

# FINANCING OF MSMEs IN GOA

## *PROJECT REPORT*

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*MAJOR RESEARCH PROJECT*

*FUNDED BY UGC*

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## ABBREVIATIONS

<i>ANOVA: ANALYSIS OF VARIANCE</i> .....	39
<i>BSE:BOMBAY STOCK EXCHANGE</i> .....	32
<i>GOVT:GOVERNMENT</i> .....	21
<i>IFC:INTERNATIONAL FINANCE CORPORATION</i> .....	14, 16
<i>INR:INDIAN RUPEES</i> .....	14
<i>MANCOVA: MULTIVARIATE ANALYSIS OF COVARIANCE</i> .....	39
<i>MDP:MANAGEMENT DEVELOPMENT PROGRAMME</i> .....	41
<i>MFG:MANUFACTURING ENTERPRISE</i> .....	19
<i>MSME :MICRO SMALL AND MEDIUM ENTERPRISES</i> .....	PASSIM
<i>MSMED:MICRO SMALL AND MEDIUM ENTERPRISE DEVELOPMENT</i> .....	14
<i>MTT:MARKET TIMING THEORY</i> .....	26
<i>NBFC: NON BANKING FINANCIAL COMPANY</i> .....	40
<i>OECD: ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT</i> .....	23
<i>SIDBI: SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA</i> .....	56, 70
<i>SME:SMALL MEDIUM ENTERPRISE</i> .....	13, 14, 15, 16
<i>VCF:VALLUE CHAIN FINANCE</i> .....	34

## ABSTRACT/EXECUTIVE SUMMARY

While there is general agreement that the SME market is significant in size and importance, there is considerable variation in their definition around the world. In India, micro, small and medium enterprises as per MSMED Act, 2006 are defined based on their investment in plant and machinery (for manufacturing enterprise) and on equipment for enterprises providing or rendering services (Verma, 2016) . The present ceilings on investment for enterprises to be classified as MSMEs are as follows:

*Table 1 Present ceilings on investment for Manufacturing Enterprises*

<b>Manufacturing Enterprises – Investment in Plant &amp; Machinery</b>	
Description	INR
<b>Micro Enterprises</b>	up to Rs. 2.5 million/25 Lakh
<b>Small Enterprises</b>	above Rs. 25 Lakh (2.5 million)& up to Rs. 5 Crore (50 million)
<b>Medium Enterprises</b>	above Rs. 5 Crore (50 million) & up to Rs. 10 Crore (100 million)

*Source: Micro, Small & Medium Enterprises Development (MSMED) Act, 2006*

*Table 2 Present ceilings on investment for Service Enterprises*

<b>Service Enterprises – Investment limit in equipment</b>	
Description	INR
<b>Micro Enterprises</b>	up to 1 million / Rs. 10 lakh
<b>Small Enterprises</b>	above Rs. 10 Lakh (1 million)& up to Rs. 2 Crore (20 million)
<b>Medium Enterprises</b>	above Rs. 2 Crore (20 million) & up to Rs. 5 Crore (50 million)

*Source: Micro, Small & Medium Enterprises Development (MSMED) Act, 2006*

Access to finance is a major hurdle faced by MSMEs. Predominantly 93% of units remain excluded from access to formal finance or are dependent on self-finance or the unorganized market. The SME market has been perceived by banks as risky, costly, and difficult to serve (*Source: IFC Report, 2010*) (Ardic, Mylenko, & Saltane, 2011).

Hence, this research has the broad objective of studying the financial structures and associated problems of selected samples of MSMEs in Manufacturing and Services sector.

Specifically, the research has the following objectives:

1. To study the composition of capital structures in selected MSMEs in manufacturing and Service (tourism) sectors and to highlight the differences in financial structures across sectors with the reasons thereof;
2. To identify the factors responsible for lower institutional financing to MSMEs in Goa with special interest in the type of finance, namely term loans or requirement towards working capital;
3. To trace the problems faced by MSMEs with respect to obtaining finances across different financial institutions in Goa;
4. To find out the reasons from the point of view of financial institutions, with respect to lower financing to MSMEs in Goa.
5. To study the differences, if any, across sectors, in dealing with the issues of institutional financing.
6. To identify the role played by Associations or Federations of industries in coping with the finance related issues.

## **Methodology of Research**

Literature review was first carried out. Exploratory study consisted of seven case studies of selected firms, with focus on the problems faced in obtaining finance. This was followed by quantitative research on a larger sample (70 units) with the help of structured questionnaire. Interviews were also conducted of the Officials of the Financing Institutions (34) with second questionnaire. Focus Group technique was adopted after individual interviews and Case Studies. The focus groups were those of the MSMEs and the Institutions. A brainstorming session was organized with the participation of representatives of the stakeholders, namely, the firms and the financial institutions, for an attempt to obtain a holistic view of the problems faced.

## **Findings and Conclusions**

This research empirically proves that there is significant difference in capital structures of MSMEs at an initial stage and later stage, with higher debt being raised at an initial stage than at later stage. The size, whether micro, small or medium, does not show a significant difference in capital structure. It also shows that capital structure significantly differs between the manufacturing and service sector.

At initial stage, all the several factors which were tested were found to be significant when taken together, for short term as well as long term.

At a later stage, the factors which were tested do not significantly influence the likelihood of MSME raising funds from the financial institutions for long term debt. The reason could be that the firm is settled in long term and has earned creditworthiness. In the short term the factors significantly influencing the likelihood of MSME raising debt from the financial institutions were personal relationship, documentation formalities and Subsidies from Govt.

In the opinion of MSMEs, Commercial banks have high tendency to ask for the collateral or guarantors which is the limiting factor. Also lack of flexibility in changing limit of borrowing is a limiting factor for commercial banks.

Regarding the opinion of Financing Institutions, Public and Private banks give high importance to disclosure requirements, whereas credit rating is given high importance by Public sector banks and NBFCs. Public sector banks and Cooperative banks have stated that the MSMEs lending is highly risky. However, though Public sector banks opined that lending to MSMEs is risky, the probability of default is stated to be low, as their collection efforts were good. Associations had no role in assisting the MSMEs in respect of financing issues.

### **Theoretical contributions**

Capital structure of MSMEs seems to abide by Pecking Order theory at the initial stage, whereas, at later stage, it is better explained by Market timing theory. Market timing theory explains also the apathy towards Govt. schemes of financing due to inconvenience, and lack of timeliness. Berger and Udell (1998) have stated that the choice of funding sources is made over time and along the firm life cycle. The findings of this research have affirmed that in the case of MSMEs, they start with higher debt in their capital structure, and at a later stage, equity takes over. The size whether micro, small or medium doesn't show a significant difference in capital structure, which means concerning capital structure, MSMEs are regarded as a common cohort. Findings of this research seem to justify that universally, MSMEs is considered as a single unit, having common policies.

The findings highlight that capital structure significantly differs between the manufacturing and service sector with manufacturing firms have higher debt-equity ratios in both initial and later stages of their life, as compared to the service sector, due to larger availability of collateral security.

Information asymmetry is an issue concerning both, financing institutions and MSMEs. Hence, perceived risk of adverse selection seemed higher. It also explains MSMEs not availing new avenues of financing.

### **Managerial Implications**

The findings about the differences across different firms and the related patterns of the debt equity ratios can help the financing institutions and MSMEs to have better planning with respect to capital structure. It will assist in overcoming the difficulties in relation to financing.

# CHAPTER 1-INTRODUCTION

## [A] Sector Profile

### Global Definition of MSME

While there is general agreement that the SME market is significant in size and importance, there is considerable variation in their definition around the world. A common definition of SMEs includes registered businesses with less than 250 employees. European Commission determines the criteria as number of employees, annual turnover and annual balance sheet (European Commission: 2005). It is determined that meeting the criteria of the number of employees is mandatory, while filling another from the two financial criteria is a choice of the enterprise. The definition of SMEs that came into effect from 1 January 2005 is shown in the following table.

*Table 3 Definition of Small and Medium Enterprises with European Union standards.*

Enterprise category	Headcount: Annual Work Unit	Annual Turnover/Annual Balance Sheet total
Medium Sized	<250	<= €50 million
Small	< 50	<= € 10 million
Micro	<10	<= € 2 million

A. Source: European Commission (2005)

*Table 4 Definition of Small and Medium Enterprises by World Bank Standards*

Enterprise Indicators	Number of Employees	Total Sales /Total Annual Sales
Medium Sized	>50; <=300	<= \$ 3000000-15000000
Small	>10; < =50	<= \$100000 - 3000000
Micro	<10	<= \$ 100000

Source: Independent Evaluation Group (2008)

Alternative criteria for defining this sector include annual sales, assets, and size of loan or investment, annual turnover or industry. To qualify as a micro, small, or medium enterprise (MSME) under this World Bank classification, a firm must meet two of three maximum requirements for employees, assets, or annual sales. For client reporting purposes, IFC's Global Financial Markets Department uses loan size as a proxy, since some banks are unable to report according to SME firm size.

### **MSME Definition in India**

In India, micro, small and medium enterprises as per MSMED Act, 2006 are defined based on their investment in plant and machinery (for manufacturing enterprise) and on equipment for enterprises providing or rendering services. The present ceilings on investment for enterprises to be classified as MSMEs are as follows:

*Table 5 Present ceilings on investment for Manufacturing Enterprises*

Manufacturing Enterprises – Investment in Plant & Machinery	
Description	INR
Micro Enterprises	up to Rs. 2.5 million/25 Lakh
Small Enterprises	above Rs. 25 Lakh (2.5 million)& up to Rs. 5 Crore (50 million)
Medium Enterprises	above Rs. 5 Crore (50 million) & up to Rs. 10 Crore (100 million)

*Source: Micro, Small & Medium Enterprises Development (MSMED) Act, 2006*

*Table 6 Present ceilings on investment for Service Enterprises*

Service Enterprises – Investment limit in equipment	
Description	INR
Micro Enterprises	up to 1 million / Rs. 10 lakh
Small Enterprises	above Rs. 10 Lakh (1 million)& up to Rs. 2 Crore (20 million)
Medium Enterprises	above Rs. 2 Crore (20 million) & up to Rs. 5 Crore (50 million)

*Source: Micro, Small & Medium Enterprises Development (MSMED) Act, 2006*

## **Contribution to Indian Economy**

Following are the highlights of the contribution of MSMEs to Indian economy:

- Indian MSME sector consists of approximately 45 million units
- It produces more than 6,000 products ranging from traditional to high-tech items
- It shows high product diversification: 67% of its produce is from manufacturing goods, followed by 17% in services and 16% in repairs and maintenance.
- It provides employment provided to around 101 million people.
- It accounts for 45% of the manufacturing output.
- It contributes nearly 8-9% to the country's GDP.
- It accounts for 40% of the country's exports

(Source: <http://www.makeinindia.com/article/-/v/nurturing-a-manufacturing-culture>); (Make in India)

## **Qualitative contribution to the economy**

Some of the qualitative contributions of MSME sector are as follows:

- It plays an important role in providing backward and forward linkages to the large private sector.
- Large number of SME units help build competitive spirit not only among the domestic market but also in the export markets.
- It also plays a significant role for developing the nation through high contribution towards domestic production.
- It plays a crucial role in reducing regional imbalances, assuring more equitable distribution of national income and wealth along with its contribution to economic growth and development.

*(Source: <http://www.cii.in/webcms/Upload/Enhancing%20role%20of%20SMEs%20in%20Indian%20defence%20industry1.pdf>)*

### **Challenges for the SME segment**

Despite its significant contribution to growth, SME sector does not get the required support and hence, faces a number of problems. Some of the major concerns are:

- SME sector is unable to face the stiff competition from global competitors. Besides, the tough competition from global players, the uncertain global economic scenario also poses challenges to this sector.
- Availability of infrastructure, technology and skilled manpower is limited for this sector. The existing infrastructure which generally includes power, water, roads, etc. is inadequate. Non availability of suitable technology and usage of obsolete technology leads to low production capacity thereby constraining further modernization and expansion of the sector. Lack of professionalism, training and labour laws has rendered limited skill and knowledge to this sector. It thus continues to operate in an informal set –up.
- Access to finance is a major hurdle faced by MSMEs. Credit to SMEs qualifies as priority sector credit and banks have been advised to achieve 20% year-on-year growth in credit to MSMEs. Yet 93% of units in this sector remain excluded from access to finance or depend on self-finance or the unorganized market, which is not sustainable in the long run. Besides, access to finance through bank credit, SME sector’s access to capital markets is limited.
- The institutionalized financial sector has a high risk perception of the MSME sector, owing to their vulnerability to economic trends and risk of elongation of working capital cycles. The SME market has been perceived by banks as risky, costly, and difficult to serve.

*(Source: IFC Report, 2010).*

Considerable delays in settlement of dues by the large –scale buyers to the MSME units have been witnessed due to slowdown in industrial growth. This adversely impacts their recycling of funds and in turn their business operations.

Hence, this project focuses on the problems related to finance by the MSMEs.

## **[B]Objectives of Research**

The research has the broad objective of studying the financial structures and associated problems of selected samples of MSMEs in Manufacturing and Services sector. These sectors are the predominant contributors to the economy of Goa. Hence, it is of prime significance to study their financing patterns and the related issues.

Specifically, the research has the following objectives:

1. To study the composition of capital structures in selected MSMEs in manufacturing and service (tourism) sectors and to highlight the differences in financial structures across sectors with the reasons thereof;
2. To identify the factors responsible for lower institutional financing to MSMEs in Goa with special interest in the type of finance, namely term loans or requirement towards working capital;
3. To trace the problems faced by MSMEs with respect to obtaining finances across different financial institutions in Goa;
4. To find out the reasons from the point of view of financial institutions, with respect to lower financing to MSMEs in Goa.
5. To study the differences, if any, across sectors, in dealing with the issues of institutional financing.
6. To identify the role played by Associations or Federations of industries in coping with the finance related issues.

## **[C] Methodology of Research**

At the first level, secondary data was collected from the published sources especially in the state of Goa, from the data available from the Government, Associations of Industries and Goa Chambers of Commerce etc.

After analysis of the above data, a sample of firms was selected for in-depth study in each of Medium, Small and Micro firms. Case studies were written of the selected firms covering their progress since inception with particular focus on the problems faced in obtaining finance. Case study method is preferred as the first step to understand the nuances and the complexities of myriad factors involved in financing of a firm.

This was followed by quantitative research through field collection of data on a larger sample in each category with the help of structured questionnaire. The structured questionnaire was made with the help of a cross case analysis of the case studies written and literature review. Interviews were also conducted of the Officials of the Financing Institutions in Goa to study their problems unearthed with the help of quantitative data collected from the firms and their representatives.

Focus Group technique was adopted after individual interviews and Case Studies. The focus groups for the purpose will be those of the MSMEs and the Institutions separately. A brainstorming session was organized with the participation of representatives of the stakeholders, namely, the firms and their associations and the financial institutions, for an attempt to obtain a holistic view of the problems faced.

## [D] Sampling Frame

The research proposal had stated that case studies would be documented from each category of MSME's in manufacturing and service (tourism) sector. The sampling frame was accordingly selected.

*Table 7 Sampling Frame of MSMEs for Case Studies*

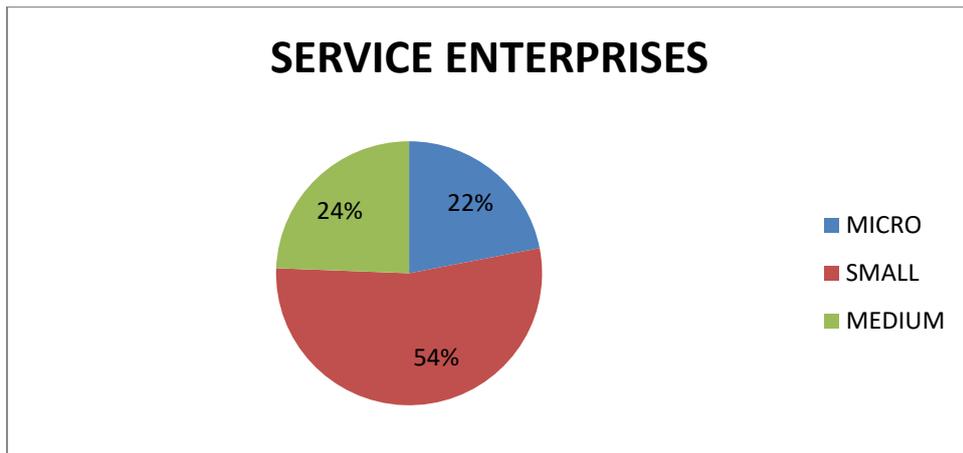
Type/Scale	Medium	Small	Micro
<b>Manufacturing</b>	1.Tulip Diagnostics (small-medium)	2.Jayraj Cashews (small)	3.Ajanta Medicals (micro-small)
<b>Service (Tourism)</b>	4.Maberest Group (Hotel Fidalgo) (medium)	5.VedAyurved Bhavan (small)	6.Jupiter Canteen(micro-small) 7.ABC's <sup>1</sup> (name Changed)(micro-small)

The case studies were followed by quantitative research through field collection of data on a larger sample in each category with the help of structured questionnaire.

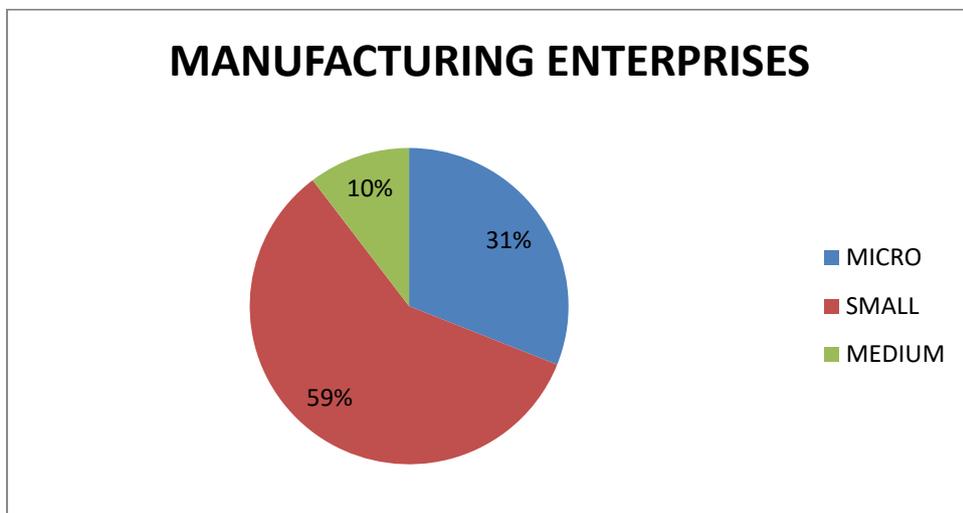
*Table 8 The sampling frame for Quantitative Analyses*

	MICRO	SMALL	MEDIUMM	TOTAL
<b>SERVICE</b>	9	22	10	41
<b>MFG</b>	9	17	3	29
<b>TOTAL</b>	18	39	13	<b>70</b>

<sup>1</sup> Name changed due to non-disclosure agreement



*Figure 1 Service Enterprises*



*Figure 2 Manufacturing enterprises*

## **[E] Summary of Findings**

This research empirically proves that there is a significant difference in capital structures of MSMEs at an initial stage and later stage with higher debt being raised by the firms at an initial stage than at later stage. The size whether micro, small or medium does not show a significant difference in capital structure, which means when it comes to raising funds, MSMEs are regarded as a common cohort and hence, it is justified in being used a single unit of analysis.

It also shows that capital structure significantly differs between the manufacturing and service sector. This has been explained by the security requirements that can be fulfilled by the manufacturing sector, having physical assets like plant and machinery much above that in service sector. Thus, it justifies the use of sector as a distinguishing criterion for defining MSMEs differently in India across manufacturing and service sector. The manufacturing firms also find it easier to raise debt compared to the service sector irrespective of the age. The debt to manufacturing sector is much higher in manufacturing sector in both stages, initial and later, as compared to service sector.

At initial stage, all the several factors tested were significant when taken together, for availing short term as well as long term loans.

At a later stage, since there is already set up and running business, it is easier for the MSMEs to approach and raise funds from the organised financial sectors. Hence, the factors tested do not significantly influence the likelihood of MSME raising long term funds from the financial institutions.

The following factors significantly influence the likelihood of MSME raising short term funds from the financial institutions, at later stage:

1. Personal relationship
2. Documentation Formalities
3. Well supported by Govt./ subsidies

Among all the financial institutions, MSMEs opine that commercial banks have high tendency to ask for the collateral or guarantors which is the limiting factor. Also lack of flexibility in changing limit of borrowing is a limiting factor for commercial banks.

Regarding the opinion of financial institutions, Public and Private Banks give high importance to disclosure requirements, whereas credit rating is given high importance by Public sector banks and NBFCs. Among all the institutions, Public sector banks and Cooperative banks have stated that the MSMEs lending is highly risky. However, though Public sector banks feel that lending to MSMEs is risky, the probability of default is very low, as their collection efforts are very good.

