

An Analysis of Role of Commercial Banks in Financing of Micro and Small Enterprises (MSEs)

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Abstract

Finance is the sine-qua-non for any organisation. SMEs are contributing immensely to India's economic growth. The national objectives of equitable and inclusive growth can be best achieved through development of MSEs. Access to adequate and timely credit at a reasonable cost is the most critical problems faced by this sector. The present paper attempts to review the growth of MSMEs in India. This paper examines the trends in the sectoral allocation of bank credit to the MSE sector in comparison to non-MSE sector. The paper also attempts to examine the variations in bank credit to the MSE sector across bank groups. The time period for the present study is from 2005-06 to 2009-10. Trends in NPAs in MSE sector across different bank groups are also studied. The study concludes that perhaps the higher incidences of NPAs do not encourage commercial banks to extend credit to the MSE sector. Lastly recommendations are made for increasing flow of credit to MSEs.

Keywords: *Inclusive Growth, Adequate Credit, NPAs & MSEs*

Introduction

Finance is the sine-qua-non for any organisation. Finance is needed to meet day-to-day requirement of the business. Financial needs of business should be properly analysed and various sources should be adequately tapped to raise the funds. Commercial Banks play a dominant role in mobilising the public deposits and lending to various sectors of economy. Commercial Banks play an important role in economic development and growth of small scale industries even since independence and have approximately 85393 branches all over India to cater the needs of various sectors of economy.

The role of micro, small and medium enterprises in the economic and social development of the country is well established. This sector contributes 8 percent of the country's GDP, 45 percent of the manufactured output and 40 percent of its exports. The MSMEs provide employment to about 60 million persons through 26 million enterprises. MSMEs are evenly distributed throughout length and breadth of the country. The national objectives of equitable and inclusive growth can be best achieved through development of MSEs. The major advantage of the sector is its employment potential at low capital cost. The labour intensity of the MSME sector is much higher than that of the large enterprises.

Access to adequate and timely credit at a reasonable cost is the most critical problems faced by this sector. The major reasons for this have been the high risk perception among the banks about this sector and the high transaction costs for loan appraisal. Growth of MSE sector is encouraged to achieve multiple goals like rapid increase in employment, balanced regional growth, mobilisation of country's productive factors of production and skills and innovations of entrepreneurs to check migration of labour from rural areas to urban areas and sustaining industrialization without disturbing ecological balance.

A significant growth of MSEs has taken place due to the comprehensive packages provided by the Government and its various organisations. The Government of India provided MSEs with various concessions, tax exemptions etc. and in particular reserved the manufacture of a

few commodities to the small scale sector. In this paper, an attempt has been made to throw light on the flow of credit to MSE sector by commercial banks in the post reforms period.

Main Objectives of the Study

The main objectives of the present study are as follows:

- To review the growth of MSMEs.
- To analyse the trends in commercial bank's credit to small scale and micro enterprises during the post liberalisation period.
- To make suggestions for increasing the flow of credit to MSEs

Database

The present study is based on secondary data. The various sources of data for the present study are Fourth All-India Census of MSMEs (2009-10), various publications of RBI such as Basic Statistical Returns of Scheduled Commercial Banks, Report on Trend and Progress of Banking in India, Report on Currency and Finance, Statistical Tables Relating to Banks in India, Handbook of Statistics on Indian Economy.

This paper provides a brief account of MSME sector based on the Fourth All-India Census of MSMEs (2006-07) data and related developments in credit deployment to the MSE sector of all SCBs. MSEs have the inherent capability to use resources efficiently and satisfy local needs.

Performance of MSME Sector

Traditionally, a large proportion of small scale enterprises in India were under the unregistered sector. As per available statistics (4th census of MSME sector), this sector employs an estimated 59.7 million persons spread over 26.1 million enterprises. It is estimated that in terms of value MSME sector accounts for about 45 percent of the manufacturing output and around 40 percent of the total export of the country. Fourth census of SMEs is the first census after change in definition of the sector and includes for the first time medium enterprises and services.

