

Financing Fences of MSMEs: A Study on Adilabad District of Telangana State

Topunuru Kaladhar^{1*}, E. Upendar², P. Rajalingam Goud³

^{1*}Assistant Professor, Department of Economics, ICFAI School of Social Sciences, IFHE, Hyderabad, India

²Assistant Professor, Department of Management, Mother Theresa College of Engineering and Technology, Peddapally, India

³Assistant Professor, Department of Commerce, SBS, Central University of Karnataka, India.

***Corresponding Author:** Topunuru Kaladhar

^{*}Assistant Professor, Department of Economics, ICFAI School of Social Sciences, IFHE, Hyderabad, India

Abstract

This study aims to investigate the major financial problems encountered by the Micro, Small and Medium Enterprises (MSMEs) in the Adilabad region of Telangana State. Growth of MSME is very important for the economy, and it is considered the backbone of the economy and the engine of economic development. Yet, access to adequate financing is seen by the MSMEs as one of the major constraints on their growth. In its report on MSMEs (2012-2017), the Indian Planning Commission identified one of the major issues underlined was finance. The survey conducted by MSMEs reveals that Government, financial organizations and banks were not providing timely loan disbursement. Financing challenges often involve high interest rates, limited collateral, lengthy credit approval timelines, and financial literacy constraints for MSME owners. To draw valid conclusion the primary data was analyzed with multiple regression to know the impact of financing problems such as high interest rates, limited collateral, lengthy credit approval timelines, and financial literacy constraints on the fund's procurement in this study. The result shows financing problems were positively effecting for the growth of MSME sector.

Keywords: financing, MSMEs, growth, economy, multiple regression

JEL classification: G21, G23, G32

1. Introduction

The Micro, Small, and Medium Enterprise (MSME) sector plays an essential role in the Indian economy and has always been viewed as an engine for employment generation. This sector has been largely insulated from competitive threats at both the domestic and international levels (Lestari, Panggayuh, & Setiawan, 2024). There are 30 million businesses from different sectors with 69 million workers. These together account for over 45 percent of industrial production and 40 percent of the exports (Desai, 2008). India's MSME sector is heterogeneous in terms of firm size, diversity of products/services and technological sophistication. Without registration, over 94 percent of MSMEs, a large percentage of them also being a part of the informal or unorganized sector. However, access to financing in quantity remains the primary challenge. Akterujjaman (2010) conducted a study in which he identified financing as a major obstacle for MSMEs.

MEMEs are defined based on "the criteria of asset investment in plant and machinery/equipment and yearly turnover", as outlined in the Revised Classification effective from 1st July 2020, as shown in Table 1 (Rajagopal 2022).

Table 1

Enterprise Type	Manufacturing Companies and Service Providers based "Investment in Plant and Machinery or Equipment"
Micro	"Not more than one crore and annual turnover; not more than five crore"
Small	"Not more than ten crore and annual turnover; not more than fifty crore"
Medium	"Not more than fifty crore and annual turnover; not more than two hundred and fifty crore"

Source: Ministry of MSME in India

Since all commercial activities depend on finance, finance is a must for every organization. Capital is needed by businesses of any size to run their operations. The provision of timely and sufficient capital through term loans and working capital loans is essential, particularly during the early stages and expansion phases of MSMEs. Usually, MSMEs are dependent on these sources for their funding requirement. Studies and committees like RBI (2010) and ACI (2011) have addressed the business exigent of providing timely and adequate access to credit for the sectors' healthy growth. According to the Indian Prime Minister's Task Force (RBI 2010), a lack of financial support has hindered the growth of MSMEs in the economy. India's Prime Minister had appointed a task force in 2010 under the MSME sector which had a lot of action items in its recommendations but still, the issues that persist are finance-related. MSME owners usually have limited loan access. From the AIMA report (2023), the primary constraint of the Indian MSME industry is finance, followed by marketing, technology, infrastructure and tasks with government policy as shown in Table 2.