Associations had no role in assisting the MSMEs in respect of financing issues.

## **[F]Managerial Implications**

The differences across different firms and the related patterns of the debt equity ratios can help the financing institutions and MSMEs to have better planning with respect to capital structure. It will assist in overcoming the difficulties in relation to financing.

## **[G]Limitations of the Study**

The sampling size for quantitative survey is less due to the time factor involved. The scope of the study is limited to the state of Goa. Hence, the findings need to be considered with the background information about the state of Goa.

# CHAPTER 2-LITERATURE REVIEW

## Literature Review

The literature review is broadly presented under the following sections:

- SME-taxonomy,
- Theoretical background,
- Antecedents of financial leverage
- Unconventional sources of finance.

### [A]SME- Taxonomy

The abbreviation "SME" is used in the European Union and also by international organizations such as World Bank, United Nations and World Trade Organization (WTO). International scenario reveals that different countries have their own definitions of MSMEs. In some of the European countries, there are three broad parameters which define MSMEs namely, headcount, turnover, and total of their Balance Sheets. In EU, MSMEs are defined as firms with either revenue of €10–50 million or a balance-sheet total of €10–43 million. On the other hand, OECD follows the parameters of employment and sales turnover.

In India, the firms are classified as MSMEs based on the quantum of investment in plant and machinery, separately for the manufacturing and service sector. Thus, the parameters are sector specific and limited to investment in plant and machinery. The difference in the definitions of MSMEs across nations and regions accentuates the need to validate the research findings in any country for their generic applicability.

*Table 9 Classification Parameters*

<b>COUNTRY/REGION/OR ORGANISATION</b>	<b>CLASSIFICATION PARAMETERS</b>
<i>EGYPT</i>	<i>sector specific and number of employees</i>
<i>KENYA</i>	<i>number of employees and turn over</i>
<i>Nigeria</i>	<i>Asset base and number of staff</i>
<i>Somalia</i>	<i>Revenue and number of employees</i>
<i>South Africa</i>	<i>Sector wise, number of employees and turnover</i>
<i>India</i>	<i>Sector, investment in plant and machinery</i>
<i>Bangladesh</i>	<i>Sector, fixed asset size and number of employees</i>
<i>European union</i>	<i>Employees, turnover and balance sheet total</i>
<i>China</i>	<i>Industry specific, operating revenue and number of employees</i>
<i>Hong Kong</i>	<i>Manufacturing /Non-manufacturing specific and number of employees</i>
<i>Indonesia</i>	<i>Number of employees</i>
<i>Japan</i>	<i>Retail/wholesale/manufacturing/industry specific, employees and invested capital</i>
<i>Malaysia</i>	<i>Full time workers or shareholders fund</i>
<i>Korea</i>	<i>Manufacturing/transportation/mining specific, number of employees and capital assets</i>
<i>Philippines</i>	<i>Employees and asset size</i>
<i>Singapore</i>	<i>Manufacturing/Service specific, Asset size</i>
<i>Taiwan</i>	<i>Sales Volume ,employees and service/(Manufacturing/Construction / mining industry specific)</i>
<i>Vietnam</i>	<i>No fixed definition ,generally employee less than 500</i>
<i>Thailand</i>	<i>employees or fixed assets</i>

## **[B]Theoretical Background**

Necessary background for the research is identified with the help of theories of financing by different researchers. The theories have assisted in explaining the differences in factors affecting financing patterns of larger entities and those of MSMEs.

### **Modigliani Miller Theorem [1958, 1985]**

Modigliani states that the firm value is independent of how it is financed in a controlled environment (under perfect competition conditions).This theorem was developed in the absence of taxes, bankruptcy costs, agency costs, and asymmetric information, and in an

efficient market. It was also known as capital structure irrelevance principle. It simply states that value of the firm is independent of capital structure, However as per Miller (1985), an alternative hypothesis states that, if we move to a world where there are taxes, when the interest on debt is tax deductible, and ignoring other frictions, the value of the company increases in proportion to the amount of debt used.

### **Trade off Theory** [Kraus and Lichtenberger (1973)]

The trade-off with reference to capital structure theory refers to the amount of debt and equity finance employed by a firm by balancing the cost and benefits. This version of the hypothesis goes back to Kraus and Lichtenberger, who considered a balance between the dead-weight costs of bankruptcy and the tax saving benefits of debt. Often agency costs are included in the balance.

### **Agency Cost Theory** [Jenson & Meckling (1976)]

Agency theory indicates that the firm can be viewed as a network of contracts between resource holders or Stakeholders. An agency relationship arises whenever one or more individuals (principals), hire one or more other individuals (agents) to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in business are those between

1. Stockholders and managers
2. Debt-holders and stockholders.

### **Pecking Order theory** [Donaldson (1961), Myers and Majluf (1984)]

It states that the cost of financing increases with asymmetrical information. The priority by a firm is given to internal funds first, then to debt and equity at last. An important purpose of

the theory is to explain the fact that corporations usually are financed partly with debt and partly with equity. It states that there is an advantage to financing with debt, the tax benefits of debt and there is a cost of financing with debt, the costs of financial distress including bankruptcy costs of debt and non-bankruptcy costs. According to Myers and Majluf (1984), the rationale for the pecking order is asymmetric information.

This means in a start-up phase the firm would depend largely on the internal finances including borrowings from Friends, Family, and Relatives and in the next stage as they progress, they would raise debt and lastly avail of equity as a source of financing

### **Information Asymmetries**

[George Akerlof, Michael Spence, and Joseph E. Stiglitz (2001)]

Information asymmetry deals with the study of decisions in transactions where one party has more or better information than the other. Adverse selection refers to a situation where sellers have information that buyers do not have, or vice versa, about some aspect of product quality .It applies to the Financing decisions made by various lenders prevalent for SME's financing.

### **Market Timing Theory [Baker and Wurgler (2002)]**

The MTT suggests how the enterprise in an economy decides whether to finance its investment with equity or debt option. It is one of the corporate theories that contrasts with pecking order and trade off theory. It simply states that firms do not generally care whether they finance with debt or equity; they just choose the form of financing which, at that point in time, seems to be more valued by financial markets. Huang and Ritter (2009) find that the net equity issues track the firm financing deficit when the cost of equity is low.

Past Literature supported the fact that the financing deficit was positively related to variations in the debt level, thereby confirming pecking order behaviour for non-listed Spanish SMEs. Irish SMEs behaved in a manner roughly consistent with pecking order theory and that there were no major differences between the capital structure of service and manufacturing SMEs. Greater informational asymmetry was found for non-listed service SMEs relative to unlisted manufacturing SMEs, thus suggesting a greater likelihood of observing pecking order behaviour in the service sector relative to manufacturing. (Bhaird & Lucey, 2010); (Lopez-Gracia & Sogorb-Mira, 2008) ; (Serrasqueiro & Nunes, 2011).

For the purpose of present research, Pecking Order Theory (PO Theory) and Market Timing Theory (MTT) have been taken as basic framework. The research seeks to investigate into the divergent positions on financing patterns of SMEs, and assess their applicability to different situations.

*This research endeavours to evaluate the applicability of the theories on capital structure of MSMEs in the two stages of start-up and later stage and find out if there is any difference with reference to debt and equity financing.*

## **[C]Antecedents of financial leverage**

The antecedents of financial leverages have been researched earlier in varying contexts. The literature review is presented in three sections of impact of industry on capital structure, impact of firm related factors, and the criteria used by financing institutions to evaluate debt proposal. The justification of present research in view of existing literature is stated thereafter.

### **Impact of industry on capital structure**

Literature enlists several firm characteristics that impact firm capital structure or leverage. The increases in the tangibility of assets raise the firm's debt ratio. Since many of the benefits and costs of debt depend on the type of assets the firm uses in its operations, the firm's industry may be useful in predicting its leverage (Faulkender & Petersen, 2006); (Hegde Desai, Borde, & Nagar, 2016).

Frank et al. (2005) studied American firms and found that firms that have a high market-to-book ratio and more profits tend to have low levels of leverage, whereas the firms that have more tangible assets and larger firms tend to have more leverage (Frank et al., 2005). Besides firm related factor, they found that high industry leverage and high inflation rates push the firms to have higher leverage (Frank & Goyal, 2005). Thus, industry influence on the firm's capital structure has been affirmed by previous researchers. This research examines the influence of sector on the Debt Equity Ratio (DER), in particular, the manufacturing v/s services sector, as availability of tangible assets substantially differentiates the two sectors. In the Indian context, the definition of MSMEs has adopted dissimilar quantum of investments in plant and machinery across the two sectors. This research specifically seeks to find the role of industry and the tangible assets backup on capital structure with particular reference to SME sector.

### **Impact of firm related factors on capital structure**

SMEs find it difficult to access long term bank financing for many reasons including collateral requirement, credit history, credit worthiness, networking/relationships and transaction costs. This is supported by Scholtens (1999), Schiffer and Weder (2001); Ayyagari et al. (2006); Beck and Demirgüç-Kunt (2006).

The capital structure of SMEs in Vietnam is positively related to growth, business risk, firm size, networking, and bank relationships but not related to tangibility (Nguyen & Ramachandran, 2006). Harris et al.(2009) have quoted other authors to enlist firm related factors like volatility, profitability, growth opportunity, size, uniqueness of products, advertisement and research and development expenditure. Ngoc & Nguyen, (2009) stated that liaison of SME with customers and government promotes use bank loans while liaisons with suppliers and social ties reduces use of bank loans further supporting use of venture funds over debt. Informational asymmetry, financial reporting (unavailable and unreliable financial data) and credit risk add to the problems of SMEs and financial institutions are reluctant and prudent in providing finance (Yigui Ma & Shumin Lin, 2010). Improving political affiliation allows greater access to long term fund while entertaining and gift giving improves short term debt (Guariglia, Newman, & Du, 2013). In Ghana and Nigeria, the size of the firm, age of the firm, ownership type and relationship banking have a positive impact on a decision to extend credit to small firms in West Africa. (Boateng & Abdulrahman, 2013). International accounting standards improves informational asymmetries (Barth, Lin and Yost 2011).

### **The criteria used by financing institutions to evaluate debt proposals**

The criteria used by financing institutions are mainly the success factors that relate directly to functional management skills, namely planning of the enterprise, knowledge of competitors, being mainly market-focused, quality work enjoying priority, client service, financial understanding, financial management, knowledge and skills with regard to the enterprise and the utilisation of experts. Success factors that relate to personal characteristics that are used as financing criteria by financiers are creativity, innovation and commitment to the enterprise (Nieuwenhuizen & Kroon 2003). Five factors have been identified by Bhalla and Kaur 2012 towards decision making criteria by the banks. These are loan characteristics,

financial and collateral backup, margin money and earlier track record, entrepreneurial characteristics, skills and purpose of loan. Substitution effect and rent extracting behavior encourage venture capital over bank finance (Berger and Schaeck 2011). Large, more diversified, firms face lower default risk. In addition, older firms with better reputations in debt markets face lower debt-related agency costs. Thus, the trade-off theory predicts larger, more mature firms to have relatively more debt (Frank & Goyal, 2009).

The firms' capital structure undergoes a change with the age of the firm (Hegde Desai, Borde & Nagar, 2016). The firms which have a proven track record find it easier to raise debt than the firms at a start-up stage. Financing gap for SMEs can be studied at which point it originates in firm's life cycle by analysing financing preferences of SMEs (Satish Kumar and Rao 2015). Financial constraints are more severe for younger and smaller firms. Start-ups/new entrepreneurs appear to be financially constrained. Bank lending is the major provider of external business finance (Carreira & Silva, 2010)

### **Factors affecting risk perception of bank managers in MSME lending**

Perceived properties of risk source is the source from where the risk has emerged. The risk source in MSME lending is the information insufficiency that MSME units have, which is termed as the information asymmetry. Possible consequences are the two possible risks resulting from this information asymmetry –Risk of adverse selection and Risk of moral hazard. Risk of adverse selection is that risk perceived by the bank manager when he is not able to assess MSMEs ability to pay the credit taken and risk of moral hazard is when the bank manager is not able to assess the borrowers' willingness to pay back the loan

The emerging economies like India have been recently focussing on start-ups. The previous research has tested the impact of age on the leverage and found that maturity has favourable impact on leverage.

*This research has queried into the capital structure of MSMEs across initial start-up stage and the later stage. It has operationalized age into start-up stage and later stage. It has endeavoured to enquire whether there is significant difference across the firms' capital structure across initial and later stage. It has then sought to establish whether the factors like size and sector have an impact on the capital structure as represented by debt equity ratio in the initial and later stage.*

*The factors affecting the debt availability have been researched in comprehensive way in this research, again with reference to start up stage and later stage. Literature review pointed that lesser studies are available in the area of short term loans. Hence, this research has also investigated factors affecting short term loans. The difference across different financial institutions has also been studied. The factors have been then studied from the side of Financial Institutions to get a holistic scenario.*

The literature also pointed towards SME use of other sources of finance, predominantly, venture capital. Hence, a review of other sources of finance available to SMEs is presented below.

### **Emerging sources of finance for MSMEs**

Bhaumik e.t al, 2015 explored entrepreneurial finance and its relationship with growth. They expressed a need for research to go beyond traditional supply side/market failure issues to

better understand the role of entrepreneurial cognition, objectives, ownership types and firm life-cycle stages in financing/investment decisions (Bhaumik, Fraser, & Wright, 2015). Segmented studies treat the source of capital as the only source of financing received by the entrepreneurial firm (Cosh, Cumming, & Hughes, 2009) . For example, most venture capital (VC) studies do not acknowledge that the firm may have received money from other sources of capital. Many discussions have revolved around the unsuitability of debt for early-stage financing (This is mainly due to the fact that debt holders bear the downside risk, but do not share the upside of successful innovation (Berger et al., 1998),(Berger & Schaeck, 2011), (Stiglitz & Weiss, 2016), (Hanssens, Deloof, & Vanacker, 2015). Firms experience changing needs over the financial growth life-cycle. Start-ups traditionally rely on insider finance, trade credit and, to a lesser degree, angel finance. More recently, start-ups may use crowd-funding and accelerators (see below) as sources of funding. As the firm grows and gains a track record, it is more likely to become ‘investor ready’ to access external finance such as bank debt, venture capital and public debt/equity .For some firms with growth potential, a change in ownership structure associated with additional forms of debt and equity finance may be appropriate, such as in growth oriented management buyouts and listings on stock markets.

Some of the emerging sources of finance have been stated below:

1. BSE SME Platform- Bombay Stock Exchange has set up the BSE SME Platform as per the rules and regulations laid down by SEBI. BSE SME Platform offers an entrepreneur an investor friendly environment, which enables the listing of SMEs from the unorganized sector scattered throughout India, into a regulated and organized sector.

The listed SMEs will step into the threshold of BSE SME Platform and foray in to the world of finance for further growth and development. BSE SME will assist these

SMEs to raise equity capital for their growth and expansion and thus help them blossom into full-fledged companies.

2. Private equity funds are financial intermediaries between sources and entrepreneurial firms (Cumming & Johan, 2013). Private equity funds invest in non-listed companies and include investments in mature firms. As the name suggests, private equity is largely exempt from public disclosure requirements (Kaplan & Schoar, 2005).

3. Venture capitalists (VC) focus on financing and advising young innovative start-ups. In order to make investments in start-ups, VCs firms raise money from institutional investors through ‘vehicles’ called funds and through the deal flow between the entrepreneurs and VC fund. VC is a financial intermediary, and works by taking the investors’ capital and investing it directly in firms.

4. The equally important source for start-up capital is angel capitalists (AC) (Wong, 2012). AC are also called ‘business angels’ and are individuals who invest a part of their personal wealth in an equity stake of an entrepreneurial venture. AC can be compared to VC. However, AC uses their own private money for investing, while VC use money of many different investors bundled into an organisation (limited partnership) to invest together. A business angel (BA) is a private investor that invests part of his or her own wealth and time in early stage innovative companies. Key differences between business angels and venture capital (VC) are as follows:

- (i) Own money vs. other people’s money,
- (ii) Very early stage vs. start-up or growth stage, and
- (iii) Lower amounts vs. higher amounts

5. Crowd funding involves raising funds from large pool of crowd collected online by means of web platform. Crowd funding is a collective effort of people who network and pool their money together usually via internet platforms from the general public (the “crowd”).

6. Bootstrapping refers to the use of personal assets or funds raised from family, friends, and employees. As many as 80–95% of entrepreneurial firms engage in some form of bootstrapping

7. Value chain finance -Another alternative source of financing is value chain finance (VCF). A value chain consists of a series of value-adding activities to the final product. The valuing chain starts with production, continues with processing or elaborating of the final product and ends with marketing and sales to the end user .VCF allows integration of all the players within the chain and is based on sharing and trading, for example machinery and information.

Therefore, it can possibly reduce risks and increase growth in the sector .VCF is known as the flow of funds to and among the different links inside the value chain (Miller & Jones, 2010). In other words, VCF can be defined as any or all of the financial services, products or support services flowing to or through a value chain to address the needs and constraints of the chain. Factoring is an example of VCF. It is a form of account receivable financing. The entrepreneur transfers his billing and credit risk to the bank. In exchange for a small fee towards the company, the entrepreneur receives his money immediately instead of waiting for example 90 days until the bills are paid.

8. Hybrid instruments, such as mezzanine finance, form a bridge between traditional straight debt and pure equity. It can take a form of convertible debt.

9. Trade credit is also an important source of finance for many SMEs and start-ups, which can substitute or supplement short-term bank lending. This mainly consists of the extension of traditional credit instruments and credit-mitigation tools, such as loans and guarantees, peer to Peer Business Lending.

The exploration of the field showed that only venture capital was the upcoming source in Goa along with funding from family and friends. Hence, this research has considered these two sources for survey, along with traditional sources like debt and ownership funds.

# **CHAPTER 3- RESEARCH METHODOLOGY**

Following were the stages in research methodology:

1. Literature review
2. Case studies as exploratory first level study
3. Instrument preparation for quantitative survey
4. Field survey of MSMEs with the instrument
5. Quantitative survey of financing institutions
6. Management Development Programme for obtaining data from focus groups of MSMEs and Financial Institutions along with brainstorming session and panel discussion.
7. Conclusions and managerial implications

## **1. Literature review**

Literature review was done with different sources. Secondary data was collected from the published sources, from the data available from the Government as well as Associations of Industries and Goa Chambers of Commerce etc. This was helpful in knowing the field situation about MSMEs in Goa. Literature review was done of academic publications in the area of financing of MSMEs globally. Prior research reports were also referred in this area.

Thus, sufficient appraisal of various types of literature was done before embarking on field study.

## 2. Case studies as exploratory first level study

This research was carried out in two stages of field work. The first exploratory research was done with the help of case studies. A sample of firms was selected for in-depth study in each of Medium, Small and Micro firms. The research proposal had stated that case studies would be documented one from each category of MSME's in manufacturing and service (tourism) sector.

Also for manufacturing the sector specified were pharmaceuticals and cashew processing.

Hence, case studies were done of the following firms:-

*Table 10 Case Studies Sampling Frame*

Type/Scale	Medium	Small	Micro
<b>Manufacturing</b>	1.Tulip Diagnostics (small-medium)	2.Jayraj Cashews (small)	3.Ajanta Medicals (micro-small)
<b>Service(Tourism)</b>	4.Maberest Group (Hotel Fidalgo) (medium)	5.VedAyurved Bhavan (small)	6.Jupiter Canteen(micro-small) 7.ABC's (micro-small)

Case studies were written of the selected firms covering their progress since inception with particular focus on the problems faced in obtaining finance. Some firms were started as small and had grown into medium level firms. Firms were selected based on their sectors and their willingness to share their stories. Attempts were made to write case studies of firms from both manufacturing and services sectors covering major types of industries in the state of Goa.

Case study method is preferred as the first step to understand the nuances and the complexities of myriad factors involved in financing of a firm. Several factors relating to problems in obtaining long term and short term finance, from different financing institutions were enlisted. It was found that generally the problems were more at the inception stage than at a later stage. In fact, major differences were noticed across these two periods in life stage of the firms. The generally preferred sources and the financing institutions were revealed by the firms. The case studies were very helpful to get insight into the realities of financial positions and problems faced by MSMEs. The exposure to financing patterns and problems helped in constructing structured instrument for quantitative analyses.

### **3. Instrument preparation for quantitative survey**

The instrument for survey was prepared to study the objectives of the research, namely the capital structure of the firms and the associated problems faced with respect to different financial institutions. The structured questionnaire was made with the help of a cross case analysis of the case studies and literature review. The instrument was prepared in four parts. First part captured the firm demographic data. Second part was related to collection of information about capital structure of the firm. This was separately collected for initial and later stages. Part C and D contained questions relating to factors affecting obtaining finance from diverse institutions, separately for initial and later stages and also for short term and long term. The instrument was duly tested for reliability before the actual field survey (Cronbach's Alpha 0.736).

