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Preferred Sources of Financing by MSMES and Reasons for Such Preference in Tripura State in Northeast India

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Abstract:
Micro, Small and Medium Enterprises (MSMEs) are considered to be growth engine of any economy, and their importance increased tremendously for the developing countries. But it is, equally true that MSMEs face unique challenges. The focus of this study is identifying preferred financing sources and reasons for such preference by the MSMEs in the hilly state of Tripura in North East India. For the study primary data were collected through schedules.
The study reveals that owners or managers of MSMEs are not aware about non conventional financing sources. Policy makers should take steps to educate and sensitize owners and managers of MSMEs about those sources. It is also seen that while most preferred source of financing is Banks/Financial Institutions, but MSMEs are still depended upon own fund, fund from Friends and Relatives and Money Lenders for financing their business. Therefore, policy makers should frame policies to involve Banks/Financial Institutions to invest in this sector to make the sector more vibrant.

Keywords: Economy, Financing, MSMEs, Entrepreneurs, Businesses, Preferred Financing.

Introduction:

Growing small businesses are known to have a good effect on the economy by creating jobs, wealth generation, and innovation (Carter and Jones Evans, 2006). Fatoki and Asah (2011) discovered that firm type is an important parameter in obtaining debt from commercial banks, with smaller enterprises facing more trouble compared to larger firms.

Micro, Small and Medium Businesses (MSMEs) play very commendable role in country's socioeconomic growth because they provide jobs, promote fair regional development, and thus help to combat poverty (Holems et al., 2003). SMEs do, however, encounter significant obstacles, such as financial accessibility issues that impede their expansion and development. To initiate a business, secure its growth, and facilitate expansion, small and medium-sized enterprises (SMEs), particularly in developing nations, predominantly rely on banks as the primary external funding source (Beck, Demiguc-Kart, & Singar, 2013). Because of their ability to expand, MSMEs-despite their modest beginnings-are also viewed as the cornerstone of businesses in the future generation. According to earlier research, SMEs have more financial restrictions than larger companies because lenders view them as riskier investments (Berger & Udell, 2016).

Micro, Small and medium-sized enterprises (MSMEs) face numerous obstacles at the time of seeking financial assistance, attributed to their compact scale, limited diversity, and vulnerable financial structures. Additionally, a sample of data indicates that smaller businesses than larger ones are subject to more real and perceived limitations. Due to their inability to provide excellent collateral or their relative lack of transparency on their creditworthiness, they have all been regarded as unfavourable borrowers (Boot et al. 1991; Ayadi and Gadi, 2013).

In view of the above, this study tries to find out the preferred sources of financing by MSMEs in Tripura state along with reasons for such preference.

Review of Literature:

Small and medium-sized businesses have employed a sizable portion of private industrial workers in Japan, one of the developed world's industrial structures (Banock, 1969).

It is said that small businesses in the United States create eight out of ten jobs (Mead and Liedholm, 1998).

Vijaylakshmi et al. (2005) studied Venture Capital Funding for Micro, Small, and Medium Enterprises (MSMEs) in India and discovered that MSMEs struggle to obtain funding for new ventures because banks are reluctant to lend money for projects deemed high risk. It is also claimed that venture capital and other alternative investments are becoming more popular in India, especially for the MSME sector.

The company's capital structure is solely dictated by its capital requirements. When evaluating a company's capital structure, it is essential to consider both the factors impacting it and the indicators of obstacles in acquiring capital (Faulkner and Peterson, 2006).

According to Abor (2007), MSMEs' performance suffers when debt makes up a large portion of their capital structure. Therefore, depending on the amount that requires an ideal level of leverage, the loan might have both a negative and positive impact on performance.

Rajan (2009) made note of the SMEs' reliance on owners' savings and their predilection for using the 3Fs-family, friends, and fools-as a source of capital in their financial structure.

As per Klapper's (2010) study, businesses with fewer than five years of operational history don’t resort to debt financing.

Based on the findings of the study by Fatoki and Asah (2011), MSMEs' access to debt financing from commercial banks is impacted by company size, with small businesses receiving less preference than large businesses.

