

## A Study on Effects of Micro Financing on MSMEs in Karnataka

R.Ravi\*, Dr. Avinash Roy<sup>2</sup>

\*Director, P.G. Department of Commerce, Vidyavahini P. G. College, Tumkur,  
E-Mail: raviharitsa@gmail.com, Mobile: 09448785276

<sup>2</sup>Professor, Department of Commerce, University of Allahabad, Allahabad

**Abstract:** The research article focuses on realizing the importance of small businesses as the engine of growth in the Indian economy; the government took some steps towards addressing the conditions that hinder their growth and survival. Growth of small organisations is influenced by the background/resource of the entrepreneur, the nature of the firm, and the strategic decisions taken by the owner/manager. Entrepreneurs of the small businesses are the sole strategic decision makers and their close control supports easy translation of entrepreneurial vision into action. Their ability, need and opportunity are the major determinants of growth. Small business entrepreneurs show different

motives and also have different attitude and behaviour towards growth. Also a given set of entrepreneurial characteristics beneficial in one context may work adversely in the other. A fit between strategy, structure and processes is more favourable to the performance. In this article a conceptual model on growth strategy in small entrepreneurial organisations is presented. The propositions made in this article reflect strategic and entrepreneurial dimensions of growth and takes a view that entrepreneurial motivation is different from growth motivation.

**Keywords:** *SMEs, entrepreneurial growth strategy, entrepreneurship.*

### 1. Introduction

MSME Development Organization (The Small Industries Development Organization (SIDO)), headed by the Additional Secretary & Development commissioner (Micro, Small and Medium Enterprises), is one of the apex bodies of the Government of India, Ministry of Micro, Small and Medium Enterprises, to assist the Government in formulation of policies and programmes, projects schemes, etc., for the promotion and development of Micro, Small and Medium Enterprises in the country and also coordinating and monitoring the implementation of these policies and programmes etc. Promotion and development of Micro, Small and Medium Enterprises is primarily the responsibility of the States and Union Territories (UTs) and the role of the Central Government (including the MSME Development Organization (formerly known as SIDO)) in this field is to aid and assist the States/UTs in this endeavor.

MSME Development Organization (formerly known as SIDO) functions through a network of MSME - Development Institute (Formerly Known as Small Industries Service Institute)s (MSME - Development Institute (Formerly Known as Small Industries Service Institute)s), Branch MSME - Development Institute (Formerly Known as Small Industries Service Institute)s, Regional Testing Centers (RTCs), Field Testing Stations (FTSs) and autonomous bodies. It renders services such as:

- Advising the Government in policy formulation for the promotion and development of Micro, Small and Medium Enterprises and small scale service and business entities (collectively referred to as small enterprises) and for their graduation to medium enterprises.
- Providing techno-economic and managerial consultancy, common facilities and extension services to small enterprises.
- Providing facilities for technology up gradation, modernization, quality improvement and infrastructure of/for small enterprises.
- Developing human resources through training and skill up gradation of small entrepreneurs as well as its own man power.
- Providing economic information services to the Government and small enterprises.
- Maintaining liaison with other Central Ministries, Planning commission, State Governments and other organizations concerned with development of small enterprises.

Over the years, MSME Development Organization (formerly known as SIDO) has served a useful purpose as a catalyst of growth of small enterprises through its countrywide and varied network of specialized field organizations. Micro, Small and Medium Enterprises Board:

- To facilitate coordination and inter-institutional linkages among various Ministries, State Governments, Banks, Financial Institutions, Micro, Small and Medium Enterprises Associations, etc., the Micro, Small and Medium Enterprises Board has been constituted as the apex advisory body to advise the Government on all issues pertaining to the small scale sector.
- The Minister in-charge of the Ministry of Micro, Small and Medium Enterprises, Government of India is the Chairman of the Board. The Board comprises Industry Ministers of State Governments, Secretaries of various Departments of Government of India, the heads/senior representatives of financial institutions, public sector undertakings, industry associations and eminent experts in the field and meets periodically.

