Bridging the Credit Gap: Branch Managers' Perspectives on MSME Financing

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Abstract

Access to finance has been acknowledged as a critical component for MSMEs' success in building productive capacity, competing, creating jobs, and contributing to poverty alleviation in developing nations. MSMEs can't acquire or absorb new technology, expand to compete in global markets, or even form commercial partnerships if they don't have access to capital. Lending institutions should fortify their capacity to offer financial services to MSMEs by executing commercial mechanisms that reduce costs and lessen risk. Only in this way will financial institutions see MSME lending as more profitable and be encouraged to build lending programs specifically for MSMEs. Several factors in the financial services industry are also prompting banks to pay more attention to MSME markets. The most important source of institutional credit for small businesses is commercial banks.

The importance of bank credit in the expansion of the economy and the SME sector is widely understood, yet for the vast majority of MSME units, timely and adequate bank financing remains a distant dream. The Government is also dissatisfied with the amount of financing flowing to the MSME sector. As a result, the subject of granting credit to this industry is discussed in all forums. Though the Government has announced various drives to help the MSME sector, the Government also anticipates that banks should find ways to twofold the progression of credit to MSMEs. In India, commercial banks provide loans to MSMEs following RBI guidelines. They serve as a coordinating agency for the implementation of policy measures aimed at the MSME sector. MSMEs are the primary beneficiaries of the state Government's policies. There is a possibility of a gap between the policymakers and commercial banks, as well as between commercial banks and MSMEs.

Keywords: Lending, Commercial Banks, MSMEs, Financing, Credit

"Access to capital is critical for small business success and crucial to our economic recovery. Without access to capital, many small companies are not able to maintain operations, let alone expand and create new jobs".   **- Sam Graves**

Introduction:

The development and poverty reduction of the world is based on fair access to credit and banking services. Bank access gives MSMEs greater control and security over their money, and a loan from a credit organization can be crucial to the development of a company. RBI has developed several policy areas in particular in the small industries of the country about funding for priority industries. Banks have to meet these MSMEs' needs so that they can grow and expand and thus play a major part in the Indian economy's growth. Because of a lack of collateral, poor credit history, insufficient financial records most commercial banks have been reluctant to lend to the MSME sector. Most commercial banks have developed various financial products for business banking, retail banking, and MSME banking consumers in

the recent past.

Banks in India are commercial, due to a risk level, forced to charge high interest rates, demanding high-value MSME collateral ultimately increasing the transaction cost to MSMEs. The credit provided for the MSMEs has brought about a daunting challenge for banks. This paper identifies the problems faced by the bank managers of four selected banks in Dakshina Kannada and Udupi districts while lending loans to MSMEs. The study also tries to identify the reasons for not preferring lending to micro, small and medium-sized enterprises from a banker's perspective and also proposes strategies to improve bank lending to MSMEs.

Role of Commercial Banks in the development of MSMEs: Access to finance has been acknowledged as a critical component for MSMEs' success in building productive capacity, competing, creating jobs, and contributing to poverty alleviation in developing nations. MSMEs can't acquire or absorb new technology, expand to compete in global markets, or even form commercial partnerships if they don't have access to capital. Lending institutions should fortify their capacity to offer financial services to MSMEs by executing commercial mechanisms that reduce costs and lessen risk. Only in this way will financial institutions see MSME lending as more profitable and be encouraged to build lending programmes specifically for MSMEs. Several factors in the financial services industry are also prompting banks to pay more attention to MSME markets. The most important source of institutional credit for small businesses is commercial banks.

Commercial banks have implemented a variety of promotional initiatives as a result of their nationalization to increase the flow of bank credit to small-scale businesses. The emphasis has been placed on reorienting commercial bank lending practices to emphasize need-based lending rather than security-based lending. The Reserve Bank of India has issued instructions that no worthwhile small-scale unit proposals should be rejected solely based on a lack of acceptable security. The Reserve Bank of India has advised commercial banks to pay special attention to the needs of priority sector borrowers, particularly those from the poorer sections, and has devised several schemes to benefit small-scale units, technical entrepreneurs, rural industries, craftsmen/artisans, and so on.

The importance of bank credit in the expansion of the economy and the SME sector is widely understood, yet for the vast majority of MSME units, timely and adequate bank financing remains a distant dream. The Government is also dissatisfied with the amount of financing flowing to the MSME sector. As a result, the subject of granting credit to this industry is discussed in all forums. Though the Government has announced various drives to help the MSME sector, the Government also anticipates that banks should find ways to twofold the progression of credit to MSMEs. In India, commercial banks provide loans to MSMEs following RBI guidelines. They serve as a coordinating agency for the implementation of policy measures aimed at the MSME sector. MSMEs are the primary beneficiaries of the state Government's policies. There is a possibility of a gap between the policymakers and commercial banks, as well as between commercial banks and MSMEs.

