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Credit Financial Systems for the Small Enterprises in India

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Abstract

A survey was conducted on the credit financing landscape for small businesses in Delhi, India, a concerning trend emerged, particularly affecting financially vulnerable entrepreneurs. The study revealed that numerous small business owners, particularly those with limited financial resources, encountered significant challenges when attempting to secure loans from public banks. Faced with stringent eligibility criteria and complex approval processes, these entrepreneurs found themselves in a position where accessing credit became a formidable task.

As a consequence, a substantial number of business owners turned to private lenders in their pursuit of financial support. While this provided a seemingly accessible alternative, it unveiled a darker side as well. When these entrepreneurs encountered difficulties in repaying loans to private lenders, they found themselves vulnerable to exploitation and abuse. This stark reality underscores the urgent need for policy interventions and improved mechanisms within the public banking sector to ensure that credit financing is accessible to all, mitigating the risks and hardships faced by small business owners in their pursuit of financial stability and growth.

Keywords: Credit finance, small and medium enterprises, Loan repayment

Introduction

Credit finance for small business owners in India plays a pivotal role in fueling entrepreneurial ventures and fostering economic growth. Small businesses often require financial support to initiate, expand, or sustain their operations. In India, various financial institutions, including banks and non-banking financial companies (NBFCs), offer credit facilities tailored to the unique needs of small enterprises.

These credit options encompass diverse financial products such as business loans, working capital loans, and term loans. Business loans are typically utilized for capital expenditure, while working capital loans help cover day-to-day operational expenses. Term loans, on the other hand, offer a lump sum amount for specific business purposes, with a predetermined repayment period.

Government-backed schemes and initiatives further enhance accessibility to credit finance for small business owners. These schemes aim to provide financial support, often with subsidized interest rates and relaxed eligibility criteria, promoting inclusivity and empowerment within the entrepreneurial ecosystem.

Additionally, the emergence of digital lending platforms has simplified the application and approval processes for small businesses, fostering financial inclusion. Entrepreneurs can now access credit swiftly, with minimal paperwork and collateral requirements, facilitating agility in business operations.

Understanding the intricacies of credit finance is crucial for small business owners in India to make informed decisions, manage cash flows effectively, and contribute to the overall economic development of the country.

Literature review

Malcolm athaide (2019). This study investigates credit constraints within the micro, small, and medium enterprises (MSMEs) sector in India using conventional models. The mixed findings may not accurately represent Indian MSMEs, given that these models are designed for larger firms in western markets with lower information asymmetry. The proposed augmented model, termed the Financing Deficit Model, integrates the Fazzari and Petersen model and Carpenter and Petersen model. It considers working capital as both a use and a source of funds, along with gross fixed asset formation and leverage as drivers of credit constraints for information asymmetric MSME firms in India. The research suggests that this augmented model proves robust in assessing credit constraints for Indian MSMEs, aligning with existing literature on its variables.[1]

Kaushik Chaudhary (2018), using a comprehensive dataset on micro, small, and medium enterprises in India, the researchers have examined whether the gender of the owner matters in firm performance and in credit access from institutional sources. The study finds significant underperformance in the size, growth, and efficiency of firms owned by women when compared to those owned by men. In line with the evidence in the existing literature, our findings also support the view that women-owned firms are disadvantaged in the market for small-business credit. These findings suggest that addressing gender discrimination in the small-business credit market could help, partly, in bridging the performance gap between male- and female-owned firms.[2]

Chandra shekhar (2020), the recognized role of MSMEs in social and economic development notwithstanding, this sector encounters various challenges, with finance being the foremost hurdle. Timely and sufficient access to credit at a reasonable cost is crucial for MSME growth. Financial institutions limit their involvement in this sector due to small loan sizes, high servicing costs, and the challenge of providing tangible collateral. The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has played a vital role in offering credit guarantees to Indian MSMEs since its establishment in 2000. Despite this, impediments from both bankers and entrepreneurs prevent the sector from receiving timely and adequate credit. This paper aims to emphasize avenues for securing institutional finance by leveraging the benefits of the Credit Guarantee Scheme.[3]

Vivek belgavi (2018), Micro, Small and Medium Enterprises (MSMEs) are an integral cog of the growth engine of different global economies. In India in 2018, MSMEs employed 40% of the workforce, contributed 37% of GDP and 43% of exports. [1] In spite of exclusive legislations and policies, lack of access to formal credit has hampered MSMEs from realizing their full potential. For lenders, the fragmented and opaque nature of available MSME information poses serious challenges in underwriting. This policy brief proposes a policy framework for establishing databanks intended to further facilitate the use of alternative data in the MSME lending landscape.[4]

