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ROLE OF MICRO-FINANCE INSTITUTION IN FUNDING SMALL AND MEDIUM ENTERPRISE

Ms. Monika Bhatia
Assistant Professor, School of Management Studies,
Ansal University, Gurgaon

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Abstract

For startups and small enterprises, microfinance is a means of funding support that do not have convenient connectivity to banking and associated services. Microfinance's primary goal is to enable the poor to alleviate poverty and thereby lead to economic growth. In addition to offering small loans, microfinance provides a broad variety of services such as insurance, investments, money transfers, and non- monetary services such as coaching, consulting, etc. The micro-business sector has been recognized around the globe as a significant cornerstone of economic development. Lower capital requirements and organizational versatility define the market. Due to their creative entrepreneur ethos, micro-enterprises play a significant role in the growth of the nation. Small and medium enterprises (SMEs) play a vital role in creating jobs and generating revenues in many growing countries, such as India. In numerous emerging economic systems, small and medium-sized enterprises (SMEs) play a significant role in creating jobs and generating profits. In the collective attempt to reduce poverty, this position is especially important. As well as becoming the foundation of the homegrown private sector, SMEs also represent as a recruiting tool for budding entrepreneurship. Despite the financial inefficacy, money is one of the significant indicators of the progress of small businesses. Microfinance is a significant source of growth for companies. This research paper is focused on the emergence of microfinance institutions (MFIs) and their and desire to contribute towards the growth of micro-enterprises. Micro-enterprises include micro, small and medium-scale (MSME) enterprises. The goal of this study was to cover the gap by analyzing the effect of micro - finance agencies on small and medium-sized business in their expansion and progress. This study analyzed the functions of these micro-finance banks and institutions in small and medium-sized enterprises, as well as the degree to which microfinance services banks ' credit schemes have supported small business owners.

Key-Words

Microfinance; Micro, Small Businesses, Banks, SME, Microfinance Institutions, Entrepreneurship Finance

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Introduction

Microfinance has been as a crucial reform and instrument for poverty reduction, regional growth and economic advancement. Over more than 30 years, microfinance has been 'bottom-up' represented. Microfinance is the provision of small loans to the underprivileged and poor people to support them for developing or extending an enterprise that generates revenue, and hence relieves poverty. In the late 1970s with the research of Dr Muhammad Yunus from Bangladesh, the microfinance trend started to extend quickly to certain other emerging economies and nations. A significant tool for fostering business growth is microfinance. Small business growth is prone to exposure and sufficient financing and promising marketplaces have been obtained. In addition, company cash flow is strengthened by microfinance. Small-scale financial services (credit services) are referred to as microfinance; they are offered to individuals who run those businesses; they manage local or micro-enterprises where both rural and urban communities grow, reuse, restore or exchange products (Stanley, 2008). The evolving microfinance paradigm, however, worked in a revamped political and philosophical climate in the 1980s. Market values have been in the emerging world, with increasing focus on fiscal stability and the need to disassociate off long-term lender funding from microfinance programs. It was thought that, instead of putting an undue tax burden on others, the poor could bear the full benefit of any assistance obtained.

In this analysis, Small Businesses (SBs) apply to companies controlled solely by their founders, have a comparably smaller capital base, are constrained by revenue and asset size, have substantially minimal markets presence, function in local and possibly the best-specialized market segments, and are much more autonomous of external influences and constraint. Microfinance is a universal concept that refers to the provision of a broad range of services to poor and low-income families and individuals, comprising payment services, deposits, loans, transfer of money and insurance, to expand their small businesses in order to help people prosper. For the motive of this research, microfinance institutions were restricted to semi-formal financial institutions set up as a business organization by private individuals to deal directly with the needy and SBs in their local setting to help foster citizens and sustainable progress via market-driven business innovation (Khavul 2010).

Micro Small and Medium Enterprises (MSMEs) are a growing trend because they are only little investment-based businesses that can hire many persons. These are vigorously encouraged by state and local governments in regions such as Jharkhand, Bihar, and Uttar Pradesh as they recruit a massive proportion of the populace. Typically, MSMEs are focused on the production of local goods that further helps to preserve cultural and regional products. The Department of MSMEs Administration is directly accountable and is held responsible for the implementation of advancement programs for all MSMEs.

