ARIV
International Journal of Business
Paper ID: AIJB12052020 Vol1 Issue 2 2020

Financing-Role of Banking Sector in Entrepreneurship Development in India and the Problems Therewith

CA Amit Nath
Senior Faculty, Techno India University, Kolkata, West Bengal

Abstract

The main objective of this study is to identify the role played by the banking sector in the development of entrepreneurship in India and to search the problems faced by entrepreneurs in obtaining the loans from the banks for their startups/expansion and the major difficulties faced by the banks towards sanctioning and recovery of the loans. The study is conducted on young pass outs who want to start up their own business, young entrepreneurs who have just started their own business and bank authorities of certain banks. It is also based on secondary data which is collected through newspaper, websites, magazines and journals. The findings of this study shows that banks play a major role in entrepreneurship development by not only financing the capital required for startup or expansion of the existing business or financing the day to day operations in the form of long term loans, medium term/working capital loans, cash credit, overdraft etc. only after proper verification but also support entrepreneurs in selection of business proposal, preparation of Techno economic viability report, market survey to know the demand of their products, training required for their startups, obtaining government clearance, purchase of machinery & tools and sales of products/services. The study recommends that more financial institutions should come up with low interest rate, flexible loan schemes and more support for the development of entrepreneurship in India. The entrepreneurs can also opt for gold loans where loans are easily available without much documentation.

Keywords: Project financing, Role of Banking sector, Entrepreneurship development, Bank loans

Introduction

Many educational institutions in India including IIM encourages young students to begin their career by starting their own business/new ventures rather than working under the control of others or doing job in a company owned by others. In order to achieve this, the b-schools are nowadays developing the entrepreneurship skills in their students by including “Entrepreneurship skills development” as part of their syllabus where students from different streams i.e. engineering, MBA-finance, MBA-Marketing, MBA-HR, B.com etc. come together with a new idea of business by presenting their business models in details in front of financers/banks. Even the Government of India is also encouraging young Indian talents to undertake ventures as entrepreneurs provide products and services to the society, create employment opportunities, generate taxes for the Government and thus are responsible for financial growth of the country. But, the major problem faced by the startups/ young entrepreneurs in expansion of their existing business is the arrangement of required funds both for capex (procurement of fixed assets) and opex(day to day operational expenses). Bank plays a major role in entrepreneurship development by financing the required funds and providing necessary guidance, but they demand variety of information in the form of documentation and also need collaterals as security. Banks also face problems while granting and recovery of loans.

Research objectives

The main objective of this study is to identify the role played by the banking sector in the development of entrepreneurship in India and to search the problems faced by entrepreneurs in obtaining the loans from the banks for their startups/expansion and the major difficulties faced by the banks towards sanctioning and recovery of the loans.

Literature Review

Sushmitha. R. Shetty, Swathi Bhat, Abhinandan, performed a study on the role of financial institution in Entrepreneurship development and their study was purely based on secondary data which was collected through magazines, journals and various other sources of secondary data. On the basis of the findings, it was recommended that government and financial institutions including the World Bank should develop a strong holistic approach to program and schemes created by them. All administrative bottlenecks and stringent conditions which make funds inaccessible to SMEs should be removed by the authorities and the banks.

Misal dilip m, performed a study on “role of financial institution and commercial banks in entrepreneurship development in India”. On the basis of the findings, the conclusion made was that major difficulties faced by entrepreneurs include lack of finance to start a business. Entrepreneurship can be cultivated among the present youth and it can be developed systematically with the help of Banks and financial institutions. There are today a large number of financial institutions like Industrial Development Bank of India, Small Industries Development Bank of India, and various commercial banks provides financing needs of entrepreneurs. A financial institution performs a wide variety of promotional activities for new entrepreneurs. Access to finance represents one of the most significant challenges for entrepreneurs and for the creation, survival and growth of small businesses. Indian Commercial Banks have established an Entrepreneurship service call to provide consultancy services to prospective entrepreneurs. In addition; commercial banks also assist new entrepreneurs in selection of venture, preparation and evaluation of project report, market survey, and training at different levels, obtaining government clearance, procurement of machinery and equipments and marketing of products of the enterprises.

