Bank Financing for MSME; Boon or Bane

A study on impact of bank financing on the financial performance of MSME companies.

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***Abstract*: Micro small and medium enterprises are very important part of the Indian economy because they are responsible for generating employment for rural market and are helpful for the economic development as they account for 40% of India's exports and 45% of total manufacturing output. Not only banks but Non-banking financial institutions as well extend credit to the credible companies but over a period of time it has become more and more difficult for these companies to avail loans due to their complicated financial condition. These companies are not able to fulfill the intricate requisites that are necessary to avail loan from a formal source of finance like banks. That's why companies look for finance to informal sources like private lenders and have to bear huge interest rates and suffer financially. The company's in recent times are facing the risk of going bankrupt in spite of repetitive boost by the government, and most of the companies are struggling to make their ends meet, while the major aim of any entrepreneur is to grow and not just survive. This research attempts to find out the impact of bank finance on financial performance of the companies who have availed bank finance over the period of five years through advanced tools like Piotroski Score and to understand whether the companies are caught in debt trap through credit scores and to find out the probability that they might go bankrupt in the future through Altman Z score, and suggest appropriate funding opportunities that the bankrupt companies can explore. Most of the companies have been found to have poor Altman Z score which comes under red or grey zone. There are many other sources of finance that the company can consider for raising funds rather than band financing for debt restructuring.**

***Keywords*: Piotroski score, Altman Z score, MSME, Debt restructuring, Fundraising.**

INTRODUCTION

According to the recent definition for micro small and medium enterprises,
• Micro enterprises - Investment of less than `1 crore and turnover less than `5 crore
• Small enterprises - Investment of less than `10 crore and turnover less than `50 crore
• Medium enterprises - Investment of less than `50 crore and turnover less than `250 crore

Due to the generalized definition, most of the companies have come under the purview of Small enterprises or medium enterprises and have maintained their position for more than 10 years. Hence this sector faces growth stagnancy and financial distress. The companies having bank loans have seen deteriorating/ week financial performance over long run. Most of the companies are not able to avail bank loans due the complexity involved in the documentation procedure. From time to time government has come up with supportive changes through which the companies can ease their financial burden but the benefit that they get is not traceable. The recent developments that the government came up with are certain policy changes such as Rationalization of custom duties on Steel screws, plastic builder wires, prawn feed, finished gem stones, and export of garments, leather, and handicraft items etc. Government has also come up with many financial boosters like reduction of custom duties on semis, flats and long products of non alloys, copper scraps etc. More over budget allocation for MSME has almost doubled to 15700 cr for 2021-22 from 7572 cr in 2020-21 which is an indicator of rising demand of finance from MSME sector.

REVIEW OF LITERATURE

The study suggests that in future the micro small and medium enterprises will be in more need of finance and Banking system of India is not sufficient enough to suffice the extravaganza demand as they prefer keeping safe exposure to avoid concentration risk. The detailed study conducted in this sector throw light upon the fact that as big as 92.8% of the companies in MSME sector prefer more of Retained earnings/ self finance and 2.1% through non institutional investors, and remaining small share goes for institutional ones due to their credit rationing theory. (**Abhijeet Biswaas- 2018- A study of the factors influencing financing gap for MSME sector.)**

Time and again it has been proven that banks show reluctance towards lending the MSME sector. In 1994-95 the overall credit exposure for banks was 15.17% and further fell to 7.2% in 2006-7 and saw a rise up to 13% in 2013%. After the introduction of MSME Development act 2006 banks started extending additional loans to this sector. he various reasons behind this would be Fierce competition, poor technology base, lack of infrastructure, lack of skilled labor, marketing and distribution problem, delayed payments, mindset problems, outflow of wealth etc to name a few. (**Rajib lahiri 2016- Problems and prospects of micro small and medium enterprises)**