Pinho (2011) stated that managers and owners have options when deciding on the financial structure of MSMEs thanks to unofficial sources of funding.

Smaller and younger SMEs rely on internal sources of financing (personal or family resources), trade credit, and angel financing for the initial capital, according to Berger and Udell's (2012) study on small business finance in the US. This is because the market's availability of small business funding is restricted for them.

A comprehensive understanding of the financial preferences of MSMEs can be achieved by examining both the supply and demand aspects of financial resources. The sources of money also indicate the type of funding that the company has access to (Gudov, 2013).

Nagaraja (2013) observed that for accelerating economic development of both developed and developing nations, investment is required for growth of MSMEs. Remarkably, when it comes to innovation, creativity, and job creation, MSMEs have outperformed their larger enterprises in many countries.

In their research on the financing habits and preferences of Indian SMEs, Baker, Kumar, and Rao (2017) noted that the owners and managers depend on trade credit, loans from friends and family, and money from money lenders. They added that informal finance sources are used by Indian SMEs more frequently than formal ones. Indian MSMEs use unofficial funding sources more frequently than official ones. It was also said that because they need money for ongoing operations, MSMEs' owners and management rely on short-term funding. It was noted that MSMEs favor internal funding sources over commercial banks. Financing performance is impacted by a variety of firm variables, including sector, export activity, size, legal status, and business state. They contended that as a company progresses from incubation to growth, growth to maturity, and maturity to expansion, its funding preferences alter. The traits of owners and management also affect a company's desire for funding.

Mittal and Madan (2018) noted that the main obstacle facing e-startups is the lack of a performance history.

Gupta and Chadda (2018) conducted research on MSME financing. They have calculated the increase and identified the difficulties facing MSME. The importance of banking in relation to banking preferences for loan applications and costs has been brought up. The study found that MSME's are somewhat bothered by the cost and cumbersome procedures involved in loan applications, as well as the relevance of relationship banking to banking preferences for loan applications.

Maiti (2018) observed that there is room for various approaches to support MSMEs' access to financing in developing countries, as demonstrated by India. According to Biswas, A. (2014), banks do not have a great deal of faith in recently established businesses or start-ups, which poses financial difficulties for MSME sector banks. While giving loans to start-ups, they view MSME initiatives as hazardous and are afraid about non-performing assets. Therefore, banks typically only give this industry the amount specified under their commitments to lend to priority sectors. The absence of collateral security poses a substantial obstacle for MSMEs seeking bank loans. Banks typically demand collateral for lending to SMEs, creating challenges for MSMEs in accessing credit. Additionally, a lack of credit history hinders prospective business owners from securing bank loans.

Gupta, Saini, and Chadda (2018) conducted a study which led to the conclusion that the association between banking preference for loan applications and costly, complex procedures is significant across the whole loan application process.

Ullah and Khan (2020) in their study examined financial preferences and took into account the demography of the enterprises in order to determine the financing pattern. The conclusion was that internal finance is used more by older organizations. Larger companies use bank loans to cover their fixed asset and working capital requirements, and as a company grows, less informal financing is preferred.

Objectives of the study:

1) To study the preferred sources of finance by the MSMEs.
2) To find out reasons for preference for a particular source of financing.

Methodology:

For the purpose of study, schedules have been prepared to collect information about awareness of owners or managers of MSMEs about unconventional financing sources, the order of preference for financing sources and the reason of such preference were asked.

The sample size was calculated by using Taro Yamane's formula. The samples were selected by convenience sampling technique considering constraints associated with probability sampling for such data. Total sample size is 703 covering all the 8(eight) districts of Tripura. The collected data were codified and compiled and different statistical analysis was done to derive different conclusions. KMO and Barlett's test were done to test the sampling adequacy and sphericity. Thereafter, Eigen analysis and Scree-Plot were done to do factor analysis for making similar variables into same factor. Thereafter, component matrix, rotated component matrix and component score coefficient matrix were calculated. After that, multinomial logistic regression was run on preference of factors.

