Our Heritage

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Role of Banks In Promoting Entrepreneurship Through Financing The Small and Medium Enterprises

Rachana Saxena, Ph.D

Associate Professor New Delhi Institute Of Management

Tughlakabad Institutional Area

New Delhi 110062

+91-9358947150

dr.rachna.saxena@gmail.com

OrcidId:orcid.org/0000-0003-3514-2757

Chandrani Ganguly, Ph.D

Associate Professor New Delhi Institute Of Management

Tughlakabad Institutional Area

New Delhi 110062

+91-9818548257

Prof.cganguly@gmail.com

Absract

Since the time of independence, the small-scale sector in India has been a major contributor to country's Gross Domestic Product (GDP). This traditional sector in India is considered to have huge growth prospect with its wide range of products. With 40 percent share in total industrial output and 35 percent share in exports, the small-scale industrial sector in India is acting as Engine of Growth in the new millennium.

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Now a days Indian **small-scale industries** (SSIs) are mostly modern small-scale industries. Modernization has widened the list of products offered by this industry. The items manufactured in modern Small-scale service & Business enterprises in India now include rubber products, plastic products, chemical products, glass and ceramics, mechanical engineering items, hardware, electrical items, transport equipment, electronic components and equipments, automobile parts, bicycle parts, instruments, sports goods, stationery items and clocks and watches for this **banks** are helping the entrepreneurs to develop the business as well as develop the **economy**.

The definition for small-scale industrial undertakings has changed over time. Initially they were classified into two categories- those using power with less than 50 employees and those not using power with the employee strength being more than 50 but less than 100. However the capital resources invested on plant and machinery buildings have been the primary criteria to differentiate the small-scale industries from the large and medium scale industries. An industrial unit can be categorized as a small- scale unit if it fulfills the capital investment limit fixed by the Government of India for the small-scale sector.

As per the latest definition which is effective since December 21, 1999, for any industrial unit to be regarded as Small Scale Industrial unit the following condition is to be satisfied: -

Investment in fixed assets like plants and equipments either held on ownership terms on lease or on hire purchase should not be more than Rs 10 million.

However the unit in no way can be owned or controlled or ancillary of any other industrial unit.

The traditional small-scale industries clearly differ from their modern counterparts in many respects. The traditional units are highly labor consuming with their age-old machineries and conventional techniques of production resulting in poor productivity rate whereas the modern small-scale units are much more productive with less manpower and more sophisticated equipments.

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Khadi and handloom, sericulture, handicrafts, village industries, coir, Bell metal are some of the traditional small-scale industries in India. The modern small industries offer a wide range of products starting from simple items like hosiery products, garments, leather products, fishing hook etc to more sophisticated items like television sets, electronics control system, various engineering products especially as ancillaries to large industrial undertakings.

Entrepreneurship

An entrepreneur is a person of very high aptitude who pioneers change, organizes production and takes the risks associated with the production process. Entrepreneur can also be viewed as a person that wants to works for himself; it is sometimes synonymous with self employment. Entrepreneurship therefore by implication is the act of being an entrepreneur, it involves all the activities and function undertaken by an entrepreneur. Entrepreneurship is believed to provide an important avenue for individuals to advance up the income ladder. For some, it may provide a better route than paid employment, while for others, who may be disadvantaged when pursuing paid employment, it may provide the only route. Entrepreneurs are charged with the responsibility of innovating new products, better production method, creation of markets and managing the production process. They are in a nutshell engaged in wealth creation. Financing therefore is needed by entrepreneurs to enable them carry out their function effectively.

Credit and the Growth of a Rural Enterprise

For any business to grow credit is essential, lack of credit is a barrier to investment and the growth of income of poor households. Access to credits enhances the adoption of new and more advance technologies that will enable rural households to expand agricultural and non agricultural enterprise which in turn improve their income levels and hence help in reducing the incidence of poverty. Capital as a result of access to credit also enhances the level of household’s productive and physical assets and also raise expenditure that lead to improvement in the consumption of the rural poor. Olajide (1980) identified two sources of credits for entrepreneurs and classified them as internal and external. While the internal funds arise from net flow as a

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result of entrepreneurial activities, the external funds arise from Loans extended by micro finance providers, and Equity introduced by new proprietors. Rural enterprise require capital which is believed to be provide by microfinance providers, as financing to microenterprise is universal not only in rural areas but even in urban areas. Credit to small and medium enterprises have been an important instrument in fostering the development of industrialization and improving the efficiency of the enterprise as well as expanding productivity.