There are 30 MSME - Development Institutes and 28 Branch MSME - Development Institutes set up in State Capitals and other industrial cities all over the country. The main Functions and Duties /activities of these institutions are as follows:

- ❖ Assistance/Consultancy to Entrepreneurs.
- ❖ Assistance/Consultancy to Existing Units.
- ❖ Preparation of State Industrial Profiles.
- ❖ Preparation/Updating of DI Potential Surveys.
- ❖ Project Profiles
- ❖ Entrepreneurship Development Programmers.
- ❖ Motivational Campaigns
- ❖ Production Index
- ❖ Management Development Programmes
- ❖ Energy Conservation
- ❖ Pollution Control
- ❖ Quality Control & Up Gradation
- ❖ Export Promotion
- ❖ Ancillary Development
- ❖ Common Facility Workshop/Lab.
- ❖ Preparation of Directory of Specific Industry
- ❖ Intensive Technical Assistance
- ❖ Coordination with District Industries Centers.
- ❖ Linkage With State Govt. Functionaries
- ❖ Market Surveys
- ❖ Other Action Plan Activities Assigned by Headquarters

MSME - Development Institutes and its Branches have common facility workshops in various trades. There is at present 42 such common facility workshops attached to MSME - Development Institutes throughout the India. Small entrepreneurial organisations have high influence of entrepreneurs' personality and style, less formal planning and control and loose organisation structure and administrative system. These organisations are the outcomes of initiatives of entrepreneurial talents.

Karnataka was home to nearly 600,000 small-scale units (of which 350,000 are registered), nearly 75 per cent of them located in and around *Bangalore, Mysore, Mangalore, Belgaum, Hubli and Shimoga* are considered for the present study.

Small businesses have some fundamental advantages. They need low investment as compare to their large counterparts. However due to this reason they also face resource limitation—both human and financial resources. They offer employment to the local talents. Flexibility and closeness to the customers are the major advantages; due to informal settings these organisations can strike the market fast. They also have the advantage of economies of scale and lower overheads. In entrepreneurial small organisations close control supports easy translation of entrepreneurial vision into action. But due to limited exposure the small organisations have less information about the market and suffer from lack of economies of scope.

Firms are the means for realising entrepreneurial ambitions of individual entrepreneurs. Entrepreneurial ventures work on the principle motto of profitability and growth with a long term desire of market dominance. This is based on innovation in products, processes or practices. There exists difference between strategic orientations of entrepreneurial and small ventures. All small ventures do not work on innovations or dominance motive.

Micro Small and Medium-sized enterprises (MSMEs) have been playing a pivotal role in country's overall economic growth, and have achieved steady progress over the last couple of years. From the perspective of industrial development in India, and hence the growth of the overall economy, SMEs have to play a prominent role, given that their labor intensiveness generates employment. The SME segment also plays a major role in developing countries such as India in an effort to alleviate poverty and propel sustainable growth. They also lead to an equitable distribution of income due to the nature of business. Moreover, SMEs in countries such as India help in efficient allocation of resources by implementing labor intensive production processes, given the abundant supply of labor in these countries, wherein capital is scarce.

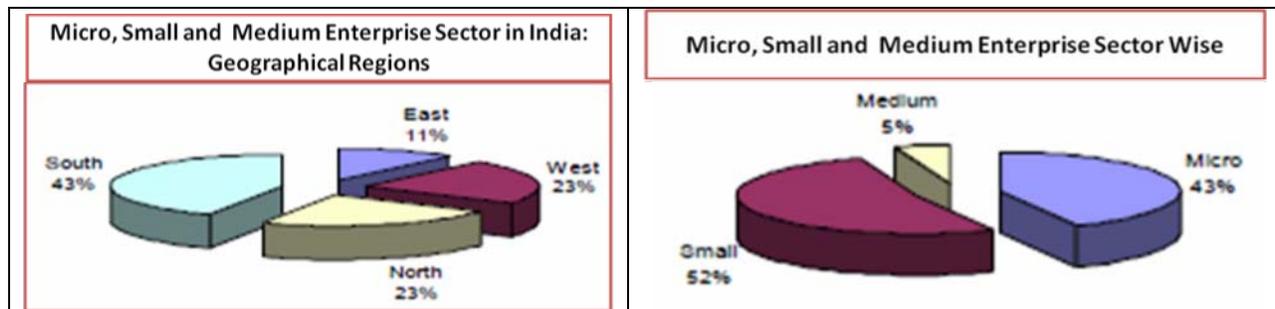
The enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 was a landmark initiative taken by the Government of India to enable the SMEs' competitive strength, address the issues and challenges and reap the benefits of the global market. SME policy initiatives at the national and state level are aimed at strengthening the role of SMEs at the base as well as at the higher level.

