

THE ROLE OF CREDIT IN ENTREPRENEURSHIP DEVELOPMENT.

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Abstract

The objective of this paper is to examine the role of credit in entrepreneurship development. The paper is based on a recent researches combining case studies with a sample survey of business houses that were benefited with the availability of credit from a Indian government financial institution. The findings of the study reveals that the entrepreneurs who received training and expert advice performs better than those who did not avails such services. This study also reveals the fact that not only capital but some economic and institutional constraints are the major problems faced by the entrepreneurs. Stiff competition among micro, small and medium enterprises and poor infrastructural support are the barriers faced by the entrepreneurs of such Enterprises.

Keywords: Credit, Entrepreneurship development, Entrepreneurs, institutional constraints.

INTRODUCTION

It is generally agreed that micro, small and medium enterprises (MSMEs) play a vital role in creation of employment and generation of income in many developing economies of the world. The significance of MSMEs for creation of employment and generation of income is apparent from the estimated 39.4 million businesses operating in India which employ more than 80.8 million people. Out of these MSMEs, 31.79 percent are engaged in manufacturing and 68.21 per cent in service enterprises. MSMEs also serve as fruitful for future entrepreneurs and strengthen the backbone of the country's private sector.

One of the key concerns for policy development surrounding MSMEs in India and the world over pertains to the determinants of successful MSMEs (Rogerson, 2000). It has been observed that one of the important factor of small business success is finance through credit. A number of MSMEs support institutions have mushroomed in India since the onset of economic reforms in the mid-1990s, extending credit to MSMEs, filling the gap left by commercial banks.

The concept of entrepreneurship has a long history, tracing back to 1940's when (Marshall, 1949; Schumpeter, 1934) associated entrepreneurship with a person, often as a risk taker; business organiser; innovator; and profit seeker, this paper adopts a more dynamic view of looking at entrepreneurship as a series of events or activities (Binks & Vale, 1990).

Trulsson (1997) provides a good summary of an entrepreneurial activity, which is said to take place if the product is new to the area, or if the sources of supply are distinctly different from those used by others in the locality, and/or if a new technology has been introduced. Existence of opportunities is considered critical for entrepreneurial activities to take place.

Khanka (1990) correctly argues that the role (responsiveness) of entrepreneurship in economic development varies from economy to economy, depending upon its material resources, industrial climate and responsiveness of the political system to the entrepreneurial function. The implication of this is that in a particular economy, we would expect more entrepreneurial activities and faster business growth during a regime with more opportunities and freedom for private business than in a restrictions regime.

OBJECTIVES

The present paper seeks to achieve the following objectives:

1. To understand the role of a credit to Micro, small and medium enterprises on Entrepreneurial activities.
2. To explore the problems faced by Entrepreneurs.
3. To assess the present status of MSMEs in India.
4. To assess the role of training and expert advice in the Entrepreneurship development.

Role of Credit in an Entrepreneurial Activity

Lack of access to credit has been identified as one of the major constraints hindering the development of small businesses and therefore, the supply of entrepreneurial activities not just in India, but in other developing countries (see for example, Aboudha, 1996; Bagachwa, Harris & Tinios, 1993; K-Rep, 1997; Kuzilwa & Mushi, 1997; Nsana, Knudsen, & Kristiansen, 1993). Commercial banks have traditionally concentrated their lending to

large formal enterprises which possess collateral and therefore, are deemed to be less risky. Recent studies on the supply and demand for financial services in India show that less than 5 per cent of households (not necessarily all entrepreneurs) in the urban and rural areas in India had access to credit from formal sources; less than 2 per cent of low-income entrepreneurs have access to financial services.

Although the role of credit as a determinant of successful entrepreneurial activity may look obvious when using a partial analysis, the dynamics in the entrepreneurial processes make this role less obvious. The analysis of an entrepreneurial activity shows that finance does not in itself create economic opportunities. Rather it is entrepreneurial people who see ways in which they can generate income from situations, skills or contact or other push factors (Christen, 1997). It is in this context that the role of credit should be seen. Also it is indicated that finance (along with other institutional factors) enhances the ability of the entrepreneurs to take advantage of these opportunities, thereby leading to entrepreneurial success. Lack of it could lead to business failure.

Entrepreneurial success could be defined in a conventional sense in terms of a firm's profit generation and growth in employment, output, sales, etc., over time. Through growth a firm can graduate from one size to a higher one. Those businesses that are able to survive under intense competition are also included. In a competitive situation these successes cannot happen unless a firm is developing an edge that allows it to take advantage of opportunities. The issue then becomes that of how credit can assist in a process of exploiting such opportunities.

Kristiansen (2001) sums it up well by arguing that credit makes active business/opportunity accessible to the right energetic person(s). Lack of credit could prevent entrepreneurial activities from being undertaken, and hence lead to business failure. For practical purposes, therefore, the role of finance (credit) can meaningfully be studied by controlling other variables, for example, education, gender and motivation for success. The important issue, therefore, is identification of the people who had been, were, or are about to undertake entrepreneurial activities and analyse how the various types of finances have accelerated their entrepreneurial activities.

Requirement for Finance

Finance is normally required for three standard uses, that is for start-up or expansion i.e. in machinery and acquisition of premises (buildings), during start-up or while expanding and purchase of operating materials. Implementation of an entrepreneurial activity can only take place when these factors are in place; otherwise the activity has to be aborted. Financing of factors of production can be undertaken from own savings, generated internal profits or external funds. Credit becomes important when internal sources of finance are inadequate for an envisaged entrepreneurial activity. Initial capital could also be a factor determining the size and competitiveness of business. A research on small and medium sized firms in Nairobi (see McCormick & Pederson, 1996) has revealed that initial capital more than any other firm-level variable explained the size of the garment business. This means that lack of credit to obtain the needed physical capital is likely to limit business growth.

