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FINANCIAL INSTITUTIONS: A BOON TO MSMES

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ABSTRACT

The MSMEs contributes extensively to the country's manufacturing output, employment and exports and is accredited with generating the highest employment growth as well as accounting for a major share of industrial production and exports. MSMEs comprise more than 80 per cent of total enterprises in most of the economies. In recent years, the MSME sector has consistently registered higher growth rate compared with the overall industrial sector in GDP from 16 per cent at present to 25 per cent by the end of 2022.

Indian Financial Institutions and the Government have a crucial contribution in development and promotion of MSME sector role played by credit lending institutions is remarkable. Paper also aims to evaluate opportunities and challenges in the sector for raising funds through financial institutions which should be considered by policy makers for better results.

INTRODUCTION

Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. They also play a key role in the development of the economy with their effective, efficient, flexible and innovative entrepreneurial spirit. The MSME sector contributes significantly to the country's manufacturing output, employment and exports and is credited with generating the highest employment growth as well as accounting for a major share of industrial production and exports. They have unique advantages due to their size; they have comparatively high labor-capital ratio; they need a shorter gestation period; they focus on relatively smaller markets; they need lower investments; they ensure a more equitable distribution of national income; they facilitate an effective mobilization of resources of capital and skills which might otherwise remain unutilized; and they stimulate the growth of industrial entrepreneurship. The MSME sector in India is highly heterogeneous in terms of the size of the enterprises,



variety of products and services, and levels of technology. It complements large industries as ancillary units and contributes enormously to the socioeconomic development of the country.

The MSME sector is an important pillar of the Indian economy as it contributes greatly to the growth of Indian economy with a vast network of around 30 million units, creating employment of about 70 million, manufacturing more than 6000 products, contributing about 45 per cent to manufacturing output and about 40 per cent of exports, directly and indirectly. This sector, even assumes greater importance now as the country moves towards a faster and inclusive growth agenda. Moreover, it is the MSME sector which can help realize the target of proposed National Manufacturing Policy of raising the share of the manufacturing sector in GDP from 16 per cent at present to 25 per cent by the end of 2022. The present paper is an attempt to focus the present status of the performance of MSMEs in India & highlights the major challenges for the growth of MSMEs and initiatives taken to solve the constraints by both government and institutional level.

OBJECTIVES OF THE STUDY

1. To analyse the growth and performance of Indian MSMEs in present scenario
2. To analyse contribution of MSMEs in Indian Economy.
3. To analyse role of financial institutions in development of Indian MSMEs
4. To find out the major recommendation of the working group on MSMEs
5. To focus on the Government initiatives to revitalize the MSMEs sector

RESEARCH METHODOLOGY

The present research study is “Empirical” in nature. It reflects the belief that this is a valid approach to the theory development in a field where there is presently insufficient accepted theory to guide the research. Therefore, the major emphasis in such (Empirical) study is on the discovery of ideas and insight. The study is primarily based on secondary data. All financial data are compiled from Annual report of MSMEs, Government of India, different books and periodicals. Further, articles and information available in different journals and magazines are also referred to for compilation of this paper.

Definition of MSMEs

The Government of India has revised the definition, of small scale industries over the years, presently as per the enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 in terms of which the definition of micro, small and medium enterprises are as under Table-1

Table-1

Micro, Small and Medium Enterprises Development (MSMED) Act, 2006

Enterprises	Manufacturing	Services
Micro	Upto Rs. 25 lakhs	Upto Rs. 10 lakhs
Small	Between Rs. 25 lakhs to Rs. 5 crores	Between Rs. 10 lakhs to Rs. 2 crores
Medium	Between Rs. 5 crores to Rs. 10 crores	Between Rs. 2 crores to Rs. 5 crores

Source: Ministry of MSME

Evaluation of Performance of MSMEs

As per the provisions of the Act, all MSMEs are required to file an Entrepreneurs Memorandum (Part-I) at District Industries Centers (DICs). After commencement of the project, the entrepreneur concerned is required to file an Entrepreneurs Memorandum (Part-II). Prior to enactment of the MSMED Act, 2006 there was a system of registration of small scale industrial units by the DICs. Table-2 shows category wise entrepreneurs under Micro, Small and Medium for the last eight years ending 2014-15 those who filed their memorandum to DICs.