#### 4. Field survey of MSMEs with the instrument

Field collection of data on a sample in each category with the help of structured questionnaire was done across MSMEs in Goa. The sample was as follows:

*Table 11 The sampling frame for Quantitative Analyses*

	<b>MICRO</b>	<b>SMALL</b>	<b>MEDIUMM</b>	<b>TOTAL</b>
<b>SERVICE</b>	9	22	10	41
<b>MFG</b>	9	17	3	29
	18	39	13	<b>70</b>

The data collected was subjected to Logistic Regression, ANOVA, MANCOVA, Chi Square techniques using SPSS software. The analysis was done with reference to the objectives.

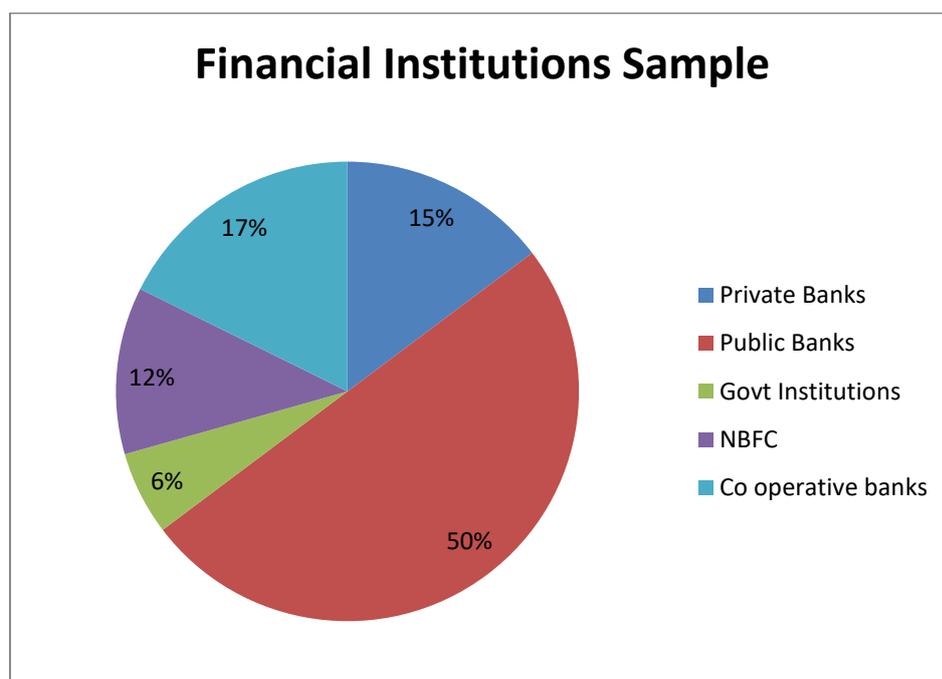
#### 5. Quantitative survey of financing institutions

Interviews were also conducted of the Officials of the Financing Institutions in Goa to study their problems in the issues unearthed with the help of quantitative data collected from the MSMEs. The questionnaire contained factors that the institutions considered as important for assessing the proposal for financing.

The sample was 34 managers and the analysis of their responses was done to obtain the multiple stakeholder perspective on the problem of financing of MSMEs. Table stating the sample composition of financing institutions

*Table 12 Descriptive Statistics of Financial Institutions*

	Frequency	Per cent	Valid Per cent	Cumulative Per cent
<b>Private Banks</b>	5	14.7	14.7	14.7
<b>Public Banks</b>	17	50.0	50.0	64.7
<b>Govt Institutions</b>	2	5.9	5.9	70.6
Valid <b>NBFC</b>	4	11.8	11.8	82.4
<b>Co-operative Banks</b>	6	17.6	17.6	100.0
Total	34	100.0	100.0	



*Figure 3 Financial Institutions*

## **6. Management Development Programme**

Management Development Programme was held for obtaining data from focus groups of MSMEs and Financial Institutions along with brainstorming session and panel discussion.

The focus groups for the purpose were of the MSMEs and the Institutions separately.

A brainstorming session was organized with the participation of representatives of the stakeholders, namely, the firms and the financial institutions, for an attempt to obtain a holistic view of the problems faced. The sessions were very useful from research point of view as well as from the point of information dissemination to MSMEs. The representatives of many financial institutions attended and had in-depth dialogues with MSME owners and managers about issues faced in financing.

## **7. Conclusions and Managerial Implications**

Conclusions were derived after quantitative and qualitative analyses of the above methodological steps and managerial implications were stated.

## CHAPTER 4- CASE STUDIES AND ANALYSIS

Case studies are documented from each category of MSME's in manufacturing and service (tourism) sector. Also within the manufacturing sector the specified and preferred industries were pharmaceuticals and Cashew Processing.

Hence, case studies were done of the following firms:-.

*Table 13 Case Studies Details*

Type/Scale	Medium	Small	Micro
<b>Manufacturing</b>	1.Tulip Diagnostics (small-medium)	2.Jayraj Cashews (small)	3.Ajanta Medicals (micro-small)
<b>Service (Tourism)</b>	4.Maberest Group (Hotel Fidalgo) (medium)	5.VedAyurved Bhavan (small)	6.Jupiter Canteen(micro-small) 7.ABC's (micro-small)

Case studies were written of the selected firms covering their progress since inception up to growth. Special focus was kept on the problems faced in obtaining finance. Some firms were started as small and had grown into medium level firms. Firms were selected based on their sectors, size and their willingness to share their stories. The cases are stated in the following section:

# **TULIP DIAGNOSTICS (PVT) LTD: A CASE STUDY**

## **(MEDIUM /MANUFACTURING)**

### **Key Points of Pharmaceutical Industry in Goa**

- Goa's pharmaceuticals industry generated revenue of US\$1.66 billion over 2014-15. The pharmaceuticals industry is one of the major employers in the state.
- A large number of companies, such as Cipla, Aventis and Blue Cross, have set up manufacturing facilities in Goa.
- Apart from the incentives and policy thrust, Goa has been selected because of its ambience and pollution-free environment, which is conducive to the pharmaceuticals industry.
- Goa Pharmaceutical Manufacturers' Association (GPMA) is a registered body formed with the objective of uniting the pharmaceutical manufacturers in Goa.
- In 2014, Goa Antibiotics and Pharmaceuticals Limited (GAPL) were acquired by the PSU firm HLL Lifecare, which has paved the way for the latter's expansion. GAPL opened its first public pharmacy outlet in Panaji in November 2014.
- According to the 2015-16 state budget, a first of its kind initiative has been launched, which will cover mental health, Ayurveda treatment as well as medication for diseases like - hypertension and diabetes.

### **Company Background**

Tulip Diagnostics Private Limited is an unlisted private company incorporated on 14 December, 1988. Its registered office is at Panaji, Goa.

**Tulip Diagnostics (P) Ltd.** is the flagship company of the Tulip Group. Tulip Diagnostics Private Limited is registered with Registrar of Companies -Goa under the Ministry of

Corporate Affairs (MCA), India. Directors of Tulip are Deepak Gaurishankar Tripathi, Natarajan Shreeram and Vinayak Kashinath Naik.

Tulip manufactures reagents and kits for Immunochemistry, Immunology (Fertility, Rheumatology, Infectious Diseases & other markers) Immunospectrophotometry, Haematology, Haemostasis and Instrumentation. The markets consist of domestic as well as exports sales.

## **Company Operations**

Initially it all started as vision of the three entrepreneurs in Pune in 1988. They chose Goa as a place for their production mainly because the land was cheaper and it also offered tax incentives in that period for enterprise start-ups then.

The General Manager said “We played to our strengths and managed the finances wisely to become what we are today”.

The first operations of the company began in a small 1000ft area plant in Old Goa back in 1999. They focussed mainly on diagnostics that was their main core competence. As the scale increased, they moved to larger premises. Eventually they had started manufacturing diagnostic kits and other products that were mainly catering to OEM (original Equipment Manufacturer) businesses in India and Abroad.

Things were not rosy for initial years and they had to face financial crunches during first 10 years. Their financial decisions were wisely made. There was strict control over expenditures. Once they established themselves and their brands in the market all over, the real cash flows and expansion took place. They started as one unit and expanded to more than nine plants across India with 7 of them in Goa.

Currently, they have a strong market presence in India and abroad. Knowledge and Innovation were said to be the key ingredients for their success in the competitive pharmaceutical Industry.

## Financial details:

Tulip Diagnostics Private Limited is an Indian Company. Tulip Diagnostics Private Limited is classified as Private non listed company.

The authorized share capital of Tulip Diagnostics Private Limited is 6,00,000,000.

The paid up capital for Tulip Diagnostics Private Limited is 2,10,00,000.

According to the corporate database website the borrowing details are the following:-

*Table 14 Financial Details of Tulip Diagnostics from Source: Zauba Corporate Database*

(Tulip Diagnostics Basic Information, 2016)

Creation Date	Modification Date	Closure Date	Assets Under Charge	Amount	Charge Holder
1987-04-10	1999-04-17	2015-06-03		13,581,000	PANAJI BRANCH
1989-06-12	1990-10-04	2015-06-03	Book debts	50,000	BANK OF INDIA
1990-07-25	-	2015-06-03		71,000	BANK OF INDIA
1990-10-04	1991-08-24	2015-06-03		550,000	BANK OF INDIA
1990-12-05	-	2015-06-03		126,000	BANK OF INDIA
1991-06-04	-	2015-06-03		639,000	BANK OF INDIA
1991-08-20	-	2015-06-03		90,000	BANK OF INDIA
1992-02-28	-	2015-06-03		150,000	BANK OF INDIA
1999-04-17	-	2015-06-03		1,500,000	BANK OF INDIA
1989-06-12	-	2015-06-03	Book debts	50,000	BANK OF INDIA
1993-03-12	-	2015-06-03		1,000,000	BANK OF INDIA
2003-10-23	-	2009-12-23	Immovable property or any interest therein	9,500,000	BANK OF INDIA

Thus, it can be seen that the capital structure of the company consisted of both the share capital and term loans. Besides, they also had cash credit/ overdraft facility for the short term requirements. According to the general Manager of the firm, it has very sound cash inflows and is able to fund their working capitals from internal funds. They have Cash Credit/Overdraft facility but hardly use it. It is also seen that the company has been consistently banking with Bank of India. This shows a good bank relationship.

# **MABEREST HOTELS PRIVATE LIMITED: A CASE STUDY OF HOTEL FIDALGO, GOA (MEDIUM/ SERVICE)**

## **Goa's Economy: Tourism and Hospitality in Service Sector**

- Goa is considered as a tourist paradise globally. It has high inflow of international tourists driving tourism revenue.
- Tourism is the largest segment in the services sector; and Goa Tourism Development Corporation (GTDC) is responsible for promoting tourism in the state.
- In 2014-15, the state attracted 3.54 million tourists, of which 0.51 million were foreign tourists. The tourist inflows increased by 30% in 2014, as compared with 2013. This was the highest growth recorded by any state in India in percentage terms
- For the year 2015-16, the budget allotted for tourism was US\$43.15 million as compared with US\$ 23.38 million 2014-15. A special purpose vehicle worth US\$ 1.66 million is expected to commence. This would prove beneficial for the creation of international convention centre at Panaji to give world class facilities at one place.
- Innovative marketing strategies to project Goa as an all-time leisure destination have resulted in higher tourist inflows over the years.
- On March 2015, the number of foreign tourists in Goa under 'e-Visa' category was 12,639. In 2014-15, the state attracted 3.54million tourists, of which 0.51 million were foreign tourists. The tourist inflows increased by 30% in 2014, as compared with2013. This was the highest growth recorded by any state in Indian percentage terms.
- For FY 2014, the number of charters that landed in Goa stood at1, 128 and the number for FY 2015 is expected to be at 1,400. As of 2014-15, Goa had 3,010 hotels, with a total of 30,248 rooms and a bed capacity of 53,177.

- The state Government has been proactive in encouraging public-private partnerships for promoting tourism by instituting a corpus fund.
- During 2014-15, the Ministry of Tourism of India sanctioned US\$ 1.46 million for the promotion of tourism at heritage sites located in Goa the Government of Goa extended the facility of providing e-visas to 150 countries.

(India Tourism Statistics, Ministry of Tourism, 2015), Airports Authority of India, Department of Tourism, Government of Goa, Economic Survey of Goa, 2014-15

## **Introduction**

Hotel Fidalgo is a hotel located in heart the heart of Panaji city that has 103 rooms ranging from economy to luxury class. Established in the year 1974, Hotel Fidalgo is a 4-star hotel where style meets comfort. This hotel is very suitable for business travellers and for those looking for a downtown accommodation in Goa. Hotel Fidalgo is a downtown hotel that has 103 rooms ranging from economy to luxury class. The economy class rooms come in the subcategories of premium and club rooms. The executive and privileged classes offer suites in addition to premium and club rooms. All rooms are centrally air conditioned and are equipped with amenities such as LCD TV, coffee-maker and Wi-Fi connectivity. This hotel also has a health spa—ZIV—which offers various spa and salon treatments and sends its patrons with 100% natural product give-aways. Hotel Fidalgo also houses a book shop and a swimming pool. There are six conference halls available within the hotel of various capacities.

Maberest Hotels Private Limited (MHPL), was incorporated on 29th May 1972. Hotel Fidalgo is a part of Maberest Hotels Private Limited.

This company has other Hotels in Pune and Hyderabad. The company is promoted by Mr Jayant Shetty and is closely held. The property was running under the name “Hotel Fidalgo” under a different management till 1998-99 when it was closed down and put up for sale. Mr Jayant Shetty then purchased it as an asset buyout in 20-02-03. Post his purchase, Mr Shetty refurbished the hotel, added new restaurants and started the hotel again in phases (October 2005 and October 2006) under the same name “Hotel Fidalgo”. During FY 2016, MHPL also started operations of new discotheque “Nyex beach club” at Anjuna, Goa. Recent Results MHPL reported an operating income of Rs. 22.28 crore and profit after tax of Rs. 0.87 crore during FY 2015 as against an operating income of Rs. 21.90 crore and profit after tax of Rs. 0.83 crore during FY 2014. (Credit Ratings, 2016)

### **Maberest Hotels Private Limited**

Maberest Hotels Private Limited was registered at Registrar of Companies Goa on 29 May, 1972 and is categorised as Company Limited by Shares and an Indian Non-Government Company. Maberest Hotels Private Limited currently has 6 Active Directors / Partners, and there are no other Active Directors / Partners in the company except these 6 officials.

*Table 15 Directors Details of Maberest Hotels Pvt Ltd*

DIRECTORS DETAILS
<b>VASANT SANJEEVA SHETTY</b>
<b>JAYANT SANJEEVA SHETTY</b>
<b>GANESH SHETTY</b>
<b>HARISH SHETTY</b>
<b>PRATIBHA SHETTY</b>
<b>SUREKHA JAYANT SHETTY</b>

## Financial Summary

Maberest Hotels Private Limited is a Private incorporated on 29 May 1972. Its authorized share capital is Rs. 120,000,000 and its paid up capital is Rs. 94,451,000. It is involved in Hotels; camping sites and other provision of short-stay accommodation.

## Share Capital

*Table 16 Share capital of Maberest Hotels Pvt Ltd*

<b>Authorised Capital</b>	Rs.120,000,000
<b>Paid up capital</b>	Rs. 94,451,000

Its borrowing details are as follows:

## Charges/Borrowing Details(Maberest Group Basic Info, 2016)

*Table 17 Financial Details of Maberest Group Source -Zauba Corporate Database*

Creation Date	Modification Date	Closure Date	Assets Under Charge	Amount	Charge Holder
2006-04-18	2008-08-30	2014-10-10		137,500,000	
2008-02-27	-	2015-06-05		15,000,000	
2009-10-29	-	2014-10-10	Immovable property or any interest therein	180,000,000	
2011-11-23	2014-01-15	2014-03-22		142,800,000	
2012-09-13	-	2015-08-06		8,750,000	
2013-07-27	-	2015-08-06		20,000,000	
2014-03-20	2015-04-09	-		211,825,000	
2015-08-31	2016-02-29	-	Immovable property or any interest therein; Credit Card Receivables	20,400,000	

1976-06-26	-	-		1,000,000	
2005-05-13	-	2006-04-18	Immovable property or any interest therein	0	
2005-11-07	-	2007-09-03		3,500,000	
1979-03-02	-	-		3,200,000	
2003-11-27	-	-	Book debts	10,000,000	
1974-10-31	-	-	Immovable property or any interest therein	3,500,000	
2003-01-31	-	-		42,500,000	

## Credit Ratings

Maberest Hotels Private Limited

ICRA has revised the long-term rating to [ICRA]BB- (pronounced ICRA double B minus) from [ICRA]BB (pronounced ICRA double B). ICRA has also revised the short-term rating to [ICRA] A4 (pronounced ICRA A four) from [ICRA] A4+ (pronounced ICRA A four plus). The outlook on the long term rating is 'Stable'.

Banks finances are required when they start renovation of building/buildings. They renovate one of the floors every year so that the repeat customers feel something new every time they visit them. The costs of recent renovations amounted to around 40 lakhs and were sourced from bank on term loan arrangement. (Credit Ratings, 2016)

## Working Capital

The company's accounts head stated that the average monthly turnover is around 26 lacs. They have cash credit facility with the bank for 50 lakhs. Major expenses include salaries and payments to suppliers as it is funded from earnings as well as banks.

They prefer to continue operations with one bank for all transactions as they feel this arrangement is better. Apart from these views, banks access is not a problem as they are

located in city and all major banks are close to their proximity. Their business is blessed with constant customers as they are located in prime location and have 6 different dining locations. The Dining location is unique and gets lot of walk-in customers apart from regular customers. On the issue of government assistance they stated that government schemes are there in place but this company has not been relying on them as they never come on time.

# CASE STUDY ON JAYRAJ CASHEWS

## (SMALL /MANUFACTURING)

### Introduction

“*Jayraj Cashews*” is a small scale cashew processing unit in a mining area situated in Phanaswadi, a small village in Honda, of Sattari Taluka, in North Goa District of Goa. It is supporting more than 150 households affected by the mining ban in Goa. It employs around 155 employees, mainly unskilled and semi-skilled. **Female employees constitute 99% of employees in the firm.**

Jayraj Cashews started its operations in 2013 under young leadership of Mr Viraj Shirodkar and Mr Vindesh Shirodkar. They were guided and supported by their father with long and rich experience in the industry, who had ventured into this business in early 1990’s. They have two more operational plants, one in Podoshi and another in Sindhudurg, a district in Maharashtra, very close to Goa.

Their product is manufactured at M/s Jairaj Cashew Industry and marketed by another agency. They supply their product mainly to Navi Mumbai market.

### Cashew Industry in India and Goa

India is largest producer as well as consumer of cashew. In India, cashew was first introduced in Goa, from where it spread to other parts of the country. Cashew (*Anacardium occidentale* L.), a tree native of Eastern Brazil, was introduced in India by the Portuguese nearly five centuries ago Initially, it found use in soil binding to check erosion. Commercial cultivation began in the early 1960s and, over the years, cashew became a crop with high economic

value and attained the status of an export-oriented commodity, earning considerable foreign exchange for the country.

- India accounts for about 65 per cent of global cashew exports.
- India exports cashew kernels to over 60 countries. Its major markets are the US, the Netherlands, Japan, Spain, France, Germany, the UK as well as Middle East countries such as the UAE and Saudi Arabia.
- The US is the largest market for Indian cashew kernels, followed by the UAE and the Netherlands, while Indian CNSL is largely exported to South Korea, followed by China and the US. ([www.ibef.org](http://www.ibef.org))

Cashew is being exported to European Union and other countries from Goa. Goan cashew is of good in size, colour and taste. Cashew processing has been a traditional industry in the state. Cashew apple is also used in the production of feni, local liquor, which has become internationally popular. Cashew nut production reached 26,340 tonnes in 2014-15. According to Central Statistical Organisation of Goa, a total of 55,936 hectares of area is under cashew cultivation which is about 35.44% of total cropped Area in Goa in year 2014.

Majority of players in Goan cashew processing industry thrive on local produce, whereas other parts of country like Mangalore, Kerala depends substantially upon imports from African countries mainly Tanzania. It has a very healthy demand all over.

The Phanaswadi village, situated in Mining belt was largely dependent on mining activities and contributed for villagers earning. Mining Ban in 2012 severely affected the villagers. Some villagers and panchayat members approached Viraj's father and persuaded him to start

the closed plant, as it would generate employment for some villagers and support households affected by mining.

## **Competitors**

According to owner, there exist more than 35 micro small and medium plants with processing capacities varying from 5-6 bags to 10 tonnes a day in Goa. Majority of them are confined to Sanquelim, Valpoi, and Ponda and Bardez areas.

## **Inception and Operation**

Jayraj Cashew is managed by new generation entrepreneurs, Mr Viraj Shirodkar and Mr Vindesh Shirodkar. It all started for them when Mr Viraj, who graduated from a premier business institute in Mumbai, ventured into family business. He was joined by his brother, a software engineer by profession who earlier worked for a multinational IT firm.

Earlier in 2005, their family had bought an auctioned cashew plant with a loan arrangement from State Bank of India and had successfully paid back the loan within next 5 years. This earned them good credit points for any future ventures.