Data Analysis:

1. Awareness of Financing Sources among MSMEs

MSMEs were asked to know their awareness about unconventional financing sources like NBFC, Trade Credit, Leasing, Venture Capital and Leasing. The collected data were processed and compiled. The result which highlights varying levels of awareness among MSMEs regarding different financing sources. Notably, NBFC and Trade Credit exhibit a high awareness level, while Angel Investors appear to be hardly known among the surveyed enterprises. The result of the same is depicted by Figure-1.

Understanding these awareness patterns is crucial for developing targeted strategies to enhance financial literacy and facilitate informed financing decisions for MSMEs.

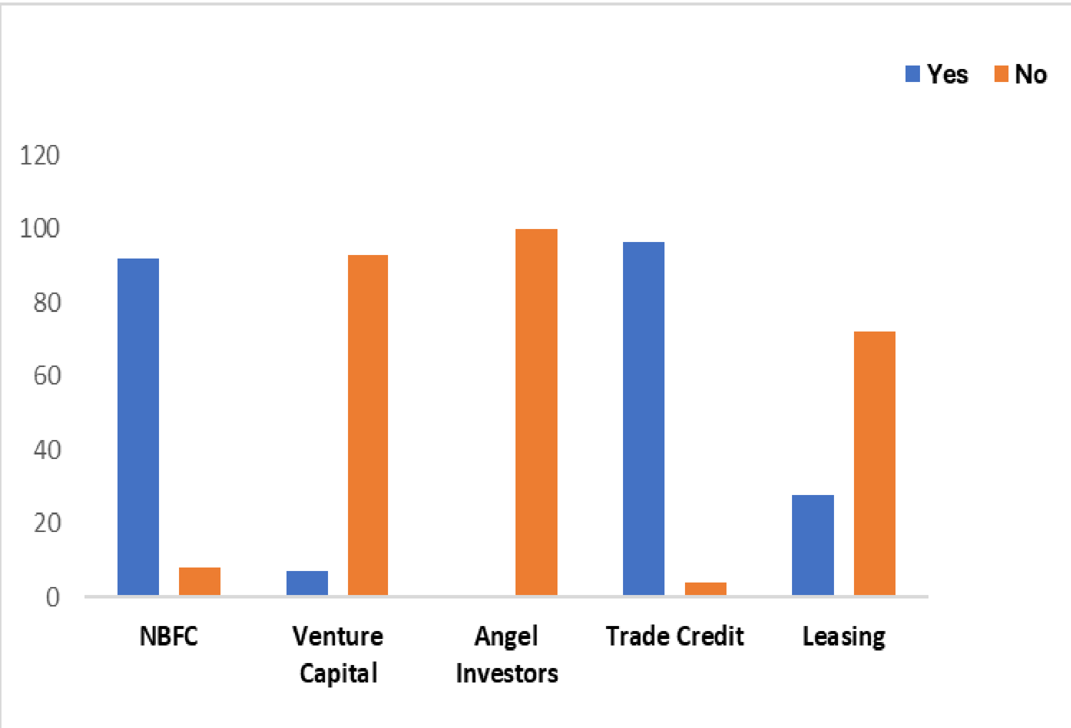

Figure-1: Awareness of Financing Sources among MSMEs

Source: Primary Data.

2. Preference for different sources of Financing

Preference of source of finance differs from firm to firm. The choice of a particular source of finance depends upon awareness and other reasons associated with firms. Understanding MSMEs' preference towards different sources of finance is very important for success and sustainability of MSMEs and its impact on the economy. This research investigates the MSMEs' preference towards various sources of financing. Identifying preferred sources of financing and reason for such preference is one of the objectives of this study.

