1.1 INTRODUCTION

Small and Medium Enterprises and a sound banking system play a pivotal role in the growth of a nation’s economy. Small and Medium Enterprises occupy a crucial stage in the development of an economy by providing large employment opportunities at comparatively lower capital cost than large industries. Further, it helps in the industrialization of rural and backward areas, thereby reducing regional imbalances and assuring equitable distribution of national income and wealth. World Bank has reported that industrial development was earlier believed to have occurred because of large enterprises, but starting in the late 1970’s, SMEs have been perceived as the last key agents for industrialization. Micro, Small and Medium Enterprises are crucial for sustainable economic growth as they contribute a sizeable share to GDP. This sector contributes on an average 49 % to GDP in high income countries and 29 % in low income countries. World Bank report 2010 has revealed that in all the economies SMEs are perceived as a growth engine. The strength of this sector lies with their widespread dispersal in rural, semi-urban and urban areas fostering entrepreneurial base, shorter gestation period and equitable distribution of income and wealth. Micro, Small and Medium Enterprises across the world, including India are the vehicles for sustainable and overall inclusive growth. In India, nearly 8 % of the country’s GDP is contributed by Micro, Small and Medium Enterprises. The Ministry of Micro, Small and Medium Enterprises report that SMEs contribution constitutes 45% of the manufacturing output and 40% of the exports. They provide largest share of employment next to agriculture in India.

SMEs have emerged as a dynamic and vibrant sector of Indian economy. Less capital intensive and high labor absorption nature of SMEs have made significant contribution to employment and also to rural industrialization. In India, Micro, Small and Medium sector has become a founding pillar of its socio-economic framework. SMEs constitute the dominant form of business organization across the world. Out of total enterprises, 99 % in European Union and about 80% in USA constitute Small enterprises. In India its share is as high as 97%. In China Small and Medium

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1 World Bank report 1994  
2 Ayyagari, Beck and Demirguekunt, small and medium enterprises across the globe, small business economics2007, 29; 415-435  
4 Pakia Lakshmi, The performance of SSI's in India, Market survey, Dec 2013
Enterprises number 42 million accounting for 99.8% of enterprises. SMEs account for more than 98% and 99.9% of business in Hong Kong and Korea respectively. Similarly, they account for 99% of business in Malaysian and Singapore while it is 97.7% of total business in Taiwan.\(^5\)

A growing economy needs the support of financial structures which is responsive to the needs of development. In this Context banking system occupies an important place in a nation’s economy. A banking institution is indispensible in modern society. It plays a pivotal role in the economic development of a country. Among the banking institutions in the organized sector, the Commercial Banks are the oldest institutions having a wide network of branches, commanding utmost public confidence and having major share in the total banking operations. In India, in the process of financial deepening, Commercial Banks have shouldered special responsibilities for meeting the needs of diverse sector of the economy at various stages of development. Commercial Banks are the largest contributors of institutional finance in most of the countries and in India, a place of pride can be assigned to them in extension of credit to various segments of the economy.\(^6\)

Banks are perceived to be the key factor to drive Small and Medium Enterprises development, as its lending facilitates the growth of business ventures. Commercial Banks are the core source for SMEs borrowing.\(^7\). Therefore access to financial services from commercial bank is a critical element for SME’s growth. Small and Medium Enterprises find it difficult to obtain external financing from banks when compared to large firms and lack of finance is an important obstacle to their growth.\(^8\). A growing economy needs the support of financial structure which is responsive to the needs of development of growth engine. SMEs play a very important and vital role in Indian economy where twin problems of unemployment and poverty constitute a major developmental programme. A sound banking system plays an indispensable role in industrial growth, production and economic growth. They mobilize resources and allocate to the activities with highest returns. In India, Commercial Banks have assumed the additional responsibilities of meeting the needs of diverse and neglected sectors of the economy at various stages of development. Therefore Commercial Banks are considered as one of the essential organs for the growth and development of SMEs. The SMEs primarily relay on bank

\(^7\)Sehrish, JavedandBeenish 2013, “The role of Commercial Banks in production of SME’s in Pakistan”, Social science Research Network, Dec 2013
\(^8\)Augisto de la torre, Maria solidad Martinez periaandsergoSchmulkar, “Drivers and Obstacles of Banking to SME’s: The role of competition and the institutional frame work”, CESifo Working paper
finance for their operations and access to timely and adequate credit is critical for its growth and development. Finance is the main pre-requisite of every productive operation. The very success of an industrial unit depends on finance and for many business problems they find their solutions on financial strength. According to Ranabijoy Deb \(^{10}\) “Every problem of the small producer concerning production or material quality or marketing is in the ultimate analysis, a financial one”.