“Almost 95 % of villagers were dependent on Mining. Mining ban in 2006 affected the village very badly. The villagers approached us with a proposal to start up the closed plant” said Viraj. Converting a looming threat to an opportunity, Mr Viraj ventured into this business. Since they had a plant that was not functional they decided to revamp it. It was decided by his father to let him manage its entire operations independently to learn the details of doing business.

Viraj prepared a business plan with estimated project cost of 1.2 Cr. It included 60 lakhs for Land and Building repairs and 60 lakhs for plant and machinery. The premises were very

large and had many sheds as like old plant setups. Most of the sheds were in ruins. Entire machinery was old and out dated and had to be scrapped. They opted to renovate and restructure one of the shed as per their needs and made alterations to accommodate new machines/equipment. The new factory installation was such that entire operations could be monitored from a single place.

Some changes included the following:-

- Open work floor to enhance monitoring
- Replacement of broken roofs with new industrial roofs
- Re plastering of walls

Initially they conducted a survey and visited 4-5 operational cashew processing plants in Mangalore. They learnt that there was a large market both for cashew processing as well as processing equipment's and machinery in the country. Most of the factories in Mangalore, imported raw cashews from outside India (African countries) and thus had mass production capacities.

*“We worked out a plan with provision for best of the machines in business. Equipped with latest machines and technology was definitely an advantage”*, the owner said. They prepared a Project plan which included the plant and machinery. They did not compromise on the machinery/equipment's rates and procured latest state of the art machinery.

They explored various funding options. They approached more than seven institutions for finance and forwarded their Project Reports. Some of them were State Bank of India branches, Canara Bank, SIDBI, Bank Of Baroda, Saraswat Cooperative Bank, and some Private Banks like HDFC, ICICI etc.

Comparing all options they found cost of capital was more or less the same when compared and it was around 12-15%. The public sector banks lacked the supportive approach while private had very good and quick approach. Some banks undervalued project cost. In one of the public sector banks they had to wait 2 hours to meet a manager for the said purpose and he did not turn up. They kept their file in the bank hoping that the manager would call back but there was no response.

Finally they sought a loan from State Bank of India, Mandovi branch for 90 lakhs with 30 lakhs as margin money and land as collateral. It was mainly because they had purchased the same plant in auction on loan from them and then had successfully repaid the loan on time. This had earned them a good reputation and credibility and the bank was also willing to grant them loan in a speedy manner.

They found quality service and support from the said branch for term loan and it helped them for the working capital requirements in difficult time. As cashew is cash crop and harvesting season is March to May, they had to stock the raw material for 9-10 months. The prices of cashew rose such that despite of provision of 1.5 Cr per year that had to re-plan the provision. Here the bank revised the working capital limits going out of the way and provided the loan on time.

It was through a seminar conducted by EDC Ltd that they had come to know about funding from government agency. They learnt about the schemes for the start-up basically and thought of capturing the opportunity. They found a suitable scheme in which EDC could fund for small industry with land as collateral. Later they sought a term for 30 lakhs with Interest rate as 11.5% per annum. Although the same scheme could fund up to 2 Cr but they could not

rely on government scheme because it took more time to get sanctioned than State Bank of India. Another Problem was that they had got clearances and licences from all departments but had to wait 6 months for Panchayat NOC certificate. It was sorted out after political intervention of local MLA.

Finally they went with State Bank of India, where they invested 30 lacs as their own as margin and rest 90 lakhs was then funded by SBI as they had a good reputation. Cost of capital across from all other institution was 12-13%. SBI had some hidden charges which later on they adjusted owing to goodwill and reputation.

They got assistance of 30 lakhs from EDC Scheme for small scale industrial unit much later.

## **Funding Summary**

*Table 18 Capital Source Details of Jayraj Cashews*

<b>OWNER EQUITY</b>	30 lakhs
<b>BANK FINANCE</b>	90 lakhs
<b>GOVT SCHEMES</b>	30 lakhs from EDC
<b>WORKING CAPITAL PROVISION</b>	1.5 Crore annually arranged with State Bank of India, Mandovi branch, Panaji

## **Working Capital**

Firm had a provision of 1.5 Cr for working capital from State Bank of India. Later due to rising prices of raw cashew, bad climate, low seasonal output and pressure from rest of Goa players (Mangalore belt); they had to seek additional 1.5Cr from State Bank of India. Total Working Capital cap was 3-3.5 Cr approx. (refer to table)

Cashew being a cash crop it has a very huge amount of working capital requirement and it needs to be stocked for a year to aid its operations due to its seasonality.

*Table 19 Cashew Price Fluctuations*

<b>Approximate Price</b>	<b>YEAR</b>	<b>REASON</b>
<b>Rs. 60 per kg.</b>	Year 1	New Govt ,Revision
<b>Rs. 80</b>	Year 2	Rise in prises
<b>Rs. 140</b>	Year 3	Govt Duty, low seasonal crop

### **Instruments of Finance**

- Loans against stock which needed a bank representative to open the stock, (not preferred). This facility is called Pledged Cash Credit
- Cash Credit
- Term Loans.

Currently both the plants together have a processing capacity of 4/5 tonnes raw cashew a day.

It has huge demand with advance bookings.

### **Facts and opinions**

- *“We chose a bank 30kms away from our place State Bank of India, Mandovi branch.”* said the owner.

Choosing a suitable bank was a major challenge, mainly due to quality of service provided by the bank. The owners and the bank representative’s relations also played an important role.

Many a times they had to negotiate and come to a solution out of the box. They negotiated on working capital provisions and eventually got it on time without affecting their business.

- On other hand a local bank which was financing his father's plant in Bicholim, also approached them. The branch manager carefully studied the financing requirements and approached the father. The service offered there was good despite not having prior connections with manager.
- The owner felt that the whole funding depends on the owner's relations with bank managers and not the Bank. They have to go out of the box for solutions. Banks have lot of formalities and procedures to follow and generally ignore the business owner's problems. They have no provision for dynamic market changes and even if they have, it comes in very late.
- Corruption and Political interference at some or the other level discourages the start-up.  
*Newly elected panch members asked for ransom despite all documents procedures and clearances in place for NOC's. It took 3-4 months for NOC from panchayat and political intervention as well from a local MLA.*
- Owners feel that all policies and interventions made by the government at central level are very commendable. It took only a small online registration to get the Udyog Aadhar Number within a day. It was felt that had it to be done manually through a state body it would take more time and money.
- Government employees showed least support; despite having all documents they were delayed unnecessarily. Some government officials or employees in key departments do not have the right sensitivity and attitude for confrontation with business owners/would be owners.

*"Many a times we had to wait hours for meeting employees. For Simple inward of file we were told to come after lunch break or tea time."* said the owner.

One Incident that the owner conveyed was that their comprehensive business plan made by an MBA graduate who studied at premier business institute was not accepted and they wanted a simple one page business plan. It was ridiculous for him. He wondered how an uneducated entrepreneur funded by the same would survive this behaviour under such environment.

# **CASE STUDY ON VED AYURVED BHAVAN**

## **(SMALL /SERVICE)**

### **Tourism and healthcare sector**

Tourism is the largest segment in the services sector; the Goa Tourism Development Corporation (GTDC) is responsible for promoting tourism in the state. It has also emerged as a main destination for Medical Tourism /Health care supported with major hospitals like Apollo, Manipal and Wockhardt having their presence in the state.

Goa has ample scope for natural wellness centres as the infrastructure is readily available. It is a best substitute for Kerala which is a major tourist destination supported by its Ayurveda wellness centres. The state has better health ratios compared to the rest of the country. Annually, around 276 persons were served per hospital bed during 2014-15.

### **Introduction:**

Ved Ayurved Bhavan is pure and traditional Ayurvedic clinic and panchakarma centre where all Ayurveda treatments, rejuvenation programs are suited to specific constitution & lifestyle based on the ancient principles of Ayurveda. It provides the accurate & thorough diagnosis together with the professional treatments by a caring staff & with proper Ayurveda oils & herbal medicines. Its Goa based Clinic Owner is Dr Chinmay Kulkarni. They are into wellness industry basically into service sector since 2011 with branches in Kolhapur, Pune and Goa. It has a poly clinic in Mumbai. The Kolhapur Clinic is managed by the elder brother Dr Shriprasad Kulkarni and Pune Clinic are jointly managed by Dr Chinmay Kulkarni and Dr Supriya Kulkarni. They have a website [www.vedayurvedbhavan.co.in](http://www.vedayurvedbhavan.co.in) providing full details.

Its Goa based clinic caters to both domestic as well as foreign clients. It also offers training in yoga, stress management, lifestyle Management to individual and enterprise employees as well.

## **Business Environment**

Ved Ayurved Bhavan boasts of loyal clients from both India and abroad. There is a significant awareness among foreigners towards Indian traditional medicinal system. The owner finds them more dedicated and devoted to Indian science.

He ventured into consulting during his Internship days in Pune and nearby villages. Over the time when confidence built up, he started permanent clinic in Pune initially. Next idea was to expand business and market it globally so that it could generate awareness and revenue from international clients. Goa was seen as the right place. In July 2011 he started operations in Goa. Owner states that the main hurdles were faced during starting the business. Despite governments interventions/assistance he feels that finance still remains a very big Issue for a new comer like him.

He started looking out for a place finalising interiors and sourcing medical equipment and medicines. The interiors were designed with the help of interior designer as right kind of ambience and natural vibe is required in natural treatments. Hence, special attention had to be given to interiors in order to focus on the target patients.

He had done a comprehensive market survey and procured Ayurveda equipment of best quality. The equipment was made from premium wood like sesame costing a lot. Initially they approached banks with project reports that they had made from their requirements. Some

of the banks they approached were corporation bank, ICICI, SBI etc. They found the banks were approachable but had lot of formalities and always asked for collateral security. After providing healthy collateral security the banks agreed but the rate of interest was 13-16% with lot of hidden charges and delays in processing loan application.

The initial cost for entire setup was estimated to be around to 17 -18 lakhs in 2009-10. Another quick option the banks offered /suggested them was to avail a personal loan again asking for IT returns and collateral in the form of Fixed deposits, Gold or Property assets. The rate of interests also was too high for personal loan. Personal loan rate of interest was around 12% and business loans 15% .Such rate of interest was not deemed affordable. The owner felt that this is why the venture funds are viewed favourably due to ease of getting finance and little paper work. Bank options were not perceived as useful as lot of policies don't support new business.

Instead they approached one of the relatives and his friend and briefed them about the venture. They were very optimistic as they themselves had business knowledge about prospects in Goa. They had earlier helped him to search for premises in Goa. Ved Ayurved Bhavan got the funds from them initially to be returned in the form of EMI or lump sum basis. They were also open to profit sharing basis. Such flexibility would not be possible with bank funding or any other sources initially. Thus, he procured funds through the venture fund. The initial start-up funds required were 17-18 lakhs in 2009.They started as a joint venture and resorted to profit sharing mechanism.

With the start of the clinic, the business flourished well and cost of operating was less because lot of purchases were done centrally, keeping in view the needs of all other clinics.

The brand being Ved Ayurved Bhavan the labels, posters, stationary bills of all other clinics were same. Only the VAT accounts and other accounts were maintained at different places. Even the Chartered accountant used to manage all accounts from single place, namely, Kolhapur. With the growth of business various banks approached for current accounts but the owner chose Corporation bank and ICICI bank as both were nearest and provided prompt facilities compared to others.

Another reason for choice of ICICI bank was that they had a merchant account with them for a point of sale machine which helps them realising the payment from customers through the ATM/Credit cards. This helped to manage their delayed payments, without having to worry about credit to customers.

Currently, besides consulting, the firm is having a distributorship of major Ayurveda medicines in north Goa. Their working capital need is increased as compared to initial times but now they are eligible for short term loans from banks as they have proper accounts and Income Tax returns. In others words they have improved their credibility. The working capital needs are higher as compared to setup cost today. Major portion of funds is required for buying medicines. Rolling operations is main tasks as there are delayed payments from customers. Amount of payment to pharmacies is large and credit duration from them is less (1 month). Cash conversion from sales usually takes 3-6 months. Buying in bulk is seen as better option.

### **Working capital options (CC/OD)**

- Quotation is raised based on which the bank gives them a short term loan
- Cash credit is given for purchase of medicines or equipment [Term duration: 0-6 months]

*Table 20 Financial Summary of Ved Ayurved Bhavan*

<b>Initial Set up Cost</b>	17-18 lakhs
<b>Finance Option</b>	Venture Funds
<b>Working Capital</b>	Cash Credit facility with corporation bank, Pilerne branch (50,000 approx.)
<b>Bank Accounts</b>	Current account with corporation bank for agency sales(distributor) Current account for clinic for consulting and sales on the over the counter sales
<b>Other accounts</b>	Merchant account with ICICI bank for point of sale machines, namely collection facility

## **Competition and Marketing**

Competition from other doctors both allopathic/Ayurvedic is present but this business has competitive edge as the focus is mainly on chronic and severe ailments. The treatments are harmless and can be continued with allopathic treatments. Results of treatments are very well evident from the patient's reports during the course.

# **CASE STUDY OF AJANTA MEDICALS PVT LTD (MICRO-SMALL- MANUFACTURING)**

## **Pharma Cluster**

The cluster is run by the Goa Pharmaceutical Manufacturers' Association (GPMA) and accounts for around 12 per cent of the country's medicine production. Principal products manufactured are tablets, capsules, ointments, liquid orals and injectable. The cluster has an annual growth rate of 18-20 per cent; and, currently, 40 units are functioning under the cluster. In 2014-15, the Pharma industry recorded revenues of US\$ 1,658 million. The export of pharmaceutical products from the state has increased from 2,157 metric tonnes in 2012-13 to 6,151 metric tonnes in 2014-15.

## **Company Background**

Ajanta Medical Pvt Ltd is small scale manufacturing plant situated in Bethora IDC, Ponda Goa. It started its operations in the year 1990. Mr Dileep Dessai is the managing director and Mr Dileep Reje is the Manager in charge of the plant. Directors of Ajanta Medicals Private Limited are Nalini Damodar Desai, Dilip Damodar Desai and Archana Bhoje. Mr Dileep Reje handles the day to day management of the plant. With almost 26 years since inception, he shared his experiences and issues related to their plant.

Ajanta Medicals Private Limited is a Private Limited Company, incorporated on 22 November 1988. It is registered at Registrar of Companies, Goa. Its authorized share capital is Rs. 1,500,000 and its paid up capital is Rs. 700,000. It is involved in manufacture of medical products.

Adusol is their main brand which is manufactured, packaged and distributed under their name. Adusol is a cough medicine formulated from ayurvedic extracts. Its main markets are Gujarat and Mumbai. It holds first and second position market share in Gujarat and Mumbai respectively. Apart from above it also operates on Loan and Licence Basis for Adcoc Ingram Healthcare. It manufactures cough medicine which is packaged under the name Apimor for Adcoc Ingram Healthcare. They also have other products.

Currently it is exploring the option to venture into Export of their brand to Gulf and African countries.

## **Operations**

Ajanta medicals have been manufacturing a liquid oral ointment. They also carry out formulation and packaging of said Adusol product in the unit. They get ready made extract and formulation is manufactured and packaged in the unit. Currently the capacity utilisation is 33 %.( 20/60 batches), with production capacity of 2000 litres per day per batch and total Annual turnover of approximately 1.5 -2 crores.

They had undergone technology upgradation and installed new machines with higher capacity. This has resulted in improved performance, efficiency and also occupation of less space. They had done renovation of the plant around four years ago. The total valuations of entire plant was around 1.5 Crores.

## **Financing options**

They had various options available for financing their short term as well as long term needs. Some of them considered by them were as follows:

- Economic Development Corporation Ltd ,Goa
- Small Industries Development Bank of India.
- Mudra Bank
- Public Sector/Nationalised Banks
  - State Bank of India
  - Canara Bank
  - Corporation Bank
- Private Sector Banks
  - ICICI Bank
  - YES Bank
  - HDFC Bank
- Non-Banking Financial Institutions(NBFC's)
  - Pyramid Finance

### **Long Term Financing options**

Initially when they started in 1990, the funds were sourced from EDC Ltd. It provides financial assistance to units for setting up projects of eligible industrial activities for acquiring fixed assets like land, building, plant & machinery and other miscellaneous assets. They have successfully repaid the loan in time.

With over 26 years of operations, they had to undergo repairs of the plant and upgrading the machines for better production and avail the benefit of operating under loan licence for third party production. They had carried out renovation and procurement of new machines some years ago. Recently within a year they had replaced an old machine with new machines. They

had considered many options for financing the same. They explored options for funding from SIDBI, SBI and NBFC's for the same.

SIDBI, Small Industries development Bank of India provides Loans for refinancing of plant and machinery. Being a government body, it offers loan at 9.75% interest with 25% of total cost as margin money. But it has a very lengthy process and lot of formalities. Moreover, it does not provide the funding on time or when required. On other hand, State Bank of India ,Ponda branch, has strongest reach and services across the country. It is considered secure and was nearest to the unit with lots of product options.

Another option namely, Pyramid Finance a non-banking financial institution was opted ahead of SIDBI, SBI and others mainly because it provided loan assistance on time and all formalities were covered in very quick time. The owners considered all the above options and selected Non-Banking Financial Company (NBFC). *“Time is money for us and we can't wait for formalities despite fulfilling all clearances and required criteria. We lose more rather than gaining if funds are not available on time”* said Mr Reje. Pyramid Finance offered loan of Rs 14 lakhs for new machinery at 13-14% rate of interest and 3 years term in a quick manner.

### **Short Term /Working Capital Financing options**

The working capital needs of the plant were around 25% of annual turnover annually. Their product being a seasonal product 1/3<sup>rd</sup> of production is covered in summer .So they need to procure raw material and stock the finished good for year round. They considered Mudra Bank, but amount has to be up to 50 thousand and discounting facilities were not suitable for them. They thought that it was good for small traders/business for working capital sourcing.

On other hand State Bank of India, Ponda being public sector bank was nearest to them. It has land building hypothecated with the same bank and working capital arrangement of 25 lakhs and provision for additional 5 lakhs in case of emergency. It was obtained in the form of cash credit against stock/finished goods.

### **Charges/Borrowing Details(Ajanta Medicals Basic Information, 2016)**

*Table 21 Financial details of Ajanta Medicals Source-Zauba corporate Database*

<b>Creation Date</b>	<b>Modification Date</b>	<b>Closure Date</b>	<b>Assets Under Charge</b>	<b>Amount</b>	<b>Charge Holder</b>
2006-11-09	-	-	Immovable property or any interest therein	1,625,000	STATE BANK OF INDIA
2008-01-09	-	-	Immovable property or any interest therein; Book debts; Movable property (not being pledge)	3,500,000	State Bank of India
2011-03-16	-	-	Movable property (not being pledge)	2,000,000	KOTAK MAHINDRA PRIME LIMITED
2012-10-23	-	-	Movable property (not being pledge)	2,500,000	PYRAMID FINANCE Private Limited
1991-04-22	1993-11-09	-		350,000	STATE BANK OF INDIA
1991-04-22	1997-12-31	-		350,000	STATE BANK OF INDIA

1993-12-11	1996-10-12	-		150,000	STATE BANK OF INDIA
2001-12-11	-	2006-06-02	Immovable property or any interest therein	0	PUNJAB NATIONAL BANK
2002-03-25	2005-03-31	-		1,500,000	STATE BANK OF INDIA
1989-06-19	1994-01-25	2007-03-29	Immovable property or any interest therein	519,000	ECONOMIC DEVELOPMENT CORPORATION OF GOA DAMAN AND DIU LTD

The charges details showed that the company had borrowings from many Institutions after, considering the pros and cons of their requirements and the features of the lending institutions.

# **CASE STUDY OF JUPITER RESTAURANT CUM CANTEEN (MICRO-SERVICE)**

Jupiter restaurant is a restaurant cum canteen operating for Vision Multispecialty Hospital Mapusa, Goa. Besides that it also provides catering services for special occasions like reception and birthday parties. A couple, Mr Sanjoy Saha and Mr Nilima Saha, managed the operations of the canteen. Sanjoy looked after the food quality, kitchen and dining operations and while Nilima looked after service and supply side and also helped in kitchen operations during peak hours.

It has around fifteen staff working between 7.00 AM and 8.00PM. Its customers have very good reviews about quality and taste. Its talked about dishes were Chapatti Bhaji, Fish Thali. and Paneer items. Continental Breakfast including Sandwiches and Pastas were their differentiated menu. They have combination of both Indian and Continental Items on the menu as they have to manage food needs of Goans, non Goans as well as international customers.

## **Story of Inception**

It was started in 2014, when Mr Sanjoy Saha decided to give up lucrative job in a major hotel and ventured out to have a start-up of his own. This Indian Institute of Hotel Management, Patna, alumni had worked in hospitality industry for almost seventeen years and left his Job when he was about to become a General Manager on promotion. He was joined by his wife Mrs Nilima Saha who later gave up her job as Housekeeping Manager in hospitality industry. She had worked in hospitality for more than 10 years.

