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## A Study on Financing Barriers and their Impact on MSMEs Growth: An Empirical Analysis in Andhra Pradesh

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**Abstract:** *Small and Medium Sector Enterprises (MSMEs) are accepted worldwide, as an engine of economic growth and represent a significant portion of the gross domestic product (GDP) and are recognized as pillars of the economy of any country. In developing countries like India, Small and Medium Sector Enterprises constitute an important part of its development. In spite of this importance, this sector faces a number of constraints like the absence of adequate and timely supply of bank finance, difficulties in procuring raw materials, marketing and distribution challenges and nonavailability of suitable technology.*

*With the help of this study, the researcher tries to identify the existing problems in accessing finance from banks and financial institutions and its impact on the growth of Small and Medium Sector Enterprises in the state of Andhra Pradesh. And these problems may differ from region to region, between sectors, or between individual enterprises within a sector.*

**Keywords:** *Small and Medium Sector Enterprises, Barriers, Finance, Financial institutions, India, Andhra Pradesh.*

### 1. INTRODUCTION

Finance is an accelerator that assists in the formation of new business, gives new opportunities to grow and employ people. It is the lubricant in the process of achieving economic growth with the availability of finance which helps in initiating industrial development ultimately leading to new investment opportunities. Finance is a process of creating, moving and using money enabling the flow of money in the organization. The organization needs finance for daily operations, to meet essential expenses and payments and is rightly said that it is the nervous system of the business body. With the growth in activities finance also needs growth. Importance of finance is also felt in Small and Medium Scale Enterprises which is the vibrant and dynamic sector of Indian economy. With its agility and dynamism, the sector has shown admirable innovation and adaptability to survive in recent economic down turn and recession. Its significance is attributable to the capacity of employment generation, low capital, technology requirement, and use of traditional or inherited skills, use of local resources, mobilization of resources and exportability of products.

Availability of finance is a key enabler for economic activity and growth in Small and Medium Sector Enterprises context. Finance encompasses equity capital, loan for capital investment, working capital for meeting cash flow gaps for which several policies, regulatory and institutional initiatives have been taken to promote the availability of finance to Small and Medium Scale Enterprises sector which is supported by Government. Small and Medium Sector Enterprises sector is an important pillar of Indian economy with its greatest contribution of 30 Million units, creating employment to about 70 Million, manufacturing more than 6,000 products, contributing to about 45% manufacturing output and 40 % exports directly or indirectly. Keeping in view of the challenges, their diversified nature, and its important role, the current study on financial barriers of Small and Medium Scale Enterprises was undertaken with the aim to study emerging patterns in the financing of Small and Medium Scale Enterprises.

There is growing recognition of the important role small and medium enterprises (MSMEs) play in economic development. The MSMEs constitute about 90% of total business units in Andhra Pradesh., and account for 60% of

employed labor force. They are often described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines. Even in the developed industrial economies, it is the SME sector rather than the multi nationals that are the largest employer of workers (Mullineux, 1997). Again, from an economic perspective, however, enterprises are not just suppliers, but also consumers; this plays an important role if they are to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demand of their clients. Demand in the form of investment plays a dual role, both from a demand-side and on the supply-side.

In view of the perennial financing challenge faced by these MSMEs, many interventions have been made by the government through its recent monetary policy and financial sector reforms. These have substantially increased banks' lending to the private sector but limited access to credit, high-interestrates, and prohibitive collateral requirements still pose significant constraints to the growth of many SME's. Access to medium to long- term financing necessary for capital investment is still tight.

## 2. MSMEs CONTRIBUTION TO ECONOMIC DEVELOPMENT AND GROWTH

Economic development is a process of economic transition involving the structural transformation of an economy through industrialization, rising GNP, and income per head. Economic growth, on the other hand, contributes to the prosperity of the economy and is desirable because it enables the economy to consume and contribute to more goods and services by increasing investment, increase in labor force, efficient use of inputs to expand output, and technological progressiveness. Any nation that experiences economic development and growth will benefit from improvement in the living standards especially if the Government can assist in growth by implementing complementary and growth-enhancing monetary and fiscal policies.

