	184	15.3967	15.3967
Medium Enterprises	74		16.2973
Significance		.335	.094
Means are displayed ...			
a Uses Harmonic Mean Sample Size = 129.980			
b The group sizes are unequal ...			

Inference:

there is a significance difference among mean effectiveness of Micro, Small and Medium Enterprises. 'F' value 6.185 found to be significant at .002 levels. The mean effectiveness of Micro, Small and Medium Enterprises are 14.79, 15.39 and 16.29 respectively. Further, Schiff post of test revealed that there is no significant difference between micro and small similarly small and medium Enterprises. In other words only mean difference of Micro Enterprises found to be significant.

3.0 Findings:

- To know the solvency, liquidity and profitability of the enterprises and to assess whether the enterprises **effectively utilize bank finance**, many ratios have been computed, in which around 37% of MSMEs were having less than standard ratio in case of debt-equity and debt to total assets. In the case of return on capital employed and return on investment around 20% of MSMEs were having less than 20% of returns. This shows unfavorable financial leverage of the enterprise.
- While observing the short term solvency or liquidity of the enterprises, we found that more than 50% of the enterprises do not have sufficient funds to meet working capital requirements. This will have adverse effect on business operation when the payment of current liability is made.
- Similarly observation on the Net Profit to Turnover ratio around 64% of the MSMEs earnings on turnover was less than 10%. In terms of net profit to turnover Medium enterprises have good returns as compared to Micro, Small Enterprises. Around 43% of MSM units have utilized 20%-30% of their earnings for interest on debt. It affects the enterprise's capacity to maintain a uniform dividend policy during difficult trading period that may occur.

4.0 Suggestions drawn from findings of the study:**4.1: MSMEs:**

- Estimate adequate financial requirements and to access regular information on various credit schemes of Government and Commercial Banks.
- Develop effective lines of communication with Commercial Banks, Government agencies, customers, parental companies, business development institutions and associations.
- Develop financial planning documents, budget and cash flow projections that lay out long term financial requirements using capital structure model, capital budgeting techniques, financial ratios, financial trend analysis which helps in estimation of finance to be required for the business and assess how much funds can be raised through equity and debt.
- Maintain proper books of accounts that lay out the financial net worth/financial position by applying financial tools like cash flow statement, fund flow statement, financial ratios and others would be in a better position to evaluate the viability of the enterprises.
- Develop the attitude of repayment of bank loan on time, which helps in gaining the confidence of bankers to lend additional loan facilities and other qualitative services.
- MSMEs have to develop the attitude of financial, marketing and managerial competency which enables them to face challenges and ability to run the business effectively.

4.2: Regulatory Measures

- Introduce system of single window clearance.
- Encourage Large Scale Industries to empower MSMEs as ancillaries in manufacturing processes with incentives to Large Scale Industries in direct proportion to work allocation
- Provide proper infrastructure facilities solely in the domain of the government so that utilization of bank loans and capacity of the enterprise is maximized
- Create awareness among the entrepreneurs about many financial schemes, services of business development institutions like National Small Industrial Corporation of India (NSIC), Technology Business Incubation (TBI), Council of Scientific Research (CSIR), Indian Institute of Technology(IIT), National Research and Development Corporation (NRDC), National

Institute Design (NID) and other institutions.

- Chamber of Commerce and Industry to organize regular Entrepreneurial meet to elicit their views, if any issues relating to inadequate finance that can be taken with the appropriate authorities to find remedies.
- Government procuring policy of buying at least 20% of annual purchase from MSMEs by public Sectors in letter and spirit.
- Form a Committee to ascertain reasons for unfavorable financial leverage of the enterprise as regards debt-equity and debt to total assets ratios.
- Enhance working capital limit.

4.3: Bankers:

- Convene the entrepreneurs meet regularly to educate them about the financial schemes of Government as and when policies are introduced by the Government to boost up MSMEs.
- While sanctioning loan to MSMEs, bank should understand the need of finance by considering the nature of business, products demand and place of business established which helps them to meet their different financial requirements.
- Collect feedback from the MSM entrepreneurs, in order to understand the need of finance and prepare credit proposals in a scientific manner.
- Give importance to non-financial services such as counseling, technical, marketing support and organizing seminars to provide latest information about various financial schemes and its benefits.
- Explore measures to reduce transaction cost and dilute rigid procedures to a reasonable level without compromising the security net of the bank providing the loan.
- Creating separate portal for MSME on bank website and place all the information to MSMEs as suggested by RBI.

5.0 CONCLUSION

In light of the findings, the study concludes that finance is the important components for MSMEs. Even RBI has made the guidelines to commercial banks to achieve 20% year on growth in credit to MSMEs and 60% of the total advances to Micro enterprises, still MSMEs are facing the financial constraints. Hence the commercial banks to assess the adequate requirement of finance especially for Micro and Small Enterprises on the basis nature and type of business accordingly extend credit facilities to MSMEs in a hassle free manner. Similarly Entrepreneurs have to formulate financial plan that lay out adequate financial requirements to run the business effectively and also analyses the financial performance through various financial tools to assess the effective utilization of owned and borrowed funds.

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