

Financing of MSMEs and Role of Credit Guarantee Fund for MSMEs sector

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Abstract

MSMEs play an important role in employment generation in India. MSMEs are required in a country like India where the population is more and labor-intensive techniques are used. MSMEs are established in rural and economically weaker districts therefore regional development as well as equal distribution of income may be achieved. The small sector industry was renamed as MSME's micro small and medium enterprises after the MSMEs act 2006. Timely access to finance is one of the main constraints in the growth of any industry because collateral security/guarantee-free loans are not provided by financial institutions. Credit guarantee funds are launched by the Government of India for providing collateral security funds to micro small and medium enterprises. This paper aims to know the credit flow for MSMEs by scheduled commercial banks and the role of CGTMSE in the MSMEs sector. The study concluded that scheduled commercial banks provide credit loans to MSMEs but the majority of the MSMEs depend on another source of funds. CGTMSE is a successful tool in financing access to the MSE sector. The credit guarantee scheme focused on the MSEs which is the backbone of the Indian economy.

Keywords: MSMEs finance, collateral-free loan, credit guarantee, CGTMSE.

1. INTRODUCTION

Micro Small and Medium Enterprises (MSMEs)

MSMEs contribute a lot to the economic development of our country. MSMEs strengthen economic structure by contributing to production, export and employment etc. The economic expansion of a country is, directly and indirectly, related to industrial growth. The expansions of the Industrial sector lead to an increase in employment opportunities, job creation, better consumption of natural resources, upliftment of standard of living, production of goods and services. After independence, India focused on the development of the country's industrial base because MSMEs play a key role in development with low investment, better employment opportunities, spreading of industries to urban and rural areas. In a country like India, manpower is abundant

but capital is scared, so low investment industries are better suited in our country. The growth of this sector also helps in eliminating monopoly power in the market, developing entrepreneurial skills, preventing the absorption of wealth and power, and balancing the social and economic development of the country.

Literature Review

Beck and Kunt (2006) explained that institutional development was the most significant characteristic that explains the variation in firm financing obstacles. The small firm finds it difficult to obtain loan commercial bank financing, especially long-term loans for several reasons, including lack of collateral, small cash flows, difficulty in proving creditworthiness, inadequate credit history, high-risk premiums. Financial and institutional deficiencies prevent SMEs from growing to their

optimal size. The study suggested that leasing and factoring are also specific financing tools to facilitate finance even in the absence of well-developed financial institutions.

Craig and Hardee (2007) found that increased bank concentration on the local market in the US tends to decline the credit limit to small enterprises. The main reason behind providing less credit to small industries is that large banks depend on the formal framework for deciding whether to give credit or not. Small scale industries are not able to fulfill the requirement and they may obtain less credit from large banks. Then, it is believed that when small banks reorganize and convert into large banks they changed their assets composition and traditional lending activities for financing SMEs. Biswas (2014) stated that the main constraint faced by the MSME is timely access to finance and collateral security. Due to the absence of collateral security, it becomes difficult for the MSMEs in securing loans from the bank. The study mentioned that the total financial requirement of Rs 32.50 trillion by the MSME sector in India but government hardly meets Rs. 12 trillion demand. There is still a financial gap of approx. 20 trillion for the MSME sector. The government needs to do lots of work to meet the financial requirement of the MSMEs sector.

Das (2016) conducted a study to evaluate the overall performance of CGTMSEs and the role of RRBs in northeast India. The study found that the overall growth of the Credit Guarantee Fund in northeast India is not good and the growth rate is not constant. Only Assam registered the highest CGTMSE growth in northeast India among all other states. The study suggested that awareness should be created through the awareness program for entrepreneurs so they can get benefit from that scheme.

Sarkar (2017) described the problem related to marketing and finance in the small scale industry in Assam. The study examined the growth and impact of government policies on the development of small scale industries in that region. The study analyzed that production, employment, and the number of small scale industries were increased in Assam. The study suggested that the government should come forward to strengthen the infrastructure of urban and rural areas and improve the raw material

facility, transport facilities and also provide financial help through commercial and nationalized banks.

Pratibha (2018) highlighted the challenges faced by the MSME and the contribution of the manufacturing output of MSME to GDP. The study analyzed that working enterprises, level of employment as well as the market value of fixed assets were increased from 2006-07 to 2013-14. The problems faced by the MSME were low return on investments, low production and productivity, non-identification of new markets, and absence of timely credits. The study suggested that the government should be turned the focus on adopting new approaches like efficient governance, promoting skill development, assessing credit through government agencies, etc. for an increase in productivity and for contributing to economic growth.