Many researchers have observed that SMEs enhances competition and entrepreneurship, therefore, they suggest that direct government support can boost economic growth and development. Also, SMEs growth boost employment more than large firm because they are labor intensive and make better use of scarce resources with very small amount of capital.

### SMEs IN INDIA - MSME ACT 2006

The Micro, Small and Medium Enterprises Development (MSMED) Act has become operative from October 2006. Being a comprehensive legislation for the promotion, development, and enhancement of competitiveness of the SME sector, a number of measures were provided in the Act for enhancing the competitiveness of Small and Medium Enterprises (SMEs) and for enabling the enterprises to avail the benefit of global markets. With the enactment of the Act, the concept of enterprise, covering manufacturing and service enterprises, and a classification of enterprises on the basis of investment in plant and machinery for manufacturing enterprises, and in equipment for service enterprises into micro, small and medium were introduced. A bill is introduced in Parliament in May 2015 to revise the investment limits upwards for the SME sector in the near future. The details are given in table 2 and 3.

**Table 1:** Definition of MSME according to the MSMED Act 2006. (Manufacturing)

Enterprises	Manufacturing
Micro	Up to 25 Lakhs
Small	Up to 5 Crores
Medium	Up to 10 Crores

Source: Ministry of MSME

**Table: 2** Definition of MSME according to the MSMED Act 2006. (Service Sector)

Enterprises	Service
Micro	Up to 10 Lakhs
Small	Up to 2 crores
Medium	Up to 5 crores

Source: Ministry of MSME

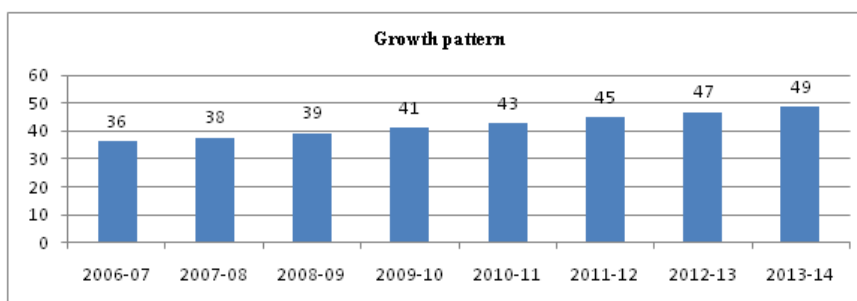
### 3. PERFORMANCE OF MSMEs SECTOR

The MSMEs sector contributes 8.7 percent of the country's Gross Domestic Product (GDP), 45 percent of the manufactured output, and 40 percent of the country's exports. The sector provides employment to about 60 million persons through 26 million enterprises in 2006-07, as revealed by the Fourth All India Census of MSMEs covering registered and unregistered segments for the reference year 2006-07. In addition, the results of the Economic Census 2005 have been included in this category as they represent the unregistered sector. Table 4 presents the aggregate performance of registered and unregistered enterprises including enterprises covered under Economic Census 2005, with estimates presented for the period 2006-07 to 2012-13.

**Table: 3** Growth patterns of MSMEs (in millions)

Year	Total MSMEs regd. & un-regd. - cumulative	The market value of fixed assets	Employment
2006-07	36.18	8685	80.52
2007-08	37.74	9205	84.22
2008-09	39.37	9771	88.11
2009-10	41.08	10385	92.22
2010-11	42.88	11059	96.57
2011-12	44.77	11833	101.26
2012-13	46.76	12693	106.15
2013-14	48.84	13896	111.42

**Source:** 4th Census report of MSMEs (2006- 07) and Economic Census (2005).



**Figure: 1** Growth patterns of MSMEs (in millions)

**Source:** 4th all India Census report of MSMEs (2006- 07) and Economic Census (2005).

The above table 4 interprets the picture of a number of enterprises, the market value of fixed assets, and gross value of output at 2004-05 prices and employment of the SME sector as visualized in the recent years. In 2012-13, with 47 million enterprises employment is 106 million, gross output at 2004-05 prices ₹ 18 trillion in 2011-12 and fixed assets market value of ₹ 13 trillion. The fourth all India census of MSMEs covers for the first time service enterprises, apart from manufacturing, and medium enterprises.

