The Financial Glitches of SMES: An Empirical Analysis

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Preface

Every enterprise needs finance to carry on its operations and to achieve its targets. The Crux of any industry lies in its ability to manage its financial resources effectively. In today's global business context, enterprises that can streamline their financial resources will undoubtedly benefit the most because finance is so indispensable in the era of globalization that it is rightly said to be the life blood of every Industry. Finance is needed for mainly two purposes i.e. to meet the capital expenditure and for working capital requirement. It needs to be available on easy terms. However, small entrepreneurs, especially in rural areas, do not have adequate resources of their own; they have to depend upon external sources also. Financial management refers to that part of the management activity which is concerned with the planning and controlling of firm's financial resources. Finance which is an essential input in industry helps us to know the level of industrial growth in any economy. Creation of SMEs requires an investment in land, building, machinery etc. The direction and speed of finance influences the pace of growth, the efficiency of production in the industrial sector and improves the quality of output through the application of more efficient production techniques and better layout. It ensures production of quality goods.

Research Design

Research design explores the existing research gap and valuable information to frame need, scope and objectives of the study. Therefore, it helps in carrying out a research plan successfully and provides the empirical and logical basis for drawing conclusion and gaining knowledge in an orderly way. Keeping this in view the present study is designed so that it gives track and systematizes the examination.

Requisite and Scope of the Study

Realizing the significance of Small and Medium Enterprises a separate department has been created in Himachal Pradesh with an objective to facilitate and enhance keenness of SMEs in the state. The new economic policy of encouraging growth of small-scale industries is based on several promotional measures, one of which is financial assistance for exclusive growth in the small-scale sector like interest free loans, exemptions from income tax, relaxation regarding land and building, and raw material at concessional rates, sales tax exemption etc. But even then they are facing many problems related to finance like securities demanded against loans, more time is taken to sanction and disburse the loans, high rate of interest charged against the loan etc. A number of studies have been conducted on the various issues related with small-scale sector but very few studies described the finance related problems of SMEs in a Pre liberalized period and Post liberalized period. Keeping in mind the importance of this factor, the paper presents a thought provoking opinion that the need of the hour is to realize the significance of finance in establishing SMEs.

Objectives for the study

- To analyze the financial structure of Small and Medium enterprises.
- To empirically examine the strategies and problems related to finance.
- To examine the Loan related experience of entrepreneurs.

Sample Design and Size

The information has been collected regarding how the units manage their financial requirement. The secondary data has been collected from various journals, newspaper, encyclopedias and internet websites. The primary data has been collected through the pre-designed questionnaire from the 100 respondents' of industrial units in the two districts and the selected districts for the purpose of present empirical analysis was Solan and Sirmour Districts. These are the two regions of the state which are rich in terms of cultural features and have developed rapidly in industrialization. Keeping in mind these influences, these regions have been prioritized for conducting the research.

Empirical Analysis

Different mathematical as well as statistical tools along with the statistical package for social sciences (SPSS) version 17.0 has been used to sharpen the inferences drawn on the basis of simple description of facts and to analyze the collected data. The findings of the empirical survey have been analyzed as under:

Meeting of the Working Capital Requirement

Major aspect to check the financial status of the units is their working capital status. The Table indicates whether the selected units are able to meet their working capital requirement.

Table 1: Ability to meet the working capital

Ability to meet working capital	Pre Liberalized Period	Post Liberalized Period	Total
Yes	23(72%)	38(56%)	61(61%)
No	6(19%)	30(44%)	36(36%)
No response	3(9%)	-----	3(3%)
Total	32(100)	68(100)	100(100%)

Source: Field Study

The table 1 shows that 61% units are able to meet their working capital requirement and only 36% are not able to meet working capital requirement. Out of 32 units established in a Pre Liberalized Period, 72% are able to meet working capital requirement and 19% are not able to meet working capital requirement and out of 68 units established during Post Liberalized period, 56% are meeting their working capital requirement and 44% are not able to meet working capital requirement. The table indicates that most of the units are in the position to meet their working capital requirement.

Loan from Financial Institutions

Entrepreneurs have to depend upon the external sources like banks and financial institutions for fulfilling their financial requirement. Table 1 highlights whether the units are getting loans or not from the financial institutions.

Table 2: Loan from financial institutions: Period of Establishment

Ability to meet working capital	Pre Liberalized Period	Post Liberalized Period	Total
Yes	23(72%)	38(56%)	61(61%)
No	6(19%)	30(44%)	36(36%)
No response	3(9%)	-----	3(3%)
Total	32(100)	68(100)	100(100%)

Source: Field Study

The table 2 shows that out of 100 units, 75% units are getting loans from financial institutions and 25% units are not taking loans from financial institutions. Out of 22 units which were established in a Pre Liberalized Period, 55% are getting loans from financial institutions and 45% units are not getting loans from them and during Post Liberalized Period 81% units are getting loans from financial institutions and 19% units are not getting loans from them. The table represents that most of the units are taking loans from financial institutions.

Variables affecting to raise the Financial Assistance

In spite of availability of various sources entrepreneurs are not getting easy loans because of various formalities to sanction the loans and to disburse the loans. Table 3 highlights the various factors which effect to raise the financial assistance.

Table 3: Variables affecting to raise the Financial Assistance:

Variables affecting to raise the finance	Pre Liberalized Period	Post Liberalized Period	Total
Cumbersome formalities	9(32%)	39(54%)	48(48%)
Delay in sanctioning the loans	12(43%)	23(32%)	35 (35%)
Non- coop attitude of bank employees	4(14%)	10(14%)	14(14%)
No response	3(11%)	-	3(3%)
Total	28(100%)	72(100%)	100(100%)

Source: Field Study

It is clear from the above table that most of the SMEs are relying on external funds to meet their capital requirement but because of above mentioned reasons they have to face the various problems. From the above table it can be inferred that in spite of the doctrines in the administration in the last two decades, the financial institutions are not able to over-come these problems of delay and complicated procedures.

