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# Assessing Financial Accessibility and Barriers for Micro, Small, and Medium-Sized Enterprises (MSMEs) in India: An Analysis of Funding Sources and Challenges

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**ABSTRACT:** The financing of micro, small, and medium-sized enterprises (MSMEs) has emerged as a significant issue for various stakeholders, including entrepreneurs, financial institutions, and governmental bodies. This study aims to identify the diverse challenges that MSMEs encounter in securing financial resources throughout different phases of their operational life cycle. It represents a pioneering effort to delve into these specific concerns. Additionally, the research investigates whether the financial literacy of MSME entrepreneurs serves as a critical barrier to recognizing and accessing available financing options. Data were gathered through structured interviews with a sample of 85 MSMEs, primarily located in Bangalore, encompassing a broad range of sectors such as precision tools, weaving, jewellery, food retail, metalworking, textiles, and bookstores. The findings corroborate previous research indicating that the reliance on formal financial sources, such as banks, is markedly lower than that on informal sources, including personal and familial funds. The study identifies key obstacles to the underutilization of formal financing, notably the insufficiency of collateral and the entrepreneurs' limited financial knowledge. In light of the conclusion that financing needs vary according to the life-cycle stage of MSMEs, the study offers targeted recommendations for entrepreneurs, financial institutions, and policymakers.

## I. INTRODUCTION

In recent years, micro, small, and medium-sized enterprises (MSMEs) have garnered significant attention in India due to their critical role in the national economy. These enterprises are vital for employment generation, with approximately 48.8 million MSMEs providing jobs for around 111.4 million individuals. The manufacturing segment of MSMEs is particularly noteworthy, as it produces over 6,000 distinct products and accounts for 7.7% of the nation's GDP. In addition, MSMEs operating within the services sector contribute a substantial 27.4% to the overall GDP of India. Despite their substantial contributions, MSMEs in India encounter numerous obstacles that hinder their growth and sustainability. They often struggle to adapt to the rapid pace of technological advancements, which poses a risk of obsolescence. Furthermore, these enterprises face high borrowing costs and frequently lack the ability to pinpoint their competitive advantages, which is essential for maintaining product quality and standards. Additionally, issues surrounding the protection of intellectual property and a shortage of skilled labour further complicate their operational landscape. Research has highlighted that access to financial resources and the availability of funding are critical for the growth of MSMEs in developing economies. In India, these challenges are exacerbated by a general lack of awareness among MSME entrepreneurs regarding funding opportunities, coupled with the limited involvement of venture capitalists, non-banking financial companies (NBFCs), foreign banks, angel investors, and initial public offerings in supporting MSME financing.

Given that banks serve as the primary financial institutions in India, the Reserve Bank of India has designated micro and small enterprises as a priority lending sector. Consequently, banks are encouraged to achieve a 20% year-on-year increase in credit extended to these enterprises, alongside a 10% annual growth in the number of microenterprise accounts. In light of these policies, this study seeks to ascertain whether such incentives and initiatives have effectively reached micro, small, and medium enterprises (MSMEs) and whether entrepreneurs are cognizant of them. Preliminary interviews conducted with entrepreneurs revealed that MSMEs possess varying financial needs at different phases of their development. This observation prompted the authors to gain a deeper insight into the diverse financing options utilized by MSMEs throughout their life cycle, as well as to investigate the obstacles encountered in accessing these financial resources. As existing literature has not adequately addressed the financial requirements of MSMEs at various

stages of their operation, this research represents a pioneering effort to explore these dimensions. Consequently, the paper emphasizes the financing sources employed by MSMEs during distinct phases of their life cycle, along with the awareness and utilization of various financial schemes provided by the government. The research aims to achieve three primary objectives: first, to identify the various sources of finance utilized by MSMEs and the specific purposes for which they are employed at different stages of their life cycle; second, to examine the challenges that MSMEs face when seeking financial support from diverse sources throughout their development; and third, to determine the factors that contribute to enhanced financial awareness among these enterprises.