### 1.2 BANK CREDIT TO SMALL AND MEDIUM ENTERPRISES IN INDIA

Bank credit to Small and Medium Enterprises in India is a part of directed credit policy of RBI and it is also part of social control measure. Integration of banking operations and policies with planning priorities has made Commercial Banks to reorient their operational polices to finance industry, specifically the Small Scale Industries. Basic functions of Commercial Banks are to accept deposit and finance short term requirements of trade and commerce. Industrial financing accounted a small fraction of total bank credit. Initially scheme of social control was introduced at the end of 1967. The basic objective of the social control was to achieve a wider spread of bank credit and direct large volume of credit flow to priority sector. The National Credit Council was established to assess the demand for bank credit from various sectors of the economy and to determine the priorities for granting the loans to the neglected sectors of the economy. In order to achieve the social objective, fourteen major banks were nationalized on 19\(^{th}\) July 1969 with an aim to serve the needs of the economy. Tandon Committee report on bank credit was a revolutionary development in rationing bank credit. In order to meet the credit requirements of all the sector of the economy and make bank credit available to meet the production requirements, the concept of priority sector lending was accelerated. With the subsequent nationalization of banks in 1969, the scope of activities included under priority sector has been gradually changed over the years. At present, Agriculture, Small Scale Industries, Small Road and Water Transport Operators, Retail Trade, Small Business, Professional and Self-employed, State Sponsored Bodies for SC and ST Education, Housing and Consumption Loans form part of priority sector lending. On the basis of the report submitted by the informal study group on statistics constituted by the RBI in 1971, the description of the priority sector was later formalized in 1972. Although initially there was no specific target fixed in respect of priority sector lending, in 1974 banks were advised to raise the share to this sector in

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\(^{9}\) Dr. K.C. Chakrabarty, SME Banking Conclave 2012

\(^{10}\) Small Scale Industries in India, Mittal publications, New Delhi, 1993.
their aggregate advances to the level 331/3% by March 1979. At the meeting of the Union Finance Minister with the Chief Executive Officer of public sector banks held in March 1980, it was agreed that banks should aim at raising the proportion of their advances to priority sector to 40%. Financing to SSI’s (now SME’s) will be reckoned in computing performance under the overall priority sector target of 40% of average net bank credit or credit equivalent amount of off balance sheet exposure whichever is higher. No sub targets for SME financing, but 60% of SSI advances should go to Micro Enterprises. Domestic Banks can fix their own target in lending to SME’s to achieve a minimum of 20% year on year growth and 15% annual growth in number of Micro units. (PM Task Force). Foreign Banks lending should not be less than 20% of average net bank credit. Any short fall in SME lending, foreign banks are required to contribute to Small Enterprises Development Fund. Lending to Micro and Small enterprises is under priority sector lending whereas lending to Medium sector is non-priority sector lending for Commercial Banks in India. Various literature on access to bank credit by SMEs finds that Micro, Small and Medium enterprises face a chronic shortage of bank financing. Identifying the difficulties in accessing credit from formal financial institutions and banks is highly discussed topic across the world. Census on Micro, Small and Medium Enterprises reports the high financial exclusion of this sector from formal financial institutions in India. The Constraints faced by SMEs in accessing finance from Commercial Banks continues to persist in spite of tireless efforts by Government and Reserve Bank of India. Problems faced by Micro, Small and Medium Enterprises in accessing funds are gathered under the concept called finance gap.

1.3 CONCEPTUAL FRAME WORK

State Government/RBI, Commercial Banks and Micro, Small and Medium Enterprises are the important stakeholders for Bank financing to SMEs. Commercial Banks in India direct credit to this sector based on the RBI guidelines. They act as the mediating agency to execute the policy measures towards SME sector. Ultimate beneficiaries of the State Government policy are SMEs. The possibilities of existence of gap can be between policy makers and Commercial Banks or/and between Commercial Banks and SMEs.
Figure 1.1: Conceptual Framework

POLICY MAKERS

GOVERNMENT/RBI POLICY DIRECTIVES

EXECUTORS

COMMERCIAL BANKS

BENEFICIARY

MICRO ENTERPRISES

SMALL ENTERPRISES

MEDIUM ENTERPRISES

PRIORITY SECTOR

NON-PRIORITY SECTOR

GAP

GAP

GAP
1.4 THE CONCEPT OF FINANCE GAP

Many countries do not report the existence of finance gap as it is not a popular term in the financial market, though the fact is that SMEs do have difficulty in accessing timely and adequate finance. Finance gap or financing problems are two sides of the same coin.11 Financing is necessary for SME’s in their startup, expansion and development and lack of availability of funds or obstacles in securing funds from financial sector is known as finance gap. Finance gap was earlier known as McMillan gap, evolved as the outcome of the report submitted by Lord McMillan, Chairman of the committee which was setup by the British Government to enquire in to banking, finance and credit in November 1929. Lord McMillan in his report has postulated the concept of finance gap in three hundred words in his report. Since then the concept has been reiterated in many instances. Radcliff Commission 1959, Bolton Committee 1971 and Wilson Commission 1979 reports addressed the provision of finance to firms in SME sector and identified a shortage of financing for startup and those firms wishing to expand.