Micro Small and Medium-sized enterprises (MSMEs) are the backbone of all economies and are a key source of economic growth, dynamism and flexibility in advanced industrialized countries, as well as in emerging and developing economies. SMEs constitute the dominant form of business organization, accounting for over 95 per cent and up to 99 per cent of enterprises depending on the country. They are responsible for between 60-70 per cent net job creations in Developing countries. Small businesses are particularly important for bringing innovative products or techniques to the market.

The combined effect of market liberalization and deregulation has forced the SME segment to change their business strategies for survival and growth. Some of the changes that SMEs are focusing on include acquiring quality certifications, increasing use of ICT, creating e-business models and diversification to meet the increasing competition. Globalization, economic liberalization and the WTO regime would undoubtedly open up a unique opportunity for the largest business community, i.e. SMEs through effective involvement in international trade by streamlining certain factors, such as, access to markets, access to technology, access to skills, finance, development of necessary infrastructure, SME-tax friendly environment, exchanges of best practices to name a few.

The SME sector has also registered a consistently higher growth rate than the overall manufacturing sector. In fact, it plays a dual role since the output produced by SMEs is not only about final consumption but also a source of capital goods in the form of inputs to heavy industries.

In Feb 2008, the Ministry of Micro, Small and Medium Enterprises (MSME), continued with its dereservation policy by removing 79 items from the list of 114 items reserved specifically for SSI (small scale industries) manufacturing. Only 35 items remain in the reserved category from the total 836 selected in 1994 denoting the declining monopoly of the SSI segment on the reserved products. However, the government has set up various schemes in place such as the Credit Linked Capital Subsidy Scheme, MSME Cluster Development Scheme and ISO 9000 Reimbursement Scheme to help SMEs for procuring timely funds. Also the government has put in place the Credit Guarantee Scheme to encourage banks to lend up to Rs 0.50 million without collateral. There has also been a recent budget announcement of setting up of a Risk Capital Fund. The below figures shows the region wise and sector wise enterprises were established in the India and each sector wise MSMEs in India.



Though MSMEs are being touted as the priority sector within the economy, they continue to face problems pertaining to finance. When it comes to banks, they have a very traditional way of lending to this segment against collateral and MSMEs end up being under financed. Evidently, the biggest challenge before the SMEs today is to have access to non debt based and non-traditional financial products such as external commercial borrowings, private equity, factoring etc.

## 2. Objectives of the Study

The aim of this study is to estimate the effects of micro-financing on business performance of MSEs in India. The primary objectives are to:

- Assess the contributions of micro-financing to the survival of MSEs in India.
- Analyze the effects of micro-financing on MSE growth and expansion capacity in India.
- Ascertain the effects of microfinance on the productivity of MSEs operators in India.
- Examine the effects of non-financial services of microfinance institutions on MSEs business performance in India.
- Document the operations and processes of micro-financing activities in India.

## 3. Statement of Hypotheses

- H1 – Micro financing makes no significant contribution to the survival of MSEs in India.
- H2 – Micro financing does not have the capability to influence the expansion capacity of MSEs in India.
- H3 – Microfinance has no significant effect on the level of productivity of MSEs in India.
- H4 – The provision of non-financial services (training and advisory services) by micro finance institutions does not enhance the performance of MSEs in India.

#### **4. Significance of the Study**

A significant amount of empirical research has been carried out both within and outside the country on the relationship between microfinance and microenterprise development. It has been observed from the literature, that most research works treated microfinance as a solution to poverty. To the best of our knowledge, the impact of microfinance on Micro and Small Enterprise survival and growth has not been empirically tested in the literature, especially in India. Most researchers in India have also not taken time to document the nature, mode of operation and processes involved in Micro financing. This study therefore becomes significant in filling this observed gap by testing empirically the impact of both the financial and non-financial services offered by Microfinance Banks on small business growth/survival and by examining the capability of Microfinance institutions in enhancing the expansion capacity of small businesses in India. The study also contributes to the literature on microfinance and small business survival.

#### **5. Scope of the study**

The study provides insight into microfinance and small business survival and growth, as well as provides a measure of the effects of micro financing on small business performance and productivity in India. It covers MSEs that have access to microfinance for a period of at least five years (2007–2012). The population for the study includes the clients of the selected Microfinance Banks, that is, the 169 Microfinance Banks in the South-West geopolitical zone that have obtained their final operating licenses as of the year 2009. These includes microfinance banks that metamorphosed from community Banks into MFBs in 2007. They are spread across both rural and urban areas of the South-West geographical zone. The microfinance clients are selected based on the following criteria:

- The client that has stayed for a minimum of 5 years with the Microfinance Banks, i.e from the period 2007 to 2012.
- The client operates/manages a small or micro business enterprise.

