

A Study on Financing Problems Faced By Small Scale Industries in Uttarakhand

Poonam Painuly

Sr. Assistant Professor, Department Of Management Studies, Gurukula Kangri Vishwavidyalaya, Haridwar, India

Abstract

Small Scale Industries in India have shown a considerable development in the recent years, but these Enterprises are facing the two most critical problems of funding and lack of product market.

The study involves in the understanding of the current situation of financial sources for Small and Medium Enterprises in the state of Uttarakhand. The objective of this study is to identify financial problems faced by SSIs by reviewing and analyzing some past surveys on SSIs as well as SSIs financing cases to gain some experience in the development of SSIs in the coming time.

The problems arise not only from capital supplying capabilities of financial institutions but also the weaknesses of SSIs themselves. The analyses of several case studies of selected SSIs successful in getting funds recently are the basis to derive possible lessons for others.

The study concludes with some recommendations for both Financial Institutions and Small and Medium Enterprises to overcome the problems identified.

About the study

Small Scale Industries (abbreviated as SSIs) play significant economic, social roles in employment creation, resource utilization, and income generation and also contribute to exports and make the economy Vibrant. Governments in most countries, whether they are highly industrialized, developing or among the least developed, have expressed increased enthusiasm and support for SSIs because of their contribution to the people's well being and satisfying their basic needs.

SSIs also occupy a vital role in the distribution system of all nations. This sector works closely with customers, which is essential to promote the industrial growth of industries. SSIs can provide new and innovative ideas to industries, which require a huge investment for developing and existing. So, it is important to facilitate SSIs.

However, SSIs in most of the developing countries face many difficulties such as shortage of capital, or the lack of materials and management skills. The promotion of SSIs may be an effective and important approach to economic development. According to the preliminary findings of a survey of 17 economies conducted by economists, the problems faced by SSIs in Asian-Pacific region differ considerably.

In developing countries like India, the main difficulty in business of SSIs is the lack of financing. SSIs are hungry of capital. Financial institutions cannot exploit completely their capital capability while SSIs face shortage of capital. The question is why SSIs cannot be qualified to borrow this available fund? Which factors cause borrowing failure of SSIs?

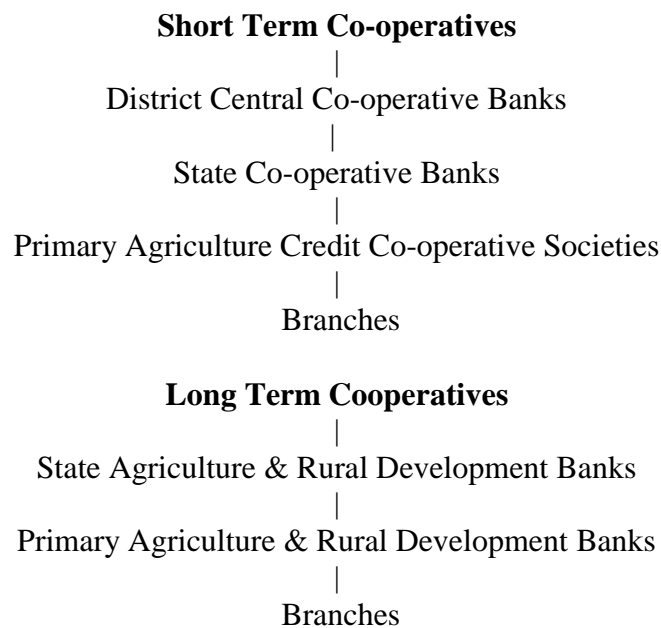
The financial institutions look at some criteria (four “Cs” (Characteristic, Capability, Collateral and Capital) model in the lending decision. For borrowers, particularly SSIs need to know the factors that influence the lending decision of financial institutions. They also need to know which criteria they should focus and improve to get fund from financial institutions. Some recent surveys on evaluating loan eligibility in New Zealand, Canada show that lack of management skill, poor performance, weak financial position, ability to repay debt and insufficient security of SSIs are the key reasons for banks to reject lending to SSIs

Co-operative banks in India finance rural areas under:

- Farming
- Cattle
- Milk
- Hatchery
- Personal finance

Institutional Arrangements for Rural Credit (Co-operatives)

- Short Term Co-operatives
- Long Term Co-operatives



	SBI	NABARD	IDBI	Co-op Banks
Total of short-term credit	68	70	44	81
SOEs	73.2	21.3	80	53.7
<i>Non-state own enterprises</i>	<i>1.73</i>	<i>3.73</i>	<i>19.2</i>	<i>24.54</i>
Farmer	0	67.64	0.85	0

Individuals	0	7.3	0	21.7
Others	25.03	0	0	0
Total	100	100	100	100

Source: Banks

Here the SSIs in India have been studied in order to understand the difficulties that they come across.