Owing to the unavailability of finances, most MSMEs (micro-small and medium-sized enterprises) developed inside the state struggle with financial dependence. This causes them to switch to uncontrolled financing channels that involve very high rates of interest, leading to ultimate loss. In order to take these loans from banks and other financial institutions, it is required to deposit security. The government evaluated this issue and build different microfinance agencies that could provide credit or mortgages at cheaper rates to these MSMEs without any need to deposit of security.

The acknowledgement that government agencies such as the National Bank for Agriculture and Rural Development (NABARD) and the Small Industries Development Bank of India (SIDBI) devote considerable time, effort and monetary reserves to microfinance in India is an obvious sign of the industry's evaluations. Micro-Enterprises, however, still appear to struggle to solve the issues that microfinance organizations claim to bring. There is a discrepancy in the evaluation of the effects of microfinance agencies on SME progress and expansion. Limited access to funding has been described as one of the key obstacles affecting the growth of small businesses, not only in India, and in many other emerging economies. Typically, banking institutions have based their loaning money mostly on major structured companies that have market experience and assets and not on small businesses because they lack experience and are potentially risky investments.

Some Definitions:

1. Micro-small and medium-sized enterprises (MSMEs): micro-small and medium-sized enterprises (MSMEs) are a growing segment of corporate sector and recently witnessed a spike in their total count following the supervision of the MSME Development Commissioner in India.
2. "Financial inclusion": Financial inclusion can be characterized as a mechanism by which marginalized communities, such as backward classes and low-income groups, can ensure accessibility to credit facilities and provide timely and sufficient loans at a reasonable rate wherever necessary.
3. Micro Credit: Microcredit is defined as "the loan facility given to low-earning individuals who need it most who want to collect minimal quantities."
4. Self-Help Groups (SHGs): SHG is an alliance of individuals with a weaker financial status who are often members of the same township / geographical area.
5. Micro Finance: Micro Finance refers to the overall spectrum of financial programs offered to the lowest class of the society that are unable to benefit from the facilities of a regular bank.
6. Micro Finance Institutions: Micro Finance Institutions (MFIs) are those entities that offer, as an autonomous organization, the entire range of microfinance facilities.

Need of the Study

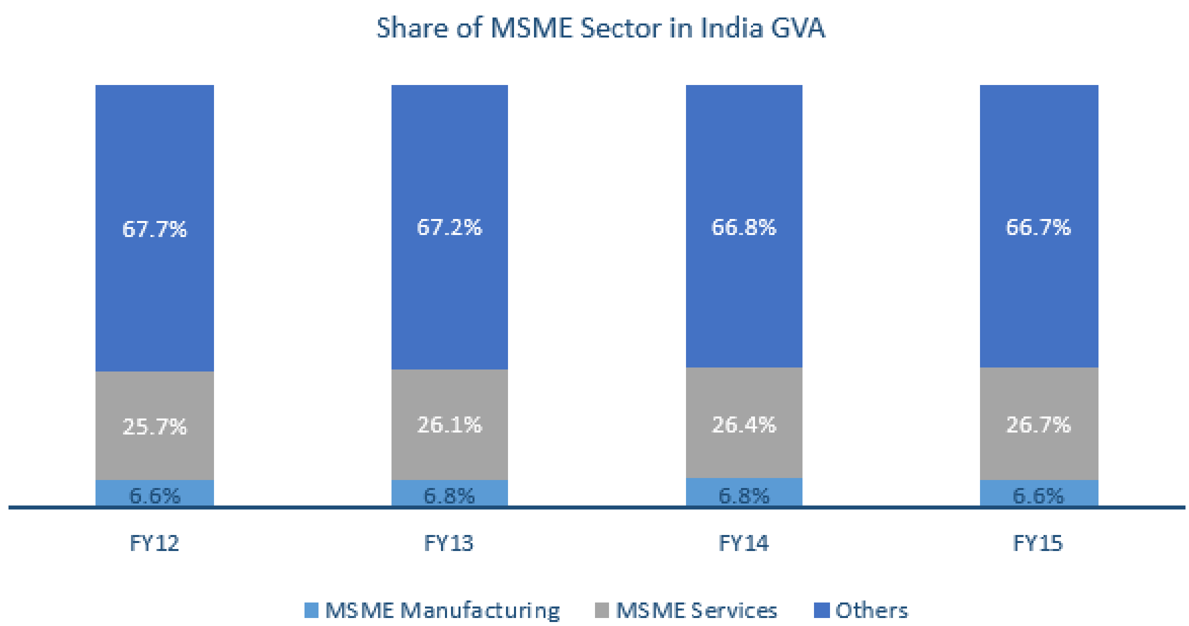
After passing more than six decades of independence, many tribal regions in the country still lacks development. It shows some evidence that the Planning Commission, during 2005- 06, in all Indian level, 47.3 percent of households are in the below poverty line in rural areas as against 33.3 percent in urban areas. While in rural areas, the highest percentage of the people below poverty line was found to be 36.8 percent. This is because of lack of sources for unprivileged people. The unavailability of funds to start a setup and earn for their livelihood is main problem in the progress of any nation. A nation can progress by encouraging small and medium scale business, by providing better resources.