#### **6. Limitation of the Study**

The main limitation of the study is the reliance on information supplied by micro and small business operators who normally do not want to make a full disclosure of their businesses to an unknown person for fear of being subjected to tax payment. In the same vein, most of the small business operators lack proper record keeping practices and do not adhere to standard book keeping and accounting procedures. Karnataka was home to nearly 600,000 small-scale units (of which 350,000 are registered), nearly 75 per cent of them located in and around *Bangalore, Mysore, Mangalore, Belgaum, Hubli and Shimoga*. Our study is also carried for the above 6 places which covers three fourth of the Karnataka state.

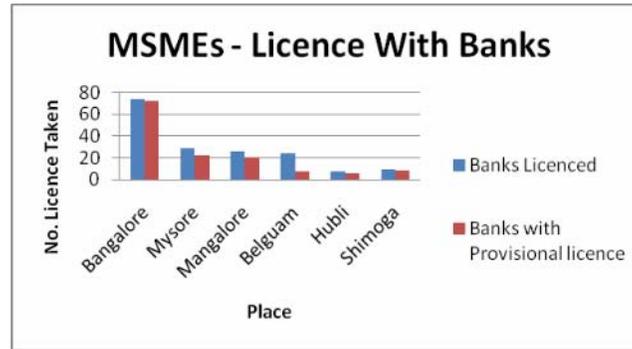
#### **7. Population of the Study**

This research identified two-in-one aggregation or study groups; these are all Microfinance bank (MFB) in India, all Microfinance Bank (MFB) clients who are operators of micro and small enterprise in India, particularly those that have benefited at one time or another from the financial and non-financial services rendered by a MFB in India. According to the CBN records as at 31<sup>st</sup> March 2012, there were 305 Microfinance Banks in the Karnataka. Out of the 305, only 169 have obtained their final license to operate as Microfinance Banks. The other 136 reportedly have provisional approval. For the purpose of this study, the population of Microfinance Banks adopted for the study is the 169 MFBs that have obtained final approval. See distribution across the Karnataka state.

Licensed & Unlicensed Microfinance Banks

License/Ciity	Bangalore	Mysore	Mangalore	Belguam	Hubli	Shimoga	Total
Banks Licenced	74	29	26	24	7	9	169
Banks with Provisional licence	73	22	20	7	6	8	136
Total	147	51	46	31	13	17	305

Source: CBN, Other Financial Institutions Department.

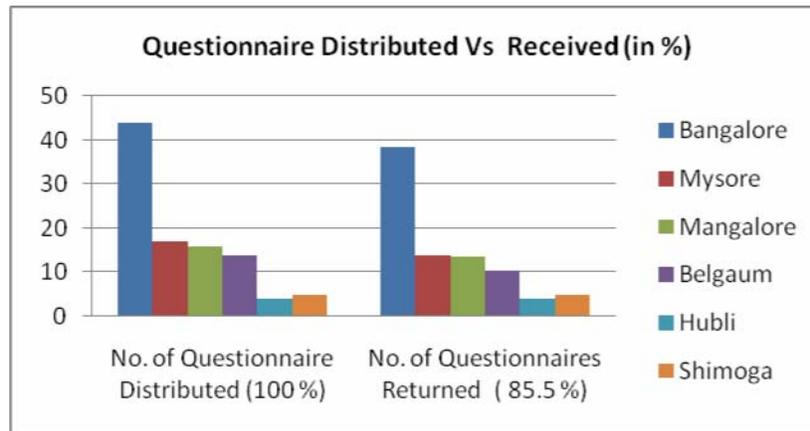


Distribution of Questionnaires and Response rate

A total of six hundred and twenty-three (623) copies of the questionnaire were administered across the Karnataka covered by the study. The basis of distribution of the copies of the questionnaire was based on the CBN records of March 2009, which provides useful insights into the geographical spread of Microfinance Banks (MFBs) across the Karnataka with particular reference to Microfinance Banks that operate within the ambit of the law that governs their operations. The records also show that there were 169 Microfinance Banks with a final licence operating area. The details of the questionnaire distribution and response rate are shown in Table Questionnaire Distribution / Response Rate of Micro, Small & Medium Enterprise Operators