Problem

In India SSIs has been formed and developed since the late nineteenth and early twentieth century. Up to the present period, SSIs have remained dissatisfied with the funding supply from all financial institutions. The gap between the funding needs of SSIs and the supply from financial institutions stems from both the capabilities of SSIs themselves and different requirement fulfillment of those that of financing bodies amongst others. In getting loans from different financial sources, SSIs have to satisfy different provisions, which sometimes turn out to be impossible to be achieved by them. Many SSIs have struggled to get fund from multiple sources at reasonable prices. Some have succeeded but the others either have stayed lack of fund or have to agree with unbearable interest.

Objectives of the study

1. Review financial sources for SSIs

- Identify the different financial sources available in India for SSIs.
- Determine contribution of each major financial institution for funding SSIs.
- Identify and analyze difficulties faced by SSIs in getting loans from financial institutions.

Research framework

The research framework has been designed in such a way that both SSIs and financial institutions are attributed and treated in one topic. The present research focuses upon the SSIs financial problems in getting funds from formal financial institutions.

The research has been carried out in Uttarakhand and research is based on secondary data.

The review of commercial banks, SSIs and Government bodies that have responsibility of supporting SSIs development was carried out. The relevant data in financing were collected and reviewed during this stage

Number of Kisan Credit Cards Issued: Agency-wise and Year-wise

As on March 31, 2012
(Numbers in Million)

Year	Cooperative Banks	RRBs	Commercial Banks	Total Banks
-------------	--------------------------	-------------	-------------------------	--------------------

2007-08	4.58	0.96	2.70	8.24
2008-09	4.88	1.28	3.09	9.25
2009-10	3.56	1.73	4.40	9.68
2010-11	2.60	1.25	4.17	8.01
2011-12	2.30	1.40	3.77	7.47

Source: NABARD

Three Financial Institutions that have been funding Small Medium Business Enterprises were contacted and studied.

The data were analyzed to understand the exact position and situation of SSIs in India especially related to financial matters. The common problems SSIs have to face were classified as: (i) on account of Government's policy;(ii) on account of financial institutions and (iii)on account of SSIs themselves. The responsibilities in handling those obstacles of the Government policies, financial institutions, or SSIs have been identified

Kinds of difficulties	Small enterprises (%)	Medium enterprises (%)
Lack of capital	47.9	62.5
Lack of market	44.4	29.2
Lack of progressive equipment	18.7	27.1
Lack of product items	15.2	27.1
Government policies	13.6	18.8
Lack of energy	13.1	14.6
Lack of materials	7.5	6.3
Lack of technical labor	5.1	16.7
Unclear local policies	3.0	2.0

Research methodology

The research is based on secondary data

Annual reports and others publication of Federal Bureau of Statistics on non-state sector and statistics YearbookState Bank, World Bank and Commercial banks

Some Government bodies such as Small Industries Development Organization (SIDO) National Small Industries Corporation Limited (NSIC)., Ministry of Small Scale Industries (SSI) and the Ministry of Agro and Rural Industries (ARI) and Project on Assistance to SSIs.

Newspapers, magazines, journals and books

Scope of the research

- ◆ The research focuses only on financing problems and issues related to SSIs in Uttarakhand.
- ◆ There are many financial institutions supporting SSIs in India, However, just three main sources known as banks, financial leasing and informal sector are chosen to study.

Findings:

Management training, Book keeping and business planning are very important for any company. It is a mirror for company to know how business of the company was, how cash situation of the company is, which area the company should improve and which one the company should reconsider. In Organization , it is essential to have a person who has background on economic or experience on that field to hold bookkeeping activities. In some case, the manager does not have economic background but he (she) wants to hold all bookkeeping of his (her) company by oneself. The manager should then attend an accounting training course.

