



The Impact of Microfinancing on the Growth of India's MSME Sector: An Exploratory Study

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Introduction:

The Micro, Small, and Medium Enterprises (MSME) sector in India plays a crucial role in driving employment opportunities and economic growth. Although most MSMEs are unregistered, they contribute 45 per cent to industrial output and 40 per cent to overall exports. These enterprises have been instrumental in industrializing rural and backward areas, reducing regional imbalances, and promoting equitable distribution of national income and wealth. However, the MSME sector faces several challenges and requires support to capitalize on opportunities in the rapidly evolving global markets. Consultancy services can aid MSMEs in enhancing their competencies in areas such as marketing, finance, business development, operations, and technology. The success of MSMEs is pivotal to rural and regional development, making them a vital component of the economy.

Objectives of the Study:

This study aims to achieve the following objectives:

1. Analyse the contribution of MSMEs to the Indian economy.
2. Evaluate the growth and performance of MSMEs in India.
3. Examine the role of financial institutions in the development of Indian MSMEs.

Research Methodology:

The data for this study has been collected from various secondary sources, including annual reports of MSMEs, reports on MSMEs from SIDBI, releases from the Ministry of MSMEs, RBI annual reports, and relevant websites.

The Significance of MSMEs in the Indian Economy:

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MSMEs play a vital role in the Indian economy, accounting for over 90% of total industrial units. The government has taken significant steps to boost the manufacturing sector and promote industrialization in the country. Various institutions have been established for policy design and the allocation of funds through Five Year Plans. The National Manufacturing Policy and the Make in India initiative, launched in September 2014, further highlight the government's commitment to positioning India as a global manufacturing hub.

Sources of Financing for MSMEs:

A substantial number of Indian MSMEs rely on self-funding due to limited financing opportunities, especially for micro-enterprises, which comprise nearly 95% of all MSMEs. Late payments by larger enterprises often pose challenges for MSMEs in managing their receivables. The Factoring Regulation Act of 2011 presents a potential solution, expected to boost the factoring industry in India. Factoring services offer advantages such as open account facilities and increased credit limits as sales grow. To support MSMEs, financial institutions in India should be more proactive in providing finance against factored receivables.

Contribution of MSMEs to Production and GDP:

The MSME sector has emerged as a significant contributor to the Indian economy, with over 90% of industrial units and substantial growth in production in recent years. By the end of FY12, MSMEs' production accounted for 37.52% of the total industrial output, amounting to Rs. 671,910 Crore. Moreover, MSMEs have been instrumental in employment creation, generating approximately 1.5 million job opportunities annually. The total employment at the end of FY12 stood at 1,011.8 Lakhs.

Financing Strategies of MSMEs:

Finance is considered the lifeblood of business, and MSMEs often face challenges in accessing regular credit flow, particularly in the unorganized sector. These enterprises rely on

MSMEs' financing strategy is essential for their growth and success. In India, a significant number of MSMEs operate in the unorganized sector and struggle to obtain regular credit flow. Start-ups and entrepreneurs often rely on informal sources for financing, especially during the challenging early stages when seed funding is scarce. However, MSMEs require timely and adequate capital infusion, primarily through term loans and working capital loans, to support their growth.

The financing needs of Indian MSMEs have traditionally been met through various sources, including:



Personal Savings, Ancestral Capital, and Loans from Relatives: Many MSMEs rely on their personal savings, family funds, or loans obtained from relatives to finance their businesses. This approach allows them to access immediate funds without complex borrowing procedures.

Retained Earnings and Asset Sale: MSMEs often use their retained earnings, generated from profitable operations, to reinvest in the business. Additionally, they may sell major assets to generate funds for business expansion or to meet financial obligations.

Institutional Financing from Scheduled Commercial Banks: MSMEs can seek financing from scheduled commercial banks, which offer a range of loan products tailored to their needs. These banks provide term loans, working capital loans, and other financial services to support MSME growth.

Venture Capital Funds and Seed Funds: Start-up MSMEs with high-growth potential may seek funding from venture capital funds or seed funds. These funds invest in promising businesses in exchange for equity ownership, providing capital and expertise to fuel growth.