Table 1: An Account of MSME Sector- 2006-07 (in lakhs.)

Economic Parameters	Registered	Unregistered	Total
Total No. of Enterprises	15.53 (5.94)	245.48 (94.06)	261.01 (100.00)
Manufacturing Enterprises	10.35 (66.67)	64.18 (26.15)	74.53 (28.56)
Services Enterprises	5.18 (33.33)	181.30 (73.85)	186.48 (71.44)
Employment	92.04 (16.62)	502.57 (83.38)	594.61 (100.00)
Manufacturing Enterprises	79.85 (86.75)	224.22 (44.62)	304.07 (51.14)
Services Enterprises	12.19 (13.25)	278.35 (55.38)	290.54 (48.86)
Female Employment	18.64 (20.26)	89.82 (17.87)	108.46 (18.24)

Source: Quick Results of 4th All India of Census of MSMEs (2006-07) **Note:** Figures in brackets are percentages

As shown in the table 1, out of total of 261.01 lakh units in MSME sector in 2006-07 more than 245 lakhs (94 percent) belong to the unregistered sector. Unregistered manufacturing enterprises are just 64.18 lakhs and services enterprises are 181.30 lakhs that is 26 percent and 74 percent respectively. As per the latest census information, MSME sector generated employment of as many as 304 lakh people of which 108 lakh (18 percent) employees are women. Unregistered manufacturing enterprises account for 224 lakhs (45 percent) and services enterprises account for 278 lakhs (55 percent) of employment.

Table 2 shows distribution of MSEs by sources of finance. No. of units that are self- financed are 242 lakhs (93 percent) out of total units of 261 lakhs. Units financed through Institutional sources are 13.51 lakh and that financed through Non-Institutional sources is 5.36 lakhs. It indicates that major portion of MSE units is self- financed.

Table 2: Distribution of SMEs by Sources of Finance

Enterprises by Source of finance	Registered	Unregistered	Total
No finance/ Self finance	13.63 (87.77)	228.51 (93.08)	242.13 (92.77)
Finance through Institutional Source	1.74 (11.21)	11.77 (4.80)	13.51 (5.18)
Finance through Non-Institutional Source	0.16 (1.02)	5.20 (2.12)	5.36 (2.05)
Total	15.53 (5.94)	245.48 (94.06)	261.01 (100.00)

Source: SME Business, Journal of Small Business and Enterprise, Vol. 7, No.4, July 2010.

Emergence of MSMEs as engine of growth of an economy requires adequate and timely credit at cost effective rates. MSE sector faces a huge shortage of credit. This limits ability to obtain working capital, machinery, equipment and raw materials, technology up gradation and finance for marketing.

Analysis of Commercial Banks Credit to MSE

Bank Credit to MSE sector vis-a-vis Total Industry: Table 3 presents the growth in bank credit to small scale industry vis-a-vis the growth in credit to industry as a whole and total bank credit. While the average annual growth in credit to MSE sector was 33.38 percent during 2005-06 to 2009-10, similar growth in credit to total industry was high at 29.44 percent during the same period. Thus credit to MSE witnessed a high growth rate during the period under review. It is also observed from the table that the annual growth rates in credit to MSE sector fluctuated widely between 18.56 percent and 66.87 percent compared with the range of 20.90 percent and 49.89 percent of total industry. Further, the share of credit to total industry in total bank credit increased from 37.97 percent in 2005-06 to 39.81 percent in 2008-09 and declined marginally to 39.20 percent in 2009-10. It can be concluded that there is increase in growth rate and percent share in credit to MSE sector.

Table 3: Growth in Total Bank Credit to Industry and MSE Sector (Percent)

Year	Growth Rate in Bank Credit			Percent share in Total Bank Credit & Total Industry		
	Total	To Total Industry	To MSE Sector	Total Industry	MSE	MSE Sector
2005-06	48.67	49.89	18.56	37.97	6.24	16.44
2006-07	27.39	25.94	29.55	37.54	6.34	16.91
2007-08	22.02	26.09	33.27	38.79	6.93	17.86
2008-09	17.85	20.90	66.87	39.81	9.82	24.66
2009-10	26.30	24.38	43.67	39.20	11.17	28.48
Annual Average Growth rate	24.69	29.44	38.38			

Source: Calculated

Growth rate in bank credit to MSE and Non-MSE sectors of the total industry has been considered in table 4.