## II. REVIEW OF LITERATURE

The primary financial resources utilized by micro, small, and medium enterprises (MSMEs) include bank loans, loans from non-banking financial companies (NBFCs), venture capital, microfinance institutions, and personal loans from family, friends, and relatives, alongside equity financing and self-generated funds (Mallick et al. 2010; International Finance Corporation 2012; Asian Development Bank 2014). The International Finance Corporation (2012) estimates that the total financing available to the MSME sector amounts to approximately 32.5 trillion Indian rupees (Rs), which encompasses contributions from both informal and formal financial sources, as well as self-financing. Informal financing and self-funding together account for Rs25.5 trillion, with informal sources alone contributing Rs24.4 trillion, indicating that a significant 78% of the financial resources for MSMEs are derived from these avenues. Conversely, only 22% (Rs6.9 trillion) is sourced from banks and NBFCs, with banks supplying the majority at 91.8%. The financial services provided by banks are often inadequate to meet the specific needs of early-stage small and medium-sized enterprises (SMEs) (Banerjee 2006). Various factors impede the availability of bank credit for these nascent SMEs in India, primarily due to their lack of established credit histories and fluctuating equity structures. Biswas (2014) highlighted that while access to external financing beyond traditional banks is crucial for sustaining long-term growth and objectives, it remains both costly and limited, presenting significant challenges for SMEs. Additionally, these external financing options typically necessitate collateral and come with high interest rates, leading SMEs to rely on NBFCs and informal lending sources, which often impose even steeper interest rates, particularly during their initial phases.

The prevalence of the informal sector in meeting the financial needs of micro, small, and medium enterprises (MSMEs) can be attributed to the significant constraints posed by formal financing sources. According to the Asian Development Bank (2014), small and medium enterprises (SMEs) in India face numerous obstacles when attempting to secure funding from formal institutions. These challenges include stringent collateral requirements, rigid lending policies, exorbitant interest rates, complex application processes, and a general lack of financial literacy among entrepreneurs regarding available financial schemes. Ambrose (2012) further elaborated on these barriers, noting the absence of collateralized assets and the restrictive regulatory environment as critical impediments to effective financial support for SMEs. Additional challenges faced by MSMEs include a shortage of skilled labor, inadequate infrastructure, and difficulties in raising capital through stock market avenues, particularly for those with a net worth below Rs100 million (approximately \$1.5 million) (Lahiri 2012). The barriers to financing have also been analyzed through various lenses, including gender dynamics (Irwin and Scott 2010), the size of the firm, the duration of lending relationships, and the utilization of overdraft facilities (Bebczuk 2004). The Reserve Bank of India (2005) identified several key issues affecting SME financing, such as limited access to financial resources for smaller firms due to insufficient financial information and informal business practices, as well as a lack of access to private equity, venture capital, and secondary market instruments. The prevailing view of SMEs as high-risk and commercially unviable entities has led to a situation where only a small fraction of these enterprises receive formal financial support (Ambrose 2012). Prasad (2006) emphasized that Indian banks, in particular, exhibit a reluctance to extend credit to small businesses, further exacerbating the financial challenges faced by this sector. This reluctance not only hinders the growth potential of MSMEs but also perpetuates their reliance on informal financing mechanisms, which may not provide the stability or scalability necessary for sustainable development.

## III. METHODOLOGY

### 3.1 Description of the Sample

The research was conducted utilizing primary data obtained through a survey methodology. A structured questionnaire was administered to 85 entrepreneurs operating micro, small, and medium enterprises (MSMEs) via interviews, which were primarily conducted through face-to-face interactions, although some were also carried out online and over the phone. The participants were predominantly from Bangalore, often referred to as the Silicon Valley of India, with a smaller representation from Mumbai. In Bangalore, data collection involved direct visits to various industrial zones,



including N.S. Palya Industrial Layout, Peenya Industrial Layout, and Weaver's Colony, as well as commercial districts in the suburbs such as Malleswaram, Rajajinagar, and Avenue Road. For enterprises located in Mumbai, data was gathered through telephone and online interviews. The research employed a non-probabilistic judgmental sampling technique, targeting entrepreneurs who maintained a bank account, either savings or current, to ensure a baseline level of financial literacy among participants. The data collection process took place during September and October of 2015. To analyze the gathered data, percentage analysis was utilized, allowing for the extraction of meaningful insights and conclusions from the responses provided by the entrepreneurs.

