

# INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, ECONOMICS & MANAGEMENT

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- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

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## DETERMINANTS FOR COMMERCIAL BANKS IN FINANCING SME (WITH SPECIAL REFERENCE TO MEERUT DISTRICT, U.P., INDIA)

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### ABSTRACT

*Banks are the main source of external finance for SMEs. The financing of small and medium-size enterprises (SMEs) has been a subject of great interest both to policy-makers and researchers because of the significance of SMEs in the private sector. They play a very significant role in the growth of the Indian economy, accounting for 45% of industrial output, 40% of exports, employing 69 million people; the contribution of these units to GDP may touch 22% in 2013. SMEs financing shows that bank credit is the major source of external finance for the SMEs. Both small and large banks play a vital role in financing SMEs. The objective of the study is to identify major decision factors used by commercial banks for financing SME's. To study the risk associated in financing SME's, factor analysis is used. The study found the following main factors which act as the driver for the financing decisions, with the help of factor analysis. They are: lack of collateral, number of defaults made by the firm with reference to previous loans, track record of the firm or owner, bad credit record, unaudited statements and lack of information about the profit earned by SME. The influence of these factors decides the risk associated with the SME lending.*

### KEYWORDS

Bank finance, Banking market structure, Financial constraints, Small and medium enterprises.

### INTRODUCTION

 SME is the abbreviation for Small and Medium Enterprises. The critical role of the MSME sector in the social and economic development of our country is well known in terms of employment generation, exports and contribution to Gross Domestic Product. These enterprises can be called as the backbone of the GDP of India. In recent years the SME sector has consistently registered higher growth rate compared to the overall industrial sector. The major advantage of the sector is its employment potential at low capital cost. The labour intensity in the SME sector is estimated to be almost four times higher than the large enterprises. The major advantage of the sector is its employment potential at low capital cost for which, three critical enablers are required. Firstly, better infrastructure, second- the increased access to risk capital and the third - creating a culture of innovation." MSMEs are important for the national objectives of inclusive growth i.e. growth with equity and inclusion.

\*The SME sector has been contributing significantly to the manufacturing output, employment and export between 2003-2004 & 2007-2008 the SME sector registered average annual growth in the number of units & employment of around 4.1% & 4% respectively. SMEs always represented the model of socio-economic policies of Government of India which emphasized judicious use of foreign exchange for import of capital goods and inputs; Labour (\*Economic survey 2008-2009)

Post globalization, SMEs is exposed to greater opportunities than ever for expansion and diversification across the sectors. Indian market is growing rapidly and Indian entrepreneurs are making remarkable progress in various sectors like Manufacturing, Food Processing, Textile & Garments, Retail, IT and Service sector. The small enterprise sector has continued to contribute immensely in creating large scale job opportunities across the space and in the process, helped reduce inter-regional rural-urban disparities in growth. Certain products belonging to this sector have also been consistently figuring in the export basket during the recent decades, although the export performance in the global market has been unimpressive and the level of threat has also enlarged.

### MSME ACT-2006

Particular	Manufacturing (investment in P&M)	Services (investment in equipment)
Micro enterprise	Up to 25 Lakh	Up to 10 Lakh
Small enterprise	Above 25 Lakh & up to 5 Crore	Above 25 Lakh & up to 2 crore
Medium enterprise	Above 5 Crore up to 10 Crore	Above 2 Crore & up to 5 Crore

Source: <http://dcmsme.gov.in> 15

### BANKING SECTOR FINANCING

#### STRUCTURES OF SME FINANCING

Financing by banking institutions form the most important source of external financing for SMEs. This is due to the dominance of the banking sector as the main intermediary in the financial systems. The banking sector has a wide range of generic short, medium and to a lesser extent, long term credit and various supplementary financing instruments including trade credit, export financing, factoring and discounting. Some banks also provide special loans targeted at priority sectors and key segments of the population as identified by the Government. There are also several credit cooperatives/credit funds, microfinance Institutions and financing companies. Letters of credit are offered by some commercial banks to facilitate trade financing but the SME are unlikely to be the main beneficiaries.