#### MSMEs in Andhra Pradesh

In recent years, the need to support MSMEs has become a top government priority in the Andhra Pradesh MSMEs have been deemed a key tool to combating the present challenges facing the region, including the need to diversify the economy, improve competitiveness, raise living standards, create jobs and bridge the regional development imbalances within countries. The World Bank called MSMEs essential engines of growth that contribute to effective markets and reduces poverty in developing countries where populations were growing rapidly and jobs desperately needed.

### 4. TYPES OF FINANCING AVAILABLE TO MSMEs

#### Internal and external funds

Internally generated funds come from a number of sources within a company and are more frequently employed. They include operational and investment profits, sales of assets, extended payment terms, reduction in working

capital and accounts receivable. Another important source of internally generated funds is expediting the collection of receivable accounts. This releases funds that may be locked up with suppliers and distributors for the firm's use. Sources that are external to a firm include owners, friends and relatives, commercial banks suppliers and distributors, government and non-government agencies.

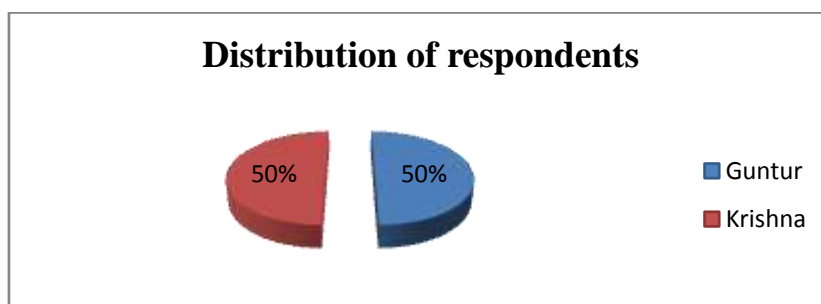
### SAMPLING DESIGN

Stratified random sampling technique was used for selecting the sampling.

**Table: 4** Distribution of respondents by location

Location	Population	percentage
Guntur (Mangalagiri)	100	50
Krishna(Kondapalli)	100	50
<b>Total</b>	<b>200</b>	<b>100</b>

Source: data compiled from field level survey



**Figure: 2** Distribution of respondents by location

Source: data compiled from field level survey

From the table 1 and figure 1 observed that equal percent of respondents was collected from each district for the convenience of research work.

### 5. OBJECTIVES OF THE STUDY

1. To study the growth and working conditions of Small and Medium Scale Enterprises in Andhra Pradesh.
2. To identify the various barriers of finance for Small and Medium Scale Enterprises in Andhra Pradesh.
3. To summarize the study and draw conclusions and offer suggestions for the growth of Small and Medium Scale Enterprises in Andhra Pradesh.

### 6. METHODOLOGY

A three-page questionnaire containing closed questions on various aspects of financial barriers was sent to hundred Small and Medium Scale Enterprises across the Guntur and Krishna districts in Andhra Pradesh. The data were analyzed using these questionnaires. In order to achieve the purpose of this study, an integration of in-depth literature review supported by semi-structured interviews was adopted. Hundred Small and Medium Scale Enterprises were interviewed via purposive sampling with each interviewee having eight minutes duration and was recorded and transcribed. The interview was guided by a schedule and was one-on-one in nature due to the constraint involved in assembling together all the targeted population. Among the population interviewed were owners of the organization, Project Managers, and senior most employees of the organization those are acting as in charges of small and medium scale enterprises. Interviewees also had enough time to enquire further about the study and also expressed their honest views through their answers. The study made use of the qualitative strategy specifically the use of interviews. Besides the primary sources, this research paper has also found the use of secondary data which are the main source of information. The sources of secondary data include 4<sup>th</sup> all India MSMEs Census report (2006- 2007), MSMEs official website, World Bank reports, economic census reports and other credible sources derived from the online library.