An SME financing gap can be understood as a situation where a small enterprise is unable to receive finance for its growth needs, due to unwillingness of financial intermediaries to offer credit or services to this sector.12

Ajlouni and Hebakamal13 enumerate finance gap as unavailability of either debt or equity finance and the existence of gap can be debated not only by supplier of funds but also by the demand for funds.

The term finance gap is used to mean that the sizable share of economically significant SME’s are not able to obtain finance from banks.14 A sizable share of economically significant small enterprises cannot obtain finance from banks, capital markets or their suppliers of finance. Furthermore, it is often alleged that many

12 Ian Gray, 2005 Addressing SME finance gap: Development finance institutions in Sub Saharan Africa
13 Ajlouni and Hebakamal, 2006, The financing problems of small and medium sized manufacturing enterprises in Jordan
14 OECD 2006, OECD report on SME finance gap
entrepreneurs who do not currently have access to funds and would have the capability to use those funds productively if funds were available.\textsuperscript{15}

In other words, finance gap is a term which is typically meant to imply that the sizable share of otherwise economically relevant SMEs cannot obtain finance from banks, capital markets or otherwise supplier of finance for their viable projects. The flow of credit would be affected by changes in either demand of supply of credit.\textsuperscript{16}

\textbf{1.5 EXISTENCE OF FINANCE GAP}

The study undertaken by McKinsey and IFC to measure the credit gap globally finds that out of 365-445 million enterprises in emerging markets, approximately 85\% suffer from credit constraint and only 15\% can either fully access the credit they need or do not need it because they are able to finance themselves either through internal capital or informal source of finance.

The credit gap for micro enterprises identified in the study was 1.4 to 1.7 trillion.\textsuperscript{17} The International Finance Corporation and Government of Japan have made an assessment of SME finance gap in India. The overall finance gap of INR 20.9 trillion, split in to debt gap of INR 19 trillion and equity gap of INR 1.9 trillion. The survey has also identified sector wise finance gap of 16.2 trillion INR in Micro, 3.9 trillion INR in Small and 0.8 trillion INR in Medium enterprises respectively. The study also evaluates the viable and addressable gap in debt and equity.\textsuperscript{18}

The National Commission on Micro Enterprises had estimated the credit gap of 72\% in un-organized sector for micro enterprises as at the end of March 2012. Sub group on flow of private sector investment for SME sector set up by Planning Commission has estimated the credit gap at 62\% which is expected to reduce to 43\% by March 2017 during the twelfth plan period.\textsuperscript{19}

\textsuperscript{15}Zakuan Chowdhury 2012, “A comparative Analysis on SME Financing in Bangladesh: Demand side problems and Supply side responses”.
\textsuperscript{16}IsaccQuaye, Abrokawahand Alfred, Open Journal of Business Management, 2014, 2, 339-350
\textsuperscript{17}Financial Access Survey 2010, “SME Finance: Supply side Data availability”
\textsuperscript{18}A research study on needs, gaps and way forward, IFC-Nov 2012
\textsuperscript{19}Sub Group on flow of Private Sector Investments for MSME Sector, Report of the Working Group for 12\textsuperscript{th} Five Year Plan
A study made by the International Finance Corporation, McKinsey and Company reports that there are around 364 – 445 million Micro, Small, and Medium Enterprises in emerging markets of which 25-30 million are formal SMEs, while the rest are informal enterprises. According to this study close to 45-55% of formal SMEs do not have access to formal finance.

The statistics compiled in the fourth census of SME sector revealed that only 5.18 % of the units (both registered and unregistered) had availed finance through institutional sources and 2.05% had finance from non-institutional sources. Hence the key challenge is to extend the credit facilities to SMEs.

The International Finance Corporation survey has identified the viable and addressable finance gap in Karnataka as a part of rest of India to be 0.91 trillion accounting for 31 % of debt gap in MSME sector.20

The slow growth of this sector is broadly attributed to lack of financing. Many banks also treat credit to this segment as necessity for meeting compliance norms rather than opportunity.21 In India, Small and Medium Enterprises operate in a challenging atmosphere despite the fact that India stands third rank in ease of doing business index. According to Greyhound22, SMEs are said to be the backbone of the India’s economy, however, not much is being done to promote their healthy growth and development.

1.6 LITERATURE REVIEW

Mishra (1984)23 aims to analyze the nature of financing and role of various agencies including Commercial Banks in meeting the need of finance in North Bengal and to examine the problems faced by entrepreneurs. The researcher has considered the Commercial Banks as one of the agencies along with the other agency and it is based on the secondary source of information. More attention is given on demand side issues.