Rupinder katoch (2023), The pervasive issue of non-performing assets (NPAs) poses a significant obstacle to the development of a robust banking sector. The MSME segment in the Indian economy is grappling with an escalating problem of delinquent assets, yet there has been limited systematic evaluation addressing this issue concerning loans extended to MSMEs. In recent years, there has been a surge in bad loans to micro, small, and medium businesses, prompting the need for both curative and preventive measures to control NPAs (Meher et al., 2020). This study focuses on identifying various preventive methods for NPA management in the MSME sector in the future. The primary data is derived from the actual implementation of preventive measures, empirically evaluated through frequency analysis based on a survey involving 316 bankers from 10 banks (5 public and 5 private sector). Hence, this study aims to illuminate the methods employed to prevent NPAs in MSMEs, considering the perspectives of bankers directly involved in lending decisions. The findings underscore key preventive measures that banks should consider while structurally modifying their mitigation strategies.[5]

Tara Nair (2019), A thorough examination of the credit flow data to the micro and small enterprise sector in India since the 1970s reveals that the strategic shift in industrial policy during the mid-2000s, creating a distinct category known as micro, small, and medium enterprises, has not yielded any tangible benefits in terms of improving access to institutional credit for MSEs'. Furthermore, it is evident that the pro-market financial inclusion rhetoric prevalent in the latter half of the current decade has not proven advantageous for MSMEs, particularly those involved in manufacturing activities, when it comes to securing bank credit. Despite the extensive publicity surrounding the Micro Units Development and Refinance Agency scheme, it appears to be more of a superficial measure, as it has not injected any new funds into the system.[6]

Tamal Bandyopadhyay (2020), The final year of the preceding decade, 2020, left virtually nothing untouched. The global pandemic swept through one nation after another, claiming lives and disrupting livelihoods while wreaking havoc across all sectors of the economy. India, significantly impacted, not only experienced a high number of infections but also faced severe economic repercussions. In such crises, those precariously positioned near poverty bear the brunt of the impact. Despite the government's efforts with a series of schemes and stimulus packages, evaluating the actual effectiveness of these initiatives in bringing relief to the vast population of poor and informal workers remains an ongoing task due to the chaos and disruption caused.[7]
Simultaneously, discussions and debates persist on the necessity of robust safety nets and a more resilient social protection framework. The urgency of quickly placing money in the hands of the poor has been a focal point. One of the initial responses to assist low-income households affected by the pandemic was to leverage the Pradhan Mantri Jan Dhan Yojana (PMJDY) accounts. A transfer of Rs 500 each for three months was made to 200 million PMJDY women account holders. In times of a pandemic, financial inclusion assumes a crucial role in providing relief to low-income households. India has made commendable progress over the years in developing a robust financial inclusion infrastructure, including digital highways, the JAM trinity, and various programs facilitating efficient Direct Benefit Transfers (DBTs) to the base of the pyramid.

Methodology

In this research, a comprehensive survey was conducted involving 200 small business owners in India to investigate the challenges they face in the realm of credit financing. The findings illuminated a significant struggle among these entrepreneurs, particularly in their efforts to secure loans and navigate the complexities of repayment. A noteworthy aspect was the pronounced difficulty experienced by business owners with limited financial means, who encountered obstacles in obtaining loans from public banks due to stringent criteria and intricate processes.

The participants represented a diverse array of enterprises, showcasing the vibrant entrepreneurial landscape in the country. Among the surveyed small businesses were Kirana stores, neighborhood grocery shops that play a crucial role in local communities. Additionally, proprietors of chai stalls, quaint tea vendors that serve as social hubs were surveyed. The survey also included interactions with owners of textile boutiques, showcasing the textile-rich culture of India. Noteworthy participants were local electronic repair shops, reflecting the omnipresence of technology in daily life. The survey further delved into the world of florists, capturing the essence of traditional craftsmanship in floral arrangements. The resilience of street food vendors and the creativity of boutique bakeries were also highlighted, underscoring the diverse culinary landscape. The findings from these interactions shed light on the unique challenges faced by each business type, emphasizing the importance of tailored support for sustaining and nurturing small businesses in India.

Kirana store owners, integral to local communities, often face challenges in accessing credit due to limited formal documentation and collateral. Traditional lenders impose stringent criteria, making it difficult for these businesses to secure loans. Additionally, fluctuating market conditions and supply chain disruptions can impact their cash flow, further exacerbating the challenges of loan repayment.

Chai stalls, serving as social hubs, grapple with financial constraints when seeking credit. The informal nature of their business, coupled with a lack of credit history, makes it challenging to navigate the conventional lending system. Repayment terms that don't align with the seasonal nature of their business contribute to financial stress, hindering their potential for growth and sustainability.

Textile boutiques, reflecting India's rich cultural heritage, encounter hurdles in obtaining loans for inventory and expansion. Limited credit history and the perception of the textile sector as high-risk by financial institutions create barriers. This restricts their ability to invest in diverse products and cater to evolving market demands, impacting long-term viability.

Local electronic repair shops, vital in today's tech-driven society, face obstacles in securing credit for equipment upgrades and business expansion. The high upfront costs of technology and stringent loan terms often lead to financial strain. This restricts their ability to keep pace with rapidly advancing technology and meet customer expectations.