Today micro finance/micro-credit access has become an important tool for rural development and poverty reduction. The study needs to undertake how much has been microfinance induced tribal economic development and their needs. This study is conducted to show how financing micro or small scale businesses lead to overall growth of a nation. This study is also conducted for understanding the importance of micro finance institutions in the development of small and medium scale enterprises.

Review of Literature

Microfinance and SMEs have always been the topic of a variety of research findings. Financial mortgages; loans from non-banking institutions (e.g., NBFCs); investment capital; microfinance institutions; loans from families, relatives and friends; equity financing; and own funds are the primary sources of finance used by MSMEs (Mallick et al. 2010; International Finance Corporation 2012; Asian Development Bank 2014).

Regardless of the hope created by the growth of SHG loans and the high rate of development, there is a discrepancy between real per capita loans given to the underprivileged and requirement, according to the NABARD 2003-04 reports on SHG bank linkages.



Source: Ministry of Micro, Small & Medium Enterprises (Annual Report 2016-17)

Figure 1-"Share of MSME sector in India GVA"

Small and medium-sized enterprises (SMEs) have been recognized globally as an element of economic progress and to foster inclusive and sustainable growth. The sector's key benefit is its job capacity at a reasonable capital structure. In most economies, the labor strength of SMEs accounts for more than 90% of profit rate and is attributed with achieving the highest rate of job creation and accounting for a large proportion of industrial export trade (Government of India, 2007), and the massive development of small and medium enterprises in advanced markets in the 1980s and 1990s has produced a widespread c The SME market, though, is dealing with several limitations (Piotr and Rekowski, 2008). The most critical one that is considered to be funding would be one of them.

According to Srinivasan's 2009 survey report, India had 54 million microfinance buyers in 2008; 39.9 million consumers were covered by the SHG framework, whereas 14.1 million was being supported by the MFI system. Although the SHG model accounts for 77% of overall dissemination, in 2007-08 its frequency of growth of 15% was less than those of the MFI model, which improved by 40%. The overall expansion of the industry is projected to have risen to 86.2 million by March 2009, with outstanding debt remaining at Rs.351 billion (Sa-dhan, 2009). This contributes to just about 6% of retail banks' overall unpaid loans in provincial and semi-urban areas in 2008 (RBI, 2009). Some research, such as the Intellecap report headlined "Inverting the Pyramid" (2007), estimate that 245 million people could be the promising consumer, indicating that there is still a lot of space for the industry to expand.

Grant Thornton and FICCI (2011) stated that the rate of financing for MSMEs is heavy and also that the duration and paperwork needed for the procurement of finance needs to be reduced. Lahiri (2012) pointed out that with the need for short-term and long-term capital from MSMEs, banking institutions must switch toward more revolutionary credit mechanisms to meet the funding requirements of those enterprises.

The biggest problem in agricultural sector and rural growth during the period of 1960s and 1970s was agricultural production, according to the discussion paper by Prof. Dr. Hans Dieter Seibel of the College of Cologne named "The Role of Microfinance in Rural Micro-Enterprises Development". Agricultural credit later became a significant contribution.