There are many issues that the micro small and medium enterprises face while availing loans from banks such as lengthy procedure, complex documentation, lack of information, lack of availability, etc. he banks also face many challenges due to MSME companies questionable credibility due to “pecking order theory” which hypothesizes that if the companies face high cost of financing they usually prefer retained earnings/ own funds. Another problem “Moral hazard problem” which proves that the business owners benefit more from other sources of lending in case of liquidation hence they prefer informal sources. Also there are high switching costs if companies feel like switching their banks in case of any issue pertaining to loans disbursal. Hence above all it is clear that most of the companies prefer other sources such as securitization of trade credit, venture capital funding, private equity funding and mezzanine financing. As there is a huge demand for equity expected in the upcoming future, there are two stock exchanges as well like BSE SME and NSE EMERGE which facilitate free flow of equity finance. According to the research the estimated demand for equity finance 10 years hence is approximately 1.6 billion INR. **(Mr.P.R Shreejeeth- 2016- A study on scope of external equity finance in MSME units in India.)**

There is a steep rise in debt demand since 2015 is around 1.6 trillion INR. States having major manufacturing hubs such as Maharashtra, Delhi, Tamilnadu, Andhra Pradesh, and Gujarat have highest demand of approximately 86% as compared to equity finance demand. According to the data as big as 82% of the credit supply for the MSME sector is contributed by informal sources of finance. In case of competition between banks, in spite of growth of non-banking financial institutions banks lead in this domain. Banks are the highest lenders when compared with formal sources of finance. Other banks like Regional Rural banks, also play a significant role in financing MSME. Having said that most of the banks reported steep rise in the Nonperforming assets pertaining to SME portfolios of banks. According to the findings if the company defaults the bank takes strict action against it instead of helping it revive, once the account becomes NPA. **(International Finance Corporation report 2019).**

Recent market has proven hat banks and nonbanking financial institutions have been facing huge problems of accumulating NPA’s from which unfortunately more than 60% accounts for MSME portfolios which is a big reason to worry. In the current pandemic condition the RBI has increased the moratorium which is doing more harm to the banks then benefit and the banks are facing difficulty in making ends meet**.** (**MSME annual report 2019-20-21)**

RESEARCH OBJECTIVES.

- Detailed financial analysis of companies in MSME sector through stocks listed on "BSE SME" and "NSE EMERGE" to study their financial strength
- To Study the credit worthiness of the companies through credit scores and understanding problems in availing credit.
- To study the possibility of bankruptasy of the MSME companies and interpret the up scaling possibilities.
- To recommend right investment avenues, and fund raising options to the financially instable companies.

RESEARCH SCOPE AND METHODOLOGY

The research that is conducted is an exploratory research that aims to find the relationship of debt financing and up scaling stagnancy (growth stagnancy) problem faced by the listed MSME companies in India in the past 5 years. The research is entirely based on secondary data which are extracted from the company websites and detailed analysis of the annual reports, Credit ratings and other details through government sites like NCGTC or CGTMSE that contain key information essential for conducting this research.
Here the sampling method that is used is stratified random sampling where the companies that I have chosen are from different subsector.
The sample is heterogeneous in nature. The research aims to explore total 16 MSME companies from two stock exchanges namely BSE and NSE from indices NSE - EMERGE and BSE
–SME. The period of study is 5 years that is 2015- 2020. The financial performance of the companies over the period of five years is studied in detail here.

- The research variables include: Piotroski Score of each company for comparison of financial strength.
- Credit score of each company declared by credit rating companies for credit history and credit worthiness of each firm.
- Altman z score of each company for estimation of future default
- All three statements namely Profit and loss statement, Cash flow statement, Balance sheet.
- Ratio Analysis.

DATA ANALYSIS

Table 1 company list.

COMPANY	SECTOR	SCRIP
ADVAIT INFRATECH	INFRASTRUCTURE TECHNOLOGY	ADVAITINFRA
ANI Integrated Services Ltd.	SERVICES	AISL
ASL Industries Ltd.	AU OMOBILE	ASLIND
Airo Lam Ltd.	CONSUMER GOODS	AIROLAM
Beta Drugs Ltd.	PHARMA	BETA
Bohra Industries Ltd.	FERTILISERS & PESTICIDES	BOHRA
Active Clothing Company limited	ACCESSORIES AND APPARALLS	ACTIVE
Anmol India Ltd	DISTRIBUTORS	ANMOL
Bothra Metals and alloys ltd	ALLUMINIUM	BMAL
Manas Properties ltd	REAL ESTATE	MANAS
Medico remedies ltd	PHARMA	MEDICO
CRP risk mgmt	CONSULTING	CRPRISK

Table 2 Individual Piotroski Score.