Mund (2020) found that scheduled commercial banks provide finance to MSMEs but still MSMEs depend on another source of finance for credit loans because lack of collateral security is the major reason for rejecting the good project by banks. Credit guarantee schemes play an important role in providing loans to MSMEs because CGFMSEs provide guarantee-free loans to the MSEs.

Objectives of the Study

Following are the objectives of the study:

- 1) To know the Credit flow to the MSMEs sector.
- 2) To know the role of CGTMSE for micro small and medium enterprises.

Financing of MSMEs sector in India (Source of finance)

Finance is the lifeblood of business. MSMEs require term loans and working capital loans mainly in the earlier stage and growth stage. (Kumar & Sharma, 2016). In India there are two types of sources of finance, one is non-institutional which are money lenders, relatives and friends who charge a very high rate of interest and another one is institutional. Reserve bank of India and scheduled commercial bank regulated the institutional lending to MSMEs in India.

The majority of the MSMEs depends upon the following source of finance:

- Their saving, loans from friends and family and loans from an unorganized market.
- Retained earnings and sale of assets.
- Financing from scheduled commercial bank of India
- Venture capital/ Seed funds

Credit flow to MSME sector

Year Ended	Public Bank	Sector	Private Bank	Sector	Foreign Bank	Scheduled Commercial Bank
March 2014	7583.78		2471.22		344.30	10399.30
March 2015	8526.89 (12.44%)		2815.48 (13.93%)		367.87 (6.85%)	11710.26 (12.61%)
March 2016	8205.48 (-3.77%)		3590.85 (27.54%)		363.73 (-1.13%)	12160.07 (3.84%)
March 2017	8289.33 (1.02%)		4309.62 (20.02%)		365.02 (0.35%)	12963.98 (6.61%)
March 2018	8645.98 (4.30%)		4107.60 (-4.69%)		488.81 (33.91%)	13242.39 (2.15%)
March 2019	9056.84 (4.75%)		5943.99 (44.70%)		691.07 (41.37%)	15691.91 (18.4%)
March 2020	9281.19 (2.47%)		6691.61 (12.57%)		776.49 (12.36%)	16749.28 (6.73%)
March 2021	9916.86 (6.84%)		8342.80 (24.67%)		852.00 (9.73%)	19111.67 (14.1%)

Source : RBI Annual Report

From the above table, it can be observed that in 2019 highest loan was granted by scheduled commercial banks i.e.18.4% and in 2020, only 6.73% of loans were granted by scheduled commercial banks which were very less than the last financial year. But scheduled commercial banks provide 14.1% credit flow to the MSMEs sector from March 2020 to March 2021. Private sector banks play an important role in financing micro small and medium enterprises. Although a large number of MSMEs are not taking a loan from banks because of a lack of collateral security, transaction cost, lengthy procedures etc. So, the Government of India launched a new scheme for MSME to take guarantee-free loans from the banks.

<https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=924#CH7>

Credit Guarantee Trust Fund for Micro Small and Medium Enterprises

The government of India launched a credit guarantee fund scheme to provide collateral security funds to micro small and medium enterprises that are eligible and covered under the scheme. Both new and existing firms are eligible under this scheme. Credit Guarantee funds are jointly set up by the Ministry of micro, small and medium enterprises and small industries development bank of India to cater the credit needs of the MSE sector and easily availability of finance to underprivileged, unserved and underserved sectors. The scheme was formally launched in August 2000 and operationally started in January 2000. Over the last few years, credit guarantee funds provide guarantee cover to collectable or third-party guarantee fee credit facilities to member lending institutions to micro and small enterprises.