Table-2

Year-wise status of filing of Entrepreneurs

Year	Micro	Small	Medium	Total
2007-08	1,56,051	17,777	491	1,74,319
2008-09	1,71,031	18,757	690	1,93,077
2009-10	1,86,126	23,999	1,412	2,13,894
2010-11	2,04,064	29,101	1,260	2,37,263
2011-12	2,42,606	34,192	2,939	2,82,496
2012-13	2,75,867	41,502	5,449	3,22,818
2013-14	2,96,526	59,127	7,338	3,62,991
2014-15	3,46,206	70,933	8,219	4,25,358
AVERAGE	2,34,810	36,923	3,475	2,76,527
CAGR	10.47%	18.89%	42.22%	11.80%

Source: EM Part-II data on MSME sector, Development Commissioner, MSME- 2014-15

The average growths of Micro, Small and Medium enterprises are 234810, 36923 and 3475 respectively, with overall average growth rate of 11.80 per cent. The maximum growth was witnessed by medium scale enterprises, i.e. 42.22 per cent. In the year ending 2014-15, there were 346206 micro enterprises with an annual growth rate of 10.47 per cent.

Performance of Micro, Small & Medium Enterprises (MSME) sector is assessed by the conduct of periodic All India Census of the Sector. The latest census conducted was Fourth All India, Census of MSME. The Census was conducted with reference year 2006- 07.

The scope and coverage of the MSME sector were broadened significantly under the MSMED Act, 2006, which recognized the concept of “enterprise” and to include both manufacturing and services sector, besides defining the medium enterprises under MSME sector. It is clear from the table-3 that the number of enterprises, employment and investment in fixed assets in India shows an increasing trend over the eight years.

From FY 2006-07, includes the activities of wholesale/retail trade, legal, education & social services, hotel & restaurants, transports and storage & warehousing (except cold storage) for which data were extracted Economic Census 2005, Central Statistics Office, M/o SPI.

Table-3
Performance of MSME, Employment and Investments

Sl. No.	Year	Total Working Enterprises (in Lakh)	Employment (in Lakh)	Market Value of Fixed Assets (Rs. In Crore)
1	2006-07	361.76	805.23	868543.79
2	2007-08	377.36	842.00	920459.84
3	2008-09	393.70	880.84	977114.72
4	2009-10	410.80	921.79	1038546.08
5	2010-11	428.73	965.15	1105934.09
6	2011-12	447.64	1011.69	1182757.64
7	2012-13	467.54	1061.40	1268763.67
8	2013-14	488.46	1114.29	1363700.54
AVERAGE		422.00	950.30	1090727.55
CAGR		3.82%	4.14%	5.80%

Source: MSME Annual Report- 2014-15, Government of India

Table-4

Contribution of Manufacturing output of MSME in GDP

(At 2004-05 prices)

Year	Gross Value of Output of MSME Manufacturing Sector (In Crores)	Share of MSME sector in total GDP (%)			Share of MSME Manufacturing output in total (%)
		Manufacturing Sector MSME	Service Sector MSME	Total	
2006-07	1198818	7.73	27.40	35.13	42.02
2007-08	1322777	7.81	27.60	35.41	41.98
2008-09	1375589	7.52	28.60	36.12	40.79
2009-10	1488352	7.45	28.60	36.05	39.63
2010-11	1653622	7.39	29.30	36.69	38.50
2011-12	1788584	7.27	30.70	37.97	37.47
2012-13	1809976	7.04	30.50	37.54	37.33

Source: MSME Annual Report- 2014-15, Government of India

As per the revised methodology suggested by CSO, MoSPI, on the basis of the data on Gross Domestic Product (GDP) published by CSO, MoSPI and final results of the latest Census (Fourth Census), the estimated contribution of MSME sector to GDP and Output, during 2006-07 to 2012-13, are as noted below:

Table-4 discloses the contribution of MSME sector to the total industrial production and GDP over seven years. It shows an increasing trend over the period of study. During the financial year ending 2012-13, this sector contributes 37.54 per cent of the total GDP of the country.

