

# Role of microfinance in funding small and medium enterprises for improving the lives of the poor in Rural India

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## ABSTRACT

Finance for micro, small, and medium-sized enterprises has been a concern for all stakeholders including entrepreneurs, financial institutions, NGOs and government organizations. Small and medium enterprises (SMEs) have long been one of the more chief sources of employment and livelihood in most developing countries, including India. On the other hand, microfinance is crucial, when it comes to escalation of business growth by way of generating steady working capital. The key objective of the study is to encourage the funding of micro finance for small and medium sized enterprises for the economic growth in rural India. Improving the productivity of these grass root small-medium entrepreneurs can be a potent method for improving the lives of the vast majority of the poor population. Thus, growth of small and medium enterprises is the twin goals of increasing global and domestic food security, and directing new sources of income to the poorest sections of society. One key tool in improving small, medium entrepreneurs could be the speedily rising capacity of microfinance, which refers to the provision of financial services to poor and low-income people. This study attempts to focus on these aspects. Data was collected through personal interviews from a sample of 50 MSMEs. The survey was conducted mainly in the district of Uttar Dinajpur in the state West Bengal covering a wide spectrum of sectors like shopkeepers, fruit sellers, tailors, jewelers, grocery shop, food retailers, metal works and book shops. The results reinforce the findings of other studies that utilization of formal sources like banks is significantly very small compared with informal sources like personal and family wealth. The study found that the main challenges faced in underutilization of formal sources were inadequacy of collateral assets and lack of financial awareness of entrepreneurs. Based on the conclusion that requirement of finance is rising for development of small and medium size enterprises in the rural India for the economic development of rural population and their growth.

## 1. Introduction

Rural economy forms the backbone of most developing countries. That being said, the problem is that significant developments in infrastructure are a little difficult to come by; thereby birthing a dearth of economic viability. In such a situation, microfinance institutes are often the only significant ways towards employment generation, alleviation of poverty and bettering the economic condition. Small, and medium-sized enterprises (SMEs) have gained increased attention in India in recent times, considering their strategic importance to the economy and the country. SMEs play an important role in generating employment—48.8 million MSMEs in the country provide employment to 111.4 million people. SMEs in the manufacturing sector alone produce more than 6,000 products and contribute 7.7% of the GDP of the country. Similarly, SMEs in the services sector contribute 27.4% of the country's GDP.

In spite of their contribution, SMEs in India face several challenges. They often need to keep pace with rapidly changing technologies and face the risk of becoming technologically obsolete. They also have to face high costs of credit and are usually unable to identify their key competitive strengths to maintain product standards and quality. SMEs also need to deal with the issue of protection of their intellectual property and with the scarcity of skilled workers

In view of the fact that banks are the predominant source of finance in India, the Reserve Bank of India includes micro and small enterprises in the list of priority lending sectors. Banks have also been advised to achieve a year-on-year growth of 20% in credit to micro and small enterprises and an annual growth of 10% in the number of microenterprise accounts. In view of such policies, this study attempts to understand whether such incentives and schemes have good impact to the SMEs and if entrepreneurs are aware of them.

While carrying out preliminary interviews with entrepreneurs for this study, it became apparent that SMEs have different types of requirements at different stages of their life cycle. This led the authors to establish a better understanding of different sources of finance used by SMEs during different stages of their life cycle and to explore the challenges in accessing these sources. As there were no studies that captured the financial needs of SMEs at different stages of their existence, this study is a first-of-its-kind attempt to investigate these aspects. Thus, the paper focuses on the sources of finance used by SMEs and on the awareness and usage of different financial schemes made available by government and other financial institutions.

## 2. Objectives of the Research

The research objectives are (i) to identify the different sources of finance used by SMEs (ii) to identify challenges faced by SMEs while accessing finance from different sources (iii) to identify factors that lead to higher financial awareness amongst rural SMEs and (iv) the ways MFIs are contributing to the development of SMEs in rural India to generate employment and eradication of poverty.

## 3. Statement of Problem

The research problem is based on the welfare of small and medium size enterprises in their various sectors of activities. This resource base should provide a platform for the development of rural SMEs, and contribute to the country's fight against hunger and poverty. Business development, requires more than natural resources, and it is not clear what challenges and opportunities rural SMEs are facing in India.

Does Microfinance assistance have an absolute condition in the development of small and medium size enterprises?