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20 A research study on needs, gaps and way forward, IFC-Nov 2012.
21 AmbarishDasgupta and Rajiv Mundhra, Indian Banking- The Engine for Sustaining India’s Growth Agenda, ICC Banking Summit, Kolkata, 2013
22 The Indian SME survey: Analyzing Indian SME perceptions around union budget, 2014
23 Samar Kumar Mishra (1984), “Studies In the Nature and Problems of Financing of SSI in North Bengal”, Thesis submitted to North Bengal University, West Bengal
Singhania (1998) examines the flow of bank credit to Small Scale Industries in India and also evaluates the impact of various packages of measures announced by RBI. The author finds that the actual flow of assistance under working capital during five year period 1991-92 to 1995-96 fell short of the requirement lay down by the Nayak Committee. An analysis of the bank credit made available to the SSI sector in last ten years reveal that in 1995-96, there is a decline in the credit flow to the SSI sector. Author opined that in a significant number of cases, bank branches have departed from the guidelines subjecting to SSIs and suggest for rethinking on the part of Government, Commercial Banks and SFCs to address the big gap between the demand and supply of working capital and term loans.

Vimala (2003) analyzes the performance of different bank groups in their advances to SSI in the state of Kerala between 1993 -94 to 2000-01. The author concludes that there is no significant difference between the performances of different bank groups in their SSI advances. The researcher has taken supply side evaluation in terms of performance in enhancing the credit to this sector.

ShilpaKulkarni (2004) examines the relationship between growth of small scale industries and supply of bank credit and also the expectations of the small scale industries as perceived by the banks. Author makes an attempt to identify the various constraints associated with credit supply. Field survey of stakeholders reveals that the supply of institutional credit is too less and often delayed and Small Scale Industries have many other expectations from bank. The study has limited application of quantitative techniques for the analysis and sample size for the field survey was very small.

OECD (2006) in its study on SME finance gap, identifies both weak demand from SMEs and limitation in supply of funds as the indicative of gap. The responsibility is attached to both the financial sector as suppliers of funds and SMEs as the demanders of the fund. Asymmetric information, relationship, performance of SMEs and

conservative nature of the financial markets are some of the reasons for finance gap identified in OECD countries.

Julius Kakuree (2008)\(^{28}\) aim to explore the experiences of Bank officers and SME borrower in credit extension to the SME sector in Uganda. The study used a triangulation of qualitative and quantitative research methodologies to examine the experiences of loan officers and SME borrowers in relation to factors that influence credit flow to SME sector. Data was collected both from supply side and demand side through structured and semi-structured interviews and also through direct observation. Data was analysed using Factor Analysis, Multi Co Linearity Analysis, Spearman’s Rank Correlation Analysis and NVIVO software. The researcher recommends designing lending guidelines that integrate both supply and demand factors.

Manivone Siharath (2012)\(^{29}\) the objective of the study is to consider the factors impeding both the demand and supply side SME operations in relation to their financial practices and to find out how the banking can best be strengthened in order to overcome the issue of insufficient funding for SMEs. The research process comprised of a three part process. Series of interviews with Government, Banks and SMEs were conducted by taking 5 Banks (2 State-owned, 1 locally owned and 2 foreign banks), 3 SME stakeholders and 4 stakeholders as sample size. Indepth interview was based on a semi structured panel of open ended questions were adopted and note taking method was used. The researcher suggests for Government subsidies and policies to enhance credit to SME sector.

1.7 RESEARCH GAP

From the reviews of the available literature, it is seen that, internationally SMEs access to bank finance and other financial institutions, quantifying and addressing the finance gap is highly discussed subject. But in India, no serious deliberations have been made regarding identifying and addressing bank SME finance gap. In developing countries like India, next to internal source of financing, SMEs depend on bank finance for their financial requirements at different stages of business cycle than


\(^{29}\) ManivoneSiharath (2012), “Potential Best Practices For Improving The Access to Development Finance By SME's In LAO PDR”,unitec.researchbank.ac.nz
any of the other source of finance made available to them. Through literature review, it is seen that the efforts towards identifying the finance gap in India were done only by the International Organizations and by planning Commission of India. The committee formed for twelfth plan, in its report confirms that there is no literature available with regard to finance gap existing for SMEs in India. In this context, an attempt is made to study the issues of Bank SME finance from the perspective of both Commercial Banks and SMEs which could help in addressing the gap existing since the inception of the concept of priority sector lending to Micro and Small enterprises in India. Various studies in India have made an attempt to address the issues either on supply side perspective or from demand side perspectives. Majority of the studies have analyzed the issues faced by the banks in lending to SMEs is based on secondary source of information. This calls for a study which can look in the problem of SMEs access to bank credit in a different perspective. Therefore this study tries to adopt a different approach which is not adopted by the stated literature to address the problems in SMEs access to bank finance. The study aims to identify and evaluating the factors responsible for finance gap between Commercial Banks and Small and Medium Enterprises and suggest actions to reduce the gap.