3. Order of Preference for Different Sources of Finance by MSMEs

The order of preferences by MSMEs, for financing sources from is summarized below:

Table-1: Preferred Sources of Finance by MSMEs in order of preference (in percentage)

Financing Sources	1st Preference	2nd Preference	3rd Preference	4th Preference	5th Preference	6th Preference	7th Preference
Banks/Financial Institutions	50.9	12.2	11.9	11.2	9.8	2.2	1.8
NBFC (Non-Banking Financial Company)	13.7	26.6	15.9	11.3	12.4	10.3	9.8
Relatives/Friends	12.7	19.8	24.3	11.2	11.6	10.8	9.6
Trade Credit	8.2	9.4	16.8	24.2	11.8	12.9	16.7
Money Lender	6.1	14.9	15.2	15.8	24.4	14.3	9.3
Leasing	4.7	10.2	9.4	12.6	13.4	26.8	22.9
Others	3.7	6.9	6.5	13.7	16.6	22.7	29.9

Source: Primary data

These results given in Table-1 threw insight about the preferences of MSMEs while selecting sources for business finance. The high percentage in the 1st position indicates the primary choices, while the distribution across different ranks shed light on the diversity in preferences among surveyed enterprises. It appears that more than 50 percent of the surveyed enterprises preferred Bank/Financial Institution as first preference for financial source. Thereafter, preference is NBFC, Relatives and Friends, Money Lender, Trade credit, Leasing and other sources in order of sequence.

It appears that Venture Capital and Angel Investors are not preferred by any of the firms. Although, Venture Capital is known by some of the firm but firms are not aware about Angel Investors. Under 'others', firms have indicated about the different Government Agencies like Tripura Industrial Development Corporation, Tripura OBC Co-operative Development Corporation Ltd, Tripura SC Co-operative Development Corporation Ltd , Tripura ST Co-operative Development Corporation Ltd and Tripura Minority Co-operative Development Corporation Ltd. and loan under different Government schemes like 'Swabalamban'.

4. Analysis relating to reason for preference:

Table-2

KMO and Bartlett's Test		
Kaiser-Meyer-Olkin (KMO) Measure of Sampling Adequacy.		.755
Bartlett's Test of Sphericity	Chi-Square	5451.749
	df	78
	p-value	0.000

Table-3

Total Variance Explained

Component	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.566	42.815	42.815	5.566	42.815	42.815	4.678	35.983	35.983
2	2.200	16.923	59.738	2.200	16.923	59.738	3.079	23.681	59.665
3	1.550	11.920	71.658	1.550	11.920	71.658	1.559	11.993	71.658
4	.925	7.113	78.771						
5	.659	5.073	83.844						
6	.500	3.844	87.688						
7	.482	3.708	91.396						
8	.343	2.635	94.031						
9	.313	2.404	96.435						
10	.217	1.672	98.107						
11	.100	.766	98.873						
12	.093	.718	99.591						
13	.053	.409	100.000						