ROLE OF FINANCIAL INSTITUTIONS AND DEVELOPMENT OF MSMEs IN INDIA

Indian MSMEs have proved themselves as key factor for overall economic development. Considering the role of MSMEs government has taken time to time initiatives for development and promotion of the sector. After analysis it is found that Government has made huge investments through five year plans for product, skill and competitive development of MSME sector. In the county like India where economy is in its developing phase has to give due consideration for key success factor. The same happened to Indian MSMEs which has attracted the attention of policy makers and researchers.

A. Formal Debt Supply to MSMEs

Within the formal financial sector as of 31st March 2012, banks account for 87 per cent of total debt supply to the MSME sector with Scheduled Commercial Bank as a leader in debt financing account for 98 per cent (Rs. 684797 Crore / Rs. 697000 Crore) and followed by Non-Banking Finance Companies and Smaller banks such as Regional Rural Banks, Urban Cooperative Banks and Government financial Institutions including State Financial and Investment Corporation around 02 per cent (Rs. 12203 Crore / Rs.697000 Crore).

The MSMEs primarily rely on bank finance for their operations and as such ensuring timely and adequate flow of credit to the sector has been an overriding public policy objective. Over the years there has been a significant increase in credit extended to this sector by the banks. As at the end of the financial year 2012 total outstanding credit provided by all Scheduled Commercial Banks to MSME sector stood at Rs. 684797 as against Rs. 486017 Crore in 2011 registering an increase of 41 per cent. Contribution of various financial sources towards MSME sector can be better understood from following table.

Table-5 we can see that total credit from SBCs to MSME sector has grown from Rs. 127323 Crore in FY2007 to Rs. 684797 Crore in FY2012. Contribution to total credit from SBCs is as follows, SBC's Contribution in Credit flow to MSMEs, Public Sector Banks 75 per cent, Private Sector Banks 19 per cent & Foreign Banks 06 per cent.

Table-5
Share of Various Institutions in Credit Flow to MSMEs

Year	Public Sector Banks	Private Sector Banks	Foreign Banks	Total (SBC's) Rs. in Crores
2007	102550	13136	11637	127323
2008	151137	46912	15489	213538
2009	191408	46656	18063	256127
2010	278398	64534	21069	364001
2011	376625	87857	21535	486017
2012	500250	152554	31993	684797

Source: MSME Annual Report, Government of India

Though financial institutions have a higher perception of MSME Sector lending, consistently they are playing a key role in MSME financing. The continuous growth in formal financing to MSME is a result of guideline by the Reserve Bank of India for Priority Sector Lending (PSL). As per the PSL guidelines bank require to supply debt to priority sectors such as Agriculture, Micro and Small Enterprises. Some key points of PSL guidelines by RBI are as follows,

- Banks require allocating sizeable share of their credit portfolio to micro and small enterprises. The Nair Committee Report (Feb'12) on PSL has recommended that all domestic and foreign banks allocate 7 per cent of their credit portfolio solely for financing micro and small enterprises.
- The Nair Committee has also recommended that foreign banks should have priority sector commitment of 40 per cent of annual bank Credit with a sub target for the micro and small enterprise sector at 15 per cent of Annual bank Credit.

Government's continuous policy focus on financing to micro and small enterprises will provide in future the large share of bank finance landscape for MSMEs.