Research questions which emerge as a result of the literature review are as follows

- What factors are responsible for determining the smooth flow of credit to Small and Medium Enterprises?
- Does the identified factor have any impact on the satisfaction of the stakeholders towards lending services?
- What perception each of the stakeholders has on other in relation to lending services?
- Is the problem of accessing finance from Commercial Banks uniform for each of the sectors within SME sector?
- Is there any impact of finance gap on the growth and performance of Small and Medium Enterprises?

Answer to the above research questions would help in reducing the existing finance gap and provide an opportunity for Commercial Banks to tap a huge untapped SME market by contributing to the development of an important sector of Indian economy.
1.8 STATEMENT OF THE PROBLEM

Although SMEs have been growing at a faster rate than overall industrial sector, they experience multiple constraints that are hindering their growth. According to IFC survey on Micro, Small and Medium Enterprises in India, 32% of units experience in-adequate linkages, 29% of SMEs are impacted by lack of infrastructure, 28% of SMEs are constrained by inadequate finance, 24% lack managerial competence and 22 % are constrained by obsolete technology. According to this survey of SMEs sector, enterprises consider access to finance as one of the biggest constraints in growth. The survey also finds that the multiple growth constraints can be largely linked to inadequate access to finance. The report of working group on re-habilitation of sick SMEs by RBI also finds lack of adequate and timely access to working capital finance is one of the key reasons for sickness in the sector. Financial constraints are having a negative impact on Small and Medium enterprise’s development and also limiting their potential to drive the national economy as expected. The SME census has reported that only 5% of enterprises in this sector had access to some form of formal finance and while over 92% of the units are unable to access to any form of finance. This Sector is un-served and under-served despite the policy efforts and more responsive formal financial sector, SMEs continues to face timely and adequate finance constraint. The problems of SMEs to obtain finance are often gathered under the umbrella concept of finance gap. The existence of gap leads to unfavorable situations to both banks and SMEs and in turn affects the welfare and growth of the economy as a whole. IFC study of 2012 has quantified the total finance gap and addressable gap by financial institutions in the near terms. There are many research studies which have been undertaken on these issues of problems on SME financing either from the perspective of bank or from the perspective of SME. But no literature is available in India which addresses the issue of finance gap from both the perspectives.

1.9 NEED FOR THE STUDY

A small enterprise is generally born as an idea, later grows and finds its place and then becomes Mega Corporation. It plays a crucial role in developing an economy. It is rightly said that small and large enterprises are like the two legs of industrialization process. Hence they have been given an important place in the frame work of Indian planning. Modern SSIs (now SMEs) in India were almost non-existent prior to
Second World War. It was during the war period that number of SSIs (now SMEs) was established. After Independence, organized efforts were made to its development. The development of this sector is dependent on timely, adequate finance at reasonable rate of interest and this responsibility is shouldered by the Commercial Banks in India. Many studies have identified finance as the most important factor for determining the survival and growth of SMEs. Access to finance allows them to undertake productive investments, expand their business and to acquire latest technology thus ensuring their competitiveness. The efforts of commercial bank to provide financial assistance began in 1956 and are being carried on till date. Their dependency on bank loans is very high amongst the various sources. Various research studies right from conceptualization of bank credit to SMEs have been analyzing and suggesting innumerable measures to improve the flow of credit to the vibrant sector of Indian economy. But even today the same situation persists. Hence it is necessary to examine the issue of non-availability of adequate and timely credit to SMEs. Any study to resolve this problem made from one side i.e. either from SME’s perspective or from commercial bank’s perspective would be incomplete. Therefore there is a need to analyze this issue from both the perspectives which in turn can provide wide opportunities to Commercial Banks and also make significant contribution to SME sector in their growth and development.

SMEs are spread across the length and breadth of the country and having a strong presence in rural areas, their growth also leads to more balanced and sustainable development. The need for research in improving credit flow to SME sector remains important even today as large segment of this sector continues to be deprived of access to credit from formal financial system.

1.10 OBJECTIVES OF THE STUDY

The study is designed with the major objective of identifying and examining the factors responsible for finance gap and also to examine the related issues with reference to banks and SMEs in Karnataka.

