REVIEW OF RESEARCH
IMPACT FACTOR : 5.7631(UIF) UGC APPROVED JOURNAL NO. 48514 ISSN: 2249-894X

VOLUME - 8 | ISSUE - 4 | JANUARY - 2019

SCOPE FOR ALTERNATIVE FINANCING OPTIONS TO PROMOTE FINANCIAL ACCESS TO SMES: EVIDENCE FROM INDIA

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ABSTRACT :
Purpose

The purpose for the present study is to identify the new financing options available to SMEs to promote the access of finance and bank credit scenario with role of public, private and foreign bank along with RBI new initiatives to reach unbanked SMEs population.

Deign/Methodology/Approach

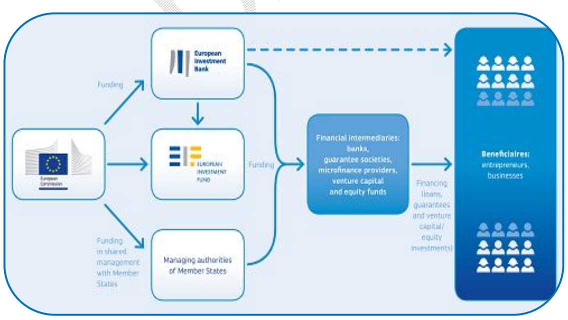
Content analysis is used for the available literature to fine-tune and streamline various sources and identify possible research issues in the said area and discusses about the scope of various alternative financing options for SME Financing.

Findings. SMEs are handicapped by a dearth of fund to expand their business. If they manage to successfully graduate from the informal to the formal economy, it is presumed that SMEs are ready to perform well.SME Stock Exchange, Crowd Funding commerce, Fintech Companies, Market place lending and securitization are emerged as an alternative to bank finance for SMEs. Apart from new alternative we have discussed traditional lending method that is bank credit scenario, public private and foreign bank role in SMEs lending and new initiatives taken by RBI to reach unbanked SMEs population

KEYWORDS : *BSE-SME, NSE-Emerge, Crowd- Funding, Market-Place lending, Reserve Bank of India , Bank Credit.*

1. INTRODUCTION

SMEs has emerged as the most vibrant and dynamic engine of growth of Indian economy over the past few decades. But SMEs face problem in accessing finance for their business. The literature reveals that SMEs are struggling to obtain fund for their investment and growth (Zaidi 2013; Boocook et. l (2001); Ang et al. 2010; Watson 2006; Singh et al 2009) . **Typically, funds from friends and family form the largest financial source for the SMEs in India followed by private money lenders.** As per the IFC Report 2013 There is a total finance requirement of INR 32.5 trillion ($650 billion) in the SME sector, which comprises of INR 26 trillion ($ 520 Billion) of debt demand and INR 6.5 trillion ($130 Billion) of equity demand 78 percent, or INR 25.5 trillion ($510 billion) is either self-financed or from informal sources. Formal sources provide for only 22 percent or INR 7 trillion ($140 billion) of the total SME debt financing. With in formal source banks are the primary lender. Rao. P (2017) identified the financing challenges faced by SMEs in India and found that SMEs faced both demand- and supply-side constraints. The most common financing challenges are high interest on credit, complex documentation procedures of lending institutions, information lopsidedness, creditworthiness, self-abstaining from



external financial resources, lack of knowledge and awareness about the financial products and services. Appropriate financing options can play a crucial role for SME financing in India. Hence, the present study will highlight key issues and opportunities lies with some of the new financing options to promote financial access to SMEs in India.

2 REVIEW OF LITERATURE

Entrepreneurs are tapping the potential of digital technology to make this large eco-system of start-ups based on futuristic ideas to flourish with ease of 2-way transactions, yet financial assistance is something that SMEs urgently need. In Lavy (1993) study it was found that most small firms rely on informal source of financing and Lack of access to finance emerges as the binding constraint for smaller firms. Binks & Ennew(1996) found that growth firms are younger, they are likely to get a tighter credit constraint as a consequence of the lack of a track record and a less developed relationship with the bank. Information asymmetry is one of the important issues for banks to extend SME credit Further study by Rao.P (2017); singh et.al. (2009) confirm that information transparency and credit scoring enhances the SMEs financing by banks. Biswas (2014) study find that other than information transparency , high risk, no collateral, new idea, lack of credit history other credit constraints, banks do not extend loan to SME. Wu et.al. (2008) study on SMEs in China find similar conclusion. On the other hand, smaller firms finance a larger share of investment with informal sources of finance, such as moneylenders or family and friends (Beck 2006,Wu et al.2008,Gartner 2010). But now due to the change in socio economic condition and new alternative SMEs are now moving towards new tools for financing.