Florists, synonymous with traditional craftsmanship, encounter difficulties in obtaining credit for seasonal variations in demand and inventory management. The perishable nature of their products adds complexity to the business model. Struggling with rigid repayment schedules, florists find it challenging to invest in marketing, diversification, and modernization.

Street food vendors, representing the vibrant culinary landscape, often resort to informal borrowing due to difficulties accessing formal credit. Traditional lenders' reluctance to understand the dynamic nature of their business and irregular cash flows hinders their growth. High-interest rates from informal sources create financial vulnerabilities, impacting long-term sustainability.

Boutique bakeries, known for their creativity in culinary arts, face challenges in securing affordable credit for equipment upgrades and marketing. Traditional lending institutions may overlook the unique needs of these businesses, leading to missed opportunities for expansion. Rigid repayment structures can impede their ability to innovate and stay competitive in the market.
Navigating these challenges requires tailored financial solutions, increased financial literacy, and a collaborative effort between government initiatives and financial institutions to support the diverse and dynamic landscape of small businesses in India.

The following is the questionnaire used for the survey:

1. Business Profile:
Type of Business:
Years in Operation:
Number of Employees:

2. Credit Financing:
Have you sought credit financing for your business?
If yes, which sources have you approached (public banks, private lenders, others)?

3. Challenges in Obtaining Loans:
What difficulties have you encountered while applying for loans?
Were there specific challenges with public bank loans?

4. Repayment Issues:
Have you faced challenges in repaying business loans?
If yes, what were the main obstacles?

5. Alternative Solutions:
Have you explored alternative financing options (e.g., community-based lending, microfinance)?
If no, what factors influenced your decision?

6. Abuse and Exploitation:
Have you ever felt vulnerable to abuse or exploitation in connection with business loans?
If yes, can you provide examples or share your experience?

7. Government Support:
Are you aware of any government schemes or initiatives for small businesses?
Have you availed of any such programs?

8. Financial Literacy:
How would you rate your understanding of financial management for your business?
Would you be interested in financial literacy programs or workshops?

9. Operational Impact:
How have these financial challenges impacted your day-to-day business operations?
Have there been any long-term effects on business growth?

10. Suggestions for Improvement:
What measures do you think would help small businesses like yours overcome financial challenges?
Any specific recommendations for government or financial institutions?

Results and Discussion

To address these pressing issues, several proposed solutions emerge. Firstly, there is a need for streamlined and more accessible credit facilities from public banks, with simplified application processes and flexible eligibility criteria. Government initiatives and schemes could be tailored to specifically assist financially vulnerable small business owners. Additionally, fostering financial literacy programs would empower entrepreneurs with the knowledge and skills necessary to navigate the credit landscape responsibly.

For Kirana store proprietors, streamlined loan application processes and relaxed eligibility criteria under government-backed schemes can empower them. Microfinance programs with flexible repayment terms aligned with seasonal demand could help in better financial management. Banks can play a role by introducing specialized loan products with simplified documentation and reasonable interest rates.

Chai stall vendors can benefit from government initiatives focused on financial literacy and awareness. Collaborative efforts between banks and local authorities could result in micro-enterprise loan schemes tailored to the cyclical nature of their business. Flexible repayment plans and lower interest rates for small business loans would encourage chai stall vendors to invest in infrastructure, improve hygiene standards, and diversify their offerings.

Textile boutique owners may find support in government-backed funds for the textile sector, easing their access to credit. Banks can contribute by designing specialized loan products for the textile industry, considering its cultural significance. Tailored financial solutions, coupled with mentorship programs, can assist boutique owners in expanding their product range, exploring new markets, and staying competitive.

Electronic repair shops could benefit from government-supported technology-focused funding programs. Simplified loan application processes and extended repayment periods could alleviate their financial burden. Banks could introduce special technology loans with affordable interest rates, enabling these businesses to upgrade their equipment and provide better services.

Florists might thrive with government initiatives providing training on financial management and modern marketing strategies. Banks could introduce customized loans with grace periods during off-peak seasons, allowing florists to manage inventory efficiently. Support for online platforms and marketing can enhance their visibility and customer reach, contributing to sustained business growth.

For street food vendors, government-backed microfinance programs and skill development initiatives can empower them. Banks could introduce specific loan products with lenient eligibility criteria and flexible repayment schedules, accommodating the unpredictable nature of their business. Collaborations with local authorities can ensure fair lending practices, helping street food vendors invest in hygiene standards, infrastructure, and diversified offerings.

Boutique bakeries could benefit from government incentives for the food and hospitality sector. Banks could introduce business loans with tailored repayment structures that consider the seasonal demand for baked goods. Mentorship programs from financial institutions can guide boutique bakery owners in marketing, quality improvement, and expansion strategies, enabling them to thrive in a competitive market.

Moreover, creating a supportive ecosystem for alternative financing models, such as community-based lending or microfinance institutions, could provide viable options for small business owners. This multi-faceted approach aims to not only alleviate the immediate challenges faced by entrepreneurs but also to foster a more inclusive and resilient financial environment for small businesses in India.

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