Given the existence of opportunities, existing firms or potential start-ups, which have adequate internal finances have a higher chance of undertaking entrepreneurial activities than those with inadequate finances. In turn however, existing firms or potential start-ups with inadequate internal funding but having access to adequate credit have a higher chance to undertake entrepreneurial activities than those with inadequate internal funding and no access to credit.

Role of training and expert advice

In addition to funding, investment in human capital even for small business is becoming an increasingly important determinant of a firm's success. Training geared towards facilitating behavioural change of the enterprise may have a positive effect on business. As Rogerson (2000) argues, entrepreneurs with larger stock of human capital, in terms of education and/or vocational training are expected to be better able to adapt to enterprise's constantly changing environment. While in the past training and skills building were taken as the responsibility of the state, the current reforms in many developing countries are increasingly commercialising this service. Private firms and NGOs are taking up training and rendering advice to small and medium businesses. Availability of funds to finance a needed training could accelerate growth potentials of an enterprise. This may create a need to assess the impact of credit jointly with training. Education and training are necessary ingredients for successful entrepreneurial activities and growth, signifying the importance of predisposing factors in business.

Case study :

K.M. Joshi Hardware Store—Haldwani

Mr Joshi started business in Haldwani town in 1998 as a sole proprietor with a retail Grocery items shop selling a variety of items including sugar, Pulses, Wheat, rice and other food items. He moved into self-employment after completing senior secondary school education. After making a reasonable amount of profit, in 2002 he decided to move into the hardware business. Hardware business in Haldwani town had for a long time been a monopoly of U.P and Delhi traders and was seen to be generating good profit.

Business Performance

The hardware business started to expand as more and more profit was made and reinjected back into the business. He also employed his wife as an assistant manager and had one shopkeeper. Demand for hardware items has been expanding rapidly in many parts of Uttarakhand mainly because of the expanding construction of the real estate projects and industry following the economic reforms of the Uttarakhand Government.

Following economic liberalisation both individual and business premises have been mushrooming. Mr Joshi took advantage of this expansion in demand for hardware items and planned to expand his business. In 2003 he applied for a loan from Uttarakhand Gramin Bank and was granted Rupees 12,60,000. He used his loan together with profits generated from his business to expand his stock and added other types of building materials. He also moved his business to a larger premise, which could accommodate the expanded stock.

Increase in price of building materials and stiff competition, has forced him to give credit to some of his good customers, which is having a negative effect on his business. Mr Joshi procures most of his materials from Orrisa state, far away from his place. The cost of hiring transport has also risen, and is affecting the business negatively.

Discussion and Evaluation

Mr Joshi reported making 'very' good profit. Through profit generated from this business he has been able to repay the Uttarakhand Gramin Bank loan with interest (a total of Rupees 14,30,000). He has also been able to build a modern family house. Through income from the business he has been able to pay school fees for his two children attending private secondary schools.

Although it is the existence of opportunity and Mr Joshi's business skills more than anything else that have contributed to his success, the credit from Uttarakhand Gramin Bank facilitated the expansion of his business. Without the loan at the material time, this expansion would have taken longer to achieve

Methodology adopted in the Study

This paper examined the importance, contribution and development potential of micro, small and medium enterprises in India. The role of commercial banks' financial support in the development process of this sector is analyzed from the annual credit data. Data was collected primarily from secondary source. Primary data are collected from various clusters. In addition to that data are collected from success story of MSME clusters. Secondary data are collected from published and unpublished reports, books, journals and various seminars.

Limitation of the Study

Attempts to evaluate the effects of credit on entrepreneurial activities are filled with methodological difficulties, so that even the one attempted here is not insulated. The study will not tell us precisely how much of the effect of the business is due to credit. Another limitation of this study is that only businesses that have received credit have been included in the sample. Ideally, a *control group* of case studies and survey of similar entrepreneurs that have not received credit was supposed to be studied and compared with those who have received credit. The third limitation is that there is a lot of heterogeneity amongst the entrepreneurs included in the sample, so that this by itself, rather than the credit provided, may be a significant factor contributing to success or failure of entrepreneurial activities among clients.

Conclusion and Policy Implications

This study had combined qualitative case studies and sample survey to assess the extent to which credit determined successful entrepreneurial activities. Credit has been instrumental to the success of the enterprise at different stages of the life of a business. Start-ups seemed to have been funded from own sources. Use of credit was made mainly for business expansion. This may mean that demand for credit is actually increasing with firm growth and firm size. Inadequate credit has also been shown to hinder or postpone entrepreneurial activities from being undertaken. It has shown that economic reforms which have been ongoing since late 1990s have had

mixed effects on the businesses. The reforms have been positive in making available inputs to businesses, particularly imported items.

The study also showed that many of the problems faced by entrepreneurs were not related to credit, but rather a result of macro and institutional constraints. The study therefore suggests that there is no need to over-emphasise the importance of credit as a determinant of successful entrepreneurial activities.

In terms of policy, the study confirms the view that while credit is important, it does not in itself create an entrepreneurial activity. If the objective is to promote entrepreneurial activity, the conditions needed, including the predisposing factors, triggering factors and constraining factors should be given due attention. In other words, an integrated approach needs to be taken in managing credit. Credit, however, does enhance the entrepreneurial activity.

The study also suggested the need for credit level to be provided on the basis of business viability and the absorptive capacity of the firm rather than pre-determined ceilings that do not address the real needs of the enterprise. The study has also emphasised on the need for entrepreneurs to maintain data about their businesses that can enable them to measure the performance of their businesses.

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