This investigation introduces an innovative framework for evaluating the sources of finance throughout various phases of the MSME life cycle. The defined stages for this study include (i) start-up, (ii) survival, (iii) growth, and (iv) sustenance. Enterprises in the start-up phase are characterized by being less than three years old, while those in the survival phase range from three to six years. Entrepreneurs in the initial stages concentrate on establishing their businesses within the market and achieving a break-even point concerning their initial investments. Once they progress beyond these stages, their focus shifts towards expanding their market presence during the growth phase. Eventually, businesses reach the sustenance stage, where they have solidified their market position, and growth stabilizes. Entrepreneurs with enterprises older than six years were prompted to share their experiences regarding financing sources and the challenges encountered (Table 1).

**Table 1: Life Cycle Stages of the Enterprises in the Sample (%)**

Stage of the Enterprise	Micro (N = 49)	Small (N = 33)	Medium (N = 3)	Total (N = 85)
Start-up (<3 years)	20.4	12.1	0.0	16.5
Survival (3–6 years)	14.3	12.1	0.0	12.9
Growth (>6 years)	20.4	45.5	66.7	31.8
Sustenance (>6 years)	44.9	30.3	33.3	38.8

### 3.2 Sector-Wise Distribution of Enterprises in the Sample

The bulk of enterprises in the start-up and survival stages were from the services sector, while enterprises in the growth and sustenance stages were almost equally distributed between manufacturing and services (Table 2).

**Table 2: Sector-Wise Distribution of Enterprises in the Sample (%)**

Stage of Enterprise →	Start-Up	Survival	Growth	Sustenance	Total Enterprise Sector ↓
(<3 years)	(3–6 years)	(>6 years)	(>6 years)		(N = 85)
(N = 14)	(N = 11)	(N = 27)	(N = 33)		
Manufacturing	35.7	36.4	55.6	54.5	49.4

### 3.3 Compliance and Listing Characteristics for Enterprises in the Sample

The enterprises exhibited a variety of legal and financial compliance characteristics, as well as differing listing attributes. A significant portion, at least fifty percent, of these enterprises were officially registered, with this figure being notably higher among those in the survival and growth phases. The registration of these enterprises likely occurred under various legal frameworks, including sales tax, value-added tax, and the Shops and Establishments Act, or they may have been registered as Micro, Small, and Medium Enterprises (MSMEs) with the relevant state department. Those enterprises that did not register as MSMEs were categorized by the authors based on the investment thresholds outlined in the Micro, Small and Medium Enterprises Development Act of 2006.

The data revealed that a comparable percentage of enterprises in the start-up (14.3%) and growth (14.8%) stages had undergone credit rating assessments. In contrast, only 9.1% of enterprises in the survival stage were credit rated, suggesting that obtaining a credit rating was not a primary concern for owners at this level. Furthermore, a mere 7.1% of enterprises in the start-up phase were listed, while no enterprises in the other stages achieved listing status, as indicated in Table 3.

**Table 3: Enterprise Compliance and Listing Characteristics (%)**

Enterprise Characteristic	Start-Up (<3 years) (N = 14)	Survival (3–6 years) (N = 11)	Growth (>6 years) (N = 27)	Sustenance (>6 years) (N = 33)	Total (N = 85)
Enterprise registered	50.0	81.8	88.9	63.6	71.8
Enterprise credit rated	14.3	9.1	14.8	12.1	12.9
Enterprise listed	7.1	0.0	0.0	0.0	1.2

#### IV. SOURCES OF FINANCE AND CHALLENGES IN ACCESSIBILITY

##### 4.1 Finance Used by MSMEs in Different Stages of the Life Cycle

The survey results revealed the major financial needs of MSMEs at different stages of their life cycle and the predominant sources of finance used to meet those requirements. Enterprises were not restricted to reporting this data for the current stage of their life cycle but could also report perceptions and experiences for other stages. The values have been computed as the percentage of enterprises reporting the sources of finance used in different stages. Therefore, the total of all reporting enterprises will be different from the total number of enterprises in the sample (Table 4). In the start-up phase, businesses typically reported utilizing funds from personal and familial resources, as well as from friends and public banks, primarily to cover working capital needs. A significant portion of financing was also directed towards collateral arrangements with public banks. This pattern suggests that entrepreneurs exhibit a considerable level of preparedness and risk aversion when initiating their ventures, indicating a cautious approach to financial management.