Qazim Tmava, Gazmend Luboteni, Florin Peci performed a study on, “The Role of Banks in Small and Medium Enterprises Financing: A Case Study from Kosovo”, and concluded that there is mutual correlation among the firm’s age, size, business plan, sector, number of owners, sources of financing and the investment growth financed from banks in Kosovo. The access to external sources of financing through bank loan is an important factor that influences the investment growth.

Oshiobugie O. Bruno, Okoh Lucky performed a study on “Impact of banks and other financial institutions in enhancing the growth of entrepreneurial development: an empirical study of south-south nigeria” and concluded that positive and significant relationship exists between banks and other financial institutions in providing loans to promote entrepreneurship development in South-South, Nigeria. Another finding revealed that positive and significant relationship exists between banks and other financial institutions in providing advisory services to promote entrepreneurship development in South-South, Nigeria. It was concluded that banks and other financial institutions play a very significant role for the performance and survival of entrepreneurs in South-South Nigeria.

Methods of Analysis

The study is conducted on young pass outs who want to start up their own business, young entrepreneurs who have just started their own business and looking for expansion and Bank authorities of certain Banks in India.

Data Collection Method

In order to meet the objectives of the study, the data has been collected from primary data and secondary Data. To get primary data for the analysis, discussions were done with young pass outs who want to start up their own business, young entrepreneurs who have just started their own business and looking for expansion in India. Interviews were conducted with owners/managers, or financial managers of the organizations and Bank authorities of certain Banks. Therefore, the research question in this study is: “Problems faced by both entrepreneurs and banks in sanctioning of the loans”. The data collected from such discussions are analyzed in this study.

Questionnaire

The questionnaire contains four major parts. The first section included data about the students who are looking for startups and owner/manager of the organization who are looking for expansion along with the data about the organization. So, the first section included data like qualification of students /owners/managers, location, type of activity like the product/service to be offered/ already offered by their organization. Second section included the data regarding amount of investments, sources of investment, debt equity mix. Third section included the data i.e. name of the bank approached by them for getting the loans and lastly the problems faced by them in getting loans. Similar questions were asked by bank authorities of certain banks in India.

Secondary Data

For getting secondary data different sources were used, which are-

- Newspaper
- Websites
- Magazines and journals

Data analysis and results

As per the study made by collecting the primary data from bank authorities of certain banks and secondary data, Bank plays an important role in the entrepreneurship development. Let us understand the process from the data collected-:

The three parties involved in finance functions are-:

1. Depositor
2. Financial intermediary i.e. Bank
3. Borrower/entrepreneur

Depositor → Bank → Borrower/entrepreneur

Depositor is the person who has surplus money and who wants to deposit his money for security purpose and with the objective of earning income in form of interest.

Bank is the financial intermediary who accepts deposits from depositors and provides interest to the depositor in return and use that deposit to provide fund to the entrepreneur and in return charge interest and processing fees from entrepreneur. This processing fees and interest spread is income for Banks.

Borrower /entrepreneur are the persons who want to start up their business or expand their existing business and needs capital to do the same. They approach to the bank for their need and bank after performing certain formalities grants loan to the borrower for which borrower has to pay processing fees and interest etc. to the banks.

Now, the question is why borrowers don't take money directly from depositors. The answer is depositors apart from getting income from their surplus funds also needs security of their funds which can be provided by banks only as they grant loan to the borrowers only after proper verifications, ascertaining the debt repayment capacity of borrowers and taking collateral as security. So, we can say that banks facilitate the process of economic growth across all sectors of the economy by financing entrepreneurs' production, consumption and commercial jobs. The numerous ways by which banks may lend funds to entrepreneurs are long term loans for funding capex(purchasing of fixed assets), cash credit, overdraft, working capital loan, medium term loans, bill discounting, factoring for funding opex(day to day operational expenses). The banks also play a major role in entrepreneurship development by organizing and sponsoring entrepreneurship education and training program. The study shows that SBI launched entrepreneurship development program and implemented a scheme of financial assistance to technically qualified entrepreneurs. SBI has also set up Research and Development Fund for development of entrepreneurship. Banks also support entrepreneurs in selection of business proposal, preparation of Techno economic viability report, market survey to know the demand of their products, training required for their startups, obtaining government clearance, purchase of machinery & tools and sales of products/services. Thus, we can say that banks play an important role in the development of entrepreneurship.