Microfinance banks are institutions constructed as a company licensed to carry on the business of providing microfinance services such as collection of savings, loans provision, insurance money transfer services and other non financial services that are needed by the poor as well as the microenterprise. The clients of microfinance banks are typically self employed low income entrepreneurs in both urban and rural areas, they include traders, subsistence farmers, street vendors, service provides (hair dressers, motorcycle riders), blacksmith and artisans.

Importance

- Growth Engine of the Economy.
- Vital Role in Economic Development.
- Growth of Employment and G.D.P.
- Fostering Entrepreneurship.
- Cater the needs of Micro, Small and Medium Enterprises in all the sectors.

Definition (1/2)

- **Manufacturing Enterprise** engaged in the manufacture or production, processing or preservation of goods.

◦ Micro Enterprise investment in P&M upto 25 Lakhs.

◦ Small Enterprise investment in P&M 25 Lakhs to 5 Crores.

◦ Medium Enterprise investment in P&M 5 Crores to 10 Crores.

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Definition (2/2)

-Service Enterprise engaged in providing or rendering of services. For example, road transport operators, business enterprises, professional and self employed.

◦ Micro Enterprise investment in P&M upto 10 Lakhs.

◦ Small Enterprise investment in P&M 10 Lakhs to 2 Crores.

◦ Medium Enterprise investment in P&M 2 Crores to 5 Crores.

REQUIREMENTS:

The following requirements are to be complied with by an industrial undertaking to be graded as Small Scale Industrial undertaking w.e.f. 21.12.1999

An industrial undertaking in which the investment in fixed assets in plant and machinery whether held on ownership terms on lease or on hire purchase does not exceed Rs 10 million.

(Subject to the condition that the unit is not owned, controlled or subsidiary of any other industrial undertaking)

Note 1:-

(a) "owned" shall have the meaning as derived from the definition of the expression "owner" specified in clause (1) of section 3 of the said Act;

(b) "subsidiary" shall have the same meaning as in clause (47) of section 2, read with section 4, of the Companies Act, 1956 (1 of 1956);

(c) the expression "controlled by any other industrial undertaking" means as under:-

(i) where two or more industrial undertakings are set up by the same person as a proprietor, each of such industrial undertakings shall be considered to be controlled by the other industrial undetaking or undertakings,

(ii) where two or more industrial undertakings are set up as partnership firms under the Indian Partnership Act, 1932 (1 of 1932) and one or more partners are common partner or partners in

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such firms, each such undertaking shall be considered to be controlled by other undertaking or undertakings,

(iii) where industrial undertakings are set up by companies under the Companies Act, 1956 (1 of 1956), an industrial undertaking shall be considered to be controlled by other industrial undertaking if:-

(a) the equity holding by other industrial undertaking in it exceeds twenty four percent of its total equity; or

(b) the management control of an undertaking is passed on to the other industrial undertaking by way of the Managing Director of the first mentioned undertaking being also the Managing Director or Director in the other industrial undertaking or the majority of Directors on the Board of the first mentioned undertaking being the equity holders in the other industrial undertaking in terms of the provisions of the following items (a) and (b) of sub-clause (iv);

(iv) the extent of equity participation by other industrial undertaking or undertakings in the undertaking as per sub-clause (iii) above shall be worked out as follows:-

(a) the equity participation by other industrial undertaking shall include both foreign and domestic equity;

(b) equity participation by other industrial undertaking shall mean total equity held in an industrial undertaking by other industrial undertaking or undertakings, whether small scale or otherwise, put together as well as the equity held by persons who are Directors in any other industrial undertaking or undertakings even if the person concerned is a Director in other Industrial Undertaking or Undertakings;

(c) equity held by a person, having special technical qualification and experience, appointed as a Director in a small scale industrial undertaking, to the extent of qualification shares, if so provided in the Articles of Association, shall not be counted in computing the equity held by other industrial undertaking or undertakings even if the person concerned is a Director in other industrial undertakings or undertakings;

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(v) where an industrial undertaking is a subsidiary of, or is owned or controlled by, any other industrial undertaking or undertakings in terms of sub-clauses (i); (ii); or (iii) and if the total investment in fixed assets in plant and machinery of the first mentioned industrial undertaking and the other industrial undertaking or undertakings clubbed together exceeds the limit of investment specified in paragraphs (1) or (2) of this notification as the case may be, none of these industrial undertakings shall be considered to be a small scale or ancillary industrial undertaking.

Note 2:-

(a) In calculating the value of plant and machinery for the purposes of paragraphs (1) and (2) of this notification, the original price thereof, irrespective of whether the plant and machinery are new or second hand, shall be taken into account.