## 7. LIMITATION OF THE STUDY

- The analysis was based on the assumption that all the respondents' information is true.
- Respondents provide data from their memory recall, there may only be rough estimates.
- The survey was restricted to hundred people because of time constraints.
- The survey was limited to geographical boundaries of Guntur and Krishna districts.

## 8. REVIEW OF LITERATURE

This study focuses on the following objective, to review the literature on Small and Medium Enterprises (MSMEs). A comprehensive review of the literature has become an essential part of any investigation as it not only gives an idea about the work done in the past and assists in the delineation of the problem area but also provides a basis for interpretation of findings. The available relevant literature on SME is reviewed with reference to their financial as well as other related aspects.

**B. Praveen Kumar (2012)**<sup>4</sup>the study reveals about the liberalization and opening up of the Indian economy, the MSEs are facing stiff competition from imports. It is imperative to upgrade technology so as to produce better quality products at a cheaper rate.

**Suresh (2012)**<sup>2</sup>in his article entitled "Study on Assessing the Performance of Micro, Small and Medium Enterprise of Canara Bank", suggests that the MSMEs are facing problems in obtaining finance for marketing, technology, research and development, infrastructure etc because they cannot afford high investments. He suggests that the performance of Micro, Small and Medium enterprises show the trend is fluctuating in the performance of MSME schemes of Canara Bank. The bank always caters to small enterprises and when the small enterprises turned into medium enterprises, the bank's role seemed to vanish. This has made it tough to target the same companies again as the scope of Canara Bank is limited to small enterprises.

**Krishnaveni Muthiah and Sudha Venkates (2012)**<sup>3</sup>in their article entitled "A Study on Barriers Affecting the Growth of Small Scale Industries in India" identified that the firms which are not interested in doing the business for long have not registered their firms. Consequently, firms need to know the advantages of registering their firms to avail facilities such as external credit, government orders and other services offered by the MSMEs supporting institutions. Firms can change their legal form to a partnership or private limited companies; this will generate more funds and more hands to work.

**Kanishka Gupta (2011)**<sup>4</sup>in an article entitled "MSMEs Cash-Strapped", examined that the main problem of MSMEs is accessing adequate and timely financing in competitive terms particularly long-term loans, which have been worsening by the current global finance.

**Ramesh Datla (2011)**<sup>5</sup>suggests in his article entitled "MSMEs Business Confidence Declines" that an allocation of Rs.5000 crores in the Union Budget 2011-12 to SIDBI for refinancing incremental lending by banks to MSMEs enterprises. In addition, he suggests that credit cost for working capital and capacity expansion and credit availability are critical for the MSMEs

**Abdul Naser.V, (2013)**<sup>6</sup>critically evaluated the contributions made by the micro, small and medium enterprises in the balanced growth of the Indian economy. The study says that since 55% of the total enterprises operate in the rural areas they promote inclusive growth and regional equity. They play a very important role in employment generation and contribute a commendable portion to the GDP, industrial production and export of the country. The paper also highlights the challenges faced by the sector and its need for structural support.

**Srinivas K T, (2013)**<sup>7</sup>studied the performance of micro, small and medium enterprises, their contribution in India's economic growth, identified the number of enterprises, employment in MSMEs and concluded that MSMEs play a significant role in inclusive growth of Indian economy.

**Krasniqi (2007)**<sup>8</sup> used a survey research to investigate the barriers to the growth of MSMEs in Kosova and found tax burden, unfair competition, and inadequate financing as barriers to MSMEs.

**Hassanein and Adly (2008)**<sup>9</sup> investigated the magnitude of the financing barrier faced by small Egyptian construction firms and found that the lack of access to suitable sources of finance is a major barrier to MSMEs.

**Zhou and Wit (2009)**<sup>10</sup> indicated that the common barriers encountered by SME's include institutional barriers, barriers emanating firm's internal operations and financial barriers.