Table 2: AIMA Report

Problem	In Percentage
Finance	75%
Market	25%
Technological	14.6%
Infrastructure	14%
Government Policy	12.75%

Data source: AIMA Report August 2003

Now in this context, finance is a crucial catalyst in the promotion of MSMEs in the economy, hence it is important to analyze barriers to the development of the MSMEs in India due to financial constraints (Sulthana, Subrahmanyam, & Habibullah, 2022). Adilabad, which is an economically backward district, has 43% of its land area as forest. Urban residents amount to only 24% of the population; the district is mostly rural. A large proportion of residents rely on businesses to feed themselves. The district has 1,904 SSI units (RBI 2010). The findings shed light on the key financial risks of Indian MSMEs, based on our discussions with entrepreneurs in Adilabad. They include insufficient and delayed credit, high credit costs, collateral requirements, little access to equity capital, risk to repayment, interest rates, and inadequate responses from government, banks, and financial organizations regarding loan applications. The objective of this study is to examine the financing problems faced by MSMEs in Adilabad district of Telangana and the impact of these problems on the growth of MSMEs and identify key reasons behind these MSMEs' lack of access to adequate funding. The remaining paper is organized as follows: section 2 elucidates the previous literature, section 3 documents the data and methodology used for this current study, section 4 outlines the results, and Section 5 lastly, concludes the study with policy suggestions.

2. Review of Literature

Many studies discussed the financing risks of MSMEs and their influence on the survival and sustainable growth of MSMEs. Indian MSME has a contribution of 45% to India's industrial output but according to the Indian Planning Commission (2012-2017), finance was identified as the biggest problem for the Indian MSME sector. The Indian Prime Minister's Task Force (RBI, 2010) too concluded that lack of finance was the primary obstacle for the MSME sector with high credit costs, collateral requirements and poor access to equity capital being the major financial constraints (Prabhakar, 2022). The survey on MSME conducted by the Confederation of Indian Industry (CII 2013) highlighted that such enterprises face issues with high credit costs, delayed access to finance, and challenges in meeting collateral requirements. There remains a considerable barrier to the progress of MSMEs: The absence of financial access constitutes an obstacle to growth for MSMEs in India (International Finance Corporation, 2012). The Reserve Bank of India (RBI) came to a similar conclusion in its report from 2009–10 on the rehabilitation of small and medium-sized companies (SMEs), which listed inadequacy and premature full current assets as the main source of struggling in the sector. Based on data covering up until October 2023, SMEs are presented with challenges in accessing bank financing due to a lack of sufficient collateral which has led to their downfall (CIEM and the Bank for Foreign Trade of Vietnam, 2007).

A few studies focus on economic risks faced by MSMEs such as Venkateswarlu and Ravindra (2012) concluded that high interest rates applied by banks and financial organizations obstruct the growth of micro and small enterprises, especially the manufacturing sector. Srinivas et al. (2005) noted information asymmetry, the risk granting system and collateral

requirements that create barriers for SMEs to access loans. Akterujjaman (2010) highlighted that the need for high interest rates and lack of adequate collateral are major obstacles for SMEs to obtain finance. The recent studies by Rajamani et al. (2022), Sethurajan and Shakena (2021) and Mittal and Raman (2021) highlighted the issue of financing which hinders MSME growth despite its contribution to GDP and poverty alleviation hence becoming the backbone of the economy of the country. Nema and Suryavanshi (2021) highlighted that 11-crore people are currently working in these MSMEs which play a crucial role in providing more employment. However, this sector has a significant challenge in getting loans from the financial organizations. That would also indicate that MSME hardships are never-ending due to persistent funding issues, and Biswas and Vernekar (2019) confirmed the same that the absence of collateral along with restricted access to financial resources provides a potent block to these enterprises' growth and development.

3. Data and Methodology

In this research article, data is utilized from primary and secondary sources. The study used a convenience sampling approach to gather information from MSME owners operating in manufacturing industries in the Adilabad district in Telangana State. A structured questionnaire utilizing a 5-point Likert scale was used for primary data collection. The survey sought to identify the funding risks faced by MSMEs and the root causes of these problems. The elements included in the questionnaire were obtained from previous studies and interviews with MSME entrepreneurs. A survey was administered to 120 MSME entrepreneurs, generating 92 responses. Seventy-six questionnaires were found appropriate for analysis from these questionnaires. The relationship between barriers/obstacles to obtaining funds was evaluated by conducting multiple regression analyses. The secondary data was also obtained from books, journals, articles, MSME websites, and annual reports of MSME units to evaluate the growth of MSME in Telangana. The table here projects a study made by Saha & Saha (2022).

Table 3: Data Collected from Various Enterprises

Name of the Enterprise	No of the Enterprises
Food Processing & Beverages	14
Textiles	12
Fly ash Bricks	17
Wooden Furniture	22
Tiles	11
TOTAL	76

Source: Primary data

4. Results and Discussion

Before going over the survey data, let us first understand the development of the MSME sector of the Indian economy in general and Telangana state in particular. This discussion is based on secondary data downloaded from multiple secondary bases such as annual reports of MSME, literature, journals, articles, MSME websites, and a few other useful references, etc. and is presented in Table 4.