Figure-2

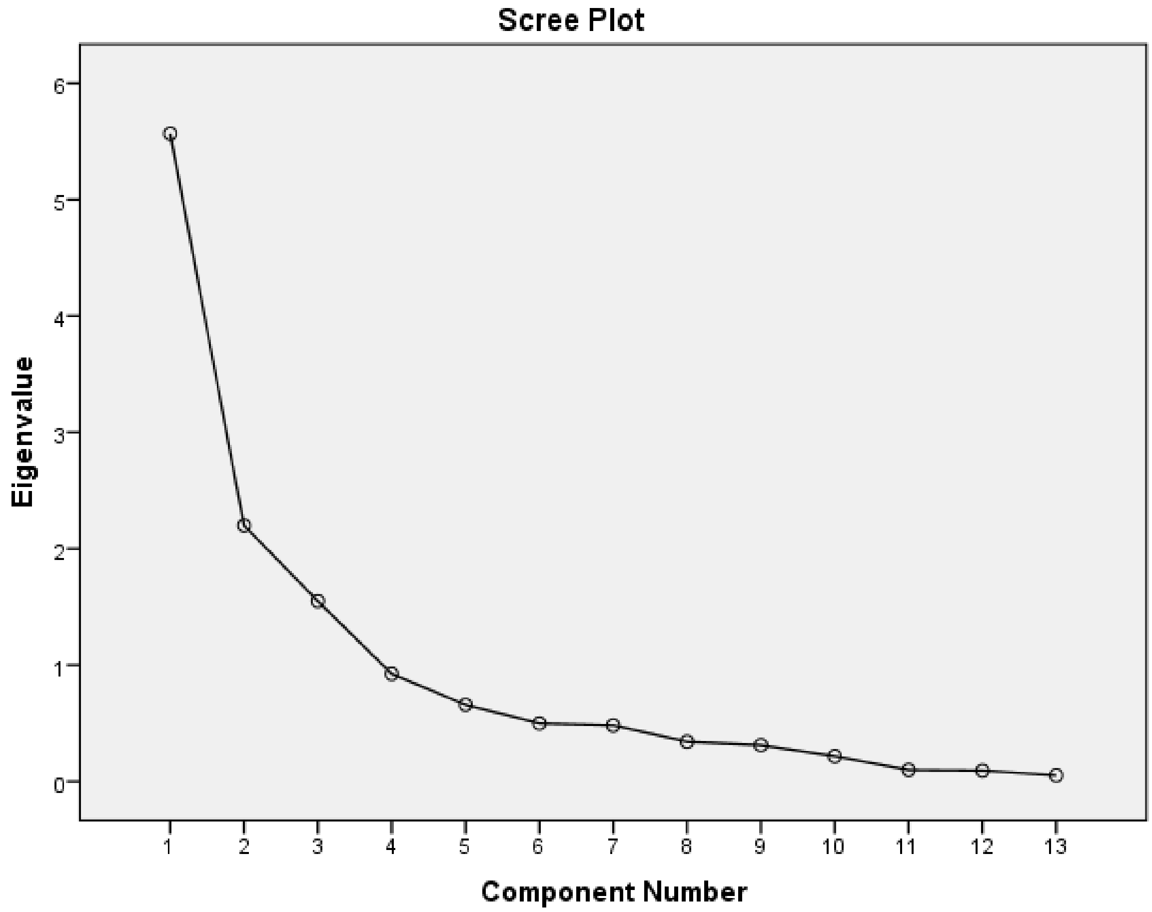

Table-4

Component Matrix (Suppress coefficients with absolute value below 0.5)			
Variables	**Component**		
	1	**2**	**3**
Trouble free accessibility of loan	.822		
Easy lending procedure	.759		
Flexible lending norms	.722		
Less collateral requirements	.705		
Low Processing Fee	.866		
Flexible repayment terms	.685		
Regular availability of loan			.758
Low interest rate	-.506	.738	
Subsidised credit		.546	
Transparency in lending	-.648		
Loan processing and other charges	.769		
Speed and timeliness in processing loan			.805
MSME specific Loan	-.617	.698	

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Table-5

Rotated Component Matrix (Suppress coefficients with absolute value below 0.5) under Varimax Rotation			
Variables	**Component**		
	1	**2**	**3**
Trouble free accessibility of loan	.898		
Easy lending procedure	.707		
Flexible lending norms	.842		
Less collateral requirements	.666		
Low Processing Fee	.949		
Flexible repayment terms	.762		
Regular availability of loan			.761
Low interest rate		.912	
Subsidised credit		.713	
Transparency in lending		.690	
Loan processing and other charges	.679		
Speed and timeliness in processing loan			.813
MSME specific Loan		.917	

Table-6

Component Score Coefficient Matrix			
Variables	**Component**		
	1	**2**	**3**
Trouble free accessibility of loan	.215	.072	.003
Easy lending procedure	.144	-.029	-.048
Flexible lending norms	.209	.108	.162
Less collateral requirements	.138	-.021	-.074
Low Processing Fee	.227	.078	.017
Flexible repayment terms	.186	.069	-.037
Regular availability of loan	-.030	.042	.492
Low interest rate	.109	.348	-.197
Subsidised credit	.050	.256	.037
Transparency in lending	-.014	.219	.227
Loan processing and other charges	.129	-.058	-.071
Speed and timeliness in processing loan	.022	-.074	.519
MSME specific Loan	.068	.331	-.010

On the basis of Component Score Coefficient Matrix, variables have been classified into three groups. Under Factor-1, variables are trouble free accessibility of loan, easy lending procedure, and flexible lending norms, less collateral requirements, less processing fee, flexible repayment terms and loan processing and other terms. Under Factor- 2, variable are low interest, subsidised credit, transparency in lending and MSME specific loan. Under Factor-3, variable are regular availability of loan and speed and timeliness in processing loan.