## 9. DATA ANALYSIS

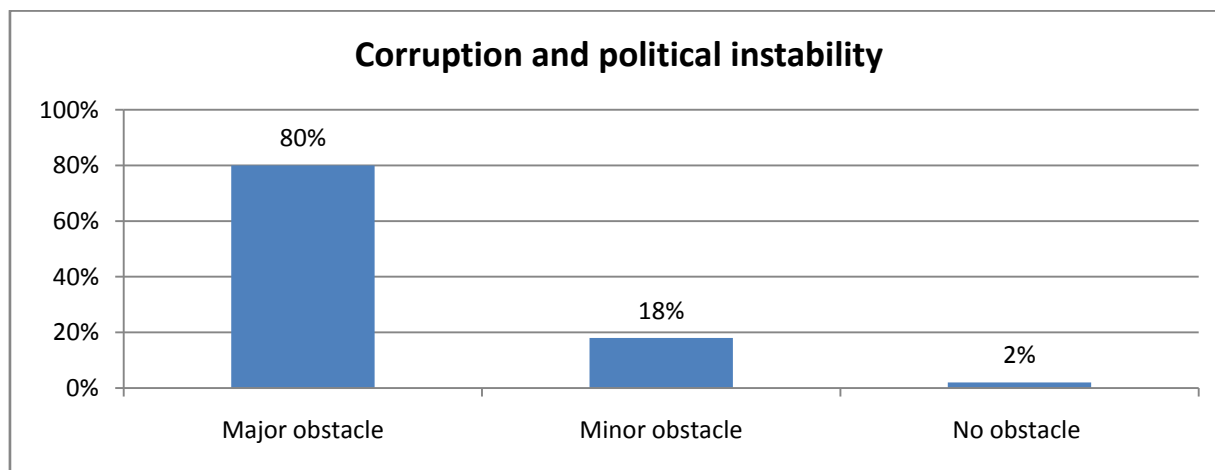
### Financial barriers facing by SMEs in Andhra Pradesh

One of the reasons for the regional differences may be the availability of financing sources. Because of the lack of availability of financing, small and medium scale enterprises tend to rely on family savings (Okpara and Wynn, 2007); that is, small business firms do not have much access to the capital markets because of their small sizes and the costs of raising capital. Most of the small business owners do not meet the requirements for commercial loans and such loans are expensive. Keyser et al. (2000) also found that a lack of starting capital is a common problem for entrepreneurs. The major financial barriers facing by Small and Medium Scale Enterprises are.

**Table: 5** Corruptions and Political Instability

Particulars	Respondents	frequency
Major Obstacle	80	80%
Minor obstacle	18	18%
No obstacle	2	2%
Total	<b>100</b>	<b>100%</b>

Source: data compiled from field level survey



**Figure: 3** Corruption and political instability

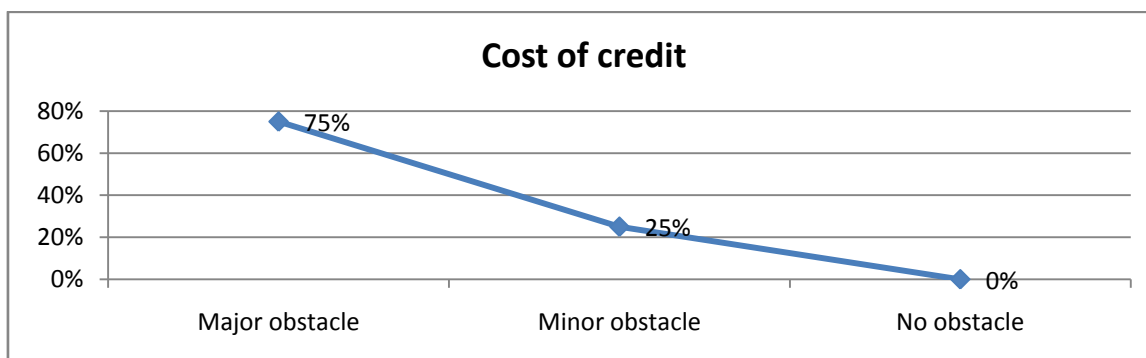
Source: data compiled from field level survey

The table 5 expresses that corruption and political instability are one of the major barriers which create hurdles to generating required finance to the small and medium scale enterprises. Out of 100 respondents, 80% of the respondents feel that corruption and political instability are the major barriers for raising finance to their business and 18% of the respondents said that these causes are minor barriers.