Time Taken to Sanction the Loans

Financial institutions do not sanction the loan immediately. Entrepreneurs have to wait to fulfill their financial requirement.

Table 4: Time Taken to Sanction the Loans

Time Taken to sanction the loan	Pre Liberalized Period	Post Liberalized Period	Total
Quickly	14(44%)	31(46%)	45(45%)
Slowly	12(38%)	25(37%)	37(37%)
No response	6(19%)	12(18%)	18(18%)
Total	32(100%)	68(100%)	100(100%)

Source: Field Study

The table 4 reveals that 45% units experience that only a few times financial institutions sanction the loans quickly, 37% units observed that these institutions sanction the loans slowly. Figures in the table indicate that the position regarding the finance has not been changed much in Pre and post Liberalized Period. Critical evaluation of this issue indicates that New Economic Policy (NEP) has not changed the position of small scale sector in a great measure.

Loans against Securities

In order to cover their risk of non-recovery of loan amount, financial institutions follow various methods for the safety of the loan sanctioned by them. They demand securities against the loan sanctioned by them. Table 5 shows the result of the response of entrepreneurs of various SMEs regarding whether the financial institutions demand the securities from them when they apply for loans or not.

Table 5: Loans Against Securities: Period of Establishment

Securities demanded to grant loans	Pre Liberalized Period	Post Liberalized Period	Total
Yes	10(71%)	54(63%)	64(64%)
No	4(29%)	32(37%)	36(36%)
Total	14(100%)	86(100%)	100(100%)

Source: Field Study

It is clear from the responses given by most of the SMEs i.e 64% units that these financial institutions demand the securities before sanctioning the loans to these units and this is the problem which is faced by both types of the units i.e. units established in Pre liberalized and Post Liberalized Period.

Disbursement of Loan

Table 6 indicates that after sanctioning the loans, how much time these institutions take to disburse the loans to SMEs. Result has been tested on the three scales i.e instantly, take too much time and after a short span. Mean and Standard Deviation has calculated to obtain the result.

Table 6: Disbursement of Loan in a Pre and post Liberalized period

Disbursement of Loans	Pre Liberalized Period	Post Liberalized Period	Total
Takes too much time	11(30%)	32(51%)	43(43%)
Instantly	12(32%)	7(11%)	19(19%)
After a short span	14(38%)	24(38%)	38(38%)
Total	37(100%)	63(100%)	100(100%)
Mean	1.90	1.98	
S.D	0.60	0.62	

Source: Field Study

The table 6 illustrates the time taken by financial institutions to disburse the sanctioned loans. As it is clear from the above table that one of the major problems faced by SMEs to get the loans from the financial institutions is that they do not only take the time to sanction the loans but also take lot of time to disburse the loans. Most of the SMEs i.e. 61.28% out of total 100 respondent units say that financial institutions take too much time to disburse the loans.

Rate of Interest on loans

Another liability which the SMEs have to bear is the interest on loan charged by financial institutions. Despite time their interest rate also indicates unfavorable conditions for SMEs as the rate of interest charged from them is quite high which is not easy for every unit to pay such a high interest.

Table 7 : Promoters Perception on the Rate of interest

Rate of interest on loans	Pre Liberalized Period	Post Liberalized Period	Total
High	23(49%)	22(42%)	45(45%)
Moderate	16(34%)	20(38%)	36(36%)
Very high	8(17%)	11(21%)	19(19%)
Total	47(100%)	53(100%)	100(100%)

The table 7 shows the rate of interest charged by the financial institutions in granting loan to SMEs. It is clear from the table that out of total 100 units, most of the units respond that these financial institutions charge high rate of interest. This is also a big problem faced by SMEs as they are not able to prepare themselves for taking financial risks due to high rate of interest on the loan.

Impact of Higher Rate of Interest

As the rate of interest is high on the loans, so in order to cover that or to maintain their profitability position SMEs follow different policies which are clear from the table below:

Table 8: Impact of High Interest Rate

Impact of High Interest Rate	Pre Liberalized Period	Post Liberalized Period	Total
Reduce the operating cost	8(23%)	14(22%)	22(22%)
Increase the selling price	15(43%)	20(31%)	35(35%)
Other policies	2(6%)	3(5%)	5(5%)
No response	10(29%)	28(43%)	38(38%)
Total	35(100%)	65(100%)	100(100%)

Source: Field Study

It is clear from the table 8 that out of total units 35% of the units increase the selling price and reduce the operating cost to recover the rate of interest. Same status is in the both type of units individually also which shows that on an average 45 to 50% units cover up their rate of interest by increasing the selling price and controlling their operation cost.

Outcome and Suggestions

Besides, the changes in the economic policy the entrepreneurs are facing the various procedural formalities of those institutions which provide financial assistance. Due to these constraints entrepreneurs rely upon the private banks and these obstacles lead to their dependence on the traditional sources. So the study reveals that primarily entrepreneurs do not have sound financial base that results into insufficient amount of capital of their own. The results indicate that there should be proper management of finance. To check the deteriorated condition of liquidity it is strongly recommended that internal source of finance must be generated from favorable fund by making operation a profitable venture. To surmount financial difficulties, the units must strengthen their internal resources of finance. Hence the proven fact is that SMEs need systematic and sound financial structure to grow. Dependency on external sources to meet finance requirements should be minimized so that SMEs able to generate funds from internal sources, which helps them in breaking the vicious circle of financial stringencies.

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