Financing Gap for MSMEs: Even though SMEs have grown at a higher rate than the entire industrial sector, they face many obstacles. Access to financing continues to be one of the biggest obstacles to the expansion of MSMEs. The most recent IFC–World Bank MSME Finance Gap Report (March 2025) estimates that in 119 emerging markets and developing

economies (EMDEs), a finance gap exists of approximately US$5.7 trillion, which is roughly 19 percent of GDP and 20 percent of total private sector credit. The research shows that 40 percent of formal MSMEs face credit constraints, with 19 percent completely and 21 percent partially constrained. Of these, women-led MSMEs encounter a gap of approximately US$1.9 trillion, representing 34 percent of the overall total. Informal businesses create an extra US$2.1 trillion in unmet financial demand, which is about 8 percent of GDP in developing countries.

Need for the Study: MSME are found throughout the country, and because they have a large presence in rural areas, their expansion contributes to more balanced and sustainable development. Various research studies have analyzed and suggested strategies to improve the flow of credit to the MSME sector from the banks. However, the same problem exists now. As a result, it is vital to investigate the issue of MSMEs' inability to obtain adequate and timely loans. Even today, there is a pressing need for study into boosting credit flow to the MSME sector, as a major section of this sector remains unable to obtain credit via the formal financial system. Therefore, the study is undertaken on the topic "Problems and Prospects of Bank Financing to Small and Medium Enterprises- A Study of Selected Banks in Dakshina Kannada and Udupi Districts" to examine the issues and opportunities of bank financing to SMEs both from SME borrower perspective and from the Bankers perspective. This research study is intended to answer the following research questions.

Research Questions:
RQ 1: What are the major operational problems faced by the banks while granting loans to micro, small and medium enterprises?
RQ 2: What are the reasons for not preferring lending to micro, small and medium enterprises by the banks?

Objectives of the Study: The purpose of this paper is to identify the issues with bank financing from the standpoint of bankers who lend money to MSMEs. The paper also attempts to assess the prospects of bank financing in Dakshina Kannada and Udupi Districts of Karnataka. The main objectives of the study are:
• To study the profile of banks that have lent loans to MSMEs in Dakshina Kannada and Udupi Districts.
• To study the problems faced by the banks in lending loans to MSMEs and also to identify the reasons for not preferring lending to MSMEs in Dakshina Kannada and Udupi Districts.)
• To suggest measures to enhance the efficiency and quality of the existing system of bank financing to Micro, Small and Medium Enterprises based on the finding of the study.

Hypotheses: The objectives of the study resulted in the formulation of the following hypotheses for the present study:
•   Pre-sanctioning conditions are the major problems of the banks while sanctioning loans to SMEs.
•   Lack of collateral by the SMEs, failure to bring their own contribution into business are considered to be the major reasons for not preferring lending to SMEs by the banks.
Research Design and Methodology
Research Design: The study is empirical and exploratory. The Stratified Random Sampling technique was used to collect data from the respondents.
Sources of data: The primary data is gathered through a very much planned survey. The

survey was conducted using a well-structured questionnaire. Primary data is gathered by interviewing and interacting with chosen bank managers in Dakshina Kannada and Udupi districts.

Secondary data was gathered from RBI bulletins, RBI occasional papers, Ministry of MSMEs publications and Reports of the Directorate of Industries and Commerce, Government of Karnataka. Data relating to the bankers was collected from officials of sample bank branches of the study area. Separate conversations with qualified persons such as bank officials, banking specialists, SME field officers of the banks, Presidents of SME Associations, and DIC officials were held to create the interview schedules.

Population and Sample Size: To study the problems and prospects of bank financing to small and medium enterprises, the researcher has chosen Dakshina Kannada and Udupi districts as they are the cradle of banking. The researcher has selected a sample of four banks visa; State Bank of India and Union Bank of India which are in the public sector and Karnataka Bank Limited and ICICI Bank Limited leading private sector banks to make the study a representative one. The researcher has also selected the sample micro, small and medium enterprises functioning in both the districts and financed by State Bank of India, Union Bank of India, Karnataka Bank Limited, and ICICI Bank Limited.