During the survival phase, enterprises predominantly sought financial support for working capital, short-term loans, and overdrafts. The primary sources of working capital were public banks and moneylenders, followed by personal savings and private banking institutions. While private banks were also utilized for short-term loans and overdraft services, the reliance on moneylenders was comparatively minimal. This continuity in the preference for formal and trusted informal financial sources mirrors the behaviour observed in the start-up phase, as businesses aimed to maintain operational stability and manage debt effectively.

In the growth stage, enterprises required working capital, collateral financing, and short-term loans to support their expansion. Public banks were the main source for working capital, supplemented by personal and family contributions, with private and cooperative banks playing a lesser role. Collateral financing was primarily sourced from public banks, while private and cooperative banks were also tapped for short-term loans, albeit with some mention of moneylenders. This trend indicates that businesses were increasingly focused on their specific financial requirements and the appropriate sources to address them, highlighting the importance of trust in securing necessary funding, particularly from public banks and familial resources. In the sustenance phase, businesses indicated that they primarily relied on financing from personal resources, cooperative banks, public banks, and private banks to meet their working capital needs. Cooperative banks played a significant role not only in providing working capital but also in facilitating collateral financing and securing short-term loans. The emphasis on working capital, collateral financing, and short-term loans highlights the critical financial requirements of enterprises during this phase. This pattern reinforces the earlier observation regarding the preference for financing sources that are deemed reliable by businesses. Enterprises in this phase tend to favour borrowing from institutions with which they have established relationships and a sense of trust. The notable reliance on cooperative banks for these financial needs invites further investigation into the underlying factors contributing to this trend.



**Table 4: Major Sources of Finance Used by Enterprises in Different Stages (%)**

Purpose	Sources of Finance	(N = 45) <sup>a</sup>	Start-up Stage	Survival Stage	Growth Stage	Sustenance Stage
			(N = 11)	(N = 25)	(N = 25)	(N = 25)
Working capital loan	Personal funds/savings	64.4	19.4	19.2	12.0	
capital loan	Money borrowed from friends	15.6	0.0	0.0	12.9	
	Public banks	13.3	27.3	28.0	16.1	
	Family wealth	11.1	0.0	12.0	3.2	
	Moneylenders	4.4	27.3	4.0	6.5	
	Private banks	2.2	18.2	8.0	9.7	
	Cooperative bank	0.0	0.0	8.0	19.4	
Collateral financing	Public banks	17.8	2.2	0.0	20.0	8.0
	Cooperative banks			0.0		12.9
Short-term loan	Moneylenders	0.0	9.1	8.0	3.2	
	Private banks	0.0	9.1	16.0	6.5	
	Cooperative banks	4.4	0.0	12.0	9.7	
Overdraft	Public banks	6.7	0.0	4.0	6.5	
	Private banks	2.2	9.1	4.0	3.2	
	Cooperative banks	0.0	0.0	4.0	3.2	
	Personal funds/savings	0.0	0.0	0.0	3.2	
Long-term loan	Moneylenders	2.2	0.0	0.0	0.0	
	Public banks	2.2	0.0	0.0	6.5	
	Private banks	2.2	0.0	0.0	0.0	
	Cooperative banks	2.2	0.0	4.0	6.5	
	SIDBI	0.0	0.0	4.0	0.0	
	Personal funds/savings	0.0	0.0	0.0	3.2	

SIDBI = Small Industries Development Bank of India.