The below table depicts more rural MSMEs that exist in India than Urban areas. Trade-related MSME enterprises share (36%) more than other category enterprises (33%) and manufacturing (31%). Thus, MSMEs play a significant role in the development of the country as well as for generating employment for people (Prabhu & Sathyanarayana, 2022).

Table 4: Estimated Number of MSMEs (Activity Wise) (Based on the Study of Prabhu & Sathyanarayana, 2022)

Activity Category	Estimated Number of Enterprises (In lakhs)			Share(%)
	Rural	Urban	Total	
Manufacturing	114.14	82.50	196.65	31
Electricity	0.03	0.01	0.03	0
Trade	108.71	121.64	206.85	36
Other Services	102.00	104.85	206.85	33
All	324.88	309.00	633.88	100

Source: MSME Annual Report (2023-24)

Table 5: Percentage Distribution of Enterprises Owned by Male/ Female

Enterprise Type	Male	Female	All
Micro	79.56	20.44	100
Small	94.74	5.26	100
Medium	97.33	2.67	100
All	79.63	20.37	100

Data source: MSME Annual Report (2023-24) (Based on the study of Samuel Anbu Selvan, 2022)

The above table depicts micro enterprises owned by more male entrepreneurs (79.56) than female entrepreneurs (20.44). Small enterprises are owned by more male entrepreneurs (94.74) than female entrepreneurs (5.26) and medium enterprises are owned by more male entrepreneurs (97.33) than female entrepreneurs (2.67). As per the above statistics in this sector, more males are coming forward to launch this business than females.

Telangana, the newly formed state in the southern region of India has a booming and vibrant economy. The MSME sector is one of the significant contributors to its economic growth. MSMEs play a key role in job generation, industrial development and general economic development. There are about 2.6 million MSMEs in the state, out of which 56 per cent are functional in rural areas and 44 per cent in urban areas, marking their significance in both rural as well as urban development (Saha & Saha 2022).

The following table presents the study made by Samuel Anbu Selvan, in 2022.

Table 6: Number of MSMEs in Telangana

Survey	Nature of Enterprises	Micro	Small	Medium	Total
National Sample Survey	Manufacturing, service, retail, wholesale	25,94,000	10,000	1,000	26,05,000
Udyam Registrations	Manufacturing, service, retail, wholesale	8,64,202	26,560	3,028	8,93,790
GoTG,2023	Manufacturing, service	34,953	18,394	1,411	54,758
Tg-iPass Registration	Manufacturing, service	15,434	6,106	666	22,206

Source: Telangana MSME Policy 2024

The demographic outline of the respondents is presented in Table 7 below based on primary data. From the given table, it is evident that 40% of respondents from MSMEs have intermediate-level education, with the majority being sole proprietors (85%) and 90% operating as unregistered entities (Samuel Anbu Selvan, 2022). Additionally, 50% of respondents lack financial awareness. A significant 75% of MSMEs face delays in loan approvals and issues related to collateral requirements, despite having applied for loans from financial organizations. Therefore, MSMEs in the Adilabad district are facing severe obstacles in securing finance due to delays in sanctions, collateral requirements, and a lack of financial awareness.

Analysis of the responses gathered from the questionnaires and discussions with entrepreneurs indicates that MSME owners rely significantly on internal sources of finance, including personal savings, loans from friends and relatives, advances from customers, and loans from local money lenders. These owners are on tight budgets as banks and financial organizations rarely provide loans to this sector owing to collateral requirements, creditworthiness and goodwill issues. Many owners do not know the options. Many entrepreneurs state financial problems are an important problem for running their businesses over past, present and future activity. This is what often makes prices of products from MSME higher than mass-produced and imported products that are usually more well-known and better quality.

Table 7: Respondents' Demographic Profile Statistics

Variable	Category	Frequency	Percentage
Gender	Male	65	85.0
	Female	11	15.0
Literacy	Illiterate	8	8.0
	School education	23	30.0

	Intermediate	30	40.0
	Graduate	15	20.0
Ownership type	Sole proprietorship	65	85.0
	Partnership	7	10.0
	Private Ltd	4	5.0
Land status	Owned	52	70.0
	Rented	12	15.0
	On lease	12	15.0
Registration Status	Registered	8	10.0
	Un-registered	68	90.0
Enterprise type	Microenterprise	44	59.0
	Small Enterprise	23	30.0
	Medium enterprise	9	11.0
Manufacturing product	Food Processing & Beverages	12	16.0
	Textiles	15	19.0
	Fly ash Bricks	16	21.0
	Wooden Furniture	23	30.0
	Tiles	10	10.64
Financing awareness	Completely aware	15	20.0
	Partially aware	23	30.0
	unaware	38	50.0
Approached financial institution	Yes	65	85.0
	No	11	15.0
Loan applied	Yes	68	90.0
	No	8	10.0
Faced obstacles to getting the loan	Yes	59	77.0
	No	17	23.0
Type of obstacles faced	Delay in sanctioning loan	56	73.0
	Collateral requirement	23	27.0