Credit Guarantee for Enterprises

Category	Maximum extent of guarantee where credit facility is		
	Upto 5 Lakh	5 Lakh to 50 lakh	50 Lakh to 200 lakh
Micro enterprises	85% of the amount in default subject to a	75% of the amount in default subject to a	75% of the amount in default subject to a

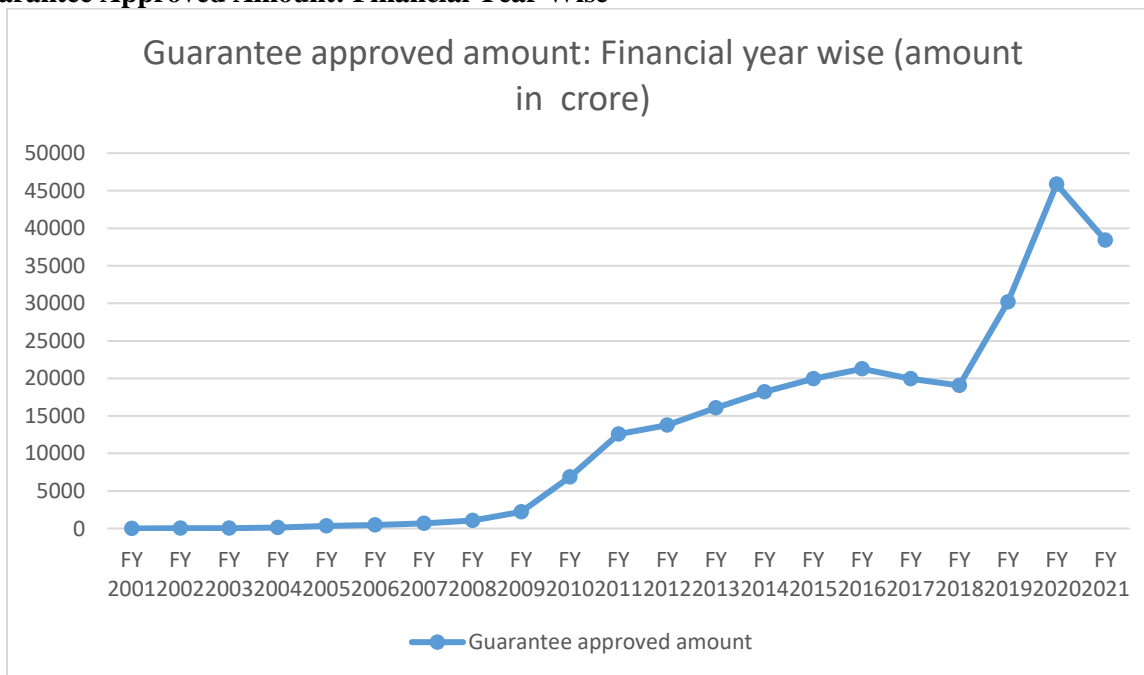
	maximum of 4.25 lakh	maximum of 37.50 lakh	maximum of 150 lakh
Women enterprises unite located in North East region.	80% of the amount in default subject to a maximum of 40 lakh		
All borrowers belongs to other categories	75% of the amount in default subject to a maximum of 37.50 lakh		
Activity	From 10 lakh to 100 lakh		
MSE retail trade	50% of the amount in default subject to a maximum of 50 lakh		

Source : <https://www.cgtmse.in/Home/VS/3>

Under CGFMSEs existing as well as new micro and small enterprises are eligible to take guarantee-free amounts upto 200 Lakh. The guarantee amount upto 50%, 75%, 80% and 85% are sanctioned for the credit facility. The guarantee covers upto 85% of the total loan

amount in the case of micro-enterprises. The extent to guarantee upto 50% of 50 lakh to 100 lakh are covered in MSE retail trade. Trust settles claims upto 75% of the amount in default of credit facility extended by lending institutions upto 200 lakh. A Credit Guarantee Fund is always a successful tool for accessing formal credit finance for MSEs.

Guarantee Approved Amount: Financial Year Wise



Source: 20th Annual Report, CGTMSE, 2020-2021.

Table 1 indicates the growth line of guarantee approved amount from the financial year 2001 to 2021. In 2021 total number of guarantees approved was Rs.83592 and the total amount approved was Rs. 36899. There is a gradual increase in the guaranteed approved amount from 2001 to 2021. The upswing credit guarantee flow proved that MSEs always get benefitted from this scheme.

2. CONCLUSION

The study analyzed the role of CGT and the credit flow of scheduled commercial banks to the MSMEs sector. Banks play an important role in addressing a problem faced by MSMEs in India, SCBs contribute a lot to the financing of MSMEs but still, there is a finance gap between demand and supply of credit flows. MSMEs can take advantage of the CGT scheme because CGTMSE provides collateral-free or guarantee-

free loans to MSMEs. Financial institutions feel safe if the loan is granted under this scheme. This is the main reason of popularize CGTMSE in enterprises and bankers.

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