Marketing activities, Lack of market is one of the biggest problems. Company should invest more on marketing activities. Which product the company should focus? Which market should the company target? How competitive are they? All those questions should be considered to build a good business planning.

Mutual trust and good relationship are very important not only to be successful in getting funds but also to be successful in general for companies in all sectors. SSIs should build trust, relationship with partners in their business.

Banking system:

Renovating the policies on financial and credit is required. The policies on finance and credit for SSIs need to be focused on the following issues. Firstly, SSIs should be treated equally with SOEs when borrowing from the banks. In order for the enterprises to be relieved for difficulties in access to capital and for the banks to secure funds for lending, the banks need to take effective measures against risk. This can be carried out by constructing the database about the current and potential customers and by strengthening the accounting and auditing system with updated information.

Secondly, the procedure on credit should be reformed as follows. The local authorities should be responsible for evaluating the value of production areas and real estate of enterprises so that these assets can be used as collateral for bank loans. The financial transaction of enterprises should be carried on through the banks, so that the financial transactions of enterprises can be monitored exactly.

State commercial banks should be active in seeking SME customers. In addition, banks should improve their consulting activities.

Financial leasing companies

Lack of distribution network is a limitation of financial leasing companies. Wider distribution network is needed. Since, financial leasing companies in India are either subsidiaries of banks or joint ventures between foreign partners and domestic

commercial banks. In the short-term, if financial leasing companies can not open more branches in other provinces, they can ask for help from holding banks that has subsidiary in places where customer located. Those banks can support information about customers, observation efficiency of using leasing assets during the leasing time. It lowers the transportation cost for both leasing companies and their customers. In the long-term, financial leasing companies should open their own subsidiary network in the whole country. However, establishment and opening more subsidiaries depend on the Government supporting policies.

The Government supporting activities

- The economic integration and co-operation between SOEs and NSEs should be strengthened extensively so as to take advantage of each participant, for example, by utilizing idle production capabilities of SOEs.
- Industrial zones should be constructed to attract the domestic and foreign investors.
- Increasing the period for tax exemption, reducing taxes on projects with renovated technology and enterprises creating more jobs especially for women, the people under the social policy.
- Government bodies that have their concerning on SSIs development can consider training and consulting on the following supporting activities:
 - Supplying financial sources and market information
 - Offer free-of-charge or low-cost short courses to SSIs to improve management, financial skill

Conclusions

• The overview of SSIs in India

SSIs play an important role in the economy development such as contribution to GDP, employee creation, capital mobilization and so on, development of industries in many different regions of the country and reducing the development gaps between urban and rural areas.

• Difficulties of SSIs in India

The total number of SSIs in India is increasing yearly. However, using obsolete technology, poor qualifications of employees, lack of management skill are weakness of them. At present, SSIs in India have not yet developed to a level that corresponds to their inherent potential. They face many difficulties in conducting their business activities, in which lack of capital is serious.

• Overall evaluation of financing sources of SSIs in India

There are three main funding sources available for SSIs in India: banks, financial leasing, and informal financial source.

Financial leasing is a new field in India. But the most of its customers are SSIs when it helps them overcome the difficulty of collateral requirement for loans. In addition, financial leasing can help SSIs overcome medium and long term capital investing on fixed assets. However, high interest rate and poor distribution network of this source are two obstacles for SSIs to enjoy the other advantages of this source.

Informal source and banks are of roughly the same portions for funding SSIs. It is very difficult to get fund from banks and financial leasing in the initial stage of business. It is because banks and financial leasing do not have much information about their customers. The information on market, business situation, management skill that are very important in evaluating how efficiency of using borrowing money is, how payment capability of the customer are. Besides, collateral required by banks is preventing SSIs approaching this source. In addition, lack of business planning, management skill, bookkeeping system and lack of product market are four big weaknesses of them. These weaknesses prevented SSIs in getting external funds.

Due to short-term and small capital supplying from informal funding source, this source is not familiar with industrial productions as that of trading and service sectors. For trading and services sectors, informal financial source plays an important role for funding SSIs, especially in initial stage. This source is much more available and accessible than the two other institutions. In addition, easy borrowing condition, simple procedure and meeting SSIs requirement on time are three advantages of this source that attracting more borrowing application from SSIs. Nonetheless, too high interest rate limits the number of SSIs asking for funds from this source.