The availability of financing for the MSME sector is projected to be 32.5 trillion Indian rupees (Rs), as per the International Finance Corporation (2012). The sum contains results from the fields of unstructured finance, structured finance and peer-finance. Unstructured sources of funds and self-finance add Rs25.5 trillion to the industry, of which Rs24.4 trillion is accounted for by informal finance. In other words, unstructured sources and self-financing represent 78 percent of the funding used by MSMEs. Banks and NBFCs, of which banks provide the bulk (91.8 percent), provide the remaining 22 percent (Rs6.9 trillion).

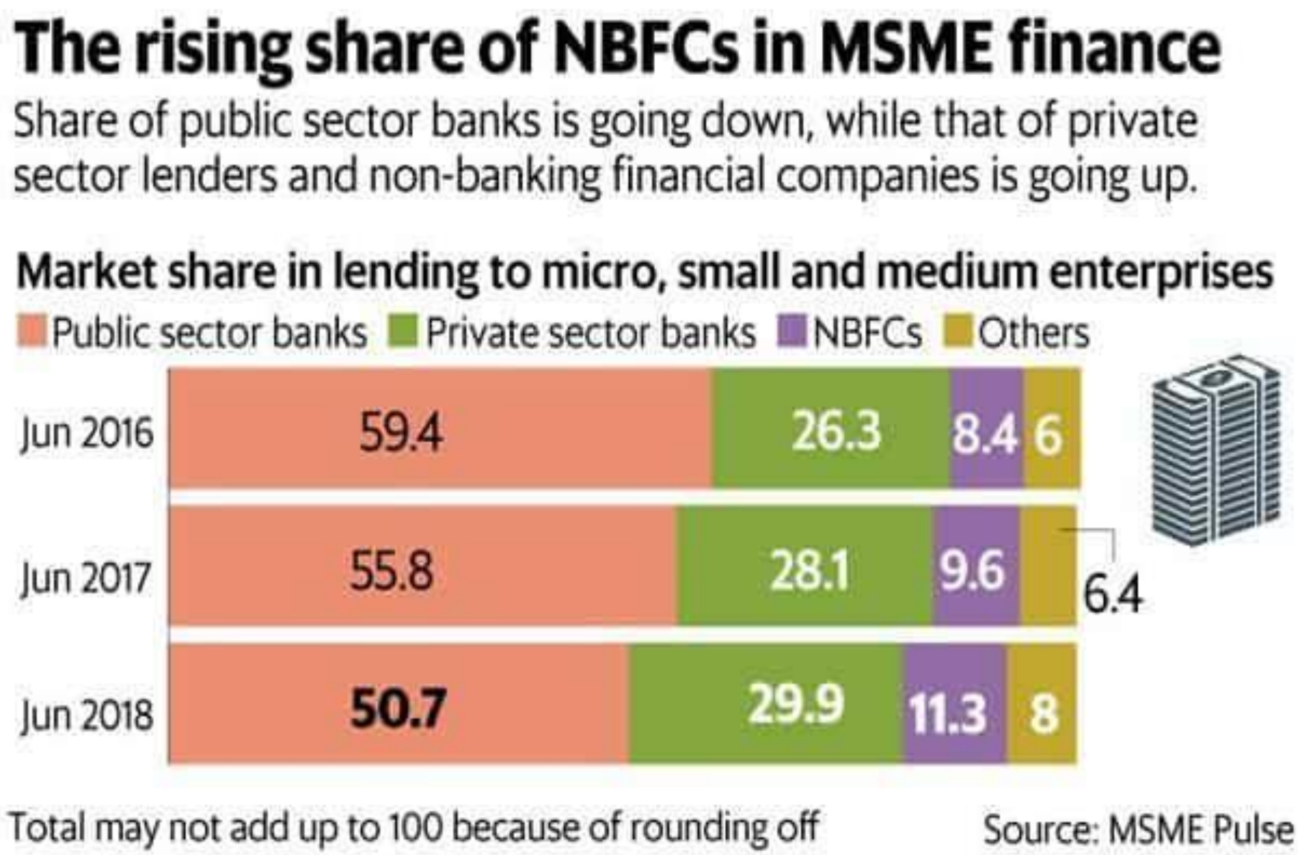


Figure 2- The Rising share of NBFCs in MSME finance

Research Objectives

Following are the research goals are involved in this paper:

(a) To summarize the relevance of microfinance institutions (MFIs) in serving small enterprises.