#### SOURCES OF SME FINANCING

SMEs draw financing from a variety of sources. Around 30- 40% of SMEs in India rely on internal Savings, retained earnings and borrowings from family, friends and money lenders (collectively known as 'informal sector') as opposed to the 60-70% which have access to formal sector finance (banks, capital markets, venture capitalists etc.) Bank's lending to the Micro and Small enterprises engaged in the manufacturing or production of goods specified in the first schedule to the Industries (Development and regulation) Act, 1951 and notified by the Government from time to time is reckoned for priority sector advances. However, bank loans up to Rs.5 crore per borrower / unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSME Act, 2006 are eligible to be reckoned for priority sector advances. Lending to Medium enterprises is not eligible to be included for the purpose of computation of priority sector lending.

Secured  
Business LoansWorking  
Capital LoansBill  
Discounting

Cash credit

Bank overdraft

## LITERATURE REVIEW

**Financing SMEs .An Industry Perspective R. Seshasayee, July-Sept 2006:** Small and Medium Enterprises (SMEs) are critical to the nation's economy. They contribute approximately 40% of India's domestic production, almost 50% of total exports and 45% of industrial employment. More important, they are the second largest manpower employer overall after agriculture. SMEs in India are mostly in the unorganized sector and are the source of livelihood for millions of people. Despite their economic significance, SMEs face a number of bottlenecks that prevent them from achieving their full potential.

**Dietsch and Petey (2008)** investigated a specific issue relating to capital requirements for bank's SME loan portfolios, namely the diversification potential within large portfolios of SMEs. Extending the standard one-factor credit default model to multiple factors, which takes into account size, sector and location, they computed economic capital allocations for large portfolios of French SME loans. They found that two opposing effects are at play when estimating aggregate credit risk for an SME loan portfolio: on the one hand, diversification decreases economic capital; on the other hand, a more complete representation of default rate dynamics in such a framework increases economic capital.

**Coluzzi et al., (2008),** studied the indicator of financing constraints for five euro area countries (Germany, Spain, France, Italy and Portugal). They found that young and/or small firms in principle grow faster than larger and older firms. At the same time, they also face considerably more severe financing restrictions than other firms. Also, firms of the manufacturing and construction sectors are more likely to feel financing constraints, which may be attributable to the high capital intensity of these sectors. As could be expected, increased sales – which reflect better success of the chosen business model – lessen financing constraints. Regarding the impact of financing constraints on growth, the authors found that more cash flow fosters growth. The probability of financial obstacles (proxied by age, size and other firm features) is found to affect growth for all countries except for Germany. The effect of higher leverage is ambiguous: it fosters growth in some countries (Spain, France and Italy) while it hampers growth in Germany and Portugal.

**Mr. S.K. Chhabra, (2009)** - has conducted a study on Role of scheduled commercial banks in socio-economic development of Nagaland. The paper also evaluates the performance of commercial banks in terms of various parameters, in which SMEs play a part. Nagaland is an industrially backward state. Till date the state is industrially represented by 10 medium and large industries, 1900 SSI units, the government of the state is desperately trying for the development of SME's in the state. Commercial banks are expected to provide adequate and timely assistance in view of the backwardness of the state; both commercial banks and financial institutions are also expected to make adequate concessions through the various conditions and norms, for commercial banks and term loan. The findings show that banks have to ensure increased credit flow.