**Table: 6** Cost of credit

Particulars	Respondents	frequency
Major obstacle	75	75%
Minor obstacle	25	25%
No obstacle	0	0%
Total	<b>100</b>	<b>100%</b>

Source: data compiled from field level survey



**Figure: 4** Cost of credit

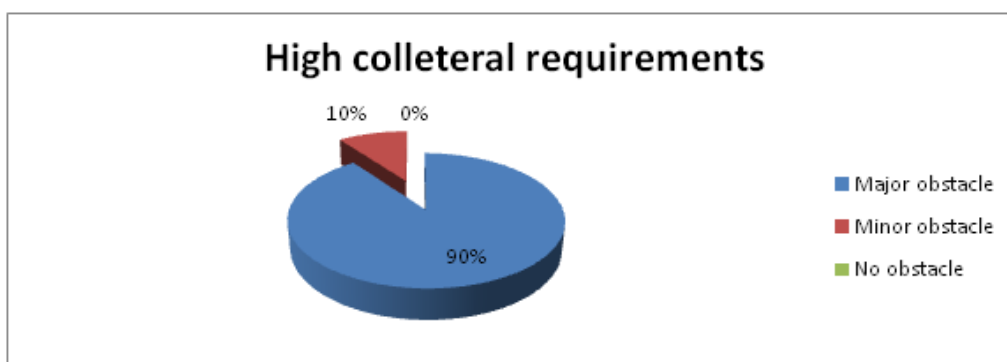
**Source:** data compiled from field level survey

In small and medium scale entrepreneurs point of view Cost of credit is also a barrier to the growth of small and medium scale enterprises. The above table convey that 75% of respondents supported to this cause as a major barrier for the growth of their business and remaining 25% respondents said that cost of credit is a minor obstacle in availing the loan for the growth of the business.

**Table: 7** High collateral requirements

Particulars	Respondents	frequency
Major obstacle	90	90%
Minor obstacle	10	10%
No obstacle	0	0%
<b>Total</b>	<b>100</b>	<b>100%</b>

**Source:** data compiled from field level survey



**Figure: 5** High collateral requirements

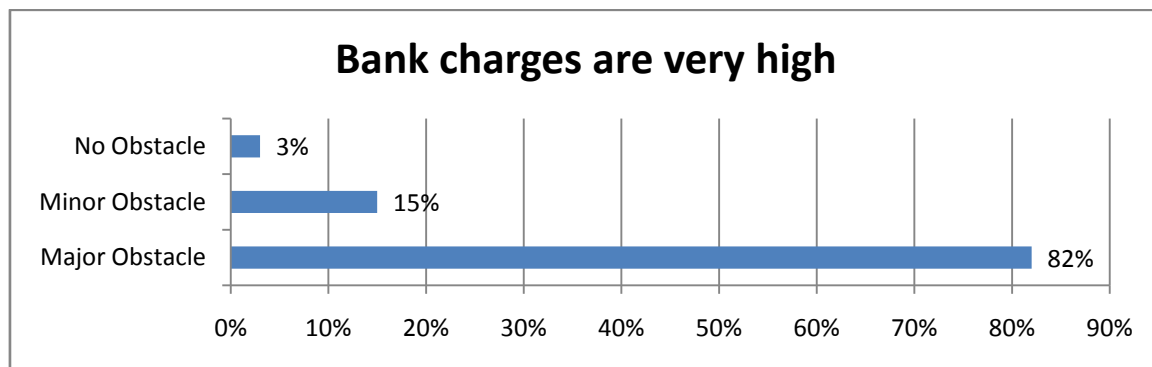
**Source:** data compiled from field level survey

A high collateral requirement is a major barrier to availing loan to the growth of small and medium scale enterprises. The above table expresses the results, like 90% of the respondents were highlighting, it is one of the serious barrier which creating hurdles to generating loan for their business, and 10% respondents support this issue as a minor barrier to their business.