(b) In calculating the value of plant and machinery, the following shall be excluded, namely:-

(i) the cost of equipments such as tools, jigs, dies, moulds and spare parts for maintenance and the cost of consumable stores;

(ii) the cost of installation of plant and machinery;

(iii) the cost of research and development equipment and pollution control equipment;

(iv) the cost of generation sets and extra transformer installed by the undertaking as per the regulations of the State Electricity Board;

(v) the bank charges and service charges paid to the National Small Industries Corporation or the State Small Industries Corporation;

(vi) the cost involved in procurement or installation of cables, wiring, bus bars, electrical control panels (not those mounted on individual machines), oil circuit breakers or miniature circuit breakers which are necessarily to be used for providing electrical power to the plant and machinery or for safety measures;

(vii) the cost of gas producer plants;

(viii) transportation charges (excluding of sales tax and excise) for indigenous machinery from the place of manufacturing to the site of the factory;

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(ix) charges paid for technical know how for erection of plant and machinery;

(x) cost of such storage tanks which store raw materials, finished products only and are not linked with the manufacturing process; and

(xi) cost of fire fighting equipments.

(c) In the case of imported machinery, the following shall be included in calculating the value, namely:-

(i) import duty (excluding miscellaneous expenses as transportation from the port to the site of the factory, demurrage paid at the port);

(ii) the shipping charges;

(iii) customs clearance charges; and

(iv) sales tax.

Every industrial undertaking which has been issued a certificate of registration under section 10 of the said Act or a license under sections 11, 11A and 13 of the said Act by the Central Government and are covered by the provisions of paragraphs (1) and (2) above relating to the ancillary or small scale industrial undertaking, may be registered, at the discretion of the owner, as such, within a period of one hundred and eighty days from the date of publication of this notification in the Official Gazette.

Ancillary Industrial Undertakings

The following requirements are to be complied with by an industrial undertaking for being regarded as ancillary industrial undertaking: -

An industrial undertaking which is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediates, or the rendering of services and the undertaking supplies or renders or proposes to supply or render not less than 50 per cent of its production or services, as the case may be, to one or more other industrial undertakings and whose investment in fixed assets in plant and machinery whether held on ownership terms or on lease or on hire-purchase, does not exceed Rs 10 million.

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Tiny Enterprises

Investment limit in plant and machinery in respect of tiny enterprises is Rs 2.5 million irrespective of location of the unit.

Women Entrepreneurs

A Small Scale Industrial Unit/ Industry related service or business enterprise, managed by one or more women entrepreneurs in proprietary concerns, or in which she/ they individually or jointly have a share capital of not less than 51% as Partners/ Shareholders/ Directors of Private Limits Company/ Members of Cooperative Society.

Small Scale Service & Business (Industry related) Enterprises (SSSBEs)

SSSBEs industry related service/ business enterprises with investment upto Rs 500,000 in fixed assets, excluding land and building, are called Small Scale Service/ Business Enterprises (SSSBEs). This limit has been raised to Rs.1 million w.e.f. September 2000.

Bank finance for SMEs

1. Term Loans for acquiring fixed assets, plant and machinery and other movables such as vehicles.
2. Working Capital Finance for running the business to meet out day to day need
for purchase of stock and to meet out running expenses.
3. Non Fund Based Facilities by way of bank guarantees, letter of credit, capability and solvency certificates.

1. Term Loan

_ Single transaction loan repayable in more than 36 months.

_ Provided for a specific purpose/project.

Documents to be obtained:-

◦ Loan application, project report, projected balance sheet.

◦ Financial statements, income tax and sale tax returns for last 3 years.

◦ Projected cash flow and funds flow for the period of repayment.

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◦ Copies of license, permit, permission etc.

◦ Assets in the name of borrower and guarantor.

Key parameters:-

Key parameters	**Others**	**Infrastructure Projects**
Debt/Equity ratio	Not more than 2:1 (3:1 exception cases)	2.55:1 (4:1 in exception cases)
Promoters	contribution 25 to 30% of project cost	Not less than 11% of project cost
Fixed Assets coverage ratio	1.4 and above	1.25 and above
Repayment period	Upto 7 yrs	Upto 12 yrs
DSCR	More than 1.75	More than 1.5
IRR (Post tax)	5% and above	4% and above
Current ratio	More than 1.25	More than 1.00

Appraising a Term Loan Project:-

_ Background of the promoter

_ Product choice & market survey

_ Industry profile & location

_ Govt. consent & necessary permission

_ Cost of project & means of finance

_ Details of plant & machinery

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_ Availability of raw material, man power, power, transport etc.

_ Marketing arrangement

_ Availability of margin for TL/WC

_ Break even analysis

_ Managerial ability

2. Assessment of Working Capital

_ Computed @20% of the projected sales turnover accepted by the bank.

_ Minimum margin of 5% on projected sales turnover.

