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The Role of Credit Rating Agencies Affecting MSME Financing-Gaps and Merits with Analytics

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ABSTRACT

Micro, small, and medium-sized enterprises (MSMEs) are vital to a nation's economic growth. They need finance to expand, update, diversify, and finance their regular business operations. For now, most financial institutions and banks pay them no attention. This research aims to identify the critical determinants of MSMEs' success in Telangana, including those external to the sector and internal to the company. In this research, we use multiple regression analysis as one of the main statistical tools for comparing MSMEs' performance across the study period. For this reason, research was carried out to discover the obstacles faced in Telangana in micro, small, and medium-sized enterprises (MSMEs). Findings emphasize the importance of capital investment to MSMEs over manpower. This study is novel and will be of great interest to many people. The current position of micro, small, and medium enterprises (MSME) in Telangana is of interest to a wide range of participants.

Keywords:Credit rating, Finance, MSME, Banking, Analysis

1. INTRODUCTION

Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. Their profitable, effective, adaptable, and innovative mentality as business owners is a major factor in the economy's growth. The micro, small, and medium enterprise (MSME) sector accounts for a disproportionately large part of industrial output and exports and is recognized with delivering the strongest employment growth in the country. They ensure a more equitable distribution of national income; facilitate an effective mobilization of resources of capital and skills which might otherwise remain underutilized; and stimulate the growth of industrial entrepreneurship. Their advantages stem from their size, labor-capital ratio, gestation period, focus on smaller markets, investment needs, and market size. There is a wide range of sizes of enterprises, types of goods and services offered, and technological sophistication in India's micro, small, and medium rigid sector. It's a huge boon to the country's economy and social growth because it supports major industries as enabling elements. Considering their reliance on supply contracts from international companies and other large purchasers, they must make adjustments to remain competitive. This places a heavy burden on micro, small, and medium-sized enterprises (MSME) to manage costs and quality while adhering to various standards.

1.1 Financial Management in MSMEs:

Production, distribution, and development rely heavily on financial resources. Most of the capital used by these smaller enterprises comes from within the organization, in the form of either retained earnings or borrowed money. Less money is dispersed through banking and government channels. The process of obtaining a loan from a commercial bank or a government agency is fraught with difficulties for entrepreneurs with small enterprises. The state financial corporation takes several months to decide whether to issue term loans based on the information and documents it requires. In the banking industry, guarantees are standard procedure, but the small business sector cannot provide them. Most entrepreneurs who are illiterate or semiliterate avoid applying for small loans through government organizations due to their onerous application process.

1.2 Scope Of the Study:

This study analyzes the contribution of MSMEs since the enactment of MSMED to the industrialization of Telangana, increasing production output, improving employment generation, and creating capital assets through channeling investment. We collected the data we need from reliable secondary sources, such as MSME annual reports, RBI instructions, and academic journals. To assess the role played by MSME in Telangana, we studied data on the state's industrial infrastructure, employment, and investment in these companies.

1.3 Research Hypothesis:

According to this study, there are number of independent and dependent factors affecting the performance of MSMEs units. For this study, a model has been developed that aims to describe factors influencing MSMEs and challenges that they are facing while conducting their business. Therefore, formulate two research hypotheses which are explained in the following sections.