(b) To highlight the overview of small scale enterprises and analyze their financial needs

(c) To analyze the current and potential role of MFIs in serving Small and Medium Enterprise

Research methodology

In conducting this study, investigators have implemented doctrinal methods of data collection. This study is focused on descriptive claims, statistical evidence, case studies, comparative analysis and theoretical logic formed through the understanding of different sources of secondary knowledge, including papers, books, journals, web sources, etc.

Conclusion

(a) To summarize the relevance of microfinance institutions (MFIs) in serving small enterprises:

The absence of adequate to financing has been described as one of the key constraints hampering micro business growth. The World Bank for Women has reported that fewer than 2% of low-income businessmen globally have exposure to financing facilities. In terms of the profit generation of a business and progress in terms of jobs, production, and revenues etc. over time, business success may be characterized in a traditional sense. A business can upgrade from one size to a bigger one via growth. In particular, it also involves companies that are also realizing outcomes such as additional employment of society members and enhanced welfare of households (excessive access to education, health, and decent healthcare) and those companies that are able to thrive under fierce competition. If a organization creates a strength that helps it to seize opportunities, these accomplishments do not happen in a highly competitive environment. The question then becomes how credit will assist in the exploitation of such possibilities (Kuzilwa, 2003). Without capital, small and medium-sized enterprises (SMEs) cannot adopt or integrate new technology, and neither can they grow to remain competitive in the global markets or even develop business relations with larger enterprises. That due to inadequate financial intermediation is therefore identified as the one of the reasons responsible for the growth of SMEs. So, the strategies of microfinance agencies have been designed to promote financing. Microfinance is significant since it provides the financially underprivileged with funding and access to funding, such as someone who is unable to receive current accounts, personal loans, or loans from conventional banks.

These groups will have to use borrowing or collateral advances at exceptionally high interest rates without microfinance, or perhaps even borrow more money from family members and friends. Microfinance allows them to reinvest in their companies and, as a consequence, to invest in self. The microfinance agency has developed as a respectable replacement for borrowing and an important tool for the provision of funds, offering financial support for the expansion of small and medium enterprises. Simple exposure to the services provided by microfinance agencies has a direct effect on the growth of SMEs' revenues, income and hard property. More than 98 percent of all manufacturing enterprises in many recently developed nations belong to the SME sector and contribute for the entirety of the labor force. In supplying scattered local markets, SMEs experience a comparative benefit over large organizations.

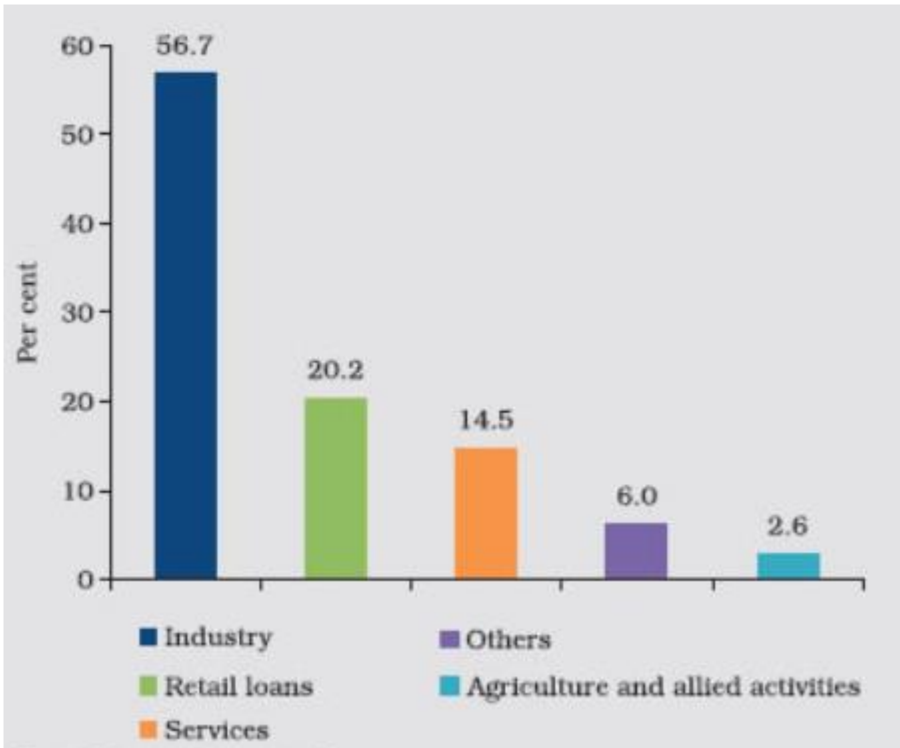


Figure 3-"Distribution of NBFC credit- till September 2019; Source: Supervisory returns RBI"