Problems faced by Entrepreneurs in borrowing the Loan

- **Misconception of the business plan**: A business plan is very important for getting loans from the banks. An entrepreneur must be very clear about his business plan. Banks need the TEV (Techno Economic Viability) report which clearly tells about the business plan and feasibility of the project. The entrepreneur has also to prepare the financial projections report so that bank can know the profits earned and how their interest can be paid on time. Bank is also interested to know the sources and applications of fund. Bank is also interested to know the cash flows and various financial ratios in order to ascertain the risk associated with the grant of the loan. As a fresh graduate, entrepreneurs may face problem to prepare the same due to technical complexities. So, they take the help of consultants but there can be misconception of the business plan between what entrepreneur has interpreted and what the consultant has drawn. In such case, owners fail to interpret his/her own business plan, or the bank officials fail to do so the way the owner does. This reduced their capability to negotiate with banks for loans.
- **Books of accounts not properly maintained**-: Bookkeeping and proper accounts should be maintained to get loans from banks. There are some pre operating expenses whose record should also be properly maintained by the owner. Due to lack of technical or accounting skills there may be unavailability of proper financial records which can act as a hurdle in borrowing loans.
- **Books of accounts not audited-:** Banks rely on audited financial statement which are certified by a practicing-chartered accountant. Lack of this can act as a hurdle in granting of loans by the banks.
- **Unavailability of proper documents**-: Banks require many documents such as PAN of owner, MOA & AOA of company to be formed by the owner, Personal net worth of owner, list of directors, their qualifications, the net worth of directors, quotations of fixed assets to be purchased etc. Unavailability of proper records can act as a hurdle in borrowing loans.

- **Inadequate collateral security**-: For risk coverage, banks expect collateral security from the owners. Small entrepreneur lacks assets that can be accepted by banks as collateral due to poverty.
- **Non- viability of TEV report**-: Banks grant loan only on the basis of Techno economic viability report. On the basis of this report, they judge the efficiency of the business and capability of the business to generate profit for repayment of interest and principal portion. If the banks are not satisfied about the viability of the project, there are chances that the loan gets rejected.
- **Non availability of guarantor/lack of connection**-: Banks also need guarantor or good connections so that their money is guaranteed in case of business failure. Young entrepreneurs sometimes lack to arrange guarantor due to inability to network which again create hurdle in borrowing loans.
- **Inadequate profitability-:** Banks are very much interested to know the profits earned/to be generated by the entrepreneur as this is the source of income to repay the loans. If the profits are not satisfactory/ adequate, Banks don't sanction the loan.
- **Inadequate ratios-:** Banks are also interested in ratios like debt/equity ratio, current ratio, debt service coverage ratio, interest coverage ratio, gross margin ratio which if not found satisfactory or adequate can lead to problem of non-sanctioning of loans.
- **Sanctioning of fewer amounts as compared to the amount of loan applied for-:** Generally, bank always ask for owners fund before granting loans so that the owners get involved in the business seriously. This is known as debt equity mix. Depending upon the risk, banks do not agree to the amount applied for. Also, if banks found that the project amount is overstated then they agree for lesser amount of loan than required by the owner that can create problem for the entrepreneurs.
- **Untimely disbursement of loans-:** Even if the loan is approved, sometimes it is not disbursed on time which has its impact on the economic viability and desirability of continuance of the project.
- **High cost involved in proving of credit worthiness-:** In case entrepreneurs approach banks for loans for expansion of business, banks ask to hire credit rating agency to know the credit worthiness of the organization which can be costly.
- According to the primary data collected from young entrepreneurs, some of them faced the problem of poor response from banks, some found the procedure to be too complicated and some were discouraged by the high rate of interest.