_ 25% of estimated sales turnover shall be computes as working capital requirement.

_ For working capital limit of more than Rs. 5 Crore MPBF and Cash Budget Systems are used.

_ Drawing from the account shall be against Drawing limit arrived based on Stock and Receivable statement.

Security:-

-No collateral security/guarantee are taken in respect of loans to small enterprises (SSI)

- Upto Rs 5 Lakhs.
- Upto Rs 25 Lakhs for good track record and sound financial position.
- Upto Rs 50 Lakhs covered under credit guarantee scheme for micro and small enterprise (CGMSE).

-For other SE/ME units collateral security/guarantee as determined by bank.

Time Norms for disposal of SME proposal:-

_ Upto 25,000 within 2 weeks.

_ Upto 5 Lakhs within 4 weeks.

_ More than 5 Lakhs within 8 weeks.

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Non Fund Based Limit:-

Deferred payment	**Purpose**	**For acquisition of capital goods (p&m)**
	Terms of payment	In tune with credit extended by manufacturer/supplier.
	Security	1st charge on fixed asset
Bank guarantees	**Purpose**	**In lieu of earnest Money Deposits, security Deposit, bid Bonds, advance Payment, Performance, retention Money etc.**
	Margin/ Security	As per bank norms
Letter of credit	**Purpose**	**Purchase of raw material, inputs and capital goods. LC to be opened as per terms of supplier of such goods/ services**
	Margin/ Security	As per bank norms

Export Finance Schemes:-

Pre Shipment Finance	Packing Credit
Post Shipment Credit	FDB/FBE/BRD
Bank Guarantees	Guarantees for import of capital goods
Foreign Letters of Credit (FLC)	Both for import of raw material and capital goods

Other facilities extended to SME by banks

_ Concessional rate of interest on the basis of various parameters.

_ Take over of the loans from other financial institutions.

_ Standby credit for capital expenditure.

_ Cash award for ISO certification.

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_ Technology up gradation scheme.

_ Loans scheme for solar water heaters to SME.

_ Loan scheme for reimbursement of investment made in fixed assets by SMEs.

_ Co financing with SIDBI for project under SE.

_ Artisans credit card scheme.

_ Laghu udyami credit card scheme.

_ Composite loan scheme upto Rs. 100 Lakhs

_ KVIC loans under margin money and interest subsidy.

_ Bills of exchange discounting facility to SE unit at concessional rate of interest.

_ Loans for P&SE (Examples: doctors).

_ Credit Guarantee Fund Scheme for micro and small enterprise (CGMSE).

_ Export Credit risk cover by ECGC.

_ SME Debt Restructuring.

_ Rehabilitation of Sick SE units.

Special Package to provide relief to SME

_ Need based ad hoc working capital demand loan upto 20% of existing fund based limit.

_ Increased working capital limit for elongated operating cycle.

_ Reduction in margin in advances against book debt by 10%.

_ Relaxation in cash margin on LCs and guarantees.

_ Extension in moratorium period in respect of term loan wherever implementation has been delayed.

_ Book debt outstanding upto 180 days.

_ Term loan for Power gen sets.

_ SME debt restructuring and second restructuring.

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Development Finance Matrix: India:-

AII-India Dev. Banks (IDBI, IFCI,ICICI,IIBI,IDFC,SIDBI)	**State Level Institutions** -State Financial Corporations- SFCs- 18) - State Industrial Development Corporations- SIDCs- 28) -State Small Industries Development Corporations- SSIDCs-17) -Technical Consultancy Organizations –TCOs-18)
Specialized Financial Institutions (Exim Bank, & NABARD)	
Investment Institutions (LIC,GIC,NIC,NIA,OIC,UII,UTI)	
Others: (NEDFi, NSIC, KVIC,TFCI, ICICIVenture,IVCF)	

Institutional Network: Finance and Credit in India:-

Long-term	**Short-term & Medium-term**	**Agriculture Credit**
-All India Financial Institutions (AIFIs) -Regional DFIs	- Commercial Banks - -Regional Rural Banks (RRBs)	- Cooperative Banks - NABARD
Non-banking Finance Companies (NBFCs)	Government owned Institutions/ Corporations	Non-Govt. Organisations (NGOs) & Micro Finance Institutions (MFIs)