## V. ANALYSIS OF FINANCIAL ACCESSIBILITY

### 5.1 Factors Influencing Financial Access

Enterprises were requested to evaluate the ease of financial accessibility based on three specific criteria: the distance of a bank or financial institution from the enterprise's location, the approachability of the institution, and the straightforwardness of the financing process. The analysis revealed that the proximity of financial institutions significantly impacted the perception of financial accessibility among many enterprises in the growth and sustenance phases. These enterprises often face immediate financial needs, leading them to regard the closeness of a financial institution as a crucially beneficial aspect.

Enterprises across the start-up, growth, and sustenance phases rated the approachability of formal financial institutions as a key factor influencing their access to finance, while those in the survival phase assigned the lowest importance to this criterion. This discrepancy may stem from the survival-stage enterprises prioritizing the need to achieve financial stability and settle debts, valuing their existing relationships with financial institutions over factors such as location or approachability. A significant number of enterprises from all four developmental stages acknowledged that the simplicity of financial processes played a vital role in facilitating their access to finance. Additionally, enterprises were invited to provide qualitative insights on four specific topics: the factors that promote financial access, the barriers to financial access, their expectations of government intervention in financing, and the type of government support they deemed necessary for their financial needs. A diverse range of responses from enterprises was collected and analyzed.

**Table 10: Key Factors Influencing Financial Access (%)**

Key Factor	Start up Stage (N = 14)	Survival Stage (N = 11)	Growth Stage (N = 27)	Sustenance Stage (N = 33)
Proximity of a bank or financial institution to the location of the enterprise	50.0	45.5	74.1	57.6
Ease of approachability of the bank or financial institution	71.4	54.5	92.6	72.7
Simplicity of the process to access finance	78.6	63.6	92.6	81.8

Note: Data reflects individual responses from entrepreneurs; figures may not add up to 100%.

## 5.2 Factors That Encourage Financial Access

**Start-up stage:** Enterprises highlighted the need for loans without collateral, affordable interest rates, and loan guarantees provided by government. They also reported the need for guidance by personnel from the financial institution, and the need for a paradigm shift by which financial institutions view MSMEs as prospective customers rather than as an interference. A few entrepreneurs emphasized that financiers should have faith in lending to businesses that had continued to operate in the same place for generations.

**Survival stage:** Enterprises asked for provision of quick finance and flexibility in the repayment schedule.

**Growth stage:** Enterprises emphasized the need for information on MSME finance schemes and the need for banks and other financial institutions to deliver the benefits prescribed through these schemes, especially those that involve minimal or no collateral. The role of a good relationship with a bank in securing access was also highlighted. Respondents also felt that approved or empaneled suppliers with long-term experience of supplying to the government must get preference over others while taking advantage of assistance through MSME finance schemes.

**Sustenance stage:** The primary concern reported by enterprises was the interest rate. Respondents felt that their relationship with public banks was better (because it was more personalized) compared with private banks. There was also concern regarding the time needed to process loan requests, with some enterprises resorting to taking gold loans for meeting immediate financial requirements.

## 5.3 Experiences in Seeking Financial Assistance from Financial

Enterprises were surveyed to evaluate their experiences in seeking loans from banks, non-banking financial companies (NBFCs), and microfinance institutions, using a rating scale from 1 to 3, where 1 indicated a poor experience, 2 a neutral experience, and 3 a positive experience. Among the banks, a significant number of enterprises in the start-up phase reported favorable experiences; however, this positive sentiment diminished among those in the growth and sustenance phases. Nearly half of the enterprises in the growth phase characterized their experiences with banks as either poor or neutral, while this figure exceeded fifty percent for those in the sustenance phase. In contrast, the ratings for NBFCs showed a consistent level of satisfaction across the start-up, growth, and sustenance phases, with negative feedback exclusively coming from enterprises in the growth phase. The feedback regarding microfinance institutions was limited, with the few reporting enterprises in the start-up and survival phases giving ratings of good and neutral, respectively, while the two enterprises in the sustenance phase provided mixed ratings of good and bad. Overall, more than half of the enterprises expressed positive experiences with banks, NBFCs, and microfinance institutions, except for the ratings from sustenance stage enterprises regarding banks (Table 11).