From literature review it is clear that access to finance is still the major Problem lies with SME financing in India so it is essential to ensure adequate flow of capital for the growth of SMEs and so there is a need for alternative SME financing options other than the traditional bank SME credits.

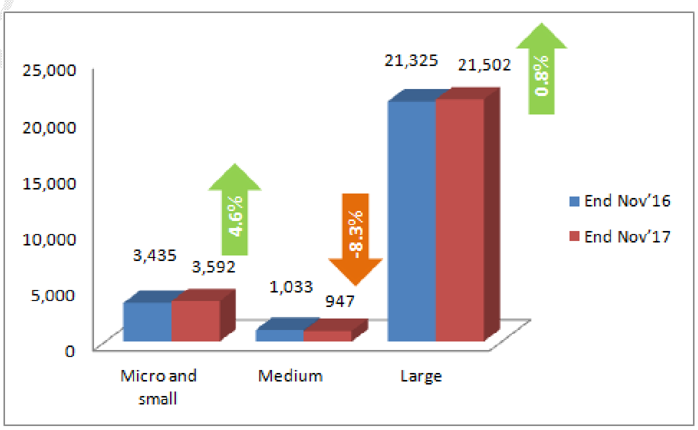
OBJECTIVE OF THE STUDY

- To identify alternative source of finance available to SMEs and challenges and opportunity lies with the alternative source of financing;
- To analyze the status of Bank credit and RBI Initiative to finance the unbanked SMEs Population.

3. TRADITIONAL FINANCING SOURCE FOR SMES FINANCING

3.1. Bank credit: According to the Economic Survey 2017-18, data on credit disbursed by banks shows that out of a total outstanding credit of Rs 26,041 billion as in November 2017, 82.6% of the amount was lent to large enterprises and SMEs got only 17.4 % of total credit.

Figure 1: Credit Outstanding to Industry (billion)

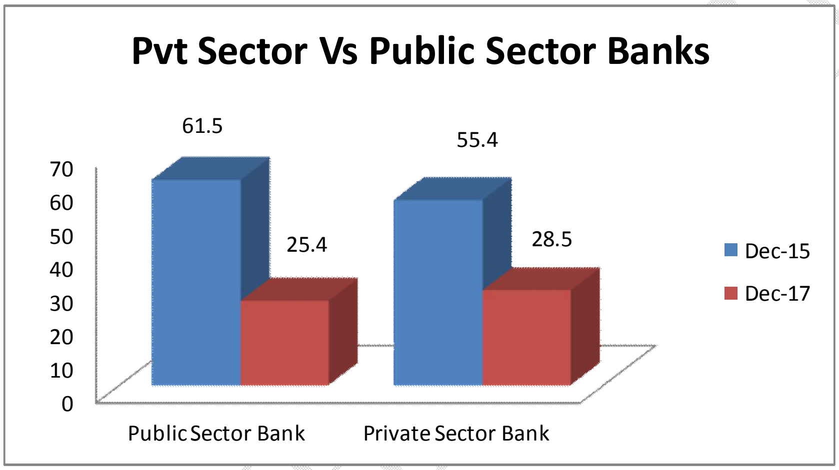


Source : Reserve Bankof india

3.2. ROLE OF PUBLIC SECTOR BANK, PRIVATE SECTOR BANK AND FOREIGN BANK IN SMES CREDIT:

In India MSME financing categorizes under the priority sector lending. As per the norm laid by Reserve Bank of India every scheduled commercial banks in India having more than 20 branches have to finance 7.5 % of adjusted net bank credit (ANBC) out of the 40 % of the total priority sector finance to MSME sector (RBI report 2014-15). There are no such strict rules applicable to the foreign banks that are operating in India but have to lend 32 % of the ANBC to the priority sector lending. CIBIL report (2018) says market share of private banks has grown from 25.4 per cent to to 28.5 per cent during the two year period from December 2015 to December 2017. In the same period, the market share of Public sector banks has reduced from 61.5 per cent to 55.4 per cent.