Table 1: Population and sample size of branches of State Bank of India, Union Bank of India, Karnataka Bank Limited and ICICI Bank Limited

Banks	Population size	Sample size	Usable response
State Bank of India	69	44	41
Union Bank of India	73	46	40
Karnataka Bank Limited	77	48	43
ICICI Bank Limited	16	10	8
Total	235	148	132

Source: Data Compiled

Table 2: Sample distribution of bank branches between Dakshina Kannada and Udupi districts

Name of the Bank	District		
	Dakshina Kannada	Udupi	Total
State Bank of India	25	16	41
Union Bank of India	22	18	40
Karnataka Bank Limited	26	17	43
ICICI Bank Limited	5	3	8
Total	78	54	132

Source: Survey Data

Data Processing and Statistical Analysis
In this study, mean and standard deviations were calculated using descriptive statistics. To analyze and interpret the data reported in this study, the researcher used the Statistical Package for Social Sciences Research (SPSS). Statistical tests such as the Chi-square test and Fisher's Exact Test were used.

Analysis of Data: For the purpose of this study banks operating in the public sector i.e. Union Bank of India and State Bank of India and banks operating in the private sector i.e., ICICI Bank Limited and Karnataka Bank Limited operating in Dakshina Kannada and Udupi districts are considered. The study branches from these banks having micro, small and medium enterprise loan accounts are considered for the study.

Table 3: Name of the bank and Ownership Status of the sample branches:

Name of the Bank	District					
	Udupi		DK		Total	
	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
Karnataka Bank Limited	17	31.5	26	33.3	43	32.6
ICICI Bank Limited	3	5.6	5	6.4	8	6.1
Union Bank of India	18	33.3	22	28.2	40	30.3
State Bank of India	16	29.6	25	32.1	41	31.1
Total	54	100.0	78	100.0	132	100.0
Ownership Pattern						
Private Sector Bank	20	37.0	31	39.7	51	38.6
Public Sector Bank	34	63.0	47	60.3	81	61.4
Total	54	100.0	78	100.0	132	100.0
Parameters			Chi square value	d.f	p	
Ownership Pattern			0.099	1	0.754	NS
Bank			Fishers exact test	.	0.938	NS

Source: Survey Data

An analysis of the above table reveals the information relating to the name of the bank and their ownership status having sanctioned loans to SMEs. Total bank branches considered for the study having MSME loan account were 132. The above table also reveals that out of the

132 branches under study 38.6% (51) were private sector banks and 61.4% (81) were public sector banks. It can be inferred from the above table that most of the bank branches operating in the public sector have sanctioned loans to MSMEs. The test result reveals that there is no significant difference between Dakshina Kannada and Udupi districts about the ownership status of the bank (p=0.754>0.05).

Table 4: Pre-sanctioning conditions are the major problems of the banks while sanctioning loans to SMEs

Problems faced	Responses	District					
		Udupi		DK		Total	
		No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
The size of the loan is small and therefore transaction cost is very high	No	25	46.3	46	59	71	53.8
	Yes	29	53.7	32	41	61	46.2
	Total	54	100.0	78	100.0	132	100.0
SME borrowers do not have strong financial base	No	24	44.4	34	43.6	58	44.0
	Yes	30	55.6	44	56.4	74	56.0
	Total	54	100.0	78	100.0	132	100.0
Lack of collateral	No	20	37.0	29	37.2	49	37.1
	Yes	34	63.0	49	62.8	83	62.9
	Total	54	100.0	78	100.0	132	100.0
Most of the SME borrowers are first-generation entrepreneurs, don't have business experience	No	23	42.6	34	43.6	57	43.2
	Yes	31	57.4	44	56.4	75	56.8
	Total	54	100.0	78	100.0	132	100.0
Lack of infrastructure	No	30	55.6	43	55.1	73	55.3
	Yes	24	44.4	35	44.9	59	44.7
	Total	54	100.0	78	100.0	132	100.0
Political Pressure	No	43	79.6	57	73.1	100	75.8
	Yes	11	20.4	21	26.9	32	24.2
	Total	54	100.0	78	100.0	132	100.0
Too many procedural requirements	No	20	37.0	30	38.5	50	37.9
	Yes	34	63.0	48	61.5	82	62.1
	Total	54	100.0	78	100.0	132	100.0

Lack of Professionalism	No	25	46.3	41	52.6	66	50.0
	Yes	29	53.7	37	47.4	66	50.0
	Total	54	100.0	78	100.0	132	100.0
Difficult to assess the credit worthiness	No	23	42.6	32	41.0	55	41.7
	Yes	31	57.4	46	59.0	77	58.3
	Total	54	100.0	78	100.0	132	100.0