**Table 11: Experience Rating of MSMEs while Seeking Financial Assistance from Banks, NBFCs and MFIs (%)**

Source of Finance Used	Experience Rating	Start-Up Stage	Survival Stage	Growth Stage	Sustenance Stage	Total
Bank	Bad	20.0	–	19.0	33.3	27.1
	Neutral	20.0	–	23.8	24.2	23.7
	Good	60.0	–	57.1	42.4	49.2
	No. of Responses	5	0	21	33	59
Nonbanking financial company	Bad	0.0	–	20.0	20.0	0.0
	Neutral	33.3	–	60.0	33.3	27.3
	Good	66.7	–	–	66.7	63.6
	No. of Responses	3	0	5	3	11
Microfinance institution	Bad	0.0	0.0	–	50.0	0.0
	Neutral	0.0	100.0	–	–	25.0
	Good	100.0	0.0	–	50.0	50.0
	No. of Responses	1	1	0	2	4

MSMEs – micro, small, and medium-sized enterprises, MFI – microfinance institution, NBFC – nonbanking financial company.

## VI. ANALYSIS OF FINANCIAL AWARENESS

The financial literacy of entrepreneurs was assessed through their familiarity with prominent financial programs designed for micro, small, and medium enterprises (MSMEs). These programs encompassed the Credit Guarantee Fund Trust for Micro and Small Enterprises Scheme, the Credit Linked Capital Subsidy Scheme aimed at technology enhancement, and the Growth Capital and Equity Assistance Scheme provided by the Small Industries Development Bank of India (SIDBI). Additionally, entrepreneurs were inquired about their utilization of any of these financial schemes for their businesses. Each participant also indicated their educational background from a range of options, including less than 10 years of education, completion of secondary school (10 years), pre-university college (12 years), bachelor's degree, master's degree, professional qualifications (such as chartered accountant or company secretary), or other educational achievements, including technical diplomas.

### 6.1 Use of Schemes

The proportion of schemes availed by MSMEs is provided in Table 13 and is differentiated by educational attainment. Overall, only 10 of the 85 enterprises have obtained finance through an MSME credit support scheme. Entrepreneurs with less than a bachelor's degree were less likely to have availed themselves of such a scheme for their enterprises than those entrepreneurs with higher qualifications

**Table 13: Use of Schemes (%)**

No. of Schemes Availed	10th/ SSLC (N = 24)	12th/ PUC (N = 4)	Bachelor's Degree (N = 25)	Master's Degree (N = 6)	Professional Qualification (CA/CS) (N = 2)	Others (N = 24)
0	95.8	100.0	80.0	83.3	50.0	91.7
1	4.2	0.0	20.0	16.7	50.0	8.3

CA / CS – chartered accountant/company secretary, PUC – pre-university college, SSLC – secondary school leaving certificate.



## VII. CONCLUSIONS

The research indicated that the financing options available to micro, small, and medium enterprises (MSMEs) are influenced by their respective stages within the enterprise life cycle. The study delineated four distinct phases: start-up, survival, growth, and sustenance. During the start-up phase, entrepreneurs typically rely on personal savings, contributions from friends and family, and public sector banks to secure working capital and collateral financing. The reliance on informal sources, such as trusted personal networks, is particularly notable, as these avenues often alleviate the pressure associated with repayment challenges. In the survival phase, MSMEs tend to turn to moneylenders and public banks for financial support, supplemented by personal funds and private banking options. The primary focus during this stage is to achieve a break-even point concerning their investments, prompting enterprises to seek a blend of informal and formal financing solutions. The preference for private banks and moneylenders for short-term loans can be attributed to their accessibility and the speed of fund disbursement, which are critical for meeting immediate operational needs. As enterprises transition into the growth stage, they increasingly utilize public banks for working capital and collateral financing, while also seeking short-term loans from private banks. Finally, in the sustenance stage, business owners draw upon personal funds, cooperative banks, public banks, and loans from friends, primarily for working capital. The strategic selection of financial sources demonstrates a growing awareness among entrepreneurs regarding the importance of aligning specific financial needs with appropriate funding channels, highlighting a more conservative approach to financing.

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