COMPANY	**SECTOR**	**SCRIP**	**PIO ROSKI SCORE**
Advait Infratech	INFRASTRUCTURE TECHNOLOGY	ADVAITINFR A	5
ANI Integrated Services Ltd.	SERVICES	AISL	5
ASL Industries Ltd.	AUTOMOBILE	ASLIND	7
Airo Lam Ltd.	CONSUMER GOODS	AIROLAM	6
Beta Drugs Ltd.	PHARMA	BETA	6
Bohra Industries Ltd.	FERTILISERS & PESTICIDES	BOHRA	4
Active Clothing Company Limited	ACCESSORIES AND APPARALLS	ACTIVE	5
Anmol India Ltd	DISTRIBUTORS	ANMOL	6
Bothra Metals and alloys ltd	ALLUMINIUM	BMAL	4
Manas Properties ltd	REAL ESTATE	MANAS	4
Medico remedies ltd	PHARMA	MEDICO	5
CRP risk mgmt	CONSULTING	CRPRISK	6

Companies like Bohra industries limited, from fertilizers and pesticides sector and Bothra Metals and Alloys from mining industry and Manas properties from real estate sector have a very week Piotroski score of 4 which is an indicator that these companies are facing financial distress due to unavailability of finance. The low free cash flow is the indicator of liquidity issues.

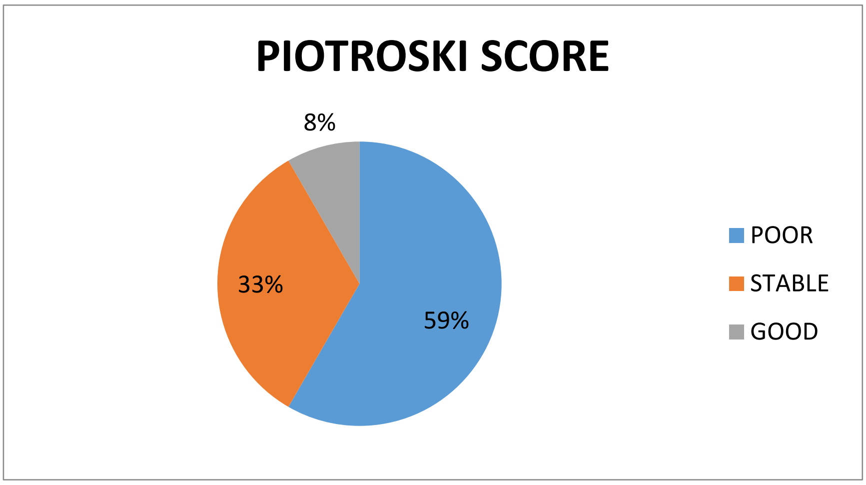
Companies like Advait Infratech, Ani integrated services, Active clothing company limited and Medico remedies limited from different sectors like infrastructure, apparels and pharmaceuticals have a Piotroski score of "5" which is due to less liquidity ratios and high asset turnover ratio which need good working capital availability due to their intensive service oriented business model.

The companies having 6 to 7 are safe but need to develop their Piotroski score is an indicator that the company needs to review its financial state.

Table 3 Summary of Piotroski scores

PIOTROSKI SCORE	NUMBER OF COMPANIES
POOR	7
STABLE	4
GOOD	1

Chart 1 Piotroski score



On the bases of above study, hypothesis test was conducted to find out the effect of bank financing on the financial conditions through the analysis of Piotroski scores. The null hypothesis states that the companies have on an average a Piotroski score of 7 and the alternative hypothesis states that they perform poor.

Piotroski Score Hypothesis est = (Ho = 7) (H1<7)

Table 4 Piotroski score student test.

HYPOTHESIS	
MEAN	5.25
Ho	7
S DEV	0.965307299
SQUR OF 12	3.4641
MEAN-Ho	-1.75
S DEV/SQUR	0.278660344
SCORE=	-6.280046784
0.5 significance (critical value)	-1.796

According to the hypothesis test the T statistics comes into rejection region which indicates that on an average the companies are not having a Piotroski score of 7 so we have to conclude that the company has a score lesser than7 which means most of the companies are underperforming.

Table 5 Altman Z score summary.