Figure 2. Private Sector Bank Vs Public Sector Banks Lending To SME's

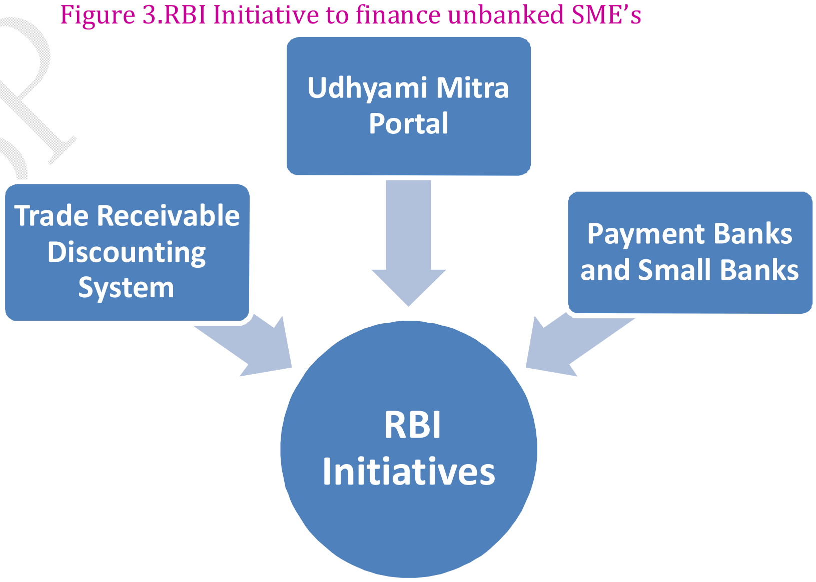


Source : Reserve Bankof india

3.3. RBI INITIATIVE FOR ALTERNATIVE FINANCING OPTION TO SMES:

RBI has taken new initiative to finance the unbanked SMEs population .Here is a list of recent tech-based initiatives launched by the RBI for benefit of the SME ecosystem.

Figure 3.RBI Initiative to finance unbanked SME's



1. **Trade Receivable Discounting System**: To solve the problem of delayed payment to SMEs, RBI has licensed three entities for operating the Trade Receivables Discounting System (TReDS). The objective is to create Electronic Bill Factoring Exchanges which could electronically accept and settle bills so that SMEs could encash their receivables without delay.
2. **An Udyami Mitra portal** has been set up to leverage IT architecture of StandUp Mitra portal which aims at instilling ease of access to SMEs' financial and nonfinancial service needs. The Portal, as a virtual market place endeavours to provide 'End to End' solutions not only for credit delivery but also for the host of credit-plus services by way of hand holding support, application tracking, and multiple interfaces with stakeholders.
3. **Payment Banks/ Small Finance Banks (SFBs):** RBI has recently issued licence to 10 Small Finance Bank and 11 Payment banks. Payment banks can't lend directly but can be distributors of the credit products, while SFBs would predominantly be in SMEs space.

4. SCOPE FOR ALTERNATIVE FINANCING OPTIONS TO MSME FINANCING:

The SMEs have always lamented lack of institutional finance as an impediment to their growth. However, lately few alternate sources of finance have become available in the market as a supplement to bank credit. Alternative finance tend to be more transparent about fees and eligibility as well as flexible in terms of payment.

4.1. CAPITAL MARKET:

Access to finance is SMEs biggest challenge and to overcome this, almost all major countries capital markets have realized the need for a separate exchange for SME segment. In India, the BSE and the NSE launched their platform for small and medium enterprises to list on the BSE and the NSE and later migrate to the main board of the BSE and NSE without the need to make an initial public offering. The BSE SME and NSE Emerge are a new source for SME IPOs and provide a listing opportunity to the SMEs with minimum compliances and cost compared to the main board.