All India Financial Institutions
Financial Assistance

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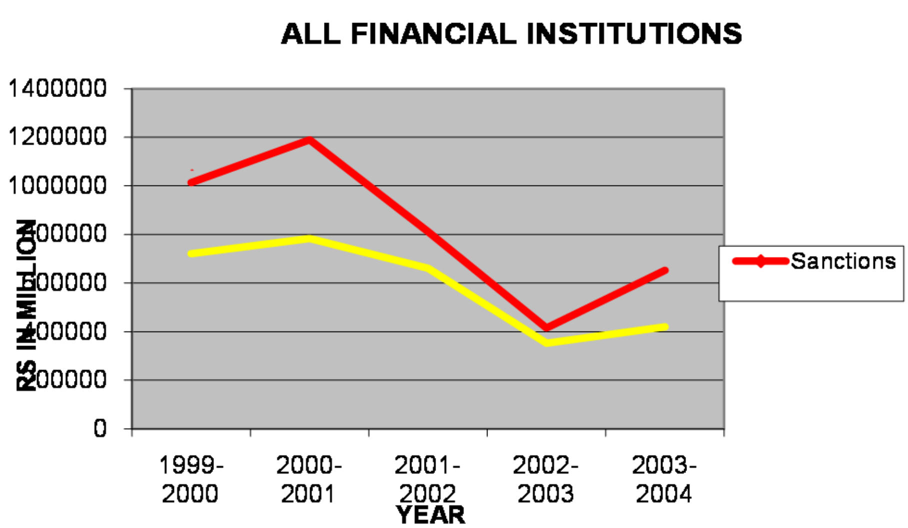
(Data Relate to All India Development Banks and Investment Institutions only)
Viz. IDBI, IFCI, SIDBI, IIBI, IDFC and LIC, GIC, National Insurance Co. Ltd,
New India Ass. Co. Ltd , Oriental Insurance Co. Ltd., United India Insurance Co. Ltd.
Source : Reserve Bank of India



Source : Report on Development Banking in India 2003-04

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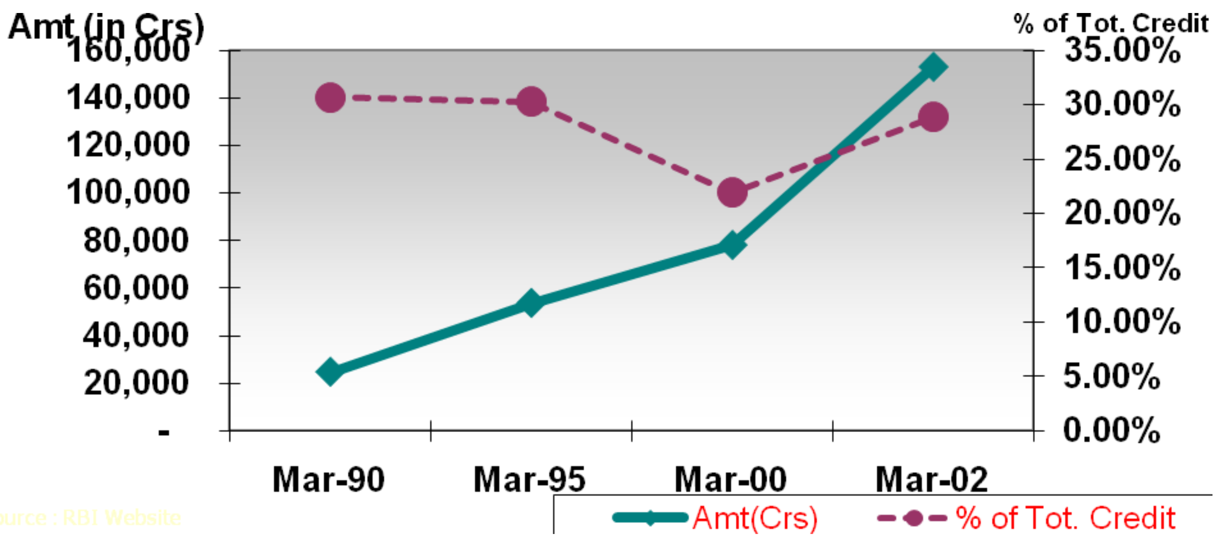
Long Term Loans by Commercial Banks:-