In India, microfinance plays a prominent part in India's growth. For rural residents, it serves as a poverty alleviation vaccine. It strives to enable financially disadvantaged groups to achieve a higher level of residential and public wealth formation and income protection. The greatest importance of microfinance in India is that it gives small businessmen accessibility to money. As mentioned earlier, microfinance offers loans, insurance and exposure to bank deposits in India. By providing those loans, the idea of microfinance also supports women. When women become autonomous, it serves as a catalyst for empowering disadvantaged women; women are able to actively contribute to a very well-being of their communities and are ready to counter all gender discrimination. Underprivileged rich and poor households and females are also the main targets of microfinance. No cap is imposed by the Reserve Bank of India with regard to the min and max amounts to be granted as a loan.

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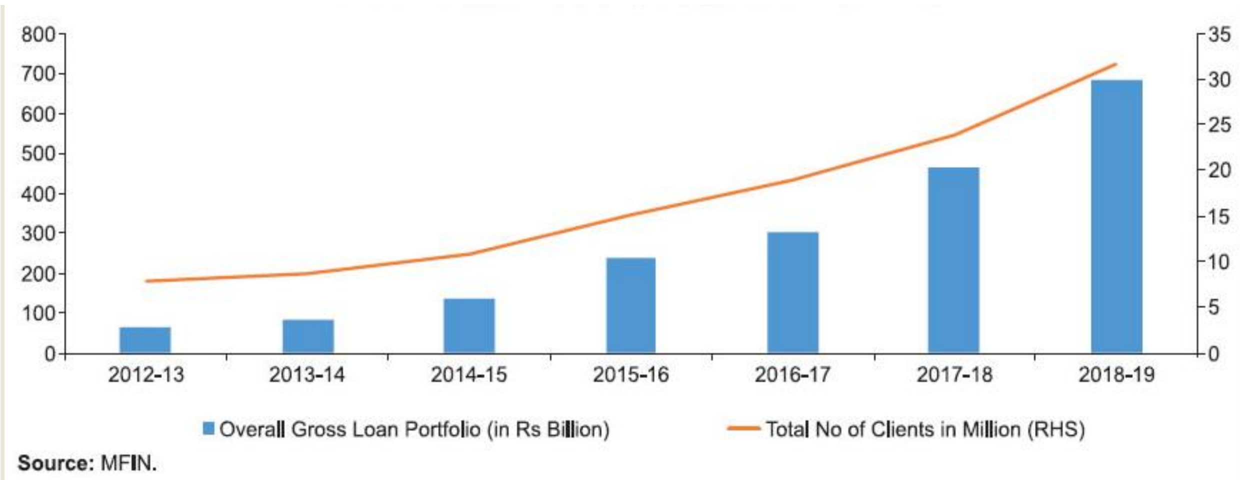

Figure 4-"Trends in loans and clients by NBFC-MFIs

Consequently, microfinance is not a monetary scheme, but a mechanism to alleviate the world's misery and bring about progressive reform and, in particular, to boost the position of women around the world so that they can become self-reliant. The objective of microfinance is in the interests of the public and that's what makes it appropriate as a legitimate national policy objective.

(b) To highlight the overview of small scale enterprises and analyze their financial needs

Small-scale business is a very essential portion of a nation's economic growth. Over the years, by performing a prominent part in the industrial development and economic prosperity of the nation like India, this segment has gained considerable priority. Small business is a corporation that hires a limited number of staff and therefore has a small amount of revenue. It is usually privately owned in alliance or a public company by a sole owner or shareholders. In a restricted or local region, a small-scale company is usually operated on and the engineering implemented is labor intensive with smaller capital expenditure compared to a major organization. A small scale entity's legal concept can vary from region to region. In India, the concept of a small-scale enterprise has undergone numerous changes and improvements and is currently established under the MSME Act 2006. At the point of the eventual establishment of the company and over the life cycle of the businesses, small-scale enterprises need financing. Distinct financial organizations play a significant role in the emergence of these ventures, and multiple government strategies are also in progress, especially for the small sector. Industry divisions need funds for different purposes. They need fixed assets that consist of property and construction, plants and machinery, furniture and fixtures, etc., to establish their business.