2.0 LITERATURE REVIEW

Ayeni-Agbaje et al. **[1]** analyzes the role of banks in SME growth, finds a favorable association between bank loans and SME expansion, and recommends that commercial bank lending schemes and rules be made more accommodating to small and medium-sized enterprises. Dr S.S.Jeyaraj & Dr.A. Prakash **[2]** investigated and analyzed how borrowers felt about BDFCL's lending services. The majority of borrowers are only somewhat satisfied with the services offered by banks, according to the data obtained from consumers. I Quaye, E Abrokwah et al. **[3]** investigated into potential solutions to Ghana's financial challenges. The objective was to identify the specific mechanisms through which microfinance institutions help to close the funding gap faced by small and medium-sized enterprises. Based on the results, the study suggests that MFIs improve their service delivery channels and establish long-term partnerships with small and medium-sized enterprises. Javed G Hussain et al. **[4]** researchers used primary data and found that Chinese SME owners depend more heavily on family support and less on financial institutions for financing, while their British counterparts rely more heavily on financial institutions for financing and rely less on savings. The research finds that in order to narrow the funding disparity, these two nations' financial systems need to be improved. Maumita Choudhury &Chandana Goswami **[5]** Comprehensive literature reviews were conducted for the years 2005-2016 to investigate the problems with institutional lending to MSMEs. Bank competition for new MSME borrowers, government regulation, bank credit policies, a lack of data on small and medium-sized enterprise (SME) borrowers, and the nature and scale of the business are all important considerations when making loans to these enterprises.Mr Abhijeet Biswas et al. **[6]** Using primarily primary data, this study investigates what causes the financial gap in the micro, small, and medium enterprise sector and concludes that reducing the information gap between borrowers and lenders is important.Purnima Rao et al **[7]** brings attention to the actual problems faced by SME proprietors in the present. Using a convergent interviewing approach, we discover that the complexity of lending institution procedures, information asymmetry, the high cost of credit, and a lack of creditworthiness are the primary causes of the financing gap. There is a lag period between loan application submission and funding, and there are issues with the collateral requirements.Touheda Yasmin Chowdhury et al **[8]** investigated the challenges that female business owners encounter while attempting to secure financing from commercial banks. Exploratory factor analysis was used to analyze data acquired from women business owners in Sylhet, Bangladesh. The research shows that women business owners are less likely to apply for bank loans due to concerns about the cost of obtaining financing, the terms and conditions of the loan, the security of the collateral, and the quality of their personal relationship with their bankers. Tagoe et al. **[9]** Utilizing six different companies, this study looks at how financial sector liberalization (FSL) laws have affected MSMEs' management of their finances in Ghana. To better understand the effects of FSL and the processes at play, their findings, which support and extend the conclusions of prior studies, are incorporated into a framework. Getting cheap loans for a suitable time period is the biggest problem for small and medium-sized enterprises. Berger and Udell **[10]** proposed a broader theoretical basis for studying credit constraints faced by micro, small, and medium-sized enterprises. According to this model, cutting-edge technologies are the primary medium via which governmental policies and national financial structures influence access to credit. The causal chain from policy to financial structures influences the viability and profitability of various lending technologies. In turn, these innovations have substantial consequences for the accessibility of finance for micro, small, and medium enterprises. Thampy **[11]** Explain briefly how the lack of access to capital is preventing the critical Indian small and medium enterprise (MSME) sector from expanding. In this article, we take a look at some of the biggest problems plaguing small and medium-sized business finance in India. Concerns have been raised about whether transaction lending alone would be sufficient to handle the information difficulties, or whether lending would have to be based on a relationship with the SME, given the knowledge asymmetry between banks and SMEs. How much the availability of lending to SMEs is impacted by the size and location of the bank. M. Mungaya, A. H. Mbwambo et al. **[12]** have discussed that similarity between the stylized patterns of MSMEs financing in other parts of the world with that of Malaysian MSMEs is something that the study would attempt to investigate. Using descriptive analysis, findings of the study showed that the MSMEs in Malaysia are no less different from the rest of their counter parts.

3.0 METHODOLOGY

The data has been collected from secondary sources. As secondary information, the handbook of RBI reports is used, wherever necessary, as well as reports from government and non-governmental organizations. This paper examined the importance, contribution and development potential of micro, small and medium enterprises in Telangana.

Quantifying financing gaps involves determining how much financing products should have been provided to projects and SMEs that are considered financially viable, if the market conditions were optimal (meaning these projects / SMEs would have been able to pay back a loan or generate value with the equity financing obtained if the supply of financing would have covered the demand). In the context of this gap analysis study, the following estimates have been necessary to define: ◎ The number of SMEs that have difficulty seeking finance (both debt financing, and equity financing), when such challenges should not exist. Later in this study, these SMEs are considered as 'viable but unsuccessful' (for debt finance) or 'unsuccessful' (for equity finance); and ◎ The average amount of financing these SMEs would have requested / received if they had completed and filed their application with the financier, or if they had obtained their financing fully or with 'acceptable' conditions (for each type of financing). These estimates are primarily designed to give an idea of what additional financing should be available / accessible in a given market, especially with the assistance of financial instruments (whether the latter mobilize ESI Funds or not), as certain assumptions are involved.

Method: In this section of the paper, we use multiple regression analysis as an explanatory multivariate technique to analyze correlations between variables and establish the validity of the model. The study spans 7 years between 2015 and 2022.

Table 1: Details of MSMEs units, capital investment and No. of Employee

Year	No. of SSI/MSMEs	Capital Investment (Rs. In Lakh)	No. of Employee
2015-16	4710	29551	23301
2016-17	4806	22792	20996
2017-18	4907	29234	23195
2018-19	5016	38502	24451
2019-20	5505	5073	30387
2020-21	5931	43290	27104
2021-22	7009	66941	32136

Thus, we choose capital investment and number of employees as independent variables and MSMEs unit as a dependent variable. Regression is generally used to explore the relationship between two or more independent factors. An analysis of the covariance between MSMEs unit and capital investment, and number of employees, is conducted using a multiple regression statistical model defined as follows:

pital investment, and number of employee, we use a multiple regression statistical model defined by: Y = b0 + b1x1 + b2x2+……..+bnxn+ ε,

Where: Y= the explained variable;

x1= the explanatory variable 1;

x2= the explanatory variable 2;

n= number of observations

b0b1……..bn= Model parameters.

ε = specification error, unknown (the difference between the true and the specified model);

4.0 RESULTS AND ANALYSIS

Multiple regression analysis was done to look at the associations between the different factors. Typically, a statistical analysis would involve looking into how some variables act and then creating some sort of model to describe the dynamics at work. Furthermore, the level of confidence that the right relationship is roughly the estimated relationship must be assessed in order to assess the statistical significance of the proposed relationship.