**Mr. Bisman & Neelam Goela have investigated (2010)-The SIDBI: Retrospective on SME finance: in Indian journal of economics:** This paper reports on an investigation into country, regional development and the macroeconomic financing function of SIDBI, examining how the SIDBI fulfilled its role with respect to fostering the start-up and growth of SME's in lesser developed regions of India. This paper states, aspiring entrepreneurs, as well as owners of existing SME'S may face difficulties in obtaining loan finance from commercial banking organizations. Due to interest rate change, lack of collateral or security for loans and risk factors, components of supply gap on the part of SME owners concerning their awareness of sources about availability of funding( for a review see, hulmea et at.2003) development banks act to bridge the aspects of the finance gap. This paper finally suggests that the SIDBI has not been the panacea from small business in particular regional area. However, several factors served to exculpate the SIDBI from fulfilling its role of providing finance to SME'S in line with national objective to eradicate regional imbalance.

**Prof Björn Berggren, Lars Silver** found in a Research paper in 2011 on "Financing entrepreneurship in different regions: The failure to decentralise financing to regional centres in Sweden. The purpose of the paper is to analyse the financial search behaviour of small and medium-sized enterprises (SMEs) in different regions and the perceived importance of different external financiers for these firms. The findings show that large differences exist in the financial search behaviour exhibited by firms in the four different types of regions. In the metropolitan areas, firms are more active in searching for new owners, especially professional investors. In smaller municipalities, banks dominate as the most important financier. The paper fulfils an important role in elaborating on the use and importance of different types of financing in various regions.

## OBJECTIVES

The present study has been undertaken with the following objectives:

1. To identify the major decision factors considered by commercial banks for financing SME's.
2. To study the risk associated in the financing of SME's by commercial banks.
3. To identify the major grounds for rejecting the loan proposals from SME's.

## RESEARCH METHODOLOGY & SAMPLING PROCEDURE

Research is based upon primary and secondary data. A set of 100 Questionnaires filled and returned by the officials of different commercial Banks in Meerut distinct was taken as the sample for this study, in which 76 officials responded. The sample was heterogeneous in product and process. Factor analysis was used to analyze the data.

## DATA ANALYSIS AND INTERPRETATION

FACTOR

/VARIABLES Q3.1 Q3.2 Q3.3 Q3.4 Q4.1 Q4.3

/MISSING LISTWISE

/ANALYSIS Q3.1 Q3.2 Q3.3 Q3.4 Q4.1 Q4.3

/PRINT INITIAL CORRELATION KMO EXTRACTION ROTATION

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/CRITERIA MINEIGEN(1) ITERATE(25)

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/ROTATION VARIMAX

/METHOD=CORRELATION.

FACTOR ANALYSIS

[DataSet2] C:\Users\Admin\Desktop\bank sheet.sav



CORRELATION MATRIX					
		Prob: Collateral	Prob: NPA	Prob: Interest rate	Prob: Size of SME
Correlation	Prob: Collateral	1.000	.539	.293	.167
	Prob: NPA	.539	1.000	.361	.371
	Prob: Interest rate	.293	.361	1.000	.240
	Prob: Size of SME	.167	.371	.240	1.000
	Non-registered org	.037	.112	.137	.171
	Unaudited statement	-.062	.050	.113	.133

CORRELATION MATRIX		
		Non-registered org
Correlation	Prob: Collateral	.037
	Prob: NPA	.112
	Prob: Interest rate	.137
	Prob: Size of SME	.171
	Non-registered org	1.000
	Unaudited statement	.287

KMO AND BARTLETT'S TEST		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy		.647
Bartlett's Test of Sphericity	Approx. Chi-Square	57.403
	Df	15
	Sig.	.000

