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Research Paper

AN ANALYSIS OF CREDITWORTHINESS TOWARDS BORROWING AND COMMITMENT LEVEL OF MICRO & SMALL ENTERPRISES IN RURAL AREAS

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ABSTRACT

The expansion and development of the enterprises depends on adaption of technology up-gradation in the existing mechanism. The enterprises engaged in business can utilize credit facilities provided by banks for the growth of business. Despite the commercial banking activities exist in all the parts of our country, the Micro and Small Enterprises located in rural areas are still facing problems for inadequate supply of credit to improve their businesses. Banks provide credit to these enterprises after analyzing their creditworthiness as the main part of their lending process in spite of credit risk which is often faced by rural banks. The five components of Creditworthiness are the determinants for sanctioning credit and also discriminating elements according to situation that prevails in the concerned market. The credit system and procedure used by rural banks is to measure the Creditworthiness of micro & small enterprises. The system helps the bankers to weigh the characteristics of the borrowers and conditions of the loan, attempting to estimate the chance of default. The objectives of the study are to measure the commitment level and the constituents of creditworthiness through statistical tools. It is observed after analyzing the creditworthiness that Cognizance is required more to know about the banking procedures in availing credit. The enterprises which do volume of business normally have capacity to repay credit when we compare to other enterprises. No enterprise bothers about their credit-score which is most important to provide credit facilities by rural banks. The capital is maintained according to nature of business and the age of enterprise that exist in the market. In connection with collateral no enterprise is ready to give or pledge the collateral to the bank while borrowing credit for their development of business.

KEYWORDS: Creditworthiness, Enterprises, Borrowing, Commitment, Rural, Credit

INTRODUCTION

The entrepreneurs make to grow their business which leads to overall growth of the economy to the extent possible. Further expansion and development of the enterprises depends on adaption of technology up-gradation in the existing mechanism. The enlargement by the way of modifying the current production system or replacing old system will definitely require an additional amount of investment. The enterprises engaged in business can utilize credit facilities provided by banks for the growth of business. Banks keep on lending money to all the sectors of industry and especially to those engaged in businesses in the form of Micro and Small enterprises. The major revenues made by banks are through the interest generated by lending and the charges or fee they charge for providing banking facilities to

the business enterprises. Despite the commercial banking activities exist in all the parts of our country, the Micro and Small Enterprises located in rural areas are still facing problems for inadequate supply of credit to improve their businesses. Banks provide credit to these enterprises after analyzing their creditworthiness as the main part of their lending process in spite of credit risk which is often faced by rural banks.

MICRO & SMALL ENTERPRISES

The Government of India has been making intensive efforts for the promotion and development of micro & small enterprises which enabled to grow higher than the overall the growth of industrial sector. To facilitate the development of MSEs and increase their effectiveness, the government has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. One of the major policies



of government is inclusion of micro & small enterprises under priority sector lending. This sector has been receiving financial assistance from the commercial banks as well as from rural banks to improve their businesses. However, micro & small

enterprises located in rural areas need to be developed equally that are located in urban area

According to MSMED Act, 2006 the Micro & Small Enterprises is broadly classified as under:

<i>Particulars</i>	<i>Original Investment in Plant & Machineries of Manufacturing Enterprises (in ₹)</i>	<i>Original Investment in Equipment of Service Sector Enterprises (in ₹)</i>
Micro Enterprises	Not exceeding 25 lakhs	Not exceeding 10 lakhs
Small Enterprises	More than 25 lakhs and up to 500 lakhs	More than 10 lakhs and up to 200 lakhs

CREDITWORTHINESS

The creditworthiness is an assessment of the likelihood that a borrower will default on their debt obligations. Creditor's judgment of an entity's current and future ability and inclination to honor debt obligations as agreed upon. Creditworthiness is a valuation performed by lenders that determines the possibility a borrower may default on his debt obligations. It considers factors such as *repayment history* and *credit score*. Lending institutions also consider the amount of available assets and the amount of liabilities to determine the probability of a customer's default.

Several businesses have established credit rating systems to determine the Creditworthiness of an enterprise. It is essential for every enterprise to keep track of his credit score because this is the primary factor that financial institutions use to decide whether the enterprise is eligible for borrowing at a prescribed interest rate. *Payment history* or *credit history* represents how an enterprise meets *debt obligations*. All these factors establish Creditworthiness or the financial character of an enterprise.

Creditworthiness is depicted as a credit score. A high credit score provides high creditworthiness. In addition, creditworthiness considers other factors such as age of enterprise, Turnover, Financial Obligations, Length of Payment History and Ability to repay debt. It determines the interest rate, terms and conditions of financial assistance or credit facilities that are offered by banks. The various prominent credit reporting agencies measure creditworthiness of enterprises and submit the reports to the concerned banks. Lenders pay the credit reporting agencies to access credit data of potential customers using their own credit scoring system to grant approval of credit.

CONSTITUENTS OF CREDITWORTHINESS

The five components of Creditworthiness are the determinants for sanctioning credit and also discriminating elements according to situation that prevails in the concerned market.