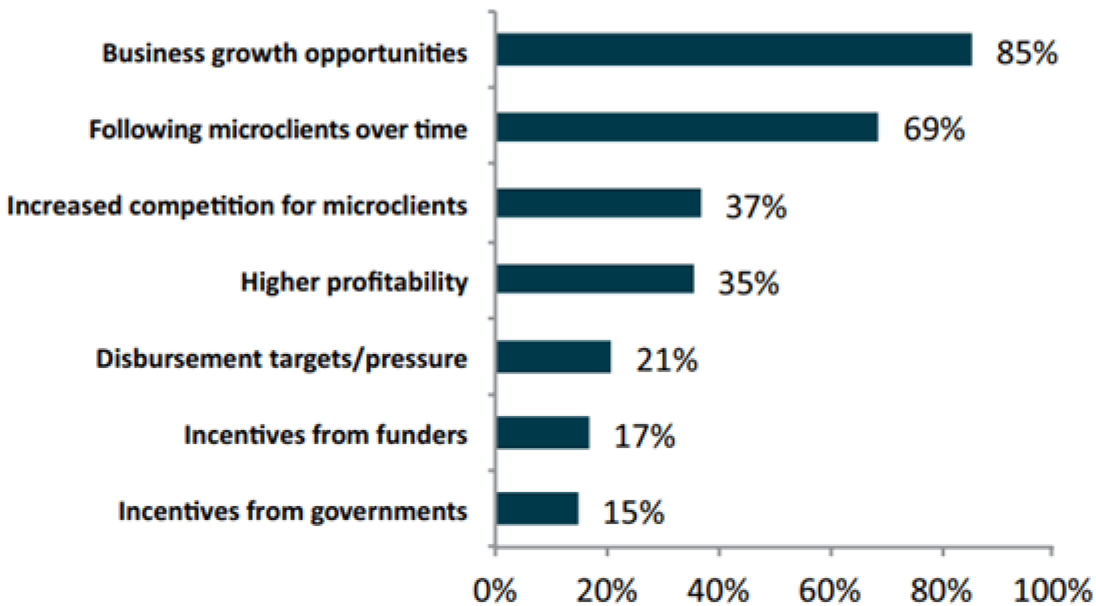

Figure 5- "MFI Reasons to serve small businesses";
Source- CGAP MSE Industry Survey 2011

In addition, these units also need investment funds for other tangible assets, including goodwill, trademarks, current and non-current assets. It needs raw resources and warehouses to fuel machinery. Any processing costs have to be incurred in order to process raw materials into finished products. Minimum inventories consisting of raw goods, shops, inventory in progress and finished goods products etc. by the SSI department should also be continuously monitored. Similarly, goods are typically sold on a credit terms and, accordingly; some liquidity is required before consumers, i.e. various debtors, receive it. Additional units are faced with issues such as overdue payment by parental units, resulting in multiple debtors.
Every unit therefore needs funds to sustain current assets, including cash, raw materials and inventory in process, finished products, various debtors and short-term investments and working capital.

(c)To analyze the current and potential role of MFIs in serving Small and Medium Enterprise:

This methodology is regarded to be very successful in alleviating poverty and is also efficient in providing different information relating to education, housing, healthcare, constitutional rights and much other information that proves to be valuable in upgrading the living standards of poor people. As they were among the most marginalized parts of society, several microfinance initiatives have also reached women who live in households in society. As they have no property or any kind of financial protection of their own, these women are financially vulnerable. Studies have shown that these approaches have strengthened women's position by providing them with opportunities for self-employment, which in turn generates financial, social stability and also empowers women gain self-confidence and helps to boost their status in society.