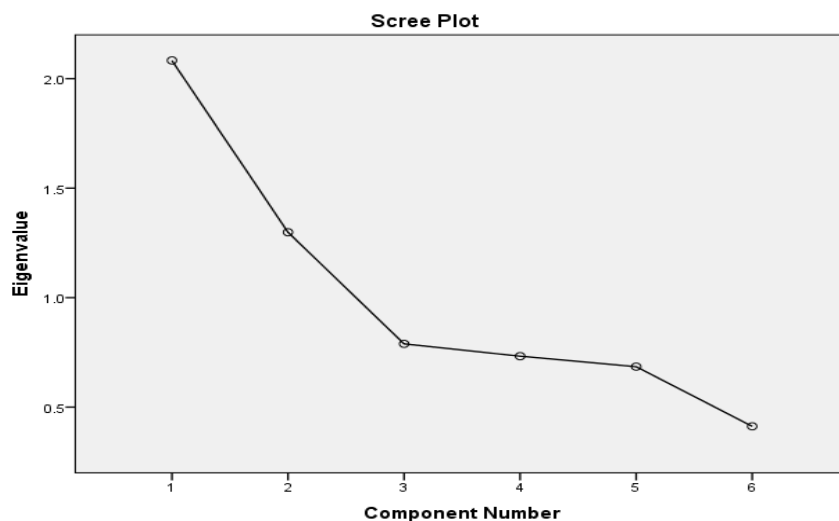
COMMUNALITIES		
	Initial	Extraction
Prob: Collateral	1.000	.649
Prob: NPA	1.000	.714
Prob: Interest rate	1.000	.429
Prob: Size of SME	1.000	.396
Non-registered org	1.000	.565
Unaudited statement	1.000	.629

Extraction Method: Principal Component Analysis.

TOTAL VARIANCE EXPLAINED						
Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.083	34.717	34.717	2.083	34.717	34.717
2	1.299	21.642	56.358	1.299	21.642	56.358
3	.789	13.149	69.508			
4	.733	12.211	81.718			
5	.685	11.411	93.129			
6	.412	6.871	100.000			

TOTAL VARIANCE EXPLAINED			
Component	Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %
1	2.002	33.363	33.363
2	1.380	22.996	56.358

Extraction Method: Principal Component Analysis.



COMPONENT MATRIX <sup>a</sup>		
	Component	
	1	2
Prob: Collateral	.673	-.443
Prob: NPA	.809	
Prob: Interest rate	.655	
Prob: Size of SME	.609	
Non-registered org		.666
Unaudited statement		.758

Extraction Method: Principal Component Analysis.<sup>a</sup>

a. 2 components extracted.

ROTATED COMPONENT MATRIX <sup>a</sup>		
	Component	
	1	2
Prob: Collateral	.780	
Prob: NPA	.845	
Prob: Interest rate	.624	
Prob: Size of SME	.526	
Non-registered org		.743
Unaudited statement		.793

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.a

a. Rotation converged in 3 iterations.

#### COMPONENT TRANSFORMATION MATRIX

Component	1	2
1	.947	.322
2	-.322	.947

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

#### FINDINGS

After undertaking the study, the following findings emerged about the drivers of the bank financing for SMEs. Bank respondents have shown mixed preference for SME financing. Among these categories banks prefer partnership firms and Ltd. Companies. The study says that financing SMEs is not highly risk associated. The impediments faced by banks are the reasons why SME loans are rejected.

Bank considers following major factors about an SME while financing it-

Component-1

- Availability of collateral.
- No of default firm made in previous loans (NPA)
- Interest rate.

Component-2

- Non-registered organization.
- Unaudited statements

#### CONCLUSION

India has a vibrant SME sector that plays an important role in sustaining economic growth, increasing trade, generating employment and creating new entrepreneurship in India. SMEs mainly approach banks for their external financing. But there are many obstacles in financing a firm for the banks. The Government of India encourages entrepreneurship by providing various kinds of benefits. As a result many of unemployed people start SMEs. Their main motive is to overcome the unemployment situations and to analyse their ability to run a business. As a result it reduces the probability of the success. This is the main obstacle faced by each bank in SME lending. Based on the study conducted, we find that some of the major factors which act as the driver for the financing decisions are- lack of collateral, lack of bankable business plan, Number of defaults made by the firm during previous loans, lack of track record of the firm or owner, bad credit record, and lack of information on SME. The influence of these factors decides the risk associated with the SME lending. Banks should take into account these factors as the drivers while choosing an SME for financing.

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