Source : RBI Website

Long Term Loans by AIFIs:-

Source : RBI Website

Comparative Chart – in Rs cr :-

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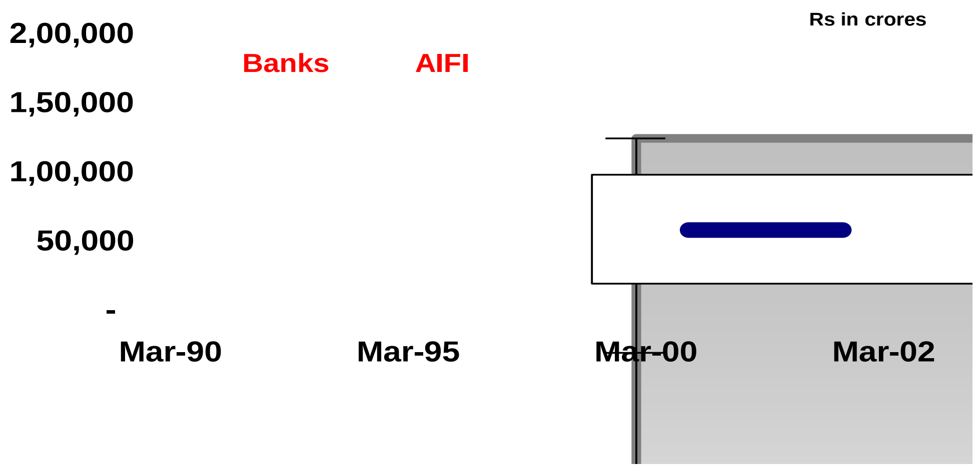

Source : RBI Website

Role of Small Industries Development Bank of India

SIDBI was established in April 1990 under an Act of Parliament as a wholly-owned subsidiary of Industrial Development Bank of India and as the principal financial institution for the following three-fold activities:

Financing the Small Scale Sector

Credit is the prime input for sustained growth of small scale sector and its availability is thus a matter of great importance. The main objective of SIDBI has been to provide short term credit/working capital to small enterprises for its day to day requirement for purchasing raw material and other inputs like electricity, water, etc. and for payment of wages and salaries; and long term credit for creation of fixed assets like land, building, plant and machinery. To ensure that financial assistance is made available to small units on easy terms and with hassle-free procedures it has been a matter of policy in SIDBI to identify the areas of gaps in credit delivery system and fill them through devising appropriate new schemes and implementing them. It provides credit to SSIs through a good network of PLIs spread across the State and in the country

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as a whole under the schemes of indirect assistance in addition to making provision for credit under direct assistance schemes. The assistance under indirect schemes is provided by way of refinance, bills rediscounting, and resource support in the form of short term loans, etc. However, direct assistance is provided under several tailor made schemes through its Regional/Branch offices. The objective behind direct assistance schemes has been to supplement the efforts of PLIs by identifying the gaps in the existing credit delivery mechanism for Small Scale Industries.

Indirect Assistance:

- Loans granted by PLIs for new SSI projects and their expansion, technology up gradation, modernisation, quality promotion etc.
- Loans sanctioned by PLIs to small road transport operators, qualified professionals for self-employment, small hospitals and nursing homes and to promote hotels and tourism-related activities.

Direct Assistance:

- SSI units for new/expansion/diversification/modernisation projects.
- Marketing development projects which expand the domestic and international marketability of SSI products.
- Existing well-run SSI units and ancillaries/sub-contracting units/ vendor units for modernisation and technology up gradation.
- Infrastructure development agencies for developing industrial areas.
- Leasing and hire purchase companies for offering leasing/hire purchase facilities to SSI units.
- Existing export-oriented units to enable them to acquire ISO-9000 Series Certification

Other Specific Assistances:

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- IDBI provides loans for importing equipments to existing export-oriented SSIs and to new units having definite plans to enter into export markets.

- It executes confirmed export orders by way of pre-shipment credit/letter of credit and provides post-shipment facilities.

- It also provides assistance to those small scale enterprises (from its Venture Capital Fund) which use innovative indigenous technology and expertise.

Development and Support Services

The Bank extends development and support services in the form of loans and grants to different agencies working for the promotion and development of SSIs and tiny industries. Over the years, the initiatives of SIDBI under promotional and developmental activities have crystallized into the following important areas:

- Enterprise Promotion with emphasis on Rural Industrialization
- Human Resource Development to suit the SSI sector needs
- Technology Up gradation
- Quality and Environment Management
- Marketing and Promotion and
- Information Dissemination.

Since early nineties, SIDBI along with NISIET, IIE, NECON, and NEITCO have been playing a major role in sponsoring Rural EDP (REDP) and Woman EDP (WEDP) in various parts of the North East including Assam. A wide spectrum of social groups ranging from the uneducated and underprivileged sections to qualified professionals has been benefited from these programmes. Though the nature of contribution of training has been different across different categories of

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trainees, many of the "created entrepreneurs" have made their presence felt in their respective fields of activity in the State.