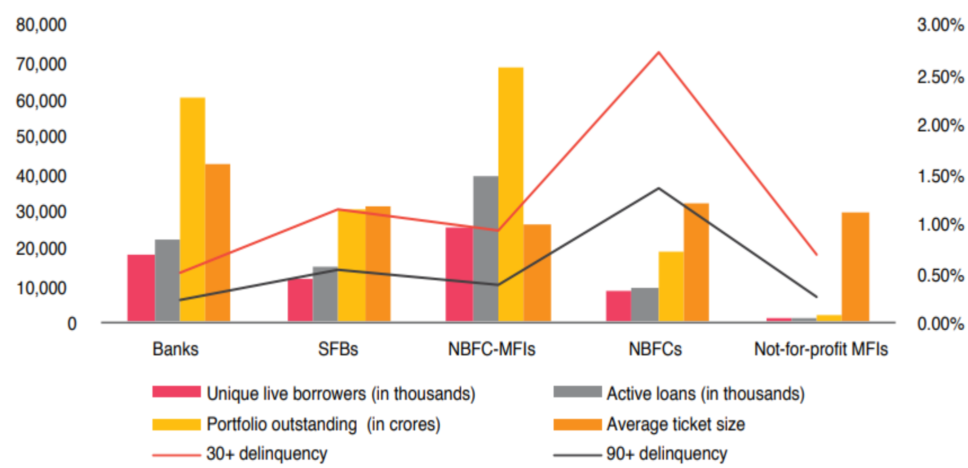

Figure 6- "Snapshot of players in the Indian microfinance industry"
Source: PwC's Microfinance Lenders Survey 2019

Microfinance also protects individuals from the manipulation of money - lenders who impose outrageously high interest rates while offering loans and corruption to the poor, making the poor worse and later turning into a poverty trap. Therefore, society's predominantly low-income individuals stand to gain from microfinance strategies and these schemes help them invest in small and medium scale enterprises. Microfinance institutions offer an important collateral replacement for short-term and consumer loans to micro-entrepreneurs.

And that's because microfinance was only vital in propelling many small firms with productivity improvements and elevated profitability to its next level. Today, the MSME sector is a vital pillar of the economy, contributing significantly to GDP, export markets, industrial production and job growth. The Central Government verified that there were approximately 50 million MSMEs by 2018, both listed and unlicensed, recruiting 120 million, next only to agricultural production. A survey by the industry body CII found that over the past 4 years, the MSME sector generated 13.5 million to 14.9 million new jobs, recording a 13.9 percent job growth rate. 6.11 percent of manufacturing GDP, 24.6 percent of service GDP and 40 percent of exports were also contributed by MSMEs.

Thinking forwards, if key gaps such as financing and development are tackled, this sector has the ability to offer far broader advantages in respect of balanced economic development. If assisted by sufficient emerging technologies and quality improvements, and armed with information access resources, they will also create awesome future progress.

India poses a huge platform for the microfinance market, considering the existence of various competitors in the microfinance environment and established micro lending platforms, with a significant proportion of its citizens in the low-income band. While government policies and existing financial institutions have improved exposure to microcredit for almost 67% of the rural Indian population,16 the substantial geographical accumulation of MFIs in a few areas of the province (34% of the microfinance divisions contribute 80% of the portfolio17) highlights the ability for acquiring h In addition , a large majority of the population of India still requires private sector access to funds and instead borrows from informal sources such as moneylenders or family, suggesting the potential of micro lending to achieve economic growth and the overall success of the company. However, in order to realize this potential for growth, it is critical that the sector recognizes and assesses evolving needs only within industry and addresses them via appropriate optimized projects and initiatives.

Microfinance has been recognized around the world as an accelerator that tends to play a critical role in Small and Medium Scale Enterprise (SMES) development and economic growth.

MFIs will need to better recognize their specific demands and to customize financing support for developing effective infrastructure to accommodate them in order to properly serve small businesses. Serving small businesses effectively is a procedure, not a one-time occurrence, so careful preparation is essential. This will entail a dedication by top management to cultivate a customer-centered strategy, attract committed and competent workers, and spend in advanced and appropriate technology.

Abbreviations

MSME: Micro, Small and Medium-scale Enterprises
NBFC: Non-Banking Financial Companies
SMES: Small and Medium Scale Enterprise
MFI: Micro Finance Institutions
GDP: Gross Domestic Product
NABARD: The National Bank for Agriculture and Rural Development
SIDBI: The Small Industries Development Bank of India
SHGs: Self-Help Groups
GVA: Gross value added

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