Table 4: Growth in Bank Credit to MSE and Non-MSE sector: (Percent)

Year	MSE	Non-MSE
2005-06	18.56	58.11
2006-07	29.55	25.23
2007-08	33.27	24.63
2008-09	66.87	10.93
2009-10	43.67	18.07

Source: Calculated

The growth rates in bank credit of both MSE and Non-MSE has just reversed during the period under study. Except in the year 2005-06, the growth rate in Non-MSE sector is lower than those of MSE sector. The highest growth rate is recorded in 2008-09 in credit to MSE sector as compared to Non-MSE sector. This shows that importance of MSE sector has increased in the economic growth and its share has increased in bank credit.

Credit to MSE sector according to Bank Groups: It is worthwhile to have broad view of the credit extended to the industry sector by different bank groups.

Table 5: Growth in Bank Credit to Industry According to Bank Groups (Percent)

Year	SBG	NBs	PSBs	PBs	FBs
2005-06	35.78	47.63	43.5	6.93	21.41
2006-07	30.12	28.49	29.03	20.58	19.73
2007-08	38.44	28.51	31.79	25.39	40.73
2008-09	19.23	35.89	30.10	2.61	25.04
2009-10	54.47	48.00	50.06	50.98	-6.73

Source: Calculated

Table 5 shows the growth in bank credit to Industry according to bank groups. The maximum variation is observed in case of foreign banks (FBs) and it fluctuated from -6.73 percent to 40.73 percent. The growth rate also show variations in (Private Banks) PBs from 2.61 percent in 2008-09 to 50.98percent in 2009-10. During the year 2009-10 State Bank Group (SBG) has shown highest growth rate of 54.47 percent.

Table 6: Share of MSE in Gross Non-Food Credit According to Bank Groups (Percent)

Year	SBG	NBs	PSBs	PBs	FBs
2005-06	12.80	13.76	13.43	5.88	-
2006-07	11.73	13.19	12.69	5.57	13.74
2007-08	12.18	14.88	13.95	14.90	14.45
2008-09	12.19	15.63	14.45	11.28	13.64
2009-10	10.64	15.58	13.93	-	17.21

Source: Calculated

Table 7: Share of MSE in Bank Credit to Industry According to Bank Groups (Percent)

Year	SBG	NBs	PSBs	PBs	FBs
2005-06	24.93	24.80	24.85	13.14	-
2006-07	23.34	24.98	24.44	13.63	29.03
2007-08	22.87	28.18	26.33	39.03	28.35
2008-09	23.52	27.15	25.99	38.85	26.59
2009-10	19.61	28.01	25.26	-	33.08

Source: Calculated

As the growth rates did not give any clear idea about the progress of credit to MSE by different bank groups, it is worthwhile to have close look at the shares of credit to the MSE sector in total non-food credit and total credit to industry. It may be seen from table 6 that there was a perceptible increase in the MSE's share in non-food credit during the period of study (viz. 2005-06 to 2009-10) for all bank groups. While the share was highest in case of NBs which was 13.76 percent in 2005-06 which increased to 15.58 percent in 2009-10 for all bank groups. The share of MSE was low in private banks (PBs) credit and it increased from 5.88 percent in 2005-06 to 11.28 percent in 2008-09.

Similarly the share of credit to MSE in total credit to MSE in total industry's credit declined in case of State Bank Group (SBG) from 24.93 in 2005-06 to 19.61 in 2009-10 and of Nationalised banks (NBs) increased from 24.80 percent in 2005-06 to 28.01 percent in 2009-10. For Private Banks (PBs) it increased remarkably from 13.14 percent in 2005-06 to 38.85 percent in 2008-09 and that of Foreign Banks increased from 29.03 percent in 2006-07 to 33.08 percent in 2009-10.