This study will investigate the underlying issues small enterprises in rural areas are facing in their development. Particular attention will be given to the issue of financing, where microfinance institutions have been carrying out a serious campaign against poverty by the provision of financial, moral and developmental support to the growth of SME's. These specific questions shall guide us into the research a>What markets are available for the small and medium size enterprises? b>Is there sufficient access to technology and labour resources?c>Do firms have access to financial capital to fund development by MFIs under the normal regulatory condition?

## 4. Research Methodology

The Data collected- for the study includes both primary and secondary data. The various sources used to collect secondary data include research papers, journals, articles, annual report of company, interview of related persons and data from various other websites. The secondary data collected is further analyzed using statistical tools to draw conclusion.

## 5. Literature review

We shall be looking at the studies carried out by other researchers on their view about small and medium size enterprises and their support from Microfinance Institutions. Maruthi Ram Prasad, Sunitha and LaxmiSunitha (2011) conducted a study on Emergency and Impact of Micro-Finance on Indian Scenario. After the pioneering efforts by Government, Banks, NGOs, etc. the microfinance scene in India has reached in takeoff stage.

An attempt could be initiated to promote a cadre of new generation micro-credit leaders in order to strengthen the emergence of Micro-Finance Institution (MFIs), so as to optimize their contribution towards the growth of the sectors and poverty alleviation. Each Indian state could consider forming multi-party working group to meet with microfinance leaders and have a dialogue with them about how the policy

environment could be made more supportive and to clear up misperceptions. With one state leading the way, we need to build on a successful model. By unleashing the entrepreneurial talent of the poor, we will slowly but surely transform India in ways we can only begin.

The Asian Development Bank (2014) has pointed out that barriers to accessing finance by SMEs in India from formal institutions include the requirement for collateral or a guarantee, inflexible policies, high rates of lending, complicated procedures, and entrepreneurs' lack of financial knowledge of applicable schemes.

The perception of an SME as a high-risk and commercially unviable proposition to lend to has resulted in only a few SMEs receiving formal financial assistance (Ambrose 2012). Prasad (2006) highlighted that Indian banks in particular are not inclined to finance small enterprises, due to reasons such as the inability to provide collateral, high levels of nonperforming assets, high transaction costs, and the inability to verify the creditworthiness of applicants, the unavailability of skilled workers, the lack of infrastructure, and an inability to raise capital through the stock market (especially for MSMEs with a net worth of less than Rs100 million (about \$1.5 million) are other challenges (Lahiri 2012).

The Reserve Bank of India (2005) identified the following issues in financing SMEs: (i) inadequate access to finance by tiny firms due to lack of financial information and nonformal business practices, with a lack of access to private equity, venture capital and secondary market instruments; (ii) fragmentation of markets with respect to their inputs as well as vulnerability of products due to market fluctuations; (iii) lack of easy access to interstate and international markets; (iv) limited access to technology and product innovations, and lack of awareness of global best practices; and (v) considerable delays in settlement of dues and payment of bills by large-scale buyers.

Grant Thomson and FICCI (2011) concluded that the cost of capital is high for MSMEs, and that there is a need to reduce the time and documentation required for procuring finance. Lahiri (2012) pointed out that with MSMEs' rising need for short-term and long-term capital, banks should move toward more innovative methods of lending to provide for those firms' financial needs. microfinance, and national bank, and additionally global improvement organizations are a portion of the establishments in the formal money related segment that have assumed critical parts in financing independent ventures in Nigeria. PrasannaKulkarni 2014. Agwu focused on that the biggest wellspring of fund for SMEs around the globe remains the business banks.

## 6. Microfinance and Microcredit:

Microfinance alludes to the arrangement of budgetary administrations custommade to the necessities of low salary individuals like smaller scale business people, especially the conveyance of little credits, the arrangement of little advances, receipt of little funds stores and simple installment administrations required by miniaturized scale business people and other destitute individuals. Microfinance is a term

that alludes to the conveyance of money related administrations to clients who are overlooked from the customary budgetary framework due to their low financial status. Miniaturized scale back is the conveyance of money related administrations to low-pay laborers and amazingly poor independently.

### 7. Micro Small and Medium Enterprises

Over the last five decades Indian Micro, Small and Medium Enterprises (SME) sector has emerged as a highly dynamic and vibrant sector. MSMEs not only help in industrialization of rural & backward areas but also play a key role in providing employment opportunities and eradication of poverty. Thus, SMEs reduces the regional imbalances and increases national income and wealth. SMEs are complementary to large industries as ancillary units and it contributes immensely to the socio-economic development of rural India.