Parameters	Chi square value	d.f	p	
Size of the loan is small and therefore transaction cost is very high				
SME borrowers do not have a strong financial base				
Lack of collateral	0.000	1	0.987	NS
Most of the SME borrowers are first-generation entrepreneurs, don't have business experience				
Lack of infrastructure	0.002	1	0.961	NS
Political Pressure	0.746	1	0.388	NS
Too many procedural requirements	0.000	1	0.984	NS
Lack of Professionalism	0.501	1	0.479	NS
Difficult to assess the credit worthiness	0.032	1	0.858	NS

Source: Survey Data

Pearson Chi-Square Test for goodness of fit			
			Problems
Problems faced	Chi-square		29.79
	df		8
	p		0.000, HS

The data has been collected regarding the problems faced by the bankers while lending loans to MSMEs. More than 55% of the respondents opine that lack of collateral (62.9%), too many procedural requirements (62.1%), difficulty to assess the creditworthiness of the borrower (58.3%) were the major problems faced by them while sanctioning loans to SMEs which are considered as problems faced at the pre-sanctioning stage. The test shows that there is a highly significant difference in the opinion of the bankers with regard to problems faced by them (p=0.000). Therefore, "pre sanctioning conditions are the major problems of the banks while sanctioning loans to SMEs" is accepted.

Table 5: Lack of collateral by the SMEs, failure to bring own contribution into business are considered to be the major reasons for not preferring lending to SMEs by the banks.

Reasons for not	Responses	District		
		Udupi	DK	Total

preferring lending		No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
It is highly risky because of higher delinquency	No	31	57.4	50	64.1	81	61.4
	Yes	23	42.6	28	35.9	51	38.6
	Total	54	100.0	78	100.0	132	100.0
Information Asymmetry	No	43	79.6	57	73.1	100	75.8
	Yes	11	20.4	21	26.9	32	24.2
	Total	54	100.0	78	100.0	132	100.0
Insufficient assets (to provide collateral) by SMEs	No	23	42.6	25	32.1	46	34.8
	Yes	31	57.4	53	67.9	86	65.2
	Total	54	100.0	78	100.0	132	100.0
Lending to SME sector is non-profitable	No	43	79.6	68	87.2	111	84.1
	Yes	11	20.4	10	12.8	21	15.9
	Total	54	100.0	78	100.0	132	100.0
SME beneficiaries don't have credit rating or have very Low credit rating	No	31	57.4	47	60.3	78	59.1
	Yes	23	42.6	31	39.7	54	40.9
	Total	54	100.0	78	100.0	132	100.0
Failure to bring own contribution into business	No	20	37.0	36	46.2	56	42.4
	Yes	34	63.0	42	53.8	76	57.6
	Total	54	100.0	78	100.0	132	100.0
Don't maintain books of accounts in a systematic manner	No	24	44.4	37	47.4	61	46.2
	Yes	30	55.6	41	52.6	71	53.8
	Total	54	100.0	78	100.0	132	100.0
Inverse Relationship between number of accounts and volume of business	No	26	48.1	42	53.8	68	51.5
	Yes	28	51.9	36	46.2	64	48.5
	Total	54	100.0	78	100.0	132	100.0
Closing down of units	No	41	75.9	62	79.5	103	78.0
	Yes	13	24.1	16	20.5	29	22.0
	Total	54	100.0	78	100.0	132	100.0
Diversion of loans	No	30	55.6	47	60.3	77	58.3
	Yes	24	44.6	31	39.7	55	41.7

	Total	54	100.0	78	100.0	132	100.0
Underutilisation of working capital	No	35	64.8	49	62.8	84	63.6
	Yes	19	35.2	29	37.2	48	36.4
	Total	54	100.0	78	100.	132	100.0
Lack of knowledge of operations of the units	No	31	57.4	50	64.1	81	61.4
	Yes	23	42.6	28	35.9	51	38.6
	Total	54	100.0	78	100.0	132	100.0

Parameters	Chi square value	d.f	p	
It is highly risky because of higher delinquency	0.603	1	0.437	NS
Information Asymmetry	0.746	1	0.388	NS
Insufficient assets (to provide collateral) by SMEs	1.532	1	0.216	NS
Lending to SME sector is non-profitable	1.360	1	0.244	NS
SME beneficiaries don't have credit rating or have very Low credit rating	0.513	1	0.743	NS
Failure to bring own contribution into business	1.086	1	0.297	NS
Don't maintain books of accounts in a systematic manner	0.115	1	0.735	NS
Inverse relationship between number of accounts and volume of business	0.415	1	0.520	NS
Closing down of units	0.236	1	0.627	NS
Diversion of loans	0.290	1	0.590	NS
Underutilization of working capital	0.055	1	0.851	NS
Lack of knowledge of operations of the units	0.603	1	0.437	NS