4.2. CROWD FUNDING:

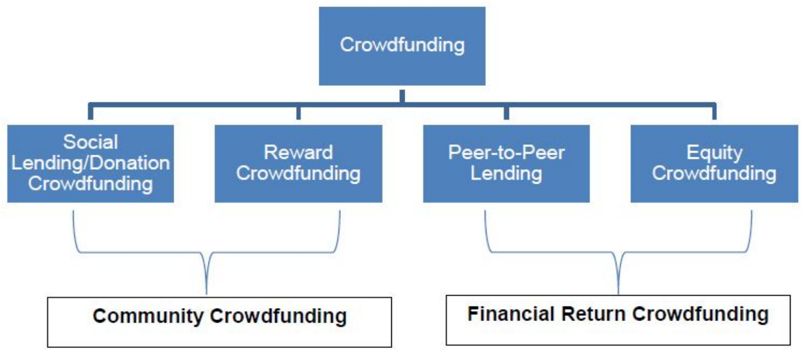
Crowd funding is a novel method of funding a variety of new venture, allowing individual founders of for-profit cultural or social project to request funding from many individual, often in return for future product or equity (Molick 2014) Crowd funding is a technique to raise external finance from a large audience, rather than a small group of specialized investors (e.g. banks, business angels, venture capitalists), where each individual provides a small amount of the funding requested (OECD Report 2015).

Importance of Crowd-funding for SMEs financing:

- It's a direct interaction between the entrepreneur and the investor through internet hence there is no intermediary such as banking institution to seek fund.

- Crowd-funding is not only for raising fund but also an important mechanism t share information with large public
- Crowd-funding increases awareness about a project
- Crowd-funding helps in getting recognition which may help in future commercialization.

4.2.1. TYPES OF CROWD-FUNDING



Source: IOSCO Staff Working Paper - Crowd-funding: An Infant Industry Growing Fast , 2014

4.3. E COMMERCE:

Ecommerce has been emerging as a new platform for lender and SMEs interaction. SMEs having access to credit through these startups is an extremely important development, especially in the context of how the Indian economy is engaging with the e-commerce opportunity. According to a Morgan Stanley report, India's e-commerce market is set to hit $200 billion by 2026, growing at 30% annually. In large part, this amazing growth is attributed to the greater adoption of technology by consumers in India's Banks, NBFCs, fintech companies tie up with e-commerce giants like Amazon, Snap deal, Flip kart, and Paytm for extending credit to SME seller. KPMG Report on impact of E-commerce on SMEs in India (2017) states that 27%of SMEs uses Ecommerce and 43% of SME participates in online sales in India. A seller with minimum 3000 INR can register itself as a seller on e commerce platform.

4.4. SECURITIZATION:

The receivables (trade credit) packaged as securitized asset and act as the commercial paper based on the credit rating of the firms. This will help Indian MSMEs to reduce their working capital investment. Securitization is quite similar to the process of factoring and letter of credit but more cost Effective.

4.5 MARKET –PLACE LENDING:

SMEs have started opting for the P2P Lending or market-place lending platform to fulfill their requirements for short-term loans that come with lower interest rates. This P2P lending is taking place through Fintech companies. FinTech companies are improving access to finance for SMEs by giving loans themselves, connecting SMEs to banks and financial institutions. Lendingkart, smelending.com, Credit mantra, Aye finance and Faircent are some of the leading fintech companies.

5. CONCLUSIONS:

SMEs are handicapped by a dearth of fund to expand their business. If they manage to successfully graduate from the informal to the formal economy, it is presumed that SMEs are ready to perform well. Alternative financial source can play an important role in this transformation of SMEs. Where by listing in stock exchange SMEs does not only get required fund but also can make a good market appearance. The BSE SME and NSE Emerge are a new source for SME IPOs and provide a listing opportunity to the SMEs with minimum compliances and cost compared to the main board. On the other hand, crowd funding has emerged as a noval method of funding to raise external finance from large audience. Apart from new alternative we have discussed traditional lending method that is bank credit scenario, public private and foreign bank role in SMEs lending and new initiatives taken by RBI to reach unbanked SMEs population. So the paper has highlighted new financing option along with opportunities and challenges lies with each option and different aspects of traditional bank credit. With India's alternate lending platforms providing the financial capital needed to help India's SMEs digitize and get ready for the future, they certainly hold the key to the country's bright economic future.

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