Problems faced by Banks in granting and recovering loans

- **Utilization of funds for different purpose-:** It may be possible that entrepreneurs may utilize the funds for a purpose that may be entirely different from the purpose as mentioned in the project report or proposal form.
- **Default in repayment of Loans**-: Bank only after proper verification and after ascertaining the repayment capacity of borrower sanction loan to them. But, it may be possible that due to adverse conditions or false information given by the borrower, the loan gets converted into NPA (Non-Performing Assets). That is the biggest risk associated with sanction of loans.
- **Inadequate collateral security/guarantor default**-: Collateral security is a security given to the bank by the borrower in the form of property like land, shares, FD etc., so that the bank can recover the loan amount in case of default by the borrower through the process of auction after seizing the property. Similarly, guarantor is a person who guarantees to repay the loan in case of default by the borrower. In case, if banks grant loans without adequate collateral security or guarantor or without ascertaining the net worth of guarantor properly then it can face severe problems in recovery of loans.

Recommendations

The young entrepreneurs must patiently understand all requirements by the banks and must be very thorough in compliance. Then, only they would be able to obtain loans from banks smoothly. Banks should also assure that timely disbursement of loan is made, once it has been approved. There is requirement that more financial institutions should come up with low interest rate, flexible loan schemes and more support for the development of entrepreneurship in India. The entrepreneurs can also opt for gold loan where loans are easily available without much documentation. Banks should also be little cautious in granting loans to reduce NPA level. Bank should also keep vigilance over the expenditures and incomes of entrepreneurs even after financing to ensure that funds are being utilized in business properly which is possible only when a proper monitoring system on credit administration and utilization is being established in the banks.

Conclusion

Students and young generations are the future of any country and various steps are being taken by the colleges, educational institutes and Government to develop entrepreneurship qualities among them. But the growth of entrepreneurship won't happen unless and until banks are involved in that. Banks plays a major role in entrepreneurship development by financing the capital required for startup or expansion or financing the day to day operations in the form of long term loans, medium term/working capital loans, cash credit, overdraft etc. only after proper verification of records and finding the plan viable. Banks also support entrepreneurs in selection of business proposal, preparation of Techno economic viability report, market survey to know the demand of their products, training required for their startups, obtaining government clearance, purchase of machinery & tools and sales of products/services. Some banks make unnecessary delay in sanction of loans, or they sanction inadequate amount or disburse the loans untimely. The licensing of new and private banks in the financial market has now increased the competition between the existing banks and has improved the conditions of financing of loan to entrepreneurs with the interest reduction, increase of the moratorium period, relaxations in collateral.

References

Misal dilip m, “role of financial institution and commercial banks in entrepreneurship development in India”, international journal of economics and business modeling issn: 0976-531x & e-issn: 0976-5352,volume7,issue 1,2016, pp.-265-267 https://shodhganga.inflibnet.ac.in/bitstream/10603/115698/5/05_chapter%202.pdf

Oshiobugie O. Bruno, Okoh Lucky. “Impact of banks and other financial institutions in enhancing the growth of entrepreneurial development: an empirical study of south-south nigeria”, Journal of Policy and Development Studies Vol. 9, No. 2, February 2015, ISSN: 157-9385

Qazim Tmava, Gazmend Luboteni, Florin Peci , “The Role of Banks in Small and Medium Enterprises Financing: A Case Study from Kosovo, International Journal of Economics and Finance; Vol. 5, No. 12; 2013, ISSN 1916-971X E-ISSN 1916-9728,Published by Canadian Center of Science and Education

Sushmitha. R. Shetty, Swathi Bhat, Abhinandan, ‘The Role of Banks in the development of entrepreneurship in India’IOSR Journal of Business and Management (IOSR-JBM) e-ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 20, Issue 7. Ver. I (July. 2018), PP 71-74