Table 1.1 **One-Sample Kolmogorov-Smirnov Test**

		No. of SSI	Investment made	No. Employment
N		14	14	14
Normal Parameters[a,b]	Mean	4840.79	29205.14	22928.21
	Std. Deviation	861.324	14800.882	4702.388
Most Extreme Differences	Absolute	.205	.276	.111
	Positive	.205	.276	.111
	Negative	-.104	-.174	-.092
Kolmogorov-Smirnov Z		.767	1.034	.416
Asymp. Sig. (2-tailed)		.598	.235	.995

Source: SPSS output

Table 2: Coefficients

Model	Unauthorized coefficients	Std.error	Standard coefficient	t	Significance
Constant	23989.9	653.8		3.656	0.004
Investment	0.0378	0.0139	0.649	2.700	0.021
Employment	0.0589	0.044	0.32	1.336	0.21

Table 3: ANOVA

Model	Sum of squares	df	Mean square	F	Significance
Regression	877718880.029	2	4385944.02	55.3	0.001
Residual	872538.326	11	73921.67		
Total	96.44426.36	13			

The above SPSS output table for the co-efficients provides information about the parameters (the value) and their significance. Therefore, b0 equals 2389.916, and this can be understood as follows: the model anticipates the deployment of 23989 units (numbers were our unit of measurement). The table also tells us that b1 equals.038 and b2 equals.059, both of which reflect the gradient of the regression line. It is more helpful to consider of this number as expressing the change in the associated with a unit change in the predictor, even if it represents the slope of the regression line. Our model estimates a 0.038% rise in MSME output for every unit increase in our independent variables. The model indicates that growth of 38 additional units can be expected for an additional investment of Rs 1 lkh. Assuming this significance level is smaller than.05, scientists generally accept that the data are indicative of a real effect. The significance levels for these two numbers are less than.05:.004 and.021. Since the values are non-zero, we can infer that the independent variable (capital investment) plays a non-negligible role.

Most influential factor on performance of MSMEs

Two factors are found to have significance relationship with performance of MSMEs, there are MSMEs units and capital investment with p-values less than .05. Thus, MSMEs have to focus on these factors in order to enhance their performance.

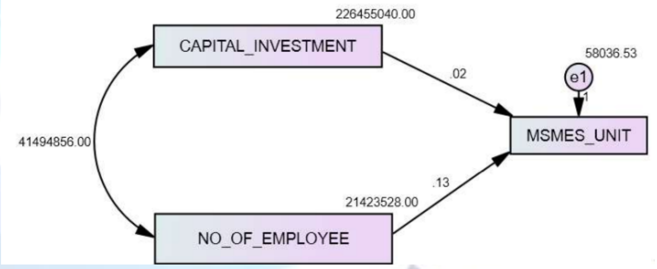

Figure 1: Influential factor on performance of MSMEs

The findings show that capital investment has a greater impact on MSMEs than does the size of the workforce. Multiple research that has examined the connection between entrepreneurial aspirations and the SME market have reached the same conclusion. Opportunity recognition requires motivation to turn into action. In addition, research on the link between capital investment, job creation, and the financial success of micro, small, and medium-sized enterprises (MSMEs) finds that the former has a greater impact than the other.

5.0 CONCLUSION:

MSMEs are facing more credit-related problems compared to large businesses. Banks and financial institutions expect transparent information regarding the financial position of the firms to extend credit. The operation of MSMEs in an informal environment leads to information asymmetries between the MSME and the banker. This increases concerns about the reliability of the company's finances. A lot of thought has been put into solving this problem in other countries. Small and medium-sized enterprises (MSMEs) are crucial to the success of India's economy. Most micro, small, and medium-sized enterprises (MSMEs) rely on internal funds rather than external sources of funding. Extreme competition from major companies is a problem for MSMEs because of factors such as the withdrawal of subsidies, a lack of infrastructure, anti-dumping policies, difficulties with product standardization and complete quality control, and so on. With the support of capital investments, the small and medium-sized enterprise (SME) sector was studied in depth for its potential to increase employment. Therefore, entrepreneurs have to focus these factors to enhance their performance. There are number of factors impact on MSMEs performance has made significant contribution to set up MSMEs sector and also develop rural industrialization is ideally suited to build on the strength of our traditional skills and knowledge by the use of technology. It is very good and healthy sign towards progress and prosperity of Telangana.

Suggestions:

To reduce the finance gap, the bank should change the mindset of top management to extend finance to the MSME sector and train credit officers with suitable courses to deal with MSME businesses. RBI should specify the proper guidelines regarding the collateral requirements. Govt. should develop an alternative source of financial schemes to promote this sector. Satisfaction of the borrowers mainly depends upon the attitude of the bank staff, rate of interest and rate of subsidy by the banks, the commercial banks should take necessary steps to resolve these issues.

Conflict of interest statement

Authors declare that they do not have any conflict of interest.

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