COMPANY	ALTMAN Z SCORE
Advait Infratech	3.437
ANI Integrated Services Ltd.	9.347
ASL Industries Ltd.	2.405
Airo Lam Ltd.	2.852
Beta Drugs Ltd.	7.321
Bohra Industries Ltd.	-1.548
Active Clothing Company limited	2.502
Anmol India Ltd	6.412
Bothra Metals and alloys ltd	-1.554
Manas Properties ltd	3.491
Medico remedies ltd	4.26
CRP risk mgmt	5.018

Altman Z score was widely used at the time of great depression to find out whether the companies have chance of going bankrupt. he accuracy have been 89% hence widely accepted by banks to evaluate credit worthiness and risk measure.

Table 7. Altman Z score eligibility criteria.

ZONE	CRITERIA	COMPANIES
DISTRESS ZONE	1.8	2
GREY ZONE	3	3
SAFE ZONE	4	7

It has been found that most of the companies come under safe zone. Companies involved in real estate business and consulting and I service providers have shown low risk of going bankrupt due to their nature of business. Companies involved in manufacturing and forex transactions have shown higher risk of bankruptacy.

Altman z score Hypothesis test = (Ho = 4) (H1>4)

The altman Z score aims to find whether the companies have a stable altman Z score or lower than the acceptable range. The null hypothesis says that on an average the altman z score is 4 and alternate hypothesis says that the altman z score is less than 4.

Table 8. Altman Z score student test.

MEAN	3.661917
Ho	4
S DEV	3.211891
SQUR OF 12	3.4641
MEAN-Ho	-0.33808
S DEV/SQUR	0.927194
SCORE=	-0.36463
0.5 significance level for single tail hypothesis	-1.796

According to the hypothesis test the T score does not fall under rejection zone hence the hypothesis is accepted that on an average the companies have a have good Altman z score and they do not fall in the bankrupt status.

FINDINGS AND SUGGESTION

- The companies have shown low performance on stock exchange, they are not actively traded.
- The companies who have high Piotroski score like ASL INDUSTRIES LTD also have low credit rating which is an indicator that irrespective of good financial strength the companies are debt ridden.
- According to the hypothesis testing done on the Piotroski scores, it can be concluded that majority of the companies are coming under poor financial strength category.
- According to the Piotroski scores done on the Altman Z score of bankruptasy most of the companies are safe from going bankrupt but their credit scores by credit rating agencies have been seen degrading.
- Due to degrading credit score the companies like "Bohra industries ltd" and "Bothra Metals and Alloys" might face difficulty while raising funds further from banks.
- The companies like "Bothra Metals and Alloys" face stagnancy and are not able to grow and upscale.

In the recent turbulent times the MSME sector should not depend on bank finance as it does harm in the long run. To avoid this scenario the companies should explore other sources like mezzanine financing, crowd funding, credit securitization, trade credit, peer to peer financing, bond issue, account receivable factoring, rights issue etc along with use of derivatives market to hedge their positions.

Companies involved telecommunication sector like "**ADVAIT INFRABUILD** belonging to an oligopolistic market where the market participants do not have much control on pricing. It gets influenced by other competitors in the same market. A telecommunication business model is such that it has operational expenses, tax implications and many other miscellaneous expenses, and not to forget corporate governance charges.

1. **Zero coupon bonds:-** he company can issue zero coupon bonds that will be useful for the company as a debt and also it will not dilute the powers of the shareholders and promoters.
2. **Convertible debentures:-** he company can issue convertible debentures that will be partially or completely convertible into equity.

ANI INTEGRATED SERVICES: The business model of this company is such that they have more of operational expenses and to fulfil that need they need short term finance. The company has downgraded its credit rating due to high employee costs and continuously increasing working capital requirement.

To fulfil the further need the company can choose an alternative funding option. The best option would be

Mezzanine Financing :- Through mezzanine financing the company can raise funds to fulfil its working capital financing needs. Mezzanine financing is a hybrid financial instrument that gives the issuers the liberty to convert the debt into equity.

ASL INDUSTRIES LTD In case of ASL industries the Company is engaged in services of steel manufacturing and automobile showrooms where there is a need of high working capital. Altman Z score shows that the company might go bankrupt and there is a need for refinancing.