1. To review policy framework for financing Small and Medium Enterprises in India and to analyze the status of commercial bank credit to SME sector
2. To identify and evaluate the factors contributing to finance gap between Commercial Banks and Small and Medium Enterprises
3. To examine the extent of finance gap across the Micro, Small and Medium Enterprises
4. To assess the Bank’s perception towards lending to Small and Medium Enterprises
5. To assess the Small and Medium Enterprise’s perception towards Bank lending services
6. To assess the impact of finance gap on the performance of Small and Medium Enterprises

1.11 HYPOTHESES

The following hypotheses were formulated to achieve the objectives of the study

1. **H0**: “There is no change in the share of bank credit to Small and Medium Enterprises in post MSMED Act 2006”.
   **H1**: “The present share of Small and Medium Enterprises credit has increased/decreased in post MSMED Act 2006”

2. **H0** – “There is no relationship between the factors and the level of satisfaction towards bank lending services”
   **H1** – “There exists a relationship between the factors and the level of satisfaction towards bank lending services”

3. **H0** – “There is no difference in the extent of finance gap between Micro, Small and Medium Enterprises”
   **H1** – “There is a difference in the extent of finance gap between Micro, Small and Medium Enterprises”

4. **H0** – “There is no difference in the perception of bank managers on the factors contributing finance gap”
   **H1** – “There is a difference in the perception of bank managers on the factors contributing finance gap”
5. **H0** – “The Bank supported Small and Medium Enterprises and Self-supported Small and Medium Enterprises have the same perception towards Bank lending services”

**H1** – “The Bank supported Small and Medium Enterprises and Self-supported Small and Medium Enterprises does not have the same perception towards Bank lending services”

6. **H0** – “There is no difference in the growth and performance of Bank supported and self-supported Small and Medium Enterprises”

**H1** – “There is a difference in the growth and performance of Bank supported and self-supported small and Medium Enterprises”

### 1.12 SCOPE OF THE STUDY

Karnataka has been spearheading the growth of Indian Industry. The structure of Karnataka presents a blend of modern high tech goods and knowledge industries on one hand and traditional consumer goods industries on the other. Micro, Small and Medium Enterprises form an important and growing segment of Karnataka as industrial sector. In fact Karnataka is called as the cradle of banking in India. The seven leading banks of the country, Canara Bank, Syndicate Bank, Corporation Bank, Vijaya Bank, Karnataka Bank, Vysya Bank and State Bank of Mysore originated from this state. As of now 7 SBI and its associates, 20 nationalized banks, 12 foreign banks 6 RRB’s, 20 other Commercial Banks that constitutes a total of 65 Commercial Banks are functioning in the state.  30 As on Dec 2014, 9844 branches are operating in Karnataka.  

The present study is confined to Karnataka alone. Karnataka has 30 districts, each having Micro, Small and Medium Enterprises base. The scope of study confined to two districts having highest number of enterprises in southern part and north part of Karnataka. Out of 114440 enterprises in Karnataka, 26974 enterprises are operating in Bangalore 9126 in Belgaum as on 31/03/13.  

The enterprises for the study were chosen on the basis of the definition stated under MSMED Act 2006 and the same is

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30 Source: Branch Banking Statistics 2010  
31 Source: www.slbckarnataka.in  
32 Source: District Information Center, Bangalore
adopted as Micro, Small and Medium industries of both manufacturing and service enterprises. Study is also confined to the specialized SME branches of seven major Commercial Banks operating in Karnataka.

1.13 RESEARCH METHODOLOGY

The design of the present study is descriptive and analytical in nature. The study attempts to describe and analyze the causes for Bank and SME finance gap with reference to Karnataka.

1.14 DATA SOURCE

The study is based on both primary and secondary data. Secondary data is collected from different published sources of Reserve Bank of India, Commercial Banks, Government departments, Planning Commission, World Bank, District Information Center, State Level Banker’s Committee, Commercial Bank’s Training Institutes and Agencies promoting SME’s. Moreover, the available literature was obtained from the University Library IIM, ISEC, Central Library and through on line off campus access. For the purpose of collecting primary data, Questionnaire survey method was adopted. Interviews and observation were also part of collecting primary data, wherever required.

1.15 RESEARCH INSTRUMENT

Survey research was conducted using two sets of well-structured questionnaire. The first set is used for collecting data from supply side i.e., Commercial Banks and the second set is used for collecting data from demand side i.e. Micro, Small and Medium Enterprises.

1.16 PERIOD OF THE STUDY

Initially, before identifying the research problem a thorough interaction with the stakeholder’s viz. Entrepreneurs, Bank Manager’s and Government Officials was undertaken to validate the relevance of the study. After review of literature, a preliminary opinion survey was conducted. A pilot study was conducted among twenty five enterprises and five Commercial Banks during Jan 2014-Feb 2014. After testing the reliability and fixing the sample size, the final questionnaire were administered during the period May 2014- July 2014 and October 2014- December 2014.
1.17 METHOD OF SAMPLING

Non-probability sampling procedure is adopted. Convenient method of sampling is used as Micro, Small and Medium Enterprises are spread across the state and no accurate information about these enterprises are available even with District Information Center. Specialized SME branches of selected major banks which are actually involved in processing of finance request are included.