Place	No. of Questionnaire distributed	%	No. of questionnaires returned	%
Bangalore	274	43.98	219	38.5
Mysore	106	17.01	83	13.8
Mangalore	96	15.41	84	13.7
Belgaum	88	14.13	63	10.5
Hubli	26	4.17	23	4.0
Shimoga	33	5.30	30	5.0
Total	623	100	502	85.5

Source: Researcher’s Analysis of Field Survey

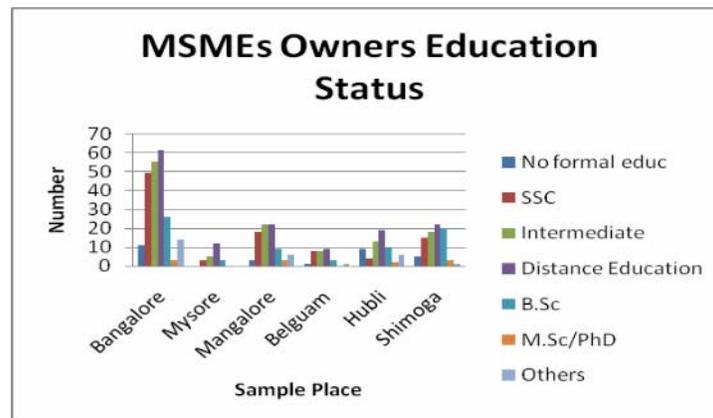


As mentioned earlier, Table shows the questionnaire distribution and response rate across the six Areas in the Karnataka state. A total of 274 copies of the questionnaire, representing 44 per cent of the total sample size were administered in Bangalore Area. In Mysore Area, a total of 106 copies of the questionnaire were distributed, representing 17 per cent of the sample size. In Mangalore 96 (representing 15 per cent) were distributed, in Belgaum Area, 88 copies of the questionnaire were distributed representing 14 per cent of the total sample. In Hubli and Shimoga Areas 26 and 33 copies of questionnaire were distributed respectively, representing 4 per cent and 5 per cent respectively of the total sample size.

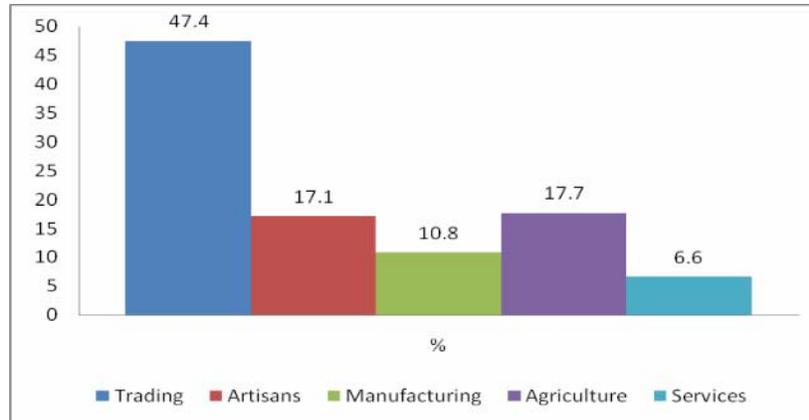
To study the project Survival Analysis examines and models the time it takes for a certain event to occur. An example of such an event is death, from which the name ‘survival analysis’ and much of its terminology is derived, but the ambit of application of survival analysis is much broader. Survival analysis focuses on the distribution of survival times. The survival model examines the relationship between survival and one or more predictors, usually termed covariates in the survival analysis literature.

Come kind of business the Bangalore is playing a major role in the establishing of all kinds of business in the sample area.

The bellow figure shows the education status of the owners who are running their firms in the state of Karnataka. It is clearly visible in the bellow figure.



The bellow figure shows the kind of business of the owners who are running their firms in the state of Karnataka are the field of Trading business more. It is clearly visible in the bellow figure and it is amounting to 47.4 per cent.



The study investigates the effects of micro financing; comprising of financial and non – financial products, offered by the Microfinance Banks on micro and small enterprise growth, survival, productivity and performance in Southern India. According to our findings, the survival of micro small and medium enterprises (MSMEs) depends largely on whether the enterprises are able to generate profit from the use of micro funds and easy access to micro credit. It also depends on regular participation of entrepreneurs in microfinance programmes; and whether entrepreneurs are able to convert the profits made in a particular year to further investments. The study also assesses the impact of microfinance on entrepreneur’s productivity.