As per the Micro, Small and Medium Enterprises Development Act, 2006, a Micro-Enterprise is defined as „A enterprise where the investment in plant and machinery does not exceed twenty five lakh rupees; A Small- Enterprise, where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees; A Medium-Enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupee.

### 8. Sources of Finance for Small Businesses

There are numerous sources of finance for new businesses in rural India. The initial step is to figure how much cash would be required and when the cash would be required Jain Raj Gupta 2018. The money related prerequisites of a business will vary contingent upon the sort and size of the business. The various sources to start a small business includes:

- The individual investment funds of the entrepreneur and in addition loved ones who might be business partners.
- Business accomplices and partners.
- Banks, private money lenders and money related organizations.
- The independent company organization and money related help program.
- Individuals from the exchange, and also makers, wholesalers, and at times, clients.

From the above recorded sources, individual funds is the most available to many individuals which can be easily utilizes in any business, anytime and anywhere depends upon choice.

### 9. Ways in which Micro finance may work for the growth of Small and medium enterprises in India

#### ***By providing easier access to credit facilities***

Microfinance institutions serve as primary credit and lending facilities for both low-income individuals and small and medium enterprises that fall shy of accessing easy loans from the organized financial sectors.

Moreover, most of these institutions provide micro loans and other financial services that attract affordable rates of interest and easy procedures and minimal documentation. Here, the financial performance of SMEs, among other factors, depends on the easier process and minimum paper works with which they can avail loans from MFIs.

#### ***By implementing inclusive policies***

SMEs often hire unskilled and semi-skilled labourers - many of whom belong to the economically deprived and marginalized categories - to carry out their routine operations. Microfinance lenders collectively target aspirations of these sections of people, thereby developing business models aimed at allaying poverty and improving their standard of living so that they can enjoy good education, insurance and health needs for their family.

#### ***By aiding business expansion***

Probably the most significant function of MFIs is offering SMEs a blueprint for business expansion and assistance to expand their operational footprint beyond the traditional strongholds. This primarily happens by way of aid to SMEs to increase the number of outlets, access more uncharted business areas and eventually become formidable contenders in the market. Moreover, a group of people, sharing common aspirations and interests, can avail credit facilities from microfinancing houses. What happens here is that should one of the participants default at the time of repayment, there is usually a chance that the share would be distributed and shouldered by the other members of the group. This way, MFIs usually find it relatively easier to recover their loans; something that leads them to lend further, thereby allowing SMEs to utilize the funds, up their productivity and increase profits in the process.

#### ***Microfinance institutes tend to enjoy better credibility***

We might attribute it to the cooperative attitude of MFIs, but SMEs have a tendency to trust microfinance houses more. Another reason behind this might be customized financial products that are in tune with the exact demands of SMEs and the nature of their businesses.

### 10. Conclusion

Developing nations have, beyond much doubt, embraced the concept of microfinance loans and microfinance institutions, and it is no surprise that these micro lending houses have come to be the lifeline of SMEs in developing countries like India. It is with the help of micro loans, that many deprived sections of the society have been able to integrate with the mainstream. Small businesses in India need access to funding for their businesses to flourish on a sustainable basis. Although, small businesses promote the development of an economy, it has not been given adequate recognition that corresponds with intensity of its contribution. It is noteworthy to state that both financial and non-financial services provided by microfinance banks and institutions have greatly assisted small businesses in India and have enhanced the distribution of business skills and the sharing of innovative ideas among the rural population. The implication of this study is that, micro-financing significantly promotes businesses by reducing the resource gap for small businesses. Micro-

financing has a huge potential for increasing the performance of small businesses through the frequent contributions in micro-financing and provision of non-financial services. This theory states that banks borrowing behavior with regards to small businesses is majorly a factor of the adequacy of capital requirement. Expert stated that an alteration in interest rate can affect the capacity of banks to give out loans to SMEs.

This means that increases in the rates of interest increases the cost of banks' external funding, but minimizes banks' profits and capital. The propensity is for the banks to trim down their supply of loans if the capital limit becomes binding. The banks may on the other hand be more enthusiastic about giving out loans in situations when the interest rate is favorable.

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