To get better funds from banks, SSIs have to fulfill all three primary requirements: formal bookkeeping system, good business plan, and enough collateral. However, the relationship with banks is very important in obtaining loans from this institution.

In case SSIs have not enough assets as collateral for the loans, they can ask for leasing companies at higher interest rates with some more flexible lending conditions.

• **Limitation of the research**

Due to limitation of time, the research focuses only on three main above funding sources. However, there are some other potential sources for SSIs in India such as international funds or international financial supporting organizations. Understanding these sources and finding ways to exploit them in further study is useful for SSIs. Still, there is overlap in definitions of SSIs and non-State enterprises.

In addition, for further study, overview of SSIs and financial institutions for SSIs in India in comparison with that of other countries who have been applying Credit Guarantee Fund may help in deciding whether or not this type of financing aid can be utilized in India.

In the research the main SSIs' weaknesses preventing them in calling for external money were presented by a summary of a series of previous researches. A model to solve all difficulties was not built. However, case studies of SSIs that were successful call for capital from outsider were analyzed. Their experience can give a lesson for other SSIs who are in the same situation.

Looking into the past is a limitation of the research. Future prospect of the SSIs in financing as well as potential funding sources is not mentioned in the research.

References

- Allen, F. and D. Gale (1994), "Financial Innovation and Risk Sharing", MIT Press, Cambridge, MA.

- Asian Development Bank (2000), "Finance for the Poor: Microfinance Development Strategy", Manila, Asian Development Bank.
- Bank for International Settlements (1986), "Recent innovations in international banking", Bank for International Settlements Report dated April 1986.
- Bhattacharyya, S. and V. Nanda (2000), "Client discretion, switching costs, and financial innovation." *Review of Financial Studies* 13(4).
- Boot, A. and A. Thakor (1997), "Banking scope and financial innovation", *Review of Financial Studies* 10(4).
- Duffie, D. and R. Rahi (1995), "Financial market innovation and security design: An introduction", *Journal of Economic Theory* 65:1-42.
- Geanuracos, J. and B. Millar (1991), "The Power of Financial Innovation", Harper Business, New York.
- Jameson, M., S. Dewan, and C. F. Sirmans (1992), "Measuring welfare effects of unbundling financial innovations: The case of Collateralized Mortgage Obligations", *Journal of Urban Economics*.
- M. Grinblatt and F. A. Longstaff (2000), "Financial innovation and the role of derivative securities: An empirical analysis of the Treasury STRIPS program", *Journal of Finance* 55 (3).
- Merton, R.C. (1992), "Financial innovation and economic performance", *Journal of Applied Corporate Finance* 4(4).
- Miller, M.H. (1992), "Financial innovation: Achievements and prospects", *Journal of Applied Corporate Finance*.
- Mohan, Rakesh (2006), "Financial Sector Reforms and Monetary Policy", *RBI Bulletin*.
- Mohan, Rakesh (2007), "India's Financial Sector Reforms: Fostering Growth While Containing Risk", *RBI Bulletin*, November.
- Mohan, Rakesh (2008), "The Growth Record of the Indian Economy, 1950-2008: A Story of Sustained Savings and Investment", *RBI Bulletin*, March.
- Morduch, J. (1998), "Does Microfinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh". Stanford, CA.: Hoover Institution
- NABARD, Annual Report of various years.
- National Knowledge Commission (2007), "Innovation in India", National Knowledge Commission, Government of India, June.
- Obay, L. (2000), "Financial Innovation in the Banking Industry: The Case of Asset Securitization" Garland Publishing, New York
- Trend and growth of Banking in India , RBI
- Tufano, P. (1989), "Financial innovation and first mover advantages", *Journal of Financial Economics*.
- White, L. J. (2000), "Technological change, financial innovation, and financial regulation in the U.S.: The challenge for public policy" in *Performance of Financial Institutions*, ed. P. Harker and S. Zenios ,Cambridge University Press, Cambridge, UK.
- Yunus, Muhammad (2002), "Grameen Bank II: Designed to Open New Possibilities." *Grameen Bank*, October.
- Yunus, Muhammad, (2003), "Banker to the Poor: Micro- Lending and the Battle Against World Poverty", New York, Public Affairs,