**Table: 8** Bank charges are very high

Particulars	Respondents	frequency
Major obstacle	82	82%
Minor obstacle	15	15%
No obstacle	3	3%
<b>Total</b>	<b>100</b>	<b>100%</b>

**Source:** data compiled from field level survey



**Figure: 6** Bank charges are very high

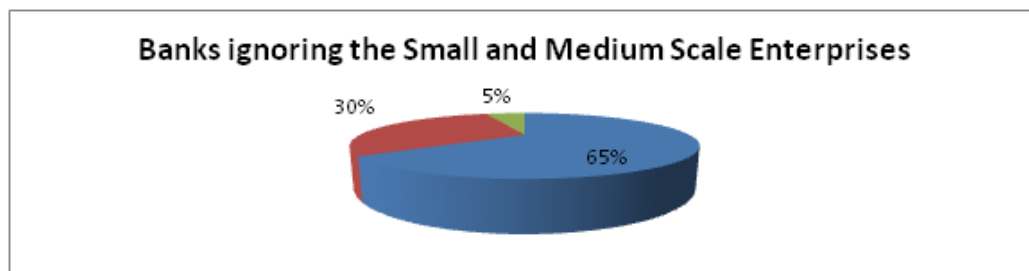
**Source:** data compiled from field level survey

From the above table, we can understand that, for availing the loans to small businesses banks are collecting huge charges which are unbearable by the owners of the small businesses. From the total respondents, 82% of the respondents feel that the charges collected by the banks are a huge burden to them and remaining 15% respondents felt that the bank charges are a burden to them up to some extent. Only 3% respondents were responding in opposite mode to the 97% of respondents.

**Table: 9** Banks ignoring the Small and Medium Scale Enterprises

Particulars	Respondents	frequency
Major obstacle	65	65%
Minor obstacle	30	30%
No obstacle	5	5%
<b>Total</b>	<b>100</b>	<b>100%</b>

**Source:** data compiled from field level survey



**Figure: 7** Banks ignoring the Small and Medium Scale Enterprises

**Source:** data compiled from field level survey

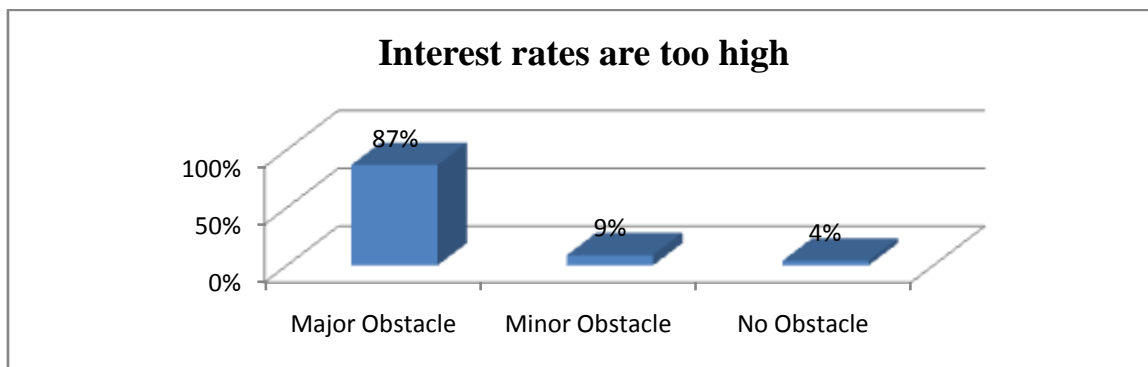
It is evident from Table 9 that banks are ignoring the small and medium scale enterprises in availing loans and this practice of the banks are the most common phenomena facing by the Andhra Pradesh Small and Medium Scale Enterprises. More than 65% of the respondents were expressing their views like, when they approaching the banks for availing loan, bankers were intentionally ignoring their loan applications and the bankers are not showing any interest in availing loans to the small and medium scale enterprises.