Source: Survey Data

Pearson Chi-Square Test for goodness of fit		
		Reasons
Reasons for not lending to SMEs	Chi-square	59.61
	df	11
	p	0.000, HS

Out of the 132 bank managers, 65.2% opine that insufficient assets to provide as collateral by the SMEs and failure to bring in own contribution into business (57.6%) were the major reasons for not preferring lending to SMEs by banks. The hypothesis was tested using Chi-square test p=.000 which is less than 0.01 indicates that lack of collateral by the SMEs and failure to bring own contribution are the major reasons for not preferring lending to SMEs by the banks. Therefore, the hypothesis is accepted.

Findings:

- The study found that out of the 132 selected bank branches who sanctioned loans to SMEs 38.6% (51) were private sector banks and 61.4% (81) were public sector banks. It can be inferred from the above table that public sector banks have sanctioned more loans to SMEs.

- The data analysis reveals that the following are the important factors affecting bank financing to SMEs: default rates of loans sanctioned to SMEs are higher than those made to large enterprises, it is costlier to gather reliable information from SMEs and SMEs do not systematically maintain books of accounts. However, these factors are not different between Dakshina Kannada and Udupi districts.

- Lack of collateral, too many procedural requirements, difficulty to assess the creditworthiness of the SMEs were the major problems faced by the bankers in both districts. But when compared between the problems there is a statistically highly significant difference about problems faced by the bankers. More than 55% of the respondents opine that lack of collateral, too many procedural requirements, difficulty to assess the creditworthiness, most of the SME borrowers are first-generation entrepreneurs and they don't have business experience were the major problems faced by them while granting loans to SMEs when compared to other problems.

- The study found that there is statistically no significant difference between Dakshina Kannada and Udupi districts about the reasons for not preferring lending to SMEs by banks. But when compared between the reasons for not preferring lending to SMEs by banks more than 50% of the respondents opine that insufficient assets to provide collateral by the SMEs (65.2%), failure to bring in own contribution into business (57.6%), SMEs don"t maintain books of accounts systematically (53.8%) were the major reasons for not preferring lending to SMEs by the banks which is statistically highly significant compared to other reasons (p=0.000<0.001).

Limitations of the Study:

- To keep the present study within manageable limits and time, the study is confined to the two public sector banks and two private sector banks in Dakshina Kannada and Udupi Districts of Karnataka.

- Due to the work pressure of the bank officials, it was difficult for the researcher to gather data.

- The researcher could not have access to all data and records relating to the bank financing to SMEs since the banks operate under secrecy and confidentiality.

Despite these constraints, a sincere effort was made to get a fairly objective, representative result by making the best use of the data available to make the study useful.

Suggestions:

- The bank may relax the collateral limits to first-generation entrepreneurs by exploring alternatives to collateral while evaluating creditworthiness. Minimum collateral

loan schemes can be introduced to encourage young entrepreneurs to venture into entrepreneurship.

- Banks should ensure the opening of more specialized MSME branches and also appoint a liaison officer to look after the redress the grievances faced by the SME borrowers. Every bank must have an MSME grievance redressal mechanism to solve the problems faced by the SME units.

Conclusion:

Despite a plethora of Government and RBI policies and programs, it is difficult for the MSME to secure adequate and timely funding. Both entrepreneurs and bankers continue to face this problem. A banker plays a key role in providing financial support to the needy. By meeting the financial requirements of various segments of society, banks contribute to the economic development of the nation. Among the various segments of the economy micro, small and medium enterprises play a pivotal role in generating employment opportunities, substantial contribution to production, exports, and national income. To boost SMEs, banks have the moral responsibility to lend to this sector. Every Bank has given the highest importance to financing SMEs in their strategical growth plan. It has become necessary to bring policy shift and create a free-market environment from regulations & interventions in economic activity. Growth resulting from globalization and liberalization is visible most profoundly in the SME segment. The relationship between the banker and the customer has become most crucial and competitive. The role of bank credit in the growth of the economy and the SME sector is well-known but access to timely and adequate bank finance is still a distant dream for the majority of the units in the SME sector. The government is also not happy with the level of credit flow to the SME sector. Hence, in all the forums, the issue related to extending credit to this sector is discussed. Though many measures have been announced by the government from time to time, for giving a fillip to the SME sector, the government expects banks also to initiate measures to double the flow of credit to SMEs.

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