B. Analysis of Bank Credit against MSMEs Fixed Investments and Production

Indian MSMEs performance is showing excellent growth in production over the period of time. Production contributing towards 45 per cent of industrial output and 40 per cent in export has attracted the attention of policy makers and financial institutions. Various initiatives jointly by Government of India and Small Industrial Development Bank of India (SIDBI) lead to financial inclusion and growth of MSME sector in recent

years. The growth percentage of bank credit with respect fixed asset investment and production of MSMEs is as follows,

Table-6
Percentage of Bank Credit to MSME Investment and Production

Year	Total Bank Credit Rs. in Cr	Fixed Asset Investment Rs. in Cr	% of Credit to Fixed Assets	Production Rs. in Cr	% of Credit to Production
2007	127323.00	868543.79	15	1351383.4	9
				5	
2008	213538.00	920459.84	23	1435179.2	15
				6	
2009	256127.00	977114.72	26	1524234.8	17
				3	
2010	364001.00	1038546.0	35	1619355.0	22
		8		0	
2011	486017.00	1105934.0	44	1721553.4	28
		9		2	
2012	684797.00	1269338.0	54	1834332.0	37
		0		5	

Source: MSME Annual Report, Government of India

Table-6 analyse that, the percentage of bank credit against fixed asset investment and production of MSME is increasing at 33 per cent and 22 per cent respectively. The increase in credit flow is indication of policy makers concern towards growth of MSME sector for economic development of the nation. Increase in credit flow from formal sector to MSME is due to GOI and SIDBI initiative which includes:

- Inclusion of Micro and Small Enterprises in Priority Sector Lending
- Funding support to Credit Guarantee Fund Scheme to enhance unsecured financing
- Financial support to increase penetration of credit rating
- Promotion of Cluster Development
- The Nair Committee Recommendations

- Priority Sector Lending Norms
- Prime Ministers Task Force on MSMEs recommendations
- Policies to facilitate multi prolonged support to - Skill Development, market linkages, technology adaptation and infrastructure

C. The product and service portfolio through which financial institutions offering credit to MSME sector

Banks offering to MSME sector can be categorised as,

- Fund Based Products (Table-7) and
- Non-Fund based Products like Letter of Credit, Bank Guarantee, Current Account, Saving Account and Remittance.

The overall support from government and competitive legal and regulatory environment has given boost to credit supply to MSMEs from financial institutions. The increased credit supply will certainly make MSME sector stronger and enhance their competitiveness in global market. Technology up-gradation, tool room facilities, incubators and entrepreneurial training facilities will surly enhance the capabilities of MSME to increase contribution in GDP and to achieve the goal of government by 2022 of 25 per cent manufacturing contribution in GDP.

**Table-7
List of Fund based Product offered to MSME Sector**

Products	Financial Institutions	Tenure	Credit Size Limit
Overdraft	Commercial Banks	1 year revolving credit, renewed annually	50%-60% of the amount of receivables
Cash Credit	Commercial Banks	3 months - 1 year, revolving credit, renewed annually	50%-60% of the amount of receivables
Short term Loan	Commercial Banks, NBFCs	3 months - 1 year, revolving credit, renewed annually	
Long Term Loan	Commercial Banks, NBFCs	1-5 Year	60%-80% of the cost of the collateral
Asset Based Financing	Commercial Banks, NBFCs	3-7 years	80-90% of the cost of asset
Credit Cards	Commercial Banks	1-3 years	Maximum limit of Rs. 1 million

MSMEs according to 4th Census

The Development Commissioner, Micro, Small Medium Enterprises (DC MSME) had so far conducted four censuses on MSMEs. The latest 4th estimates for the census are presented below in Table-8.