**Table: 10** Interest rates are too high

Particulars	Respondents	frequency
Major obstacle	87	89%
Minor obstacle	9	9%
No obstacle	4	4%
<b>Total</b>	<b>100</b>	<b>100%</b>

**Source:** data compiled from field level survey





**Figure: 8** Interest rates are too high

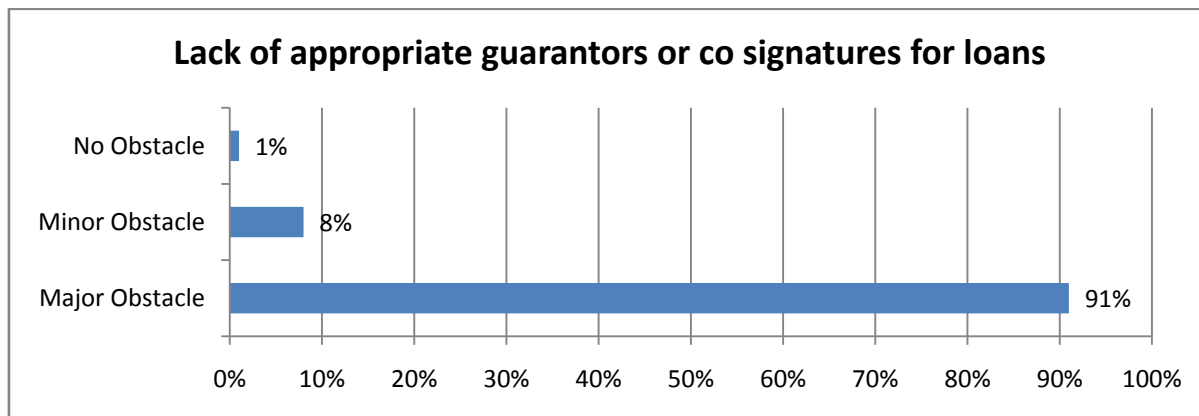
**Source:** data compiled from field level survey

The above table 10 depicted that 87% of respondents feel that, to availing the loan from the financial institution the interest rates charged by them are very high and it is a major barrier for their business growth. 9% respondents felt that interest rate is not a big difficulty to their business.

**Table: 11** Lack of appropriate guarantors or co signatures for loans

Particulars	Respondents	frequency
Major obstacle	91	91%
Minor obstacle	8	8%
No obstacle	1	1%
<b>Total</b>	<b>100</b>	<b>100%</b>

**Source:** data compiled from field level survey



**Figure: 9** Lack of appropriate guarantors or co-signatures for loans

**Source:** data compiled from field level survey

The table 11 representing that the 91% of the respondents said that banks asking for appropriate guarantors or co-signatures for availing required loan amount to the small and medium scale business, but the respondents fail to produce the same to the banks, due to this reason small entrepreneurs fail to generate loans to meet the financial requirements of the business firm which hinder the growth of small and medium scale businesses.

**10. FINDINGS**

We have analyzed the various financial barriers faced by Small and Medium Scale Enterprises units in raising finance in the state of Andhra Pradesh. The analysis of preliminary results reveals that only a small percentage of firms availed the credit scheme offered by banks. While evaluating the reason for not availing credit schemes, we can see an interesting fact that the highest percentage of respondents feel that too many formalities are there while availing credit schemes.

## 11. SUGGESTIONS

District Industries Centre (DICs) must give proper training regarding the maintaining of accounts, getting various licenses and clearances it will help to increase the managerial capacity of owners of these units and banks must provide details (features of various schemes) regarding various credit schemes. They must conduct more campaign to attract more customers. At the same time, the bank officials must ensure that the beneficiaries get loan amount without any delay and they also need to reduce the formalities regarding the loan sanctioning.

## 12. CONCLUSION

Every bank has given highest importance to financing Small and Medium Scale Enterprises in their strategic growth plan and the other side bankers need to change their attitude towards the MSMEs because Small and Medium Scale Enterprises sector is a fast growing sector in the Indian economy. This sector has consistently registered a higher growth rate than the rest of the industrial sector. In case of Andhra Pradesh, the government has taken several initiatives both at domestic and international levels to improve the availability of finance. But there are still certain impediments that the MSMEs face that are required to be addressed by the government.

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