Mr Sanjoy Saha after working for major Hotels as Food and Beverages Manager decided to quit and ventured out into businesses, as he saw an opportunity when Hospital Owner Mr Shetye approached him to lookout for appropriate canteen operator to operate the Hospital canteen. Vision Hospital, in North Goa had patients from even surrounding areas from Maharashtra. Being one of the best hospitals, it catered to clients of all classes. Apart from this, they had some specialist visiting doctors which drive more walk-in customers.

Capitalising on the opportunity, Mr Saha started Operations of Jupiter Canteen cum Restaurant. He had carefully studied the Hospital food needs and customers' footfalls in the hospitals. He had done a market survey in the Hospital before and found out the need for quality and hygienic food .The hospital also had around 150 staff whose daily food needs had to be kept in mind. It had around 700 footfalls on a normal day, with most of them being with mid to high income levels.

### **Financing needs and options**

“It happened suddenly when Mr Shetye approached me in crisis situation and informed us that earlier canteen operator had left the canteen at short notice. Although we had planned for near future we never expected it would be so sudden. I had good contacts with suppliers which I could leverage but we had very little time to arrange for finance as we were in crisis situation” stated Mr Sanjoy.

The Hospital had provided them with major Kitchen Equipment's like Gas Ranges and Utensils Washers. The major fixed cost was of the Kitchen Refrigerator and crockery items and cash counter furniture.

They had very little savings in the Bank as they had spent almost all of their savings in the construction of their house. They explored almost all the options to arrange liquid cash and approached banks .Banks demanded a lot of paperwork for a business loan and were not very optimistic about the time when finance would be available.

They projected a fixed cost of around 7 lakhs for the equipment, manpower and supplies. They got three lakhs Loan on Gold from Muthoot Finance, two Lakhs on Personal Loan in the name of Nilima from Axis Bank and remaining finance from personal Savings. Initially they faced crisis situation despite major kitchen equipment provided by the Hospital which were around 8-10 lakhs as per sanjoy's personal valuations. If they had to start on their own it would require a lot more financial burden.

They sought a loan from Axis Bank because Nilima had her salary account and it provided her loan at very urgent basis at 13% p.a .They got a Loan from Muthoot finance on Gold for a 1 year term which was another fastest source. Both the above loans were repaid within a year. They operate all days in a week without a holiday but manage staff on the shift basis. The average day sale turnover from operations is around 7 thousand while on Monday where specialist doctor's visits the hospital it touches 12 thousand a day.

They have a current account in State Bank of India and have never availed any working capital loan. However, they have cash credit and over draft facility available. They have chosen State Bank as it is the nearest to the market where all the purchases are done.

The canteen facilities are provided on the percentage sharing basis on non MRP items (kitchen preparations). It is 10% on the non-food items. Earlier it was 12 thousand per month rental as per old canteen operator.

The electricity expenses are around Rs. five thousand for a month. The salaries component is around 40-45% of turnover. Purchases are on a rolling basis. Initial investment was around seventy thousand in deposits and purchases. Other fixed expense included double door refrigerator costing around eighty thousand, cash counter cum display table worth twenty thousand, grinder, mixer, oven grill, commercial gas cylinders, coffee/tea vending machine etc. Some equipment's were bought after two months of operations and were bought in cash. The working capital is around 60-80 per cent of the turnover riding on fluctuating prices of food items and fish in particular.

As the business is now settled with regular clientele, they manage the working capital requirements from their own cash turnover.

# **ABC<sup>2</sup> (SERVING BUSINESS TOURISTS AND LOCAL BUSINESSMEN) (MICRO/SMALL-SERVICE)**

## **Introduction**

ABC is a food start up delivery service operating in a town at South Goa. It was started in February 2016 by Mr PQR. It also has a restaurant cum canteen called ABC operating in Industrial Development Council (IDC) canteen in town. Twisted Tiffin is a food packaging and delivery service. Currently it is catering to provision of meals to industrial estate area and places around Colva in south Goa.

## **Industry Background**

In India, the size of the food market in 2014 was around Rs 23 trillion. As per consultancy Boston Consulting Group , it is expected to touch around Rs 42 trillion by 2020, along with a three-fold increase in average income of household from 2010-2020. The tiffin sector caters to a demand of 2.5 lakh customers daily and there are only seven to eight organized players and over 90 percent unorganized players.

## **Inside Story**

PQR<sup>3</sup> a hotel management graduate from Institute of Hotel Management, Aurangabad started the service in early 2016. Prior to ABC he worked for Hyatt Hotels, Taj Hotels, and Disney Parks etc. While working in Goa, he could not find economic and hygienic meals and tiffin service that was willing to cater to a single meal without a month-long subscription. He found out about food needs of working class people in the industrial estate and ventured out to set

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<sup>2</sup> ABC name of Enterprise changed due to Non-Disclosure Agreement

<sup>3</sup> PQR name of Owner Non-Disclosure Agreement

up his own start up. Thus, he realised that visitors to the industrial estate and business tourists could not get good meals.

He initially launched his business with start-up capital of eight to ten lakhs and it has grown very significantly within a year. Eventually it started a 24 x 7 meal ordering service. It provides services from 9AM to 8PM and ABC from 8PM to 3PM. Currently he has started its operations in neighbouring areas of town.

"We offer freshly prepared home like daily meals for lunch and dinner, tea and snacks for parties and meetings through various food vendors. Meals are delivered in hygienic packaging," the owner said. They got a canteen contract in IDC area which is centrally located and convenient to all industries and operates as a restaurant cum canteen.

Apart from breakfasts, lunch and meals, it supplies tea and snacks to the industries nearby on fixed contract. Some employees working in town demanded supply of lunch, meals to their offices as the restaurant sitting area would be crowded during lunch hours. So they provided supply of meals to customers on monthly subscription basis. They also later extended the services to neighbouring areas of town and nearby beaches in southern Goa.

The start-up capital required for the setup was around eight to ten lakhs. Funding was obtained partly from his personal savings and borrowing from friends. They did not go on to bank funding because it required more time and paperwork and loss on the interest money.

Personal borrowing was good options as the business had good cash flows from start of operations. Later they expanded for service delivery and had technological expenses in branding, website and warm food keeping equipment.

Suppliers are paid from the day to day earnings. The food is affordably priced and accommodates all working classes. The monthly subscription business is good as it lowers the costs and is economical for customers. The quality food at economic prices is their Unique Selling Point. Thus, the business did not depend on organised sector for funds.

## CROSS CASE ANALYSIS

This is an exploratory cross case analysis. Seven cases were written across medium, small and micro firms belonging to manufacturing and services sector and in business at different levels of business life cycles. This is done with an objective to explore variables to be included in the questionnaire to be designed for quantitative analysis. The following are the results obtained:

*Table 22 Analysis of Manufacturing Sector*

Sr. No	Objective	Tulip Diagnostics	Jayraj Cashew	Ajanta Medicals
1	<b>Capital Structure of MSMEs:</b>			
	<b>Owner's Capital</b>	owner's capital	Owner's Funds	Owner's capital
	<b>Borrowed Capital</b>	The company had borrowed capital but has been fully repaid in June, 2015.	Borrowed capital present	Borrowed Capital present
2	<b>Type of Institutional Finance</b>			
	<b>Term Loan</b>	The company had Term Loan	Has a Term Loan utilized at the nascent stage.	Has Term Loan from EDC and NBFC
	<b>Working Capital</b>	It also has an OD and CC to meet its working capital requirements.	Cash Credit facility used to meet day today expenses.	Has working capital from State Bank of India
	<b>Government Support</b>	Nil	They feel government schemes are not reliable as the firm is not sure of their receipt. But they have assistance received. they also feels there is corruption in Government	Got assistance from EDC. They feel Mudra Bank also has schemes but amount is very small.

			departments which discourages start-up	
3	<b>Problems faced by MSMEs</b>	The company, when incorporated faced problems with institutional finance. However, with it in a growth phase and cash flows having become sound, the company does not seem to have problems with institutional finance. Paper work and procedures are seen as tedious.	The company in its initial stage approached a large number of banks. However, had to go 30 kms away from business place to secure bank loan. Paper work and procedures seen as tedious.	Getting loans at the initial stage is difficult. Paper work and procedures are seen as difficult.
4	<b>Across sector differences w.r.t. Institutional Finance</b>	It belongs to pharma sector-manufacturing	It is cashew manufacturing	It is pharma unit - manufacturing
5	<b>Role of federations or Associations</b>	No role seen by any federation/association in helping generate the institutional finance for the company in its start-up stage, where the help needed is highest.	No role seen by any federation/association in helping generate the institutional finance for the company in its startup stage, where the help needed is highest.	No role seen by any federation/association in helping generate the institutional finance for the company in its start-up stage, where the help needed is highest.
6	<b>Forms of Organisation</b>	Private Limited Company	Sole Proprietorship	Private Limited Company
7	<b>Size of the firm</b>	Medium	Small	Micro

*Table 23-Analysis-Services/Tourism Sector*

<b>Sr. No</b>	<b>Objective</b>	<b>Hotel Fidalgo</b>	<b>Ved Ayurved Bhavan</b>	<b>Jupiter Restaurant cum Canteen</b>	<b>ABC</b>
1	<b>Capital Structure of MSMEs:</b>				
	<b>Owner's Capital</b>	Equity capital	Owner's Fund & Funds from Venture Capitalists with profit sharing agreements.	Owner's Capital	Owner's capital
	<b>Borrowed Capital</b>	Borrowed capital present	Borrowed capital present	No formal borrowings for business. They raised money as Gold Loans, Personal Loans. These were repaid in 1 year.	No formal borrowings. Have borrowings from friends.
2	<b>Type of Institutional Finance</b>				
	<b>Term Loan</b>	They take term loan for renovation.	Has Short Term Loan	No loans	No Loans
	<b>Working Capital</b>	Cash credit to meet day today business operations.	Cash Credit facility	Nil	Nil
	<b>Government Support</b>	They feel government schemes are not reliable as the firm is not sure of their receipt.	Nil	Nil	Nil

3	<b>Problems faced by MSMEs</b>	The company did not have to face any such problems.	At a start-up stage they faced huge problems. Borrowed money from relatives as no bank was ready to finance. Also succeeded in getting Venture capital funding. Banks asked for collaterals. They were willing to give Personal Loan but not business. Paper work and procedures tedious	Loans for start-ups are difficult, time consuming and procedure laden.	Procedures and Paperwork.
4	<b>Across sector differences w.r.t. Institutional Finance</b>	It belongs to hospitality sector. (Service)	It is Ayurved Clinic and distributors of Ayurvedic medicines. (Service & Trading)	Food business (Service) No need for working capital, as adequate cash flows	Food business (Service) No need for working capital, as adequate cash flows
5	<b>Role of federations or Associations</b>	No role seen by any federation/association in helping generate the institutional finance for the company in its start-up stage, where the help needed is highest.	No role seen by any federation/association in helping generate the institutional finance for the company in its start-up stage, where the help needed is highest.	No role seen by any federation/association in helping generate the institutional finance for the company in its start-up stage, where the help needed is highest.	No role seen by any federation/association in helping generate the institutional finance for the company in its start-up stage, where the help needed is highest.
6	<b>Forms of Organisation</b>	Private Ltd. Company	Sole Proprietorship	Sole Proprietorship	Sole Proprietorship
7	<b>Size of the firm</b>	Medium	Small	Micro	Micro

The following conclusions are drawn from the above cross case analysis table with respect to the objectives of the study:

1. *To study the composition of capital structures in selected MSMEs in manufacturing and tourism sectors and to highlight the differences in financial structures across sectors with the reasons thereof;*

The capital structure is analysed on the basis of the following

- a. **The composition of the Capital Structure:** The firms studied above rely on the owner's capital rather than institutional finance. There are a few firms that have loans taken either as term loan or working capital finance.

1. **Equity/Owner's Capital:** Here the study states that the entrepreneurs depend on the own funds and if needed seek debt.

2. **Debt:** The debt is more of the term loan nature. Almost all the firms had borrowed capital. These borrowings have been from Government owned institutions like EDC or through bnks – public and private or through NBFCs like Muthoot Finance or Pyramid Finance.

3. **Working Capital:** Most of the firms studied except the restaurants have working capital finance arranged through institutions, predominantly, banks.

- b. **Source of capital:** The sources from where the firms reviewed have raised finances are the financial institutions, NBFCs, friends and relatives, personal loans. They are aware of the Government schemes too but they feel it is not a reliable source. Hence, financing through Government institutions is the least preferred source.

- c. **Initial and later stage:** More need for debt was felt at initial stage, when it was difficult to obtain. At later stage, loans for expansion were more easily available.
- d. **Manufacturing v/s Service Sector:** More institutional loan was available and availed of by manufacturing sector as compared to service sector, presumably, due to availability of collateral security. Service sector depended on owner capital and such other sources.

2. *To identify the factors responsible for lower institutional financing to MSMEs in Goa with special interest in the type of finance, namely term loans or requirement towards working capital.*

The factors are analysed as follows:

- a. **The availability of Credit:** The credit is usually needed for the firms when they are new and are newly starting the business. It is noted that it is at this crucial juncture they do not get credit. There is a problem for start-up micro and small firms to get institutional credit. If the organization is **large sized**, or has a corporate **form of business organization**, or have existed in the market for a long time, i.e. if they are in an advanced stage of their **business life cycle**, or has good quality **collateral** to offer, then they get the credit. Other firms have to depend on relatives, friends and NBFC borrowings to start business. **Relations with bank official** is the most important criterions as suggested by the organisations;
- b. **Timely availability of Credit:** The start-ups, as well as the established firms, find the institutional credit very tedious and time consuming considering the formalities and paper work involved.
- c. **Type of Finance:** All the firms have own and borrowed capital comprising their capital structure. But the restaurant firms do not have a working capital finance requirement as it is

purely cash based business and all the working capital requirements are met through internal funds.

**3. *To trace the problems faced by MSMEs with respect to obtaining finances across different financial institutions in Goa.***

The start-ups, as well as the established firms, find the institutional credit very tedious and time consuming considering the formalities and paper work involved. Non-Banking Financial Companies are least time consuming and Govt. is the most tedious. The problems are more at initial stage.

**4. *To study the differences, if any, across sectors, in dealing with the issues of institutional financing.***

This is analysed as:

- a. **Sector with respect to Size:** As the size of the organization grows the obstacles in receiving the institutional finance reduce.
- b. **Sector with respect the business life cycle:** Firms that have existed in the market for a long time, i.e. if they are in an advanced stage of their business life cycle, tend to project better cash flows and maintain books of accounts. Therefore, they have a relative ease in raising funds.
- c. **Sector with respect to the industry they belong:** The manufacturing firms tend to find it easier to raise institutional finance in comparison to the service sector as it is easy to create charge while giving the loans.

**5. *To identify the role played by Associations or Federations of industries in coping with the finance related issues.***

**The associations or federations had no role in getting funding for the business units**

**End remarks:**

It is brought out from the cross case analysis that sector, size of the firm, the form of business organization, business life cycle and age of business play a major role in procuring institutional finance. It is also seen that procedures followed by the banks to grant loans especially for start-ups are tedious and time consuming. Financial literacy of owners was limited with specific reference to Governmental schemes and new sources of finance.

The analysis has focused only on aspects across cases. Hence, some significant factors such as bureaucratic behaviour of the Govt. staff, mention of corruption in one of the cases, inordinate delays at Panchayat level are the factors which would be included in further quantitative studies, as they were existing in a single case.

The type of finance, the type of financial institution, factors or problems in obtaining finance were embedded in the instrument prepared for quantitative study. Since, considerable differences were noted in initial and later stages, the two stages, were studied separately, in quantitative research.

# CHAPTER 5- INSTRUMENT DEVELOPMENT AND STATISTICAL ANALYSIS

This chapter is presented under following sections:

- Instrument Development
- Descriptive Data Analysis
- Analysis according to the Objectives of the study

## Instrument Development

The instrument for survey was prepared to investigate the objectives of the research, namely the capital structure of the firms and the associated problems faced with respect to different financial institutions. The structured questionnaire was made with the help of a cross case analysis of the case studies written and the literature review. The instrument was prepared in four parts. First part captured the firm demographic data. Second part was related to collection of information about capital structure of the firm. This was separately collected for initial and later stages. Part C and D contained questions relating to factors affecting obtaining finance from diverse institutions. The instrument was duly tested for reliability before the actual field survey (Cronbach's Alpha 0.736). A brief description of the four parts is stated below.

### Part A Demographic Data

Demographic data of the firm sought to capture information like year of starting to determine the age of the firm and also the capacity utilization. It asked for the form of business organisation, whether sole proprietorship, partnership or a company. Further there was

question on which sector the firm belonged to, manufacturing or service. Besides broad categorization into manufacturing or service, its main activity was also questioned. Details of investments in plant and machinery to determine whether Micro, Small or Medium status, were asked. Also financial details like capital at inception and net worth were obtained.

### **Part B Sources of Funds**

Part B consisted of sources of funds in detail. Elaborations of equity obtained from different sources such as own funds, friends and relatives, ventures etc. were collected in %. Similarly debt data from different institutions was collected. Data was asked in separate sections for short term as well as long term finance. Finances obtained from Government institutions were separately asked.

### **Part C Factors limiting availing of institutional finance**

This section listed several factors collated from literature review and case studies and asked them to be rated on a scale. Attempt was made to list the factors comprehensively. Some of the factors were documentation formalities, cost of debt, attitude of staff, time taken for processing, collateral required etc.

### **Part D Assessment of Limiting Factors for Different Institutions**

This part sought to assess the limiting factors for different financing institutions such as commercial banks, cooperative banks, Govt. and Non-Banking Financial Companies. This would provide information about which were regarded as critical factors for different types of institutions.

## Descriptive Data Analysis

Descriptive data analysis is carried out according to firms' demographic data based on sector.

The cross tabulation shows characteristics of data. Further chi square tests were also done for the data to ascertain whether there was significant difference between the characteristics of the data and their composition of capital structure.

The capital structure is presented as Debt equity ratio. It maps the presence or absence of debt in the firm. Size. Sectors and Age Class wise cross tabulation of the firms is tested at initial stage. The results are as follows:

*Table 24 Size \* Debt Capital (initial)*

PARTICULARS			Debt Capital Initial Stage		Total
			Absence of Debt Capital	Presence of Debt Capital	
SIZE OR SECTOR	Micro	% within SIZE OR SECTOR	26.3%	73.7%	100.0% (19)
	Small	% within SIZE OR SECTOR	18.4%	81.6%	100.0% (38)
	Medium	% within SIZE OR SECTOR	7.7%	92.3%	100.0% (13)
Total		% within SIZE OR SECTOR	18.6%	81.4%	100.0% (70)

*Table 25 Sector \* Debt Capital (initial)*

Particulars			Debt Capital Initial Stage		Total
			Absence of Debt Capital	Presence of Debt Capital	
SECTOR	SERVICE	% within SECTOR	26.8%	73.2%	100.0% (41)
	MFG	% within SECTOR	6.9%	93.1%	100.0% (29)
Total		% within SECTOR	18.6%	81.4%	100.0% (70)

*Table 26 Age Class \* Debt Capital (initial)*

Particulars			Debt Capital Initial Stage		Total
			Absence of Debt Capital	Presence of Debt Capital	
<b>AGE CLASS</b>	<b>0-5</b>	% within AGE CLASS	63.6%	36.4%	100.0% (11)
	<b>5-10</b>	% within AGE CLASS	14.3%	85.7%	100.0% (14)
	<b>10-15</b>	% within AGE CLASS	0.0%	100.0%	100.0% (3)
	<b>15 UP</b>	% within AGE CLASS	9.5%	90.5%	100.0% (42)
<b>Total</b>		% within AGE CLASS	18.6%	81.4%	100.0% (70)

The chi square statistics is presented below which shows that there is significant difference between capital structures of the firms in manufacturing sector and the firms in service sector also of the firms in different age class at 95% confidence level, as p value less than 0.05, at initial stage but there is no significant difference in firms of different sizes.

*Table 27 Chi-Square Tests -Size, Sector, and Age Class*  
**Chi-Square Tests**

	Size			Sector			Age-Class		
	Value	df	Asymp. Sig. (2-sided)	Value	Df	Asymp. Sig. (2-sided)	Value	df	Asymp. Sig. (2-sided)
<b>Pearson Chi-Square</b>	1.77	2	0.412	4.46	1	<b>.035</b>	<b>17.90</b>	<b>3</b>	<b>0.00</b>
N of Valid Cases	70								

## **Analysis according to the Objectives of the study**

The objectives of the research are reproduced first for operationalizing and testing.

Specifically, the research has the following objectives:

- 1. To study the composition of capital structures of MSMEs in manufacturing and service sectors and to highlight the differences in financial structures across sectors with the reasons thereof;*
- 2. To identify the factors responsible for lower institutional financing to MSMEs in Goa with special interest in the type of finance, namely term loans or requirement towards working capital;*
- 3. To trace the problems faced by MSMEs with respect to obtaining finances across different financial institutions in Goa;*
- 4. To find out the reasons from the point of view of financial institutions, with respect to lower financing to MSMEs in Goa.*
- 5. To study the differences, if any, across sectors, in dealing with the issues of institutional financing.*
- 6. To identify the role played by Associations or Federations of industries in coping with the finance related issues.*

## **Objective 1. *Composition of Capital structure***

**The research aimed at answering the following questions:**

1. Is there any difference in the capital structure of the MSMEs at a Start-up stage (we termed it as an initial stage) and Later Stage?
2. Does the capital structure differ with the sector and the size?