SIDBI and Micro Credit

SIDBI launched a major project, "SIDBI Foundation for Micro Credit" (SFMC) in January 1999 as a proactive step to facilitate accelerated and orderly growth of the micro finance sector in India. It is envisaged to emerge as the apex wholesaler for micro finance in India providing a complete range of financial and non-financial services such as loan funds, grant support, equity and institution building support to the retailing Micro Finance Institutions (MFIs) so as to facilitate their development into financially sustainable entities, besides developing a network of service providers for the sector. While it is striving to accelerate the credit flow to the Micro finance sector it is working in close partnership with the Micro Finance Institutions in the country. SFMC is also poised to play a significant role in advocating appropriate policies and regulations and to act as a platform for exchange of information across the sector. It has chalked out a strategy for ensuring long term sustainable training inputs to the MFIs in the country. It is in contact with leading academic institutions such as IRMA, XIMB and IIFM to ensure that the scope of their current programmes is enhanced to capture the current trends and meet the demands of the sector. The following programmes are noteworthy and are expected to provide quality manpower to serve the sector:

- IIFM is offering an elective on Micro Finance in its PGDFM programme.
- XIMB is currently offering an elective on Micro Finance in its PGDRM programme and plans to offer a second elective soon.
- IRMA is currently offering a part elective on Rural Finance Management in its PGDRM programme, which has a major focus on Micro Finance.

Role and Steps taken by RBI for the Development of SSI Sector

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Credit to SSI sector is monitored periodically by Reserve Bank of India, Department of SSI and National Advisory Committee of SIDBI, State Level Bankers Committee and District Level Coordination Committees of the Bank.

Initiatives Announced in 1999-2000

a) Launching of A New Credit Insurance Scheme

Inability to provide adequate security to banks and low recovery are often sighted as major constraint in flow of investment credit of SSI units. The problem is more acute for export oriented and tiny sector enterprises. To alleviate this problem, a new credit insurance scheme has been launched.

b) Enhancement of Limit of Composite Loan Scheme

The composite loan scheme of SIDBI and commercial banks is designed to ease operational difficulties of the small borrowers by providing them term loan and working capital through a single window. The limit for composite loans currently at Rs. 2 lakhs has been enhanced to Rs. 5 lakhs.

c) Enhancement of Limit of Working Capital

For SSI units the working capital limit is determined by the banks on the basis of simple calculation of 20% of their annual turnover. The turnover limit for this purpose has been enhanced from Rs. 4 Crores to Rs. 5 Crores.

High Level Committee for Credit

In December 1997, RBI appointed a One-Man Committee under the Chairmanship of Shri S.L. Kapur, former Secretary (SSI), Government of India, to suggest measures to improve the delivery system and simplify the procedures for credit to small scale industrial sector. The Committee submitted its report to RBI on 30th June, 1998. The committee made 126 recommendations out of which RBI has already accepted 40 recommendations for implementation. Some of the major recommendations of the Committee are:

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Special treatment to smaller among small industries;

Enhancement in the quantum of composite loans;

Removal of procedural difficulties in the path of SSI advances;

Sorting out issues relating to mortgages of land including removal of stamp duty and permitting equitable mortgages;

Allowing access to low-cost funds to Small Industries Development Bank of India (SIDBI) for refinancing SSI loans;

Non-obtaining of collaterals for loans up to Rs.2 lakhs;

Setting up of a collateral reserve fund to provide support to first party guarantees;

Setting up of a Small Industries Infrastructure Development Fund for developing industrial areas in/around metropolitan and urban areas;

Change in the definition of sick SSI units;

Giving statutory powers to State Level Inter-Institutional (SLIIC);

Setting up of a separate guarantee organization and opening of 1,000 additional specialized branches; and

Enhancement of SIDBI's role and status to match with that of National Bank for Agriculture and Rural Development (NABARD).

The small and medium scale entrepreneurs in rural areas lack the necessary financial services, especially credit from the commercial banks; this is because they are considered not credit worthy. Consequently they depended on families, friends and other informal sources of funds to finance their businesses. Successive governments have come up with special rural biased programmes, whose principal targets is the overall development of rural enterprises with special consideration on small and medium scale enterprises and also to empower rural dwellers. These programmes range from Agricultural Development Projects (ADPs), the establishment of Agricultural Credit Banks to Better Life Programme for Rural Women and the like. Unfortunately most of the programmes failed to achieve the desired result. That lead to the

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emergence of microfinance banks aimed at extending credits to microenterprises and encouraging entrepreneurship especially in semi urban and rural areas.