5. Multinomial Logistic Regression of Preferences on Factors

Table-7

Variables under different Factors		
FACTOR-1	**FACTOR-2**	**FACTOR-3**
Trouble free accessibility of loan	Low interest rate	Regular availability of loan
Easy lending procedure	Subsidised credit	Speed and timeliness in processing loan
Flexible lending norms	Transparency in lending	
Less collateral requirements	MSME specific Loan	
Low Processing Fee		
Flexible repayment terms		
Loan processing and other charges		

Table-8

Model Fitting Information				
Model	**Model Fitting Criteria**	**Likelihood Ratio Tests**		
	-2 Log Likelihood	**Chi-Square**	**df**	**p-value**
Intercept Only	1120.509			
Final	285.046	835.463	9	.000

Table-9

Pseudo R-Square	
Cox and Snell	.791
Nagelkerke	.902
McFadden	.746

Table-10

Parameter Estimates								
Preference (The reference category is Bank)	Predictor	Coefficient (B)	Std. Error	Wald	Df	p-value	Exp(B)	Conclusion
Relatives-Friends	Intercept	-3.203	.420	58.206	1	.000		
	FACT1	**2.800**	**.372**	**56.506**	**1**	**.000**	**16.442**	**Significant**
	FACT2	-2.741	.452	36.851	1	.000	.064	Significant
	FACT3	-.654	.380	2.965	1	.085	.520	Significant
Money	Intercept	-6.544	.998	43.000	1	.000		

Lender	**FACT1**	**3.263**	**.486**	**45.059**	**1**	**.000**	**26.135**	**Significant**
	FACT2	-5.408	.818	43.740	1	.000	.004	Significant
	FACT3	**2.110**	**.495**	**18.148**	**1**	**.000**	**8.246**	**Significant**
NBFC	Intercept	-3.124	.419	55.593	1	.000		
	FACT1	**.673**	**.420**	**2.573**	**1**	**.109**	**1.960**	**Insignificant**
	FACT2	-2.811	.401	49.241	1	.000	.060	Significant
	FACT3	**3.324**	**.456**	**53.115**	**1**	**.000**	**27.759**	**Significant**

Findings:

NBFC and Trade Credit exhibit a high awareness level, while Angel Investors appear to be hardly known among the surveyed enterprises. Understanding these awareness patterns is crucial for developing targeted strategies to enhance financial literacy and facilitate informed financing decisions for MSMEs.

The study reveals that Banks/Financial Institutions emerged as the topmost preferred source of finance among MSMEs.

Banks are more preferable than Relatives-Friends in case of variables under FACTOR-2 and FACTOR-3. Relatives-Friends are more preferable than Banks in case of variables under FACTOR-1. Banks are more preferable than Money Lenders in case of variables under FACTOR-2. Money Lenders are more preferable than Banks in case of variables under FACTOR-1 and FACTOR-3. Banks and NBFCs are equally preferable in case of variables under FACTOR-1. Banks are more preferable than NBFCs in case of variables under FACTOR-2. NBFCs are more preferable than Banks in case of variables under FACTOR-3.

Suggestions:

Policy makers should take steps to educate and sensitize owners and managers of MSMEs about the different financing sources including non-conventional sources so that more external fund can be pumped in to accelerate the growth of MSMEs.

It is also seen that while most preferred source of financing is Banks/Financial Institutions, but MSMEs are still depended upon own fund, Friends and Relatives and Money Lenders for financing their business. Therefore, policy makers should frame policies to involve Banks/Financial Institutions to invest in this sector to make the sector more vibrant.

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