**Based on the above research questions the following are the objectives:**

To study if the capital structures in MSMEs vary according to the age i.e. at an initial stage and at later stage.

- ❖ To study the capital structures in MSME at initial stage as differentiated by
  - size (Micro, Small & Medium)
  - sector (Service & Manufacturing)
- ❖ To study the capital structures in MSME at later stage as differentiated by
  - size (Micro, Small & Medium)
  - sector (Service & Manufacturing)

## **Hypotheses**

Following are the hypotheses derived from the objectives:

**For Objective – 1:** To study if the capital structures in MSMEs vary according to the age, following hypothesis was tested

**$H_{1,1}$  = “*There is no significant difference in the capital structures of firms belonging to initial and later stages of working*”**

**For Objective – 2 and 3:** To study whether the capital structures in MSME are differentiated by Size at an initial and later stage of working and to study whether the capital structures in MSME are differentiated by Sector at initial and later stage of working, following hypotheses were tested:

*H<sub>2.1</sub> = “there is no significant difference in the capital structure of MSMEs as differentiated by size at initial stage”*

*H<sub>2.2</sub> = “there is no significant difference in the capital structure of MSMEs as differentiated by size at later stage”*

*H<sub>3.1</sub> = “there is no significant difference in the capital structure of MSMEs as differentiated by sector at initial stage”*

*H<sub>3.2</sub> = “there is no significant difference in the capital structure of MSMEs as differentiated by sector at later stage”*

## Testing for Difference between capital structures at initial and later stage

Towards the objective 1, difference in capital structures across firms belonging to different age groups were assessed. Various statistical tests were conducted on the sample to assert whether the capital structure differs across initial and later stage.

The difference was brought out with the help of Paired Samples Correlations of capital structure at an initial stage and later stage and also Paired Sample T Test.

*Table 28: Paired Samples Correlations of Capital Structure at initial stage and at later stage*

		N	Correlation	Sig.
Pair 1	INITIAL DER & LATER DER	70	.146	.227

\* Significance calculated at 5% level of confidence

Table 28 shows the paired sample correlations between capital structures at initial and at a later stage of the given sample. As we can see the correlations are *not significant*. The result shows that there is no correlation between the capital structure of the firms at an initial stage and at a later stage.

The findings are confirmed with the paired sample t test between capital structures at initial and at a later stage.

*Table 29: Paired Samples Test of Capital Structure at initial stage and later stage*

		Paired Differences				t	df	Sig. (2-tailed)	
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	INITIAL DER – LATER DER $H_{11}$	.66	2.11	.25	.16	1.16	2.63	69	<b>.011</b>

\* Significance calculated at 5% level of confidence

Paired sample t-Test was performed to test whether the difference between the capital structures at an initial stage and at a later stage is statistically significant. Table 29 shows that there is the difference in the capital structures of MSMEs at an initial stage and at a later stage as represented by DER and this difference is statistically significant at a confidence level of 5%.

The two tests have shown that the capital structures at initial stage and at later stage are significantly different. Thus, we reject the null hypothesis in case of the first objective and establish that the two capital structures are significantly different. However, further tests are also conducted to present better analyses of the differences with respect to age.

#### **Analyses of Differences in Capital Structures with respect to age**

Table 30 provides with descriptive analysis of the capital structures at initial and later stage, for different age groups.

*Table 30: Descriptive Statistics of Capital Structure of the MSMEs*

	AGE CLASS	Mean	Std. Deviation	N
<b>INITIAL DER</b>	0-5	.77	1.27	11
	5-10	1.67	1.57	14
	10-15	<b>3.44</b>	.96	3
	15 UP	2.06	1.72	42
	Total	<b>1.84</b>	<b>1.68</b>	70
<b>LATER DER</b>	0-5	.21	.45	11
	5-10	.50	1.11	14
	10-15	.33	.58	3
	15 UP	<b>1.72</b>	<b>1.67</b>	42
	Total	<b>1.18</b>	1.54	70

Table 30 shows that at an initial stage, the Debt Equity Ratio is higher in comparison to the Later stage Debt Equity Ratio. For example, firms which are in the age group 10 to 15 have stated that their Debt Equity ratio at the initial stage was 3.44, which has now fallen to 0.33. This shows that there is an ardent effort on part of the firms to raise debt funds at an initial stage but as they grow in age, the dependence on debt is seen to be coming down, in favour of equity.

*The results seem to agree with Pecking Order that debt is preferred source initially and later gets replaced with equity.*

Biz-Greyhound Knowledge Group SME Survey 2014 with a sample of 540 MSME highlights the key challenges faced by SMEs in India. Across all categories, access to financial and credit instruments is observed as the most critical challenge (79%), by SMEs in India. However, our sample shows that the SMEs have still preferred more debt at initial stage, though they faced challenges in obtaining debt as outlined above. Thus, in spite of the market not being favourable for granting debt, the SMEs still have high debt in the ratio at initial

stage. This could be due to unavailability of equity market, and may change in times where contemporary sources like venture capital or business angels proliferate.

Thus, we conclude that the SMEs show a preference for higher debt in initial stage, which gets replaced by equity at later stage.

Having analysed the compositions at initial and later stages, we now establish the significance of variance between capital structure at initial and later stage. We use Multivariate Analysis of Covariance (MANCOVA) for this. Table 31 below does an analysis of variances within the age class and between the age class with respect to the capital structure at initial and at a later stage.

*Table 31 Tests of Between-Subjects Effects H11*

Source	Dependent Variable	Type III Sum of Squares	df	Mean Square	F	Sig.	Partial Eta Squared
Corrected Model	INITIAL DER	22.647 <sup>a</sup>	3	7.549	2.905	.041	.117
	LATER DER	31.233 <sup>b</sup>	3	10.411	5.191	.003	.191
Intercept	INITIAL DER	121.609	1	121.609	46.797	.000	.415
	LATER DER	14.658	1	14.658	7.308	.009	.100
<b>AGECLASS</b>	INITIAL DER	22.647	3	7.549	2.905	<b>.041</b>	<b>.117</b>
	LATER DER	31.233	3	10.411	5.191	<b>.003</b>	<b>.191</b>
Error	INITIAL DER	171.511	66	2.599			
	LATER DER	132.375	66	2.006			
Total	INITIAL DER	430.789	70				
	LATER DER	260.756	70				
Corrected Total	INITIAL DER	194.159	69				
	LATER DER	163.608	69				

a. R Squared = .117 (Adjusted R Squared = .076) b. R Squared = .191 (Adjusted R Squared = .154)

The analysis above brings out that there is a significant difference in the capital structure as represented by DER between the age groups of the firm both at Initial Stage and Later Stage

at 5% level of confidence. Therefore, the hypothesis  $H_{1,1}$  there is no significant difference in the capital structure of firms belonging to initial and later stages of working is “*rejected*”.

Table 32 below shows further multivariate tests conducted between the variables to assert the differences. The difference in capital structures between age classes are seen to be significant for a confidence level of 5%. Here it is also interesting to note that dependent variable i.e. age of a firm has an explanatory capacity of 14.6% to 21.3%, which is also significant, of the dependent variable capital structure at both stages, initial and later. This also shows the importance of age of a firm and its impact on capital structure.

### Multivariate Tests of Age Class and Capital Structure

*Table 32 Multivariate Tests of Age Class and Capital Structure*

Effect		Value	F	Hypothesis df	Error df	Sig.	Partial Eta Squared
Intercept	Pillai's Trace	.438	25.332	2	65	.000	.438
	Wilks' Lambda	.562	25.332	2	65	.000	.438
	Hotelling's Trace	.779	25.332	2	65	.000	.438
	Roy's Largest Root	.779	25.332	2	65	.000	.438
AGE CLASS	Pillai's Trace	.291	3.747	6	132	<b>.002</b>	<b>.146</b>
	Wilks' Lambda	.726	3.770	6.000	130	<b>.002</b>	<b>.148</b>
	Hotelling's Trace	.355	3.791	6.000	128	<b>.002</b>	<b>.151</b>
	Roy's Largest Root	.271	5.963	3.000	66	<b>.001</b>	<b>.213</b>

Thus, at the outset, it was established with the help of paired sample correlation and t test that there is significant difference between capital structure of the firm at the initial and later stages. Further descriptive analysis was carried out to highlight that the debt equity ratio is higher at the initial stage than at the later stage. After the descriptive analyses, MANCOVA

was used to establish that there is significant difference in variance between and across the two classes (initial and later) with reference to capital structure. Further multivariate tests were also done to assert the findings. Therefore, the hypothesis H1.1 there is no significant difference in the capital structure of firms belonging to initial and later stages of working was “*rejected*”. It has also been analysed that age of a firm has an explanatory capacity of 14.6% to 21.3%, which is significant, of the dependent variable capital structure at both stages, initial and later.

### **Analyses of Capital Structure with reference to Size and Sector at Initial and Later Stage- Testing of Hypothesis 2 and 3**

Comprehensive analysis of capital structure at initial and at later stage with respect to size and sector was done using one way ANOVA. The capital structure, as represented by the debt equity Ratio, at the initial stage of the sample was analysed with reference to the size of the firm namely Micro, Small & Medium Enterprises, and then, sector it belonged i.e. services or manufacturing at initial and later stage of the firm using simple ANOVA at 5% level of significance. The results are tabulated in Table given below.

*Table 33: Analysis of Capital Structure at Initial and Later Stage with respect to Size and Sector*

<b>ANOVA –With Reference to Size and Sector Capital Structure of MSMEs</b>		<b>Sum of Squares</b>	<b>Df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.*</b>
Initial Debt-Equity Ratio and Size MSME <b>H<sub>2.1</sub></b>	Between Groups	11.95	2	5.97	2.20	.119
	Within Groups	182.21	67	2.72		
Initial Debt-Equity Ratio and Sector (Service & Manufacturing) <b>H<sub>2.3</sub></b>	Between Groups	14.79	1	14.79	5.61	<b>.021</b>
	Within Groups	179.37	68	2.64		
Later Debt-Equity Ratio and Size MSME	Between Groups	7.77	11	.706	1.73	.110

<b>H<sub>2.2</sub></b>	Within Groups	23.72	58	.409		
Later Debt-Equity Ratio and Sector (Service & Manufacturing) <b>H<sub>2.4</sub></b>	Between Groups	6.84	11	.622	3.56	<b>.001</b>
	Within Groups	10.14	58	.175		

\* Significance calculated at 5% level of confidence

From the table given above, the null hypotheses **H<sub>2.1</sub>** and **H<sub>2.2</sub>** stating the following are “*accepted*”:

- There is no significant difference between the Debt Equity Ratio (DER) of firms at an initial stage on the basis of their size i.e. Micro, Small and Medium Enterprises and
- There is no significant difference between the Debt Equity Ratio (DER) of firms on the basis of their size i.e. Micro, Small and Medium Enterprises at a later stage.

It can be seen that there is no significant difference in the DER amongst the Micro, Small & Medium Enterprises.

*Thus, with reference to Capital structure, MSMEs is a homogeneous unit of analysis, irrespective of the size.*

The variance in capital structures of the firms grouped on the basis of Sectors i.e. manufacturing and services is statistically significant. This shows that the capital structure of MSMEs is influenced by whether the firm is in Services or the Manufacturing sector.

Thus, null hypotheses **H<sub>3.1</sub>** and **H<sub>3.2</sub>**, stating the following are “*rejected*”:

- There is no significant difference in the capital structure of MSMEs as differentiated by sector at an initial stage.
- There is no significant difference in the capital structure of MSMEs as differentiated by the sector at a later stage

Manufacturing firms find it easier to raise debt in comparison to the firms in Service Sector as shown by the cross-tabulated data given below.

The highlighted portion explains the significant difference in the capital structure of MSMEs across sectors, namely, Service and Manufacturing. Around 64% of firms in the service sector have a debt-equity ratio of 1 or less. However, 68% of firms in the manufacturing sector have debt up to 3 times of equity or more. 8.6% MSMEs in the manufacturing sector have zero debt, whereas in the service sector 17.1%, (nearly double of manufacturing) has zero debt.

*Table 34: Differences across sectors of Debt Equity Ratio at Initial Stage*

Crosstab Sector v/s Initial Debt Equity classes			Initial Debt Equity Ratio Across Sectors			
			Nil Debt	Debt<= Equity	Debt = 3xEquity	Debt > 3xEquity
<b>SECTOR</b>	<b>SERVICE</b>	Count	12	14	9	6
		% within Sector	<b>29.3%</b>	<b>34.1%</b>	22.0%	14.6%
		% within Initial DER	66.7%	82.4%	47.4%	37.5%
		% of Total	17.1%	20.0%	12.9%	8.6%
	<b>MFG</b>	Count	6	3	10	10
		% within Sector	20.7%	10.3%	<b>34.5%</b>	<b>34.5%</b>
		% within Initial DER	33.3%	17.6%	52.6%	62.5%
		% of Total	8.6%	4.3%	14.3%	14.3%
<b>Total</b>	Count	18	17	19	16	
	% within Sector	25.7%	24.3%	27.1%	22.9%	
	% within Initial DER	100%	100%	100%	100%	
	% of Total	25.7%	24.3%	27.1%	22.9%	

*Table 35 Debt Equity Ratio at Initial Stage- Differences across sectors*

<b>Chi-Square Tests</b>	<b>Value</b>	<b>Df</b>	<b>Asymp. Sig. (2-sided)</b>
<b>Pearson Chi-Square</b>	8.359	3	<b>.039</b>
Likelihood Ratio	8.758	3	<b>.033</b>
N of Valid Cases	70		

Chi-Square test shows a significant difference in the proportion of capital structure across service and manufacturing sectors at the initial stage. Thus, sector accounts for differences in capital structures of MSMEs, as seen by the Chi-square and ANOVA tests, wherein the debt is obtained more easily by firms in the manufacturing sector. This is due to the fact that the manufacturing sector is able to back up its debt with physical assets as security, unlike the services sector.

The following are the findings for later stage, for differences in size and sector:

*Table 36: Differences across sectors of Debt Equity Ratio at later Stage*

Sector v/s Later DER			Later DER			
			ZERO	1.00	2.00	3.00
SECTOR	SERVICE	Count	20	13	4	4
		% within Sector	<b>48.8%</b>	<b>31.7%</b>	9.8%	9.8%
		% within Later DER	90.9%	59.1%	21.1%	57.1%
		% of Total	28.6%	18.6%	5.7%	5.7%
	MFG	Count	2	9	15	3
		% within Sector	6.9%	31.0%	<b>51.7%</b>	<b>10.3%</b>
		% within Later DER	9.1%	40.9%	78.9%	42.9%
		% of Total	2.9%	12.9%	21.4%	4.3%
Total	Count	22	22	19	7	
	% within Sector	31.4%	31.4%	27.1%	10.0%	
	% within Later DER	100.0%	100.0%	100.0%	100.0%	
	% of Total	31.4%	31.4%	27.1%	10.0%	

Chi-Square Tests	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	20.511	3	<b>.000</b>
Likelihood Ratio	22.685	3	<b>.000</b>
N of Valid Cases	70		

*Table 37: Chi-Square Test*

At a later stage, the difference between manufacturing and service sector is significant. The table highlights that for the service sector, 80.5% of firms have the debt-equity ratio up to 1, whereas in the manufacturing sector, 62 % of firms are having a ratio more than 2.

### **Conclusion**

1. This research empirically proves that there is a significant difference in capital structures of MSMEs at an initial stage and later stage with higher debt being raised by the firms at an initial stage than at later stage. The finding seems in consonance with Pecking Order theory that firm prefers debt to equity at initial stage. However, the market timing theory also explains this preference as new firms will find it very difficult to raise equity form the market at initial stage.
2. The size whether micro, small or medium doesn't show a significant difference in capital structure, which means when it comes to raising funds, MSMEs are regarded as a common cohort and is justified in being used a single unit of analysis.
3. It also shows that capital structure significantly differs between the manufacturing and service sector. This has been explained by the security requirements that can be fulfilled by the manufacturing sector, having physical assets like plant and machinery much above that in service sector. Thus, it justifies the use of sector as a distinguishing criterion for defining MSMEs differently in India across manufacturing and service sector.
4. The Manufacturing firms also find it easier to raise debt compared to the service sector irrespective of the age. The debt is much higher in manufacturing sector in both stages, initial and later, as compared to service sector.

**Objective 2- To identify the factors responsible for lower institutional financing to MSMEs in Goa with special interest in the type of finance, namely term loans or requirement towards working capital**

The following factors were listed as limiting factors for debt. They were tested for long term and short term debt. They were treated as independent variables. Dependent variable was presence or absence of debt. As the dependent variable outcomes are binary, binary logistic regression is used for testing.

- |  |   |
|--|---|
| 1. Financial Quality of Business                                     | 11. Other financial products/ services offered by institution |
| 2. Proximity of institution [convenient location, distance]          | 12. Credit Size ( Amount disbursed as per needs)              |
| 3. Personal relationship with institution[ or manager PR networking] | 13. Previous credit history [previous loans paid]             |
| 4. Documentation formalities   | 14. Reputation of Institution                                 |
| 5. Disclosure Requirements [Previous IT Returns Experience]          | 15. Flexibility in credit limits [as per business needs]      |
| 6. Credit Rating Requirement   | 16. Well supported by Government Subsidies                    |
| 7. Approach of institutions [staff in service]                       | 17. Education Skills (MSME Entrepreneur)                      |
| 8. Quick processing and Disbursal speed of execution                 | 18. Processing charges  |
| 9. Cost of capital [Interest costs]                                  | 19. Cover policy insurance flexibility                        |
| 10. Collateral requirement for Immovable property                    |   |

**These factors are first tested for long term debt**

**a. Initial Stage and**

**b. Later Stage**

The hypothesis tested is as follows:

***H<sub>04</sub>: The existence of debt in MSMEs is not influenced by Limiting Factors***

Binary Logistic Regression was chosen as statistical technique, as Logistic Regression is considered to be a better tool in comparison to linear regression due to its power to explain the outcome in terms of probability of change in dependent variable due to change in independent variable. It is also suitable when the data is nonlinear and dependent variable is binary (in this case, presence or absence of debt). The results are presented below:

INITIAL STAGE- LONG TERM DEBT

***Table 38 Binary Logistic Regression -Omnibus Test-Initial stage and Long term debt***

		Chi-square	df	Sig.
Step 1	Step	75.307	21	<b>.000</b>
	Block	75.307	21	<b>.000</b>
	Model	75.307	21	<b>.000</b>

The table above clearly shows that the model is significant as the p Values<.05.

***Table 39 Model Summary -Initial stage and Long term debt***

<b>Model Summary</b>			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	.000 <sup>a</sup>	<b>.681</b>	<b>1.000</b>

The table above shows that the independent variables are able to predict variance in probability of existence of **long term debt** in the range of 68% to 100% in the **initial stage**.

*Table 40 Hosmer and Lemeshow Test*

Step	Chi-square	Df	Sig.
1	.000	5	<b>1.000</b>

Hosmer & Lemeshow tests have to be insignificant for acceptance of the variables. It is insignificant. This means we are able to use the variables to predict the variables.

*Table 41 Classification Table*

Observed		Predicted		
		Initial Debt		Percentage Correct
		Nil Debt	Presence of Debt	
Initial Debt	Nil Debt	17	0	100.0
	Presence of Debt	0	49	100.0
Overall Percentage				100.0

This table above shows that the limiting variables in the current data have the strength to correctly predict presence or absence of **long term debt** at **initial stage**, 100% times.

*Table 42 Variables in the Equation*

Variables in the Equation									
		B	S.E.	Wald	df	Sig.	Exp(B)	95% C.I. for EXP(B)	
								Lower	Upper
Step 1 <sup>a</sup>	PP(1)	-42.86	32982.8	.00	1	.999	.000	.00	.
	TAH(1)	179.18	23182.51	.00	1	.994	6.594E+77	.00	.

L1	-19.58	10854.75	.00	1	.999	.000	.00	.
L2	8.901	3685.31	.00	1	.998	7335.71	.00	.
L3	-23.83	5726.54	.00	1	.997	.000	.00	.
L4	32.16	6976.28	.00	1	.996	9281679392 5424.7	.00	.
L5	-11.65	8457.21	.00	1	.999	.00	.00	.
L6	-4.21	12172.91	.00	1	1.000	.015	.00	.
L7	-6.527	8318.59	.00	1	.999	.001	.00	.
L8	2.631	5473.36	.00	1	1.00	13.89	.00	.
L9	-12.573	6395.17	.00	1	.998	.00	.00	.
L10	-23.284	13624.87	.00	1	.999	.00	.00	.
L11	21.143	6385.69	.00	1	.997	1521057491 .450	.00	.
L12	2.665	7960.089	.00	1	1.00	14.371	.00	.
L13	71.063	8436.359	.00	1	.993	7279017953 4471630000 0000000000 0.00	.00	.
L14	15.846	8468.711	.00	1	.999	7620729.07 0	.00	.
L15	-31.32	6543.14	.00	1	.996	.00	.00	.