Table-8
Ownership Pattern of Micro, Small and Medium Enterprises sector

Type of Organization	Registered MSME sector		Unregistered MSME sector		Enterprise total
	Enterprises total	% of total	Enterprises total	% of total	
Proprietary	14,21,548	91.57	2,32,40,914	94.67	
Partnership	63,283	4.08	1,15,207	0.47	
Private Company	30,102	1.94	1,06,743	0.43	
Public Company	7,346	0.47	66,074	0.27	
Cooperatives	4,583	0.30	1,28,945	0.53	
Others	25,630	1.65	8,90,422	3.63	
Total	15,52,492	100.00	2,45,48,305	100.00	

Source: MSME Annual Report- 2009-10, p-175, Government of India

Major Recommendation of Working Group on MSMEs

1. In order to upscale the factoring services for augmenting the flow of credit to MSME sector, it is suggested to enable setting up of a number of factoring companies which requires support by way of equity capital contribution to the new and existing factoring companies to enhance their net worth and enable them to leverage higher credit from the institutional channels.
2. In order to reduce the MSME credit gap, Scheduled Commercial Banks (SCBs) may be directed to maintain a minimum 22 per cent in their outstanding credit growth to MSME sector during the first two years of the 12th Five Year Plan (i.e. FY 2012-13 and FY 2013-14) and further minimum 25 per cent during the remaining three years of the 12th Five Year Plan (i.e. FY 2014-15, FY 2015-16 and FY 2016-17).

3. Banks should achieve 10 per cent increase in new micro enterprises borrowers on a year-on-year basis during the 12th Five Year Plan. As a Subset, banks should add at least 12 new MSMEs in their semi-urban and urban branches.
4. RBI may announce a revised OTS scheme for SMEs under which MSMEs classified in the NPA category as on 31st March 2008 would also be eligible for obtaining finance after settlement of dues under OTS.
5. To enable the MSMEs to have access to Venture Capital (VC) Funds, the following needs to be implemented: exposure by banks to dedicate MSME VC Funds be treated as priority sector lending; enhance existing exposure by banks to Capital Market cap by 20 per cent for MSME VC Funds (from 40 per cent to 48 per cent for dedicated MSME VC Funds); permit investment up to 10 per cent of the corpus of Pension/Provident Funds in dedicated MSME VC funds.
6. Intensive support is required for the emerging and innovative sectors of bio-tech, nano-tech, defense, civil aviation, aerospace, homeland and internal security, items etc.
7. Availability of Land for MSEs has to be ensured. State governments may earmark at least one industrial estate in each block. Government may identify barren lands and allot it to MSEs at affordable prices are set up industrial estates.

Policy Initiatives by Government of India on MSMEs

1. In exercise of the powers conferred under section 11 of the Micro, Small and Medium Enterprises Development Act, 2006, the Government of India has notified Public Procurement Policy for Micro & Small Enterprises (MSEs) Order, 2012 which is applicable for every Central Ministry / Department / PSU for effective implementation w.e.f. 1st April, 2012.
2. Aadhar-based Biometric Attendance System for all employees (98 per cent coverage) of the Ministry was started w.e.f. 20th August, 2014 resulting in punctuality of attendance.
3. A virtual Cluster web portal has been made available at www.msmecluster.in. It will provide facilities like common application forms, credit scoring models, etc. and a platform for Industry-Academia linkages.
4. An Employment Facilitation Portal (www.memsenaukri.com) set up by NIESBUD was launched by the Minister (MSME) on 11th July, 2014. This enables matching of job providers and job seekers.



5. B2C web portal of NSIC was launched on 31st July, 2014. This portal will market MSME products exclusively.

CONCLUSION

The Micro, Small and Medium Enterprises (MSMEs) contribute to economic development in various ways, such as creating employment opportunities for rural and urban population, providing goods & services at affordable costs by offering innovative solutions and sustainable development of the economy as a whole. SMEs in India face a number of problems - absence of adequate and timely banking, finance, non-availability of suitable technology, ineffective marketing due to limited resources and non availability of skilled manpower. The sector also contributes significantly to manufacturing output, employment and exports of the country. It is estimated that in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 per cent of total exports of the country. To make this sector to become more vibrant and significant player in the development of the Indian economy, the Government of India has taken various initiatives. The definition and coverage of the MSME sector were broadened MSME Development Act 2006 which recognized concept of 'enterprise' to include both manufacturing and service sector besides defining medium enterprises setting up a Board for developing policy frameworks and indicating procurement policy.

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