1.18 REGIONAL CATEGORIZATION OF DISTRICTS

Based on the number of enterprises located in each district in Karnataka, Bangalore in the southern part and Belgaum in the northern part of Karnataka were chosen, as Bangalore has highest number of Micro, Small and Medium Enterprises in the south and Belgaum in the north.

1.19 POPULATION

Population for the study includes all Micro, Small and Medium Enterprises and Commercial Banks (specialized SME branches) operating in Bangalore and Belgaum

<table>
<thead>
<tr>
<th>District</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangalore</td>
<td>22040</td>
<td>4810</td>
<td>124</td>
<td>26974</td>
</tr>
<tr>
<td>Belgaum</td>
<td>8810</td>
<td>307</td>
<td>9</td>
<td>9126</td>
</tr>
<tr>
<td>Total</td>
<td>30851</td>
<td>5122</td>
<td>136</td>
<td>36100</td>
</tr>
</tbody>
</table>

Source: Department of Industry and Commerce

Table 1.1: Total number of Micro, Small and Medium Enterprises in study area

<table>
<thead>
<tr>
<th>District</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangalore</td>
<td>194</td>
<td>61</td>
<td>14</td>
<td>270</td>
</tr>
<tr>
<td>Belgaum</td>
<td>41</td>
<td>11</td>
<td>04</td>
<td>55</td>
</tr>
<tr>
<td>Total</td>
<td>235</td>
<td>72</td>
<td>18</td>
<td>325</td>
</tr>
</tbody>
</table>

Table 1.2: Number of Micro, Small and Medium Enterprises selected for the study
Sample selected for the study represent 0.90% of the total population. Initially 361 SMEs were chosen for data collection but responses were received only from 325 enterprises. The response rate is 90%. The sector wise selection is based on the proportionate of each sector in the total population. The final questionnaire was administered to 325 respondents consisting of 235 Micro, 72 Small and 18 Medium Enterprises.

Table 1.3: Total Number of SME specialized Commercial Banks in the study area

<table>
<thead>
<tr>
<th>District</th>
<th>Bangalore</th>
<th>Belgaum</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canara Bank</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Corporation Bank</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>State Bank of India</td>
<td>6</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>State Bank of Mysore</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>State Bank of Hyderabad</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Vijaya Bank</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>6</td>
<td>28</td>
</tr>
</tbody>
</table>

Source: SLBC Karnataka

1.20 SAMPLE

Data was collected from 25 specialized SME branches operating in Bangalore and Belgaum with the help of the survey instrument.

1.21 TYPES OF ANALYSIS AND STATISTICAL TOOLS

The tools used for analysis of primary data consist of descriptive statistics like Arithmetic mean, Standard Deviation, and Variances. The techniques used include Factor analysis, Correlation Analysis, Regression, Chi Square, t-Test and ANOVA.
Factor Analysis

Factor analysis is a multivariate technique used to find out something more fundamental among a set of observed variables in the research studies. It seeks to resolve a large set of measured variable in terms of relatively few categories known as Factors. This technique allows the researchers to group variables into factors. In this study, the variables which enhance the satisfaction and thereby reduce the finance gap are grouped in to five factors using factor analysis. There are several methods of Factor Analysis. The study uses the Principal Component Method of Factor Analysis by using Kaiser’s Criterion.

Correlation Analysis

Correlation Analysis studies the joint variation of two or more variables for determining the amount of correlation between two or more variables. In this study Correlation Analysis Technique is used to study the relationship between the factors identified through Factor Analysis and satisfaction of SME respondents towards lending services. SME’s satisfaction towards bank lending services is dependent variable and factors identified are independent variables.

Regression Analysis

Regression is the determination of statistical relationship between two or more variables. This technique determines the cause and effect relationship between variables. Assessment of impact of factors on the satisfaction is made using Regression Analysis. The SMEs availed bank support in terms of accessing finance is considered for analysis, Dependent variable is Satisfaction and Independent variable is key factor among the SME towards bank lending services.

ANOVA

Analysis of variance is the technique used when more than two categories of samples are involved or multiple sample cases are involved. It is essentially a procedure for testing the difference among different types of data for homogeneity. In this study, one way ANOVA technique is used to make the comparison of Micro, Small and Medium Enterprises on various banking factors.
t- Test

t- Test is used for judging the significance of a sample mean or for judging the significance of difference between the means of two samples. In this study, t- Test is used to assess the perception of Commercial Banks towards lending to SME sector and perception of self–supported and bank supported SME’s towards bank lending services.

Chi-Square Test

Chi- Square Test is a non-parametric test which measures the difference between what is observed and what is expected according to an assumed hypothesis. It is used in the context of sampling analysis for comparing a variance to a theoretical variance. In this study Chi-square is used to assess the self-reported performance of Bank supported and self-supported SMEs.