	L16	11.02	4119.27	.00	1	.998	61206.93	.00	.
	L17	-29.15	5810.37	.00	1	.996	.00	.00	.
	L18	52.08	9433.99	.00	1	.996	4137962139 4667754000 000.0	.00	.
	L19	-24.69	7176.10	.00	1	.997	.00	.00	.
	Const ant	-153.80	54299.98	.00	1	.998	.00		
a. Variable(s) entered on step 1: PP, TAH, L1, L2, L3, L4, L5, L6, L7, L8, L9, L10, L11, L12, L13, L14, L15, L16, L17, L18, L19.									

However, although they are collectively significant, the table above that none of the variables are significant, individually.

### LATER STAGE- LONG TERM DEBT

The table below shows the significance of the model we are testing.

*Table 43 Binary Logistic Regression -Omnibus Test-Later stage and Long term debt*

Omnibus Tests of Model Coefficients				
		Chi-square	Df	Sig.
Step 1	Step	26.499	21	<b>.188</b>
	Block	26.499	21	<b>.188</b>
	Model	26.499	21	<b>.188</b>

The table above clearly shows that the model is not significant as the p Values>05. Hence, the factors do not predict the presence of long debt at later stage.

At a later stage, since there is already set up and running business, it is easier for the MSMEs to approach and raise funds from the organised financial sectors, than the initial stage. Hence, the factors no longer remain as limiting factors for the long term loan.

**The factors are also tested for short term debt (Initial and Later Stage)**

**INITIAL STAGE SHORT TERM DEBT**

*Table 44 Binary Logistic Regression -Omnibus Test-Initial stage and Short term debt*

<b>Omnibus Tests of Model Coefficients</b>				
		<b>Chi-square</b>	<b>Df</b>	<b>Sig.</b>
Step 1	Step	39.684	19	<b>.004</b>
	Block	39.684	19	<b>.004</b>
	Model	39.684	19	<b>.004</b>

The table above clearly shows that the model is significant as the p Values<05.

*Table 45 Initial stage and Short term debt-Model Summary*

<b>Model Summary</b>			
<b>Step</b>	<b>-2 Log likelihood</b>	<b>Cox &amp; Snell R Square</b>	<b>Nagelkerke R Square</b>
1	13.183 <sup>a</sup>	<b>.447</b>	<b>.819</b>

The table above shows that the independent variables are able to predict variance in probability of existence of **short term debt** in the range of 44.7% to 81.9% in the **initial stage**.

*Table 46 Hosmer and Lemeshow Test*

Hosmer and Lemeshow Test			
Step	Chi-square	Df	Sig.
1	.000	7	<b>1.000</b>

Hosmer & Lameshow tests have to be insignificant for acceptance of the variables. It is insignificant. This means we are able to use the variables to predict the variables.

*Table 47 Classification Table*

Classification Table <sup>a</sup>					
	Observed	Predicted			
		INITIALSHORTTERM		Percentage Correct	
		Absence of Debt	Presence of Debt		
Step 1	INITIAL SHORT TERM	Absence of Debt	57	1	<b>98.3</b>
		Presence of Debt	2	7	<b>77.8</b>
	Overall Percentage				<b>95.5</b>

This table above shows that the limiting variables in the current data have the strength to correctly predict presence or absence of **short term debt** at **initial stage**, 95.5% times.

*Table 48 Variables in the Equation*

Variables in the Equation								
	B	S.E.	Wald	df	Sig.	Exp(B)	95% C.I. for EXP(B)	
							Lower	Upper
Step 1 <sup>a</sup> SI	-38.48	5460.184	.000	1	.994	.00	.00	.

S2	-34.36	5171.484	.000	1	.995	.00	.00	.
S3	49.681	3223.962	.000	1	.988	376865526369920060 0000.00	.00	.
S4	50.424	6124.539	.000	1	.993	792202607194468300 0000.00	.00	.
S5	69.736	3550.888	.000	1	.984	193144016065273900 00000000000000.00	.00	.
S6	- 21.181	8216.463	.000	1	.998	.00	.00	.
S7	69.471	6656.929	.000	1	.992	148197958525193430 00000000000000.00	.00	.
S8	- 32.676	5532.003	.000	1	.995	.00	.00	.
S9	- 141.43 2	9726.150	.000	1	.988	.00	.00	.
S10	16.806	6290.558	.000	1	.998	19902686.84	.00	.
S11	99.659	10270.343	.000	1	.992	1.911E+43	.00	.
S12	7.220	2221.603	.000	1	.997	1366.839	.00	.

S13	- 28.291	3318.445	.000	1	.993	.000	.00	.
S14	- 16.177	2340.329	.000	1	.994	.000	.00	.
S15	103.00 8	4912.302	.000	1	.983	5.444E+44	.00	.
S16	30.490	5672.598	.000	1	.996	17440472350718.752	.00	.
S17	- 43.174	2893.239	.000	1	.988	.000	.00	.
PP	32.726	5092.179	.000	1	.995	163244080576552.80	.00	.
TAH	- 32.726	5092.179	.000	1	.995	.00	.00	.
Constant	- 502.34 9	37534.590	.000	1	.989	.00		
a. Variable(s) entered on step 1: S1, S2, S3, S4, S5, S6, S7, S8, S9, S10, S11, S12, S13, S14, S15, S16, S17, PP, TAH.								

However, although they are collectively significant, the table above that none of the variables are significant, individually.

## LATER STAGE SHORT TERM DEBT

*Table 49 Binary Logistic Regression –Omnibus test -Later stage and short term debt*

Omnibus Tests of Model Coefficients				
		Chi-square	Df	Sig.
Step 1	Step	32.511	19	.027
	Block	32.511	19	.027
	Model	32.511	19	.027

The table above clearly shows that the model is significant as the p Values<05.

*Table 50 Binary Logistic Regression –Model summary -Later stage and short term debt*

### Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	56.010 <sup>a</sup>	.384	.524

The table above shows that the independent variables are able to predict variance in probability of existence of **short term debt** in the range of 38.4% to 52.4% in the **later stage**.

*Table 51 Hosmer and Lemeshow Test*

Hosmer and Lemeshow Test			
Step	Chi-square	df	Sig.
1	5.543	7	.594

Hosmer & Lameshow tests have to be insignificant for acceptance of the variables. It is insignificant. This means we are able to use the variables to predict the variables.

*Table 52 Classification Table*

Classification Table <sup>a</sup>					
		Predicted			Percentage Correct
		LATER SHORT TERM			
Observed		Absence of Debt	Presence of Debt		
Step 1	LATER SHORT TERM	Absence of Debt	17	8	68.0
		Presence of Debt	6	36	85.7

Overall Percentage			<b>79.1</b>
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This table above shows that the limiting variables in the current data have the strength to correctly predict presence or absence of **short term debt** at **later stage**, 79.1% times.

*Table 53 Variables in the Equation*

Variables in the Equation									
		B	S.E.	Wald	Df	Sig.	Exp(B)	95% C.I. for EXP(B)	
								Lower	Upper
Step 1 <sup>a</sup>	S1	.283	.504	.316	1	.574	1.327	.494	3.564
	S2	.774	.429	3.257	1	.071	2.168	.936	5.023
	<b>S3</b>	-1.071	.447	5.749	1	<b>.016</b>	.343	.143	.822
	<b>S4</b>	-1.881	.796	5.588	1	<b>.018</b>	.152	.032	.725
	S5	.370	.585	.399	1	.527	1.447	.460	4.553
	S6	.064	.366	.030	1	.862	1.066	.520	2.184
	S7	.971	.617	2.478	1	.115	2.640	.788	8.840
	S8	-.116	.457	.065	1	.799	.890	.364	2.179
	S9	1.033	.753	1.882	1	.170	2.809	.642	12.282
	S10	-.218	.419	.272	1	.602	.804	.354	1.827
	S11	-.231	.729	.101	1	.751	.793	.190	3.310
	S12	1.101	.689	2.557	1	.110	3.008	.780	11.600
	S13	.756	.726	1.085	1	.297	2.130	.513	8.839
	S14	.354	.543	.424	1	.515	1.425	.491	4.133
	S15	-1.077	.747	2.077	1	.150	.341	.079	1.474
	<b>S16</b>	-.718	.360	3.988	1	<b>.046</b>	.488	.241	.987
	S17	-.431	.455	.897	1	.344	.650	.266	1.585
	PP	2.574	1.725	2.226	1	.136	13.112	.446	385.463
	TAH	2.738	1.985	1.903	1	.168	15.462	.316	756.509
Constant	-.579	2.536	.052	1	.819	.560			

a. Variable(s) entered on step 1: S1, S2, S3, S4, S5, S6, S7, S8, S9, S10, S11, S12, S13, S14, S15, S16, S17, PP, TAH.

At a later stage, since there is already set up and running business, it is easy for the MSMEs to approach and raise funds from the organised financial sectors. The table above shows that the following factors significantly influence the likelihood of MSME raising funds from the financial institutions (short term, later stage):

**S3**= Personal relationship at 5% level of confidence

**S4**= Documentation Formalities at 5% level of confidence

**S16**= Well supported by Govt./ subsidies at 5% level of confidence

Thus hypothesis '*H<sub>04</sub>: The existence of debt in MSMEs is not influenced by Limiting Factors*' is **rejected** for initial stage.

At a later stage, it is **accepted** for long term and rejected for short term.

## **Conclusion**

### **Factors at Initial Stage**

At the initial stage, for long term and for short term the factors are collectively significant.

None of the variables are significant, individually.

### **Factors at Later stages**

#### **Long term Loan**

At a later stage, the factors do not predict the presence of long term debt.

#### **Short term Loan**

At a later stage, the following factors significantly influence the likelihood of MSME raising short term funds from the financial institutions:

1. Personal relationship
2. Documentation Formalities
3. Well supported by Govt./ subsidies

### Objective 3

The third objective was to trace the problems faced by MSMEs with respect to obtaining finances across different financial institutions in Goa.

The hypothesis tested is as follows:

*H<sub>05</sub>: There is no significant difference between the limiting factors for availing of debt from different entities (Commercial Banks, Cooperative Banks, and NBFCs) among MSMEs*

ANOVA was done to ascertain whether there exist significant differences for factors across Institutions. The table given below denotes the findings.

*Table 54 ANNOVA limiting factors with institutions of finance*

		Sum of Squares	df	Mean Square	F	Sig.
LE1	Between Groups	.062	1	.062	.429	.515
	Within Groups	9.881	68	.145		
	Total	9.943	69			
LE2	Between Groups	.039	1	.039	.118	.733
	Within Groups	22.547	68	.332		
	Total	22.586	69			
LE3	Between Groups	.079	1	.079	.197	.658
	Within Groups	27.193	68	.400		
	Total	27.271	69			
LE4	Between Groups	.219	1	.219	.284	.596
	Within Groups	52.424	68	.771		
	Total	52.643	69			
LE5	Between Groups	.009	1	.009	.017	.896
	Within Groups	34.577	68	.508		
	Total	34.586	69			
LE6	Between Groups	.130	1	.130	1.201	.277
	Within Groups	7.356	68	.108		
	Total	7.486	69			
LE7	Between Groups	.005	1	.005	.020	.888
	Within Groups	16.281	68	.239		
	Total	16.286	69			
LE8	Between Groups	.039	1	.039	.115	.735
	Within Groups	22.772	67	.340		

	Total	22.812	68			
<b>LE9</b>	Between Groups	5.754	1	5.754	16.768	<b>.000</b>
	Within Groups	23.332	68	.343		
	Total	29.086	69			
LE10	Between Groups	.002	1	.002	.005	.947
	Within Groups	30.584	68	.450		
	Total	30.586	69			
<b>LE11</b>	Between Groups	2.885	1	2.885	6.304	<b>.014</b>
	Within Groups	31.115	68	.458		
	Total	34.000	69			
LE12	Between Groups	.929	1	.929	1.403	.240
	Within Groups	45.014	68	.662		
	Total	45.943	69			

*Table 55 Factor Coding*

1. Processing fees	LE1
2. Interest rates	LE2
3. Margin Money	LE3
4. Credit History or Rating	LE4
5. Amount of Credit granted	LE5
6. Repayment period	LE6
7. Documentation and Disclosures required	LE7
8. Time to make credit available	LE8
9. <b>Collateral or Guarantor</b>	LE9
10. Asset hypothecation /lease like land/ bldg. / machinery	LE10
11. <b>Changing Credit Limits</b>	LE11
12. Renewing or refurbishing	LE12

Thus, it is seen that the MSMEs find that there is significant difference across Commercial banks, cooperative banks and NBFCs for the two factors of Collateral requirements and Changing credit limits.

Hence, hypothesis

*H<sub>05</sub>: There is no significant difference between the limiting factors for availing of debt from different entities (Commercial Banks, Cooperative Banks, and NBFCs) among MSMEs is rejected.*

The differences between financial institutions about these two factors are explained with the help of tables given below:

**Collateral or Guarantor requirement across financial institutions**

*Table 56 LE9 \* SELECTED EXT Frequency Cross tabulations*

		SELECTED EXT				Total
		Commercial banks	Cooperative banks	NBFC	LOANS FROM other	
<b>LE9</b>	<b>1.0</b>	14.90% ((7)	0% (0)	0.00% (0)	0.00% (0)	7
	<b>2.0</b>	4.25% (2)	26.67% (4)	33.33% (1)	20% (1)	8
	<b>3.0</b>	80.85% (38)	73.33% (11)	66.67% (2)	80% (4)	55
Total		100.00% (47)	100.00% (15)	100.00% (3)	100.00% (5)	70

The table states that among all the financial institutions, Commercial banks have high tendency to ask for the collateral or guarantors which is the limiting factor. Overall rating is that all institutions do ask for these requirements, but among them, the highest is the commercial banks.

*Table 57 LE11 \* SELECTED EXT Cross tabulation*

		SELECTED EXT				Total
		Commercial banks	Cooperative banks	NBFC	LOANS FROM other	
<b>LE11</b>	<b>1.0</b>	19.15% (9)	40.00% (6)	0.00% (0)	40% (2)	17
	<b>2.0</b>	53.19% (25)	46.67% (7)	66.67% (2)	40% (2)	36
	<b>3.0</b>	27.65% (13)	13.33% (2)	33.33% (1)	20% (1)	17
Total		100.00% (47)	100.00% (15)	100.00% (3)	100.00% (5)	70

The table states that all the non-banking financial institutions and commercial banks have high limiting factor for changing credit limits.

Thus, the problems faced are traced to all financing entities and also significant differences across entities are explained, in the opinion of MSMEs.

## **Objectives 4 and 5**

The following two objectives were directed towards ascertaining the perspectives of financing institutions:

**Obj 4. To find out the reasons from the point of view of financial institutions, with respect to lower financing to MSMEs in Goa**

**Obj 5. To study the differences, if any, across sectors, in dealing with the issues of institutional financing.**

**H<sub>06</sub>: There is no significant difference between the limiting factors for availing of debt from different entities (Commercial Banks, Cooperative Banks, and NBFCs) among MSMEs, from the perspective of financing entities**

Towards achieving these objectives, separate questionnaire (See Annexure- Questionnaire II) was prepared and administered to 34 financing institutions. The results and analyses are presented below:

**Table 58 ANOVA Objective 4 and 5**

<b>ANOVA</b>						
<b>FACTOR</b>		Sum of Squares	df	Mean Square	F	Sig.
Financial Quality of Business	Between Groups	.425	4	.106	.498	.737
	Within	6.192	29	.214		

	Groups					
	Total	6.618	33			
Proximity or Distance	Between Groups	15.190	4	3.798	2.075	.110
	Within Groups	53.075	29	1.830		
	Total	68.265	33			
<b>Relationship with owner manager or old Customer</b>	Between Groups	12.820	4	3.205	2.588	<b>.058</b>
	Within Groups	35.916	29	1.238		
	Total	48.735	33			
Documentation formalities	Between Groups	1.264	4	.316	.441	.778
	Within Groups	20.766	29	.716		
	Total	22.029	33			
<b>Disclosure Requirements Previous IT Returns Experience</b>	Between Groups	9.490	4	2.373	2.327	<b>.080</b>
	Within Groups	29.569	29	1.020		
	Total	39.059	33			
<b>Credit Rating Requirement</b>	Between Groups	12.059	4	3.015	8.373	<b>.000</b>
	Within Groups	10.441	29	.360		
	Total	22.500	33			
Timely Quick processing and Disbursal speed of execution	Between Groups	5.624	4	1.406	1.603	.200
	Within Groups	25.435	29	.877		
	Total	31.059	33			
Cost of capital Interest costs	Between Groups	6.712	4	1.678	2.133	.102
	Within Groups	22.818	29	.787		
	Total	29.529	33			
Collateral requirement for Immovable property	Between Groups	3.687	4	.922	1.067	.391
	Within Groups	25.048	29	.864		
	Total	28.735	33			
Other financial products services offered by institution	Between Groups	1.617	4	.404	.478	.751
	Within Groups	24.501	29	.845		

	Total	26.118	33			
Reputation of Institution	Between Groups	1.308	4	.327	.409	.800
	Within Groups	23.163	29	.799		
	Total	24.471	33			

The above ANOVA table shows the highlighted factors which differ significantly between financial institutions.

Hence, the hypothesis  $H_{06}$ : *There is no significant difference between the limiting factors for availing of debt from different entities (Commercial Banks, Cooperative Banks, and NBFCs) among MSMEs, from the perspective of financing entities* is rejected.

The differences are explained in following tables in detail.

*Table 59 F3 \* TYPECLASS Cross tabulation*

Relationship with owner manager or old customer		TYPECLASS					Total
		Private Banks	Public Banks	Govt Institutions	NBFC	Co-operative Banks	
<b>F3</b>	<b>very low</b>	5.9%	<b>41.2%</b>	2.9%	2.9%	5.9%	58.8%
	<b>Low</b>			2.9%			2.9%
	<b>Moderate</b>	5.9%	8.8%		8.8%	8.8%	32.4%
	<b>very high</b>	2.9%				2.9%	5.9%
Total		14.7%	50.0%	5.9%	11.8%	17.6%	100.0%

The institutions have said that the factor of relationship with institutions is very less important. However, the Public Sector banks have particularly opined in large number that this factor is very less important. In all other institutions, it is seen that the percentage of the factor being present (ok) or having 'very low' influence is higher than 'very high' influence.

*Table 60 F5 \* TYPECLASS Cross tabulation*

Disclosure Requirements	TYPECLASS					Total
	Private Banks	Public Banks	Govt Institutions	NBFC	Co-operative	

Previous IT Returns Experience		Banks					
F5	very low		2.9%			2.9%	
	Low		2.9%			2.9%	
	Moderate		2.9%	5.9%	11.8%	20.6%	
	High		8.8%			8.8%	
	very high	14.7%	35.3%	2.9%	5.9%	5.9%	64.7%
Total		14.7%	50.0%	5.9%	11.8%	17.6%	100.0%

Public and Private Banks give more of 'high' or 'very high' importance to disclosure requirements, as compared to other financial institutions.

*Table 61 F6 \* TYPECLASS Cross tabulation*

Credit Rating Requirement		TYPECLASS					Total
		Private Banks	Public Banks	Govt Institutions	NBFC	Co-operative Banks	
F6	Moderate	5.9%		2.9%		11.8%	20.6%
	high	2.9%	2.9%			2.9%	8.8%
	very high	5.9%	47.1%	2.9%	11.8%	2.9%	70.6%
Total		14.7%	50.0%	5.9%	11.8%	17.6%	100.0%

Credit rating is considered as very important by public sector banks and non-banking financial companies.

The ANOVA table given below, states that there is no significant difference across the importance given to characteristics of owner, by different financial institutions.

*Table 62 ANOVA MSME Owner Characteristics*

MSME Owner Characteristics		Sum of Squares	df	Mean Square	F	Sig.
Knowledge about market in which they operate	Between Groups	.984	4	.246	1.085	.382
	Within Groups	6.575	29	.227		
	Total	7.559	33			
Able to manage the needed resources	Between Groups	2.055	4	.514	.876	.490
	Within Groups	17.004	29	.586		
	Total	19.059	33			
Able to provide correct information about enterprise	Between Groups	1.246	4	.312	.458	.766
	Within Groups					

and market	Within Groups	19.725	29	.680		
	Total	20.971	33			
Consistency in decision making and Behaviour	Between Groups	2.662	4	.665	1.056	.396
	Within Groups	18.279	29	.630		
	Total	20.941	33			

ANOVA table given below shows that for the two highlighted statements that “lending to MSME is risky” and “Probability of defaulting is high”, there are significant differences among the financial institutions.