Source: Primary data (October-December2024)

Table 8: Regression Results

Variables	Coefficient	Standard Error	Significance
Constant (C)	0.641	0.268	0.020
Non Credit (NC)	0.207	0.096	0.034
High Cost of Credit (HCC)	0.080	0.080	0.320
Collateral Requirements (CR)	0.049	0.082	0.554
Limited Equity Capital (LEC)	-0.135	0.075	0.077
Unable to Repay	0.110	0.073	0.135
Loans (UR)			
High Interest Rates (r)	-0.048	0.072	0.507
Difficulty in Getting Loans	0.113	0.059	0.059
R	R ²	Adjusted R ²	SE
0.447	0.199	0.117	0.376

Table 9: ANOVA

Model	Sum of Squares	Degree of Freedom	Mean Square	F-Ratio	Significance
Regression	2.401	7	0.343	2.42	0.028

Residual	9.638	68	0.142
Total	12.039	75	

Source: Primary data (October-December2024)

a. Dependent variable: Problems to get a loan

b. Independent variable: Financing problems (Non-Credit, High cost of Credit, Collateral Requirement, Limited Equity Capital, Unable to repay loans, High interest rates, Difficulty in Getting Loans)

The above-mentioned primary data undergo regression analysis using ANOVA. The dependent variable, problems in obtaining loans, is regressed on non-credit factors, high cost of credit, collateral requirements, limited equity capital, inability to repay loans, high interest rates, and difficulty in securing loans, with the estimated regression results presented in Table 7 (Samuel Anbu Selvan, 2022). The findings are shown in Tables 8 and 9. The R and R² are 0.447 and 0.199 which explains the dependency of the dependent variable (Problem in obtaining loan) on its independent variables. As the critical F value is 2.08 at a 5% level of significance and the computed F-value of 2.42 is more than the critical value, hence the null hypothesis is rejected. A p-value of 0.028 indicates statistical significance ($p < 0.05$), which also supports this interpretation. It explains most of the variance if all predictors are relevant in the regression. Indeed, the multiple independent variables combine to show a significant relationship with the dependent variable. This means that independent variables could explain a better part of the dependent variables' variance when the F-statistic values are higher.

MSME entrepreneurs face several risks concerning funding for sustainability. The factors listed in Table 6 highlight the major problems impacting funding difficulties, even though the number with statistical significance is small. However, these features align with those identified in the literature and interactions with MSME entrepreneurs. Non-credit, High Cost of Credit, Collateral Requirements, Inability to Repay Loans and Difficulty in Obtaining Loans are leading to positive contributions to the different problems in availing loans (Samuel Anbu Selvan, 2022). These indicate that a one-unit increase in the independent variable produces increases in dependent variable of 0.207, 0.080, 0.049, 0.110, and 0.113, respectively. The independent variables such as constrained equity capital and difficulty in or restrictions on getting a loan, have an unfavourable effect on a dependent variable. Meaning that an increase of one unit in these independent variables causes a decrease in the dependent variable of -0.135 and -0.048, respectively.

According to our interaction with MSME and our primary data regression analysis, the key reasons MSMEs are not able to avail loans from financial organizations are: the lower growth rate of MSME, informal business practices, the lack of collateral securities, lack of creditworthiness and goodwill, constraints in operating budgets, delay in obtaining adequately financial resources for machinery, equipment and raw materials and challenges faced in day-to-day operational cost management. These interlinked variables deter MSMEs from being able to get loans from financial organizations.

5. Conclusion and Policy Implications

The government will not provide jobs for all the people. Therefore, so many people are coming forward to launch their businesses in the MSME sector. MSME sector is emerged as a hub for job creation. But due to financial problems, these MSMEs fall sick. Underlying reason for sickness is finance. In this context, this study analyzed the vital financing problems faced by the MSME entrepreneurs in the Adilabad district of Telangana state. It found that MSME owners are encountered with finance related problem due to the lack of collateral requirements, limited equity capital, high interest rates, and difficulty in securing loans. Hence there is a need for the governments to take the initiative and also encourage, and provide subsidies for this sector. With the assistance of banks and financial organizations to this sector, GDP will increase, and the growth of the country will be ensured. As this study focused only few manufacturing sectors, it can further extendable to other manufacturing sectors.

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