1.22 RELIABILITY TEST

In order to test the consistency of the instrument which is used to collect the data, Cronbach Alpha is used. Each factor from the Factor Analysis attained more than .7, which indicates the total variance explained by true score is 70% that is quite good.

1.23 IMPORTANT TERMS AND CONCEPTS USED

SMEs

SMEs stand for Small and Medium enterprises. Small Scale Industries were renamed as Small and Medium Enterprises after the enactment of MSMED Act 2006. According to this legislation, Small Enterprises includes Micro enterprises. Thus, Small Enterprises stands for Micro and Small Enterprises.

MICRO ENTERPRISES

Micro Manufacturing: Enterprises having investment in plant and machinery not exceeding 25 lakhs are grouped under Micro manufacturing enterprises.

Micro Service: Enterprises having investment in equipment’s not exceeding 10 lakhs are grouped under Micro manufacturing enterprises.
SMALL ENTERPRISES

Small Manufacturing: Enterprises having investment in plant and machinery exceeding 25 lakhs but not exceeding rupees 5 crore are grouped under Small Manufacturing Enterprises.

Small Service: Enterprises having investment in equipment’s exceeding 10 lakhs but not exceeding 2 crore are grouped under Small Service Enterprises

MEDIUM ENTERPRISES

Medium Manufacturing: Enterprises having investment in plant and machinery exceeding 5 crore but does not exceed rupees 10 crore are grouped under Medium Manufacturing enterprises.

Medium Service: Enterprises having investment in equipment’s exceeding 2 crore but not exceeding 5 crore are grouped under Medium Service Enterprises.

PRIORITY SECTOR*

Priority Sector refers to those sectors of the economy which may not get timely and adequate finance in the absence of special dispensation. 33

CATEGORIES UNDER PRIORITY SECTOR

1. Agriculture
2. Micro and Small Enterprises
3. Education
4. Housing
5. Export credit
6. Others

FINANCE GAP

A sizable share of economically significant Small Enterprises cannot obtain finance from banks, capital markets or their suppliers of finance.

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33 As per revised guidelines (April 2015) of RBI based on Internal Working Group committee report, the definition of priority sector has been revised to include medium enterprises, social infrastructure and renewable energy
SMALL SCALE INDUSTRIES

An industrial undertaking in which investment in fixed assets in Plant and Machinery, whether held on ownership terms or on lease or by Hire purchase, does not exceed rupees 100 lakhs as on 31st March 2001.

MSMED ACT 2006

Micro, Small and Medium Enterprises Development Act 2006 was enacted to facilitate the development of Micro, Small and Medium Enterprises sector and also to enhance the competitiveness of this sector.

RESERVE BANK OF INDIA

Reserve Bank of India is Central Banking Institution. It formulates and implements the Government’s monetary policy, issue bank notes and coins, manages the country’s international payments, acts as investment bank to central and State Governments and extends credit to, Commercial Banks.

1.24 LIMITATIONS OF THE STUDY

- As Small and Medium Enterprises population is large and widely spread across the State, convenient sampling is used as sampling method.
- Specialized SME branches of major Commercial Banks operating in Karnataka are considered for the study.
- There are many other Financial Institutions extending credit to this sector, but the focus of the study is only on Commercial Banks.
- The study is confined to qualitative aspect of finance gap. It does not attempt to quantify the finance gap.
- The study attempts to evaluate only debt gap.
- The information provided by the respondents is assumed to be accurate.
- Responses of the Commercial Banks and Small and Medium enterprises are analyzed individually.
1.25 CHAPTER SCHEME

CHAPTER -1 INTRODUCTION

This chapter presents the basic framework of the study and the technical details of the study report. It consists of need for the study, problem statements, objectives and hypotheses of the study. It also includes detailed section on research methodology adopted.

CHAPTER – 2 REVIEW OF LITERATURE

Chapter two reviews the relevant literature on finance gap both in India and foreign countries. It includes the review of earlier studies in foreign countries on addressing finance gap and studies made in India to address the finance problems of SME sector. The role of SMEs and impact of commercial bank finance on SMEs are also included. In this chapter an attempt is made to identify the gap existing in the literature to find out the necessity of the study.

CHAPTER -3 PROFILES OF THE BANKING AND SME SECTORS

In the third chapter, an attempt is made to explain the profiles of the respondents of selected banks in the first part and profile of SMEs in the later part.

CHAPTER -4 DATA ANALYSIS AND INTERPRETATION

This chapter deals with the analysis of field survey undertaken for the study. The analysis is based on the dimensions of Commercial bank and SMEs.

CHAPTER -5 SUMMARIES OF FINDINGS

This chapter presents the observations made by the researcher based on the analysis and interpretation of the data collected through questionnaires and interviews made during the research.

CHAPTER -6 SUGGESTIONS AND CONCLUSION

This chapter concentrates on the explicit outcome of the present study. It also includes some useful suggestions for the potential directions for further related research.