To support the development of MSMEs, various organizations have been established by the central government, state governments, and banks in India. These institutions play a crucial role in providing financial and non-financial support to MSMEs. Some notable organizations include:

A. Central Government:

Central Board for Micro, Small, and Medium Enterprises

Small Industries Development Organization

National Institute for MSMEs

National Small Industries Corporation Ltd

Entrepreneurship Development Institute of India Ltd

B. State Government:

District Industry Centers

Khadi and Village Industries Commission (KVIC)

State Financial Corporations

State Small Industries Development Corporation

State Industries Development Corporations/State Industrial Investment Corporation

C. Banks:

Major Commercial Banks

Regional Rural Banks



Small Industries Development Corporations of India (SIDBI)

D. Co-operative Banks:

National Bank for Agriculture and Rural Development (NABARD)

In addition to these major institutions, MSMEs also have access to other sources of finance, including their funds, funds from relatives, credit obtained from suppliers, and other informal sources. These sources provide flexibility and convenience for MSMEs to meet their financing needs.

Role of Microfinancing in MSME Growth:

Microfinancing has emerged as a crucial tool for supporting the growth of MSMEs in India. It provides financial services to low-income individuals and small businesses that lack access to traditional banking services. Microfinancing institutions (MFIs) offer small loans, micro-insurance, and other financial products tailored to the needs of micro-entrepreneurs. By providing access to capital, microfinancing helps MSMEs overcome financial constraints, invest in their businesses, and expand their operations. It enables them to purchase machinery, hire skilled labour, improve productivity, and diversify their product offerings.

Benefits of Microfinancing for MSMEs:

1. **Access to Capital:** Microfinancing allows MSMEs to access funds that are otherwise unavailable to them. It fills the financing gap and provides entrepreneurs with the necessary capital to start or expand their businesses.
2. **Financial Inclusion:** Microfinancing promotes financial inclusion by reaching out to the unbanked and underbanked segments of the population. It allows them to engage in economic activities and improve their livelihoods.
3. **Skill Development and Capacity Building:** Microfinancing institutions not only provide financial assistance but also offer training and capacity-building programs. They equip MSMEs with the knowledge and skills required to manage their businesses effectively.
4. **Poverty Alleviation:** Microfinancing has a positive social impact by alleviating poverty. It enables individuals to create sustainable livelihoods, generate income, and improve their standard of living.
5. **Women's Empowerment:** Microfinancing has a significant impact on women's empowerment as it promotes entrepreneurship among women. It allows them to become financially independent, contribute to their households' income, and gain social recognition.

Challenges and Solutions:

While microfinancing has the potential to boost the growth of the MSME sector, several challenges need to be addressed:



1. **High-Interest Rates:** Microfinance loans often come with high-interest rates due to the risk associated with lending to small businesses. This can be a burden for MSMEs, particularly those operating on thin profit margins. To address this, regulatory measures can be implemented to ensure fair interest rates and protect borrowers from exploitation.
2. **Lack of Financial Literacy:** Many MSMEs lack financial literacy and struggle to understand loan terms, interest rates, and repayment schedules. Providing financial literacy training and advisory services can help MSMEs make informed decisions and manage their finances effectively.
3. **Limited Outreach:** Microfinancing institutions may face challenges in reaching remote rural areas where MSMEs are prevalent. Developing innovative delivery models, leveraging technology, and collaborating with local organizations can help overcome this barrier and expand outreach.
4. **Sustainability and Risk Management:** Microfinancing institutions need to ensure their sustainability and manage risks effectively. This involves maintaining a balanced loan portfolio, implementing robust credit assessment mechanisms, and having effective collection and recovery processes.
5. **Regulatory Environment:** The regulatory environment plays a crucial role in shaping the microfinance sector. Clear regulations and policies that foster responsible lending practices, consumer protection, and fair competition are essential for the growth and stability of the microfinance industry.

Conclusion:

Microfinancing has the potential to significantly contribute to the growth of the MSME sector in India. By addressing the financing needs of MSMEs, it can help them overcome challenges, seize opportunities, and contribute to economic development. However, to harness the full potential of microfinancing, it is important to address the challenges and create an enabling environment that promotes responsible lending, financial inclusion, and sustainable growth. Collaboration between financial institutions, government agencies, and other stakeholders is crucial for the successful implementation of microfinancing initiatives and the overall development of the MSME sector in India.

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