**Table 63 ANOVA PERCEPTION**

PERCEPTION		Sum of Squares	df	Mean Square	F	Sig.
<b>Lending to MSME is Risky</b>	Between Groups	9.496	4	2.374	3.940	<b>.011</b>
	Within Groups	17.475	29	.603		
	Total	26.971	33			
Funding to MSMEs doesn't fetch Required Rate of Return	Between Groups	4.103	4	1.026	1.314	.288
	Within Groups	22.632	29	.780		
	Total	26.735	33			
MSMEs doesn't adhere to payment schedule	Between Groups	5.937	4	1.484	1.594	.202
	Within Groups	27.004	29	.931		
	Total	32.941	33			
<b>Probabilty of defaulting is high</b>	Between Groups	5.617	4	1.404	2.429	<b>.070</b>
	Within Groups	16.766	29	.578		
	Total	22.382	33			
Bad loan in MSMEs would harm me or my branches credentials	Between Groups	3.212	4	.803	.759	.560
	Within Groups	30.671	29	1.058		
	Total	33.882	33			

The differences across the financial institutions are explained in tables given below:

*Table 64 P1 \* TYPECLASS Cross tabulation*

Lending to MSME is Risky		TYPECLASS					Total
		Private Banks	Public Banks	Govt Institutions	NBFC	Co-operative Banks	
P1	very low	0	0	2.9%	0	0	2.9%
	low	5.9%	17.6%	2.9%	5.9%	0	32.4%
	ok	8.8%	17.6%	0	0	2.9%	29.4%
	high	0	14.7%	0	5.9%	14.7%	35.3%
Total		14.7%	50.0%	5.9%	11.8%	17.6%	100.0%

Among all the institutions, Public sector banks and Cooperative banks have stated that the MSMEs lending is risky or highly risky. Government institutions do not subscribe that lending to MSMEs is risky, whereas NBFCs have been divided on this issue.

*Table 65 P4 \* TYPECLASS Cross tabulation*

Probability of defaulting high		TYPECLASS					Total
		Private Banks	Public Banks	Govt Institutions	NBFC	Co-operative Banks	
P4	very low	8.8%	38.2%		8.8%	8.8%	64.7%
	low		5.9%		2.9%	5.9%	14.7%
	ok	5.9%	5.9%	5.9%		2.9%	20.6%
	Total	14.7%	50.0%	5.9%	11.8%	17.6%	100.0%

However, the highlighted figure shows that though Public sector banks feel that lending to MSMEs is risky, the probability of default is very low, probably as their collection efforts are deemed very well.

## **Conclusion**

Regarding the factors affecting MSME financing, there were significant differences across financing institutions, for three factors, namely, the relationship with owner, the credit rating requirements and disclosure requirements. Credit rating was considered as very important by Public sector banks and Non-Banking Financial Companies. The Public Sector banks have particularly opined in large number that the factor of relationship with manager is very less important. Public and Private Banks gave more of 'high' or 'very high' importance to disclosure requirements, as compared to other financial institutions. Among all the institutions, Public sector banks and Cooperative banks have stated that the MSMEs lending is risky or highly risky. Government institutions do not subscribe to the view that lending to

MSMEs is risky, whereas NBFCs have been divided on this issue. However, though Public sector banks felt that lending to MSMEs is risky, the probability of default was deemed very low, possibly as their collection efforts are considered as very good.

Regarding the characteristics of owner the MSMEs, there was no significant difference between the perceptions of financial institutions.

## **Objective 6**

Last objective was to identify the role played by Associations or Federations of industries in coping with the finance related issues. MSMEs felt that no role is played by associations or federations of industries in coping with finance related issues as all of them answered this question negatively.

## **CHAPTER 6- CONCLUSIONS, THEORETICAL CONTRIBUTIONS AND MANAGERIAL IMPLICATIONS**

### **Conclusions**

1. This research empirically proves that there is significant difference in capital structures of MSMEs at an initial stage and later stage, with higher debt being raised by the firms at an initial stage than at later stage. The finding seems in consonance with Pecking Order theory that firm prefers debt to equity at initial stage. However, the market timing theory also explains this preference as new firms will find it very difficult to raise equity form the market at initial stage.
2. The size whether micro, small or medium doesn't show any significant difference in capital structure, which means that when it comes to raising funds, MSMEs can be regarded as a common cohort and is justified in being used a single unit of analysis.
3. It also shows that capital structure significantly differs between the manufacturing and service sector. This has been explained by the security requirements that can be fulfilled by the manufacturing sector, having physical assets like plant and machinery much above that in service sector. Thus, it justifies the use of sector as a distinguishing criterion for defining MSMEs differently in India across manufacturing and service sector.
4. The manufacturing firms also find it easier to raise debt compared to the service sector irrespective of the age. The debt is much higher in manufacturing sector in both stages, initial and later, as compared to service sector.
5. At the initial stage, for long term and for short term, although the factors are collectively significant, none of the factors are individually significant.

6. At a later stage, the factors which were tested were not found to significantly influence the raising of long term loan. This could be due to the fact that the firms settle in long term and earn creditworthiness.
7. At a later stage, the following factors significantly influence the likelihood of MSME raising short term debt from the financial institutions(short term, later stage):
  - Personal relationship
  - Documentation Formalities
  - Well supported by Govt./ subsidies
8. MSMEs find that there is significant difference across Commercial banks, cooperative banks and NBFCs for the two factors of Collateral requirements and Changing credit limits. Among all the financial institutions, Commercial banks have high tendency to ask for the collateral or guarantors which is a limiting factor. Also lack of flexibility in changing limit of borrowing is a limiting factor for commercial banks.
9. Regarding the factors affecting MSME financing, there were significant differences across financing institutions, for three factors, namely, the relationship with owner, the credit rating requirements and disclosure requirement, from the perspective of financing institutions.
10. The institutions have said that the factor of relationship with institutions is less important. However, the Public Sector banks have particularly opined in large number that this factor is least important.
11. Public and Private Banks give rather high importance to disclosure requirements, among all financial institutions.
12. Credit rating is considered as very important by public sector banks and non-banking financial companies.

13. Among all the institutions, Public sector banks and Cooperative banks have stated that the MSMEs lending is highly risky.
14. However, though Public sector banks feel that lending to MSMEs is risky, the probability of default is deemed low, possibly as their collection efforts were considered good.
15. MSMEs opined that Associations or Federations played no role in providing any assistance in finance related issues.

## **Theoretical Contribution**

The background theories are restated in brief, as follows to facilitate the explanation of theoretical contributions.

### **Pecking Order theory** [Donaldson (1961), Myers and Majluf (1984)]

It states that the cost of financing increases with asymmetrical information. The priority by a firm is given to internal funds first, then to debt and equity at last. Hence, firm prefers internal funds, then debt and then equity. An important purpose of the theory is to explain the fact that corporations usually are financed partly with debt and partly with equity. It states that there is an advantage to financing with debt, the tax benefits of debt and there is a cost of financing with debt, the costs of financial distress including bankruptcy costs of debt and non-bankruptcy costs.

**The theory states that the priority by a firm is given to internal finances while raising funds, then to debt and then equity at last.** According to Myers and Majluf (1984), the rationale for the pecking order is asymmetric information.

### **Information Asymmetries** [George Akerlof, Michael Spence, and Joseph E. Stiglitz (2001)]

Information asymmetry deals with the study of decisions in transactions where one party has more or better information than the other. Adverse selection refers to a situation where sellers have information that buyers do not, or vice versa, about some aspect of product quality .It applies to the financing decisions made by various lenders prevalent for SME's financing.

### **Market Timing Theory (MTT) [Baker and Wurgler (2002)]**

The MTT suggests how the enterprise in an economy decides whether to finance its investment with equity or debt option. It is one of the corporate theories that are contrasting with pecking order and trade off theory. It simply states that firms do not generally care whether they finance with debt or equity; they just choose the form of financing which, at that point in time, seems to be more valued by financial markets.

### **The findings of present research in context of above theories:**

1. This research empirically proves that there is a significant difference in capital structures of MSMEs at an initial stage and later stage with higher debt being raised by the firms at an initial stage than at later stage. The finding seems in consonance with Pecking Order theory that firm prefers debt to equity at initial stage. However, the market timing theory also explains this preference as new firms will find it very difficult to raise equity from the market at initial stage. Hence, although it is difficult to obtain debt, equity is still more difficult to obtain than debt. Hence, market timing theory also explains the preference for debt at initial stage. As the firm settles and grows, at later stage, it is found that debt is reduced. This explains that the availability of funds in the market improves at later stage of specially equity funds/ownership funds. Retained earnings may also contribute to reduction of debt.

2. It also shows that capital structure significantly differs between the manufacturing and service sector. This has been explained by the security requirements that can be fulfilled by the manufacturing sector, having physical assets like plant and machinery much above that in service sector. Thus, it justifies the use of sector as distinguishing criterion for defining MSMEs differently in India across manufacturing and service sector, and is also in

consonance with the market timing theory which states that availability of debt in market will be more when physical security is produced by firms.

3. Information asymmetry seems to be present on both the demand side and supply side. The firms are not aware of the financing options available and the financing institutions quote problem of inadequate information received from firms. This finding is derived from qualitative research methodology of case studies in the initial stage of research, focus group discussion and brainstorming sessions at the last stage of research. For financial institutions, this may lead to adverse selections as stated in theory, and for firms, the lack of information leads to a very limited consideration set, where Govt. schemes and new sources like BSE SME Platform of raising equity are not at all considered for raising the finance. Thus, adverse selection also happens from MSMEs perspective, due to information asymmetry.

4. Possible consequences are the two possible risks resulting from this information asymmetry for financing institutions –Risk of adverse selection and Risk of moral hazard. Risk of adverse selection is that risk perceived by the bank manager when he is not able to assess MSMEs ability to pay the credit taken and risk of moral hazard is when the bank manager is not able to assess the borrowers' willingness to pay back the loan. This research states that though MSME lending is perceived risky, the risk of default is perceived as less. This may be indicative that perception of risk of adverse selection is higher than the risk of moral hazard. Further research could be undertaken for better elaboration.

5. New avenues of short term sources also were not explored as banks seemed to be the prevalent sources of short term finances.

6. Qualitative methods as stated in point 4 above also point towards bureaucratic attitude and delay prevalent in sanction of loans under various Govt. schemes which seem to be a big dampener to the MSMEs and start-ups. Thus, not meeting of targets in the various schemes is

explained due to these findings as, market timing theory states that firms prefer the sources which are conveniently available in markets.

## **Future Research Issues**

This research has been done focusing on debt as source of finance. Future research could undertake detailed analyses of other sources of finance, specially the new sources of finance.

## **Managerial Implications**

Following are the managerial implications of the research:

1. Availability of funds at starting stage is a major problem for MSMEs and more so for service sector. It has been found that among services, there are schemes of financing specifically for IT sector. But in state like Goa where huge potential exists for expansion of service sector in tourism area, specific schemes could be formed for tourism related service sector.
2. Even the slogan “Make in India” seems to tilt towards favouring manufacturing sector, over service sector. There seemed to be overall preference towards lending to manufacturing sector due to availability of collateral. Promotion of service sector for start-ups could be accelerated by provision of financing schemes.
3. There is need for proactive steps to improve information asymmetry from the side of MSMEs as well as financing institutions as this seems to be major issue hampering the financing of MSMEs. In case of financing institutions, not receiving adequate documentation leads to increase in risk perception towards lending to MSMEs. Hence, MSMEs should focus on the provision of information, with professional expertise.

4. There seems to be acute problem of lack of awareness of the schemes available to MSME sector from the Govt. financing institutions as well as from other financing institutions like BSE SME platform. Special awareness drives for these schemes seems to be the need of the hour. These could be done from educational institutions too, besides taking help of associations, chambers of commerce etc.
5. The information about the limiting factors for the financial institutions may be useful for selection of financial institution. For example, Public and Private sector banks have emphasis on disclosure requirements. Public sector banks have higher tendency to ask collaterals.
6. It is found that there is no role played by associations, or chambers of commerce in assisting with the problems faced by MSMEs in context of financing. They could be involved in creation of awareness as well as assistance in documentation to MSMEs at reasonable rates, as documentation is stated as the key problem for financing that leads to delays.

Thus, the research has unearthed and reported many problems and factors affecting financing of MSMEs, especially at initial stages. The perspectives of financing institutions and information asymmetry leading to adverse selections have also been highlighted. The report may assist the MSMEs and the financial institutions to be aware and overcome the problems of financing and raise the spirit of entrepreneurship.

# ANNEXURES

## Questionnaire I- Questionnaire to MSMEs

CONSTITUTION OF YOUR FIRM	
LEGAL STATUS	<input type="checkbox"/> Sole proprietor
	<input type="checkbox"/> Partnership
	<input type="checkbox"/> Company
	<input type="checkbox"/> LLP
	<input type="checkbox"/> Other Specify _____

OPTIONS	
REGISTRATION DETAILS	<input type="checkbox"/> Udyog Aadhar
	<input type="checkbox"/> SSI /EM-I / EM-II
	<input type="checkbox"/> UAM
	<input type="checkbox"/> Other
	<input type="checkbox"/> Not Registered

ITEMs	RESPONSES
Start year [operation].....[year]	
Capacity utilisation..... [%]	
Total net worth.....[lakhs] [capital+reserves+surplus]	
Initial Capital with which.....[lakhs] started operations	

MAIN ACTIVITY	
MANUFACTURING	SERVICES
<input type="checkbox"/> Food processing/ Pharmaceutical [Manufacturing]	<input type="checkbox"/> Tourism/Hospitality/Wellness /Hotels/Restaurants
<input type="checkbox"/> Cashew processing/ allied	<input type="checkbox"/> Tour/Travel /Business/Operator
<input type="checkbox"/> Other [Manufacturing ](specify)_____	<input type="checkbox"/> Food Business/Canteen /Retail etc.
	<input type="checkbox"/> Technology/IT/ITeS/Allied
	<input type="checkbox"/> Other [Services]_____

INVESTMENT	Manufacturing[In INR]	Service[In INR]
Plant/machinery/ Equipment		
<input type="checkbox"/>	0-25 lakhs	0-10 lakhs
<input type="checkbox"/>	25 lakhs-5 Crore	10lakhs-2 Crore
<input type="checkbox"/>	5 Crore and above	2 Crore -5 Crore

Initial Stage	
[All sources expressed as % of total Initial Capital & should add up to 100%]	
Sources of funds	%
<b>Equity(if any other specify)</b>	
<input type="checkbox"/> <i>Personal funds (margin money +other)</i>	
<input type="checkbox"/> <i>Family borrowings</i>	
<input type="checkbox"/> <i>Friends borrowings</i>	
<input type="checkbox"/> <i>Partners</i>	
<input type="checkbox"/> <i>Venture</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>Debt(if any other specify)</b>	
<input type="checkbox"/> <i>Public banks</i>	
<input type="checkbox"/> <i>Private banks</i>	
<input type="checkbox"/> <i>Cooperative banks</i>	
<input type="checkbox"/> <i>Non-banking financial institutions</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>Govt schemes(if any other specify)</b>	
<input type="checkbox"/> <i>State Finance Corporation(EDC)</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>Short term (if any other specify)</b>	
<input type="checkbox"/> <i>Cash credit</i>	
<input type="checkbox"/> <i>Overdraft facility</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>Others(if any specify)</b>	
<input type="checkbox"/> <i>Microfinance</i>	
<input type="checkbox"/> <i>Moneylenders/pawn brokers</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>Total 100 %</b>	

Growth /Expansion/Refinancing at later stage	
[All sources expressed as % of total Required Capital & should add up to 100%]	
Sources of funds	%
<b>Equity (if any other specify)</b>	
<input type="checkbox"/> <i>Owners funds</i>	
<input type="checkbox"/> <i>Retained earnings</i>	
<input type="checkbox"/> <i>Friends borrowing</i>	
<input type="checkbox"/> <i>Family borrowing</i>	
<input type="checkbox"/> <i>Partners</i>	
<input type="checkbox"/> <i>Venture/group funding</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>DEBT(if any other specify)</b>	
<input type="checkbox"/> <i>Public banks</i>	
<input type="checkbox"/> <i>Private banks</i>	
<input type="checkbox"/> <i>Cooperative banks</i>	
<input type="checkbox"/> <i>Non-banking financial institutions</i>	
<input type="checkbox"/> <i>Microfinance institution</i>	
<input type="checkbox"/> _____	
<b>GOVT SCHEMES(IF ANY SPECIFY)</b>	
<input type="checkbox"/> <i>SIDBI</i>	
<input type="checkbox"/> <i>NABARD</i>	
<input type="checkbox"/> _____	
<b>SHORT TERM (IF ANY OTHER SPECIFY)</b>	
<input type="checkbox"/> <i>Discounting of bills</i>	
<input type="checkbox"/> <i>Cash credit against stock</i>	
<input type="checkbox"/> <i>Overdraft facility</i>	
<input type="checkbox"/> <i>Trade credit</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>OTHERS (IF ANY SPECIFY)</b>	
<input type="checkbox"/> <i>Microfinance</i>	
<input type="checkbox"/> <i>Money lenders/pawn brokers</i>	
<input type="checkbox"/> _____	
<input type="checkbox"/> _____	
<b>TOTAL 100 %</b>	

Factors limiting Institutional Finance		Long term					Short term				
S.no	REASON	1	2	3	4	5	1	2	3	4	5
1.	Financial Quality of Business										
2.	Proximity of institution/convenient location[distance]										
3.	Personal relationship with institution or manager[PR networking]										
4.	Documentation formalities										
5.	Disclosure Requirements [Previous IT Returns, Experience....]										
6.	Credit Rating Requirement										
7.	Approach of institutions staff in service										
8.	Quick processing and Disbursal /speed of execution										
9.	Cost of capital /Interest costs										
10.	Collateral requirement for immovable property										
11.	Other financial products /services offered by institution										
12.	Credit Size [ Amount disbursed as per needs]										
13.	Previous credit history[previous loans paid]										
14.	Reputation of Institution										
15.	Flexibility in credit limits as per business needs										
16.	Well supported by Government/Subsidies [good Government initiatives]										
17.	_____										
18.	_____										
19.	_____										

Sr no	OTHER FACTORS	NO	YES	If YES..... In what way?
1	Did any kind of Political Patronage support help in availing finance	<input type="checkbox"/>	<input type="checkbox"/>	
2	Did any kind of support from Trade Associations helped in availing finance	<input type="checkbox"/>	<input type="checkbox"/>	

Select the source of finance and rate the chosen source.	<input type="checkbox"/>																				
	Family /Relatives			Friends			Partners			Private /Venture Angel			Others								
Rate the Limiting factors/challenges below													1-LOW			2-AVG			3-HIGH		
LIMITING FACTORS	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3						
1. Project Quality																					
2. Project Amount																					
3. Repayment terms																					
4. Timely Funds																					
5. Documentation / disclosure Advantage																					
6. Expected Return																					
7. Owners Control																					
8. Absence of Fixed bearing costs																					
9. Absence of Collateral / guarantee/margin money																					
10. _____																					
11. _____																					

Select the other Sources from whom approached/availed credit in past	<input type="checkbox"/>																				
	Commercial banks			Cooperative Banks			Government Institution			NBFCs			Loans from Others								
Rate the Limiting factors/challenges below													[1-LOW			2-AVG			3-HIGH]		
LIMITING FACTORS	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3						
1. Processing fees																					
2. Interest rates																					
3. Margin Money																					
4. Credit History or Rating																					
5. Amount of Credit granted																					

6. <i>Repayment period</i>																				
7. <i>Documentation and Disclosures required</i>																				
8. <i>Time to make credit available</i>																				
9. <i>Collateral or Guarantor</i>																				
10. <i>Asset hypothecation /lease like land/ bldg. / machinery</i>																				
11. <i>Changing Credit Limits</i>																				
12. <i>Renewing or refurbishing</i>																				
13. _____																				
14. _____																				

## Questionnaire II-Questionnaire to Financing Institutions

**LOCATION**

**SRNO**

**NAME OF INSTITUTION**

**TYPE:**

- Public
- Private
- Govt
- NBFC

SR	****HOW IMPORTANT ARE THESE FACTOR WHILE LENDING TO MSMEs****	1	2	3	4	5
1	FinancialQualityofBusiness					
2	Proximity/Distance					
3	Relationship with owner/manager or old Customer					
4	Documentationformalities					
5	DisclosureRequirementsPreviousITReturnsExperience...					
6	CreditRatingRequirement or assesment					
7	Timely/Quickprocessing andDisbursalspeedofexecution					
8	CostofcapitalInterestcosts					
9	CollateralrequirementforImmovableproperty					
10	Otherfinancialproductsservicesofferedbyinstitution					
11	ReputationofInstitution					
	<b>MSME LOAN SEEKERS - CHARACTERISTICS</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
12	Knowledge about market in which they operate					
13	Able to manage the needed resources					
14	Able to provide correct information about enterprise and market(customers)					
15	Consistency in decision making and Behavior					
	<b>PERCEPTION ABOUT MSMES 1-LOW .....5-HIGH</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
16	Lending to MSME is Risky					
17	Funding to MSMEs doesn't fetch Required Rate of Return					
18	MSMEs doesnt adhere to payment schedule					
19	Probabilty of defaulting high					
20	Bad loan in MSMEs would harm me or my branches credentials					
22	Other factors (If any..)					
23						

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