Suggestions

1. ***Simplify and streamline regulations and procedures in existing support programmes*.** Regulations and conditions for existing and new enterprise support programmes need to be more transparent and procedures simplified. Bureaucracy should be reduced, decision making accelerated and information made more accessible with respect to enterprise access to funding. An evaluation of the impact of regulations and procedures should be conducted on an annual basis based on feedback from client companies.
2. ***Instigate discussion on the role of banks for local entrepreneurship development***. Local agencies should instigate discussion with regional and local management of all banks and financial institutions on how these bodies can play a stronger and more active role in promoting and providing funding to start-ups and existing SMEs.
3. ***Address weaknesses in business plan preparation and business development***. As a contribution to resolving the problem, the banks might consider producing a guide to business applicants or undertaking some work on establishing 'mentor' panels and 'patron' panels that will guide entrepreneurs while making formal application to banks.
4. ***Help firms to assess their own investment readiness***. Programmes should be designed to address a perceived lack of investment readiness in certain sectors by improving the level of knowledge in firms about their own growth and return potentials and methods of financing. Key features would include intensive working with each company; highly interactive workshops based on role play exercises, and delivered by experienced industry experts like accountants, lawyers, business angels, clearing banks, venture capital firms and corporate finance firms and a free diagnostic investment readiness tool. Such programmes enable firms to asses their own investment readiness, obtain feedback

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on their strengths and weaknesses, their ability to access equity finance, and increase investor interfaces with underinvested sectors.

5. Increase investment readiness and firm access to finance. Programmes that assist small and medium firms in increasing their investment readiness and facilitate access to finance should be primarily concerned to help firms to better access existing sources of funding, rather than creating new funds.

6. Review existing venture capital schemes. The existing schemes of venture capital provision should be reviewed as to their relevance and effectiveness in generating and supporting new companies and growing SMEs. Local agencies should examine, in co-operation with financial institutions, how joint funding initiatives might enable more venture capital to be introduced.

7. Increase development-oriented financing. Development-oriented financing initiatives should be extended from venture capital to other financial instruments, e.g. guarantees, and should be offered to all kinds of entrepreneurs, rather than just technology businesses. Extending existing institutions and instruments should be preferred to developing new ones.

8. Extend micro lending. Develop micro-lending facilities and instruments at a lever which is attractive to private banks. Accompanying this should be appropriate coaching and skills development.

9. Seek the involvement and advice of business angels. A developed venture capital system needs individual investors as well as venture capital funds. 'Angels', that is people who are prepared to invest in individual companies and frequently bring knowledge of the sector or other strategic advice to companies, are common in most OECD countries. They may be people who successfully started a company in the past and may have a series of companies in which they have invested. Often this type of investment is accompanied by mentoring where the individual investor or another nominated

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person acts as a counsellor to the entrepreneur and business. This is particularly important to businesses that are seeking to penetrate international markets or to firms that have ambitious growth plans.

10. Develop programmes to boost the numbers of business angels. The objective of such programmes is to increase the pool of business angel investors and thus boost the supply of equity to small firms. This means recruiting high net worth individuals with relevant business experience and an interest in helping to build, support, mentor and invest in early stage companies with growth potential. Often potential angels are reluctant to get involved partly due to a lack of knowledge about what is entailed and a lack of relationships with existing angel investors. The attraction of "knowledge angels" to pass on relevant processional and business experience to investee companies, without necessarily investing themselves has proved a successful ingredient of such programmes elsewhere. Widespread marketing campaigns can be helpful in increasing a general awareness of and interest for business angels activities.

11. Continue the financing of business angel networks overhead costs on a minimal level.

It is important to ensure that angel networks receive only just the level of subsidy needed to maintain their operation. For the relatively small amount of money required to run an angel network, the public sector can expect to achieve a very high level of leverage on the investment finance raised. The development of incentives to seek commercial sponsorship from firms engaged in the investment process should be discussed. This could include banks, accountants and lawyers, whose involvement will also strengthen the network, helping to introduce deals and new angel investors.

Challenges facing Microfinance Banks

(i) High Operating Cost: Small Units of services pose the challenges of high operating cost, several loan applications to be processed, numerous accounts to be managed and

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monitored, and repayment collections to be made from several locations especially in rural communities.

(ii) Repayment Problem: Loan default is a major threat to microfinance banks' sustainability; it is the deadly "virus" which afflicts the operation of the banks. It demoralizes staff and deprives beneficiaries of further valuable services.

(iii) Inadequate Experienced Credit Staff:

Micro financing is more than dispensing loans, to be viable, microfinance banks require experienced and skilled personnel. As a young and growing industry, there is a dearth of experienced staff in planning, product development and effective engagement with clients.

(iv) Problems of illiteracy, which affects record keeping and decision-making ability of borrowers and consequently affects their relationship with the banks.
(v) Inadequate or non-monitoring of micro and small enterprises by banks, leading to defaults.

Conclusion:-

So in establishing any new business, banks and financial institutions play a important role. They provide the finance as well as Cater the needs of Micro, Small and Medium Enterprises in all the sectors. Since independence the Government of India has nurtured this sector with special care with the following aims: -

- To develop this sector as a major source of employment
- To encourage decentralized industrial expansion
- To ensure equitable distribution of income.
- To mobilize capital investment and entrepreneurship skills

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