Account receivable factoring: - Accounts receivable factoring is the sale of accounts receivable to a third-party at a discount to accelerate the receipt of cash. The discount is the fee charged by the third-party buyer (or factor) for its service. The factor primarily relies on the creditworthiness of the company's customers in determining the amount of the discount. The customer is usually notified about the sale and the factor is responsible for collection. Receivables may be sold on a recourse or non-recourse basis. Spot factoring is the sale of a single invoice rather than all of a company's receivables. Accounts receivable factoring is also referred to as invoice factoring.

Reward based crowd funding: - Since the company is already in a debt trap it would be difficult to raise finance through any other source. Here the ideal source of finance would be reward based crowd funding. Where in the borrower can promise a reward to the investors in case of fulfilment of objectives.

AIROLAM LIMITED has a working capital intensive nature of operations. It has to keep the raw material ready all time on site which adds up to the company's working capital expenses. The business is cyclical in nature because it is linked to real estate. The altman Z score being in grey zone the company is falling short in managing its working capital. The company imports some materials from foreign countries hence it is exposed to foreign currency risk as well. Hence the best fund raising option would be:

Rights issue:- The company can offer its existing shareholders some more new shares through which the company can raise additional finance to fund its requirements.

BOHRA INDUSTRIES The company has shown poor financial performance, Its Altman Z score is in red zone, which means it is about to get bankrupt and moreover its credit rating has been downgraded by the credit rating company, in such a case the company should first look at fulfilling its debt obligations by raising funds through:-

Convertible bonds :- The best option would be issuing convertible bonds for the investors who are interested in this sector.

Zero coupon/ Deep discount bonds:- Zero coupon and deep discount bonds are the best options one can use for raising finance in case of restructuring.

ACTIVE CLOTHING CO. LIMITED (ACCL). Due to its wide spread operation company faces operational expenses rise every day. The company is in grey zone of Altman Z Score, Which means it needs to develop its financial performance or the company might go in red zone soon and there are chances of going bankrupt.

The operating cycle of the company remained elongated at 175 days as on March 31, 2019 mainly on account of the stretched inventory holding period and collection period, especially in the distribution segment.

Trade credit from suppliers :- The company needs to access trade credit from its esteemed suppliers for holding period for stocks. Some suppliers extend credit to point of sale, which means the payment is done after a percentage of stock is sold, through this the company can fund its holding period.

BOTHRA METALS AND ALLOYS

The Altman Z score is in grey zone and the company has a very low Piotroski score and the company's credit rating has downgraded from 2018 (last report). The company has been defaulting on the debt and the bank has declared it as substandard account. The company should seek for fund raising opportunities through informal sources like

Peer to Peer lending:- lending to peers means company from same industry can lend to each other in return of some monitory benefit. Such strategic alliances can save company from becoming bankrupt.

MANAS PROPERTIES is primarily into the business of acquiring properties and leasing / letting it out to our clients thereby earning lease rentals / license fees as consideration, as well as earning price appreciation (as the case may be).

The company has been downgraded by the credit rating company due to its non cooperation. The company has low Piotroski and Altman Z score which is an indicator that the company is financial distress and on the verge of bankruptasy. To save itself from this the company should explore informal funding opportunities like : Equity financing techniques for project based developments.

Forward funding

In this case the equity financer acquires the site for the real estate investment especially for developments and provides funds for the construction. This gives the financers greater control over the investment and often giving the developer lower interest then market norms. Usually on completion the sales made by the financer are counter balanced with the developer profits on sale. The more money financer makes, developer makes greater profits.

CONCLUSION

The study concludes that MSME companies face a lot of issues while fundraising from formal sources and it does more harm than benefit to these companies who have minimal capital to keep themselves a float the tough competition. These companies need to explore other fundraising opportunities.

The companies should not rely on debt financing, as in spite of multiple schemes available for the MSME sector the company may or may not fulfill all the criteria's and might end up becoming bankrupt due to the burden of loan.

Entrepreneurs use own finance or look for angel investors then debt finance in the start up stage as they might not be able to avail bank loans due to unavailability of collateral.

Banks are redundant to lend the MSME companies with low financial strength as they have high probability of becoming NPA. Every year government attempts to write off the NPA through capital infusion but the cycle repeats in the long run.

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