Trends in NPAs in bank credit to MSE according to Bank Group: Increase in NPAs provide disincentive to various groups of banks to extend credit to various sectors. Higher incidence of NPAs does not encourage commercial banks to extend credit to the SME sector.

Table 8.1: Bank Group-wise Trends in NPAs (Percent to NPAs in Priority Sector Advances)

Year	SBG	NBs	PSBs	PBs	FBs
2005-06	21.97	35.21	30.92	35.35	-
2006-07	8.74	61.61	25.46	22.35	16.31
2007-08	17.24	26.06	22.96	19.05	16.16
2008-09	23.98	31.24	28.72	18.41	33.80
2009-10	26.22	43.54	37.39	23.77	25.56

Source: Calculated

Table 8.2: Bank Group-wise Trends in NPAs (Percent to Total NPAs)

Year	SBG	NBs	PSBs	PBs	FBs
2005-06	12.07	18.89	16.72	10.31	-
2006-07	10.79	17.92	15.14	6.98	2.20
2007-08	10.08	17.41	14.60	5.02	2.09
2008-09	11.33	18.95	15.85	3.97	3.07
2009-10	13.14	24.44	20.13	6.55	4.19

Source: Calculated

Table 8.1 and 8.2 indicates trends in NPAs IN credit to MSE as percent of NPAs in Priority Sector Advances and total NPAs respectively according to bank groups. It has been found that highest NPAs as percent to NPAs in priority sector advances is seen in NBs (61.61 percent) in year 2006-07. NPAs in later years of study declined but it is higher among all bank groups. In case of SBG NPAs as percent to NPAs in priority sector advances declined from 21.97 percent in 2005-06 to 8.74 percent in 2006-07 and it further increased to 26.22 percent in 2009-10. In case of NBs it also increased from 35.21 percent in 2005-06 to 43.54

percent in 2009-10. For PSBs as whole it increased from 30.92 percent in 2005-06 to 37.39 percent in 2009-10. In case of PBs it declined from 35.35 percent to 23.77 percent over the period of study. In FBs it increased from 16.31 percent in 2005-06 to 33.80 percent in 2008-09 and declined to 25.56 percent in 2009-10.

Table 8.2 shows trends in NPAs in credit to MSE as percent to total NPAs. It has increased across all bank groups except PBs in case of which it declined from 10.31 percent in 2005-06 to 6.55 percent in 2009-10. In case of SBG it increased from 12.07 percent in 2005-06 to 13.14 percent in 2009-10. In case of NBs it increased from 18.89 percent to 24.44 percent and in case of FBs it increased from 2.20 percent to 4.19 percent over the period of study.

A closer look at the table 7 and table 8.1 and 8.2 makes it clear that PSBs has higher incidence of NPAs in credit to MSE, therefore the share of PSBs in credit to MSE sector is declining. On the other hand, NPAs in case of PBs and FBs credit to MSE is declining and as a result there share in credit to MSE sector is showing an increasing trend.

Conclusions

From the present study, following major conclusions can be drawn:

- Annual average growth rate in bank credit in MSE sector is highest (38.38 percent) as compared to total industry.
- As compared to Non-MSE sector, share of MSE sector increased from 18.56 percent to 43.67 percent over the period of study.
- Contribution of PBs and FBs towards MSE sector is showing increasing trend as compared to PSBs. Perhaps the reason of low contribution of PSBs is higher incidence of NPAs in credit to MSE sector.

Suggestions

Following recommendations are being made for increasing flow of credit to MSE sector:

- Commercial Banks should extend their network geographically and functionally so that they can meet the needs of the small and tiny enterprises established in villages.
- Common man which is generally referred as aam adami (Normal Man) should be made literate about the functioning of banks and their benefits.
- Interference of Political leaders should be eliminated and loans should be provided only to confident parties and for productive purposes only.
- In order to avoid NPAs, proper training should be given to staff to closely monitor creditworthiness of borrowers and the usage of bank loans in right direction.
- RBI should give more autonomy to PSBs in lending activities.

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