## 8. Findings

- Most microfinance banks have more individual client members than group based clients. With this, recovery of loans becomes very difficult, especially when there are no collateral to fall back on.
- The source of initial capital is mostly from the entrepreneurs’ personal savings.
- The composition of initial capital revealed 53.6 per cent as owners’ fund (equity finance), 26.3 per cent is debt and equity combined, while 20.1 per cent is debt finance only.
- The result obtained revealed that 68.2 per cent of the respondents would not like their enterprise to be co-financed by banks or other private individuals, while 31.8 per cent would not mind co-financing.
- Majority of the respondents agreed that they could more easily access microcredit than bank credit.
- Majority of respondents agreed that regular participation in microfinance enhanced their business.
- Only a few of the total respondents are involved in manufacturing business.

## 9. Recommendations

- Enterprises supported by MFBs should be linked up with larger financing windows like the SMEEIS fund or Strategic Partners as suggested by Ojo (2003). The linkages should be such that the entrepreneurs would be serviced through their MFBs based on social capital. This will enable MFBs to introduce loan products and strategies targeted at financing technology acquisition by MSMEs.
- In order to encourage technology acquisition for MSME expansion, MFBs can categorize their loans into low and high interest loans. The conventional loans to clients can be maintained as high interest loans, while loans for capital assets or technology acquisition should be low interest loans, which can be secured by a mortgage over the fixed asset so acquired by the micro-borrower. To achieve this, the Microfinance Banks can be recapitalized.
- MFBs should increase the duration of their clients' asset loans, or spread the repayment over a longer period of time, or increase the moratorium. This will enable the clients to have greater use of the loan over a longer period for the acquisition of capital assets and technology.

- The MFBs should employ collective group-based loan disbursement and staggered disbursement strategy; this will reduce the default rate and the volume of portfolio at risk.
- The microfinance banks should reduce the gap between their savings deposit rate and the lending rate by mobilizing more savings from the informal financial market which is an integral part of their operating environment.
- In terms of policy on support services, MFBs should assist their clients by providing training on credit utilization and provide information on government programmes to MSE operators in the country. Such MSME support and training institutions should be strengthened and properly funded while the services should be properly delivered too. MFBs can partner with relevant technology enterprise development organizations/skills training institutions to provide client-focused skills training to their clients.
- University education is found to have positive effects on entrepreneurs' productivity; Entrepreneurs should therefore be encouraged by the MFBs to improve on their current level of education by engaging in adult education or life-long learning; as this will have the potency to increase their level of productivity.
- Banks should engage in target site selection and means testing before they are sited in a particular location. This will enable the banks to develop appropriate financial product that will suit the need of the entrepreneurs in a particular location rather than offering blanket services that will not have positive impact on the MSMEs growth.

## **10. Conclusion**

The study investigates the effects of micro financing; comprising of financial and non – financial products, offered by the Microfinance Banks on micro and small enterprise growth, survival, productivity and performance in Southern India. According to our findings, the survival of micro small and medium enterprises (MSMEs) depends largely on whether the enterprises are able to generate profit from the use of micro funds and easy access to micro credit. It also depends on regular participation of entrepreneurs in microfinance programmes; and whether entrepreneurs are able to convert the profits made in a particular year to further investments.

## **11. References**

1. Ojo, J. A. T. (2003). Partnership and Strategic Alliance Effective SME Development. Small and Medium Enterprises Development and SMIEIS: Effective Implementation Strategies; CIBN Press Ltd, Bangalore, 185-212.
2. Annual report MSME 2011-2012
3. International trade statistics, WTO
4. Economic survey 2009-2010 unleashing India's Innovation: Toward sustainable and inclusive growth, mark A. dutz,
5. World bank publication, 2007.
6. [www.msme.gov.in](http://www.msme.gov.in)
7. [www.dcmsme.gov.in](http://www.dcmsme.gov.in)
8. [www.socialsciences-ejournal.org](http://www.socialsciences-ejournal.org)
9. [www.mopsi.nic.in](http://www.mopsi.nic.in)
10. [www.ibef.org](http://www.ibef.org)
11. [www.planningcommission.nic.in](http://www.planningcommission.nic.in)
12. [www.legalpundits.com](http://www.legalpundits.com)
13. [www.smechamberofindia.com](http://www.smechamberofindia.com)
14. [www.mxmindia.com](http://www.mxmindia.com)