- 1) Cognizance:** It is very important for the micro and small enterprises to understand the terms and conditions of banking system while borrowing credit from rural banks. The banks' objective is to increase transparency so that misunderstanding by the borrower would be prevented.
- 2) Capability:** It is a measure that a borrower's ability to repay credit by comparing income against recurring debts and assessing the borrower's debt-

to-income ratio. In addition bank will examine the age of an enterprise and its stability.

- 3) Credit score:** It is a statistical number that depicts an enterprise's creditworthiness. Banks use credit score to evaluate the probability that a person repays his debts. Mostly credit score is a three-digit number ranging from 300 to 850. The higher score indicates more trustworthy of an enterprise.
- 4) Capital:** The capital is the amount which the borrower invest to initiate his business. It is a large contribution by the borrower that would decrease the chance of default. Also the margin amount is insisted by the banks who lends in extending credit to micro & small enterprises.
- 5) Collateral:** This can help a borrower to secure loans. Also it gives the assurance to banks that if the borrower defaults on the loan, the banks can repossess the collateral.

The credit system and procedure used by rural banks is to measure the Creditworthiness of micro & small enterprises. The system helps the bankers to weigh the characteristics of the borrowers and conditions of the loan, attempting to estimate the chance of default. Accordingly rural banks decide in sanctioning credit to micro & small enterprises.

REVIEW OF LITERATURE

The techniques underlying credit-scoring models were devised in the 1930s by such authors as Fisher (1936) and Durand (1941) who showed that the discriminant analysis method could produce good predictions of credit repayment. The decisive boost to the development and spread of these models came after the 1960s, which were studied by Beaver (1966), Altman (1968). Adams and Graham (1981) stated that delivering productive credit to the rural enterprises was facing problems in screening, monitoring and enforcement. Ghatak (1983) in his study found that the borrower's risk type and costly for the formal lender to ascertain lack of secured collateral. The merger of banks has thinned the ranks of banks, raising the concern that small firms find it difficult to access bank credit, observed by Jayartne and Wolken (1999) and the economic reasoning for nationalizing the major banks in 1969 was the imperfection in the allocation of credit, analyzed by Narayana (2000). Joeveer et al (2006) identified particular constraints on the availability of finance for MSME such as informational asymmetries between borrowers and lenders. Feder and Gershon (2010) given a model that facilitates inferences about lender's subjective default probabilities.

Udgata (2013) stressed the recommendations given the Damodaran Committee on cluster service in banks and observed that some rural banks are discriminating against their own customers. Selvaraj S N (2014) stated that performance of rural banks in India has significantly improved after amalgamation process which has been initiated by Government of India and Shanmugasundaram V (2015) stressed about the selection of right borrowers, correct end use of funds for minimizing the occurrence of non-performing assets in lending and borrowing.

OBJECTIVES OF THE STUDY

- ✓ To study the commitment level of micro and small enterprises towards borrowing.
- ✓ To identify the constituents of creditworthiness influencing borrowing.
- ✓ To analyze the factors of creditworthiness for sanctioning credit by rural banks.

SCOPE OF THE STUDY

The extent of this study is mainly focused upon the creditworthiness of micro & small enterprises in connection with borrowing credit from rural banks. Five major elements such as Cognizance, Capability, Credit score, Capital and Collateral that are comprised in creditworthiness are analyzed as measuring factors.

Table 1: Area of Enterprises and Commitment Level

Area of Enterprises	Respondents		Mean	Range		SD
	Nos.	%		Min	Max	
Rural	57	54.3	0.91	0.54	1.19	0.096
Semi-urban	48	45.7	0.87	0.42	1.22	0.118
Total	105	100	0.89	0.42	1.22	0.107

Source: Primary Data

- ✓ The enterprises located at semi-urban area have more deviation in terms of their commitment level than rural area enterprises.

Table 2: Nature of Enterprises and Commitment Level

Nature of Enterprises	Respondents		Mean	Range		SD
	Nos.	%		Min	Max	
Manufacturing	65	61.9	0.88	0.42	1.21	0.11
Trading	31	29.5	0.93	0.72	1.18	0.08
Service	09	8.6	0.82	0.59	1.07	0.12
Total	105	100	0.88	0.42	1.21	0.10

Source: Primary Data

- ✓ The service oriented enterprises have more deviation than trading and manufacturing.

Table 3: Age of Enterprises and Commitment Level

Age of Enterprises	Respondents		Mean	Range		SD
	Nos.	%		Min	Max	
< 10 years	24	23.0	0.85	0.63	1.08	0.08
10 - 20 years	28	26.6	0.87	0.59	1.16	0.09
20 - 30 years	34	32.3	0.93	0.42	1.21	0.12
> 30 years	19	18.1	0.92	0.58	1.17	0.11
Total	105	100	0.93	0.42	1.21	0.10

Source: Primary Data

- ✓ The commitment levels of enterprises that exist more than 20 to 30 years deviate highly than others.

Table 4: Type of Enterprises and Commitment Level

Size of Enterprises	Respondents		Mean	Range		SD
	Nos.	%		Min	Max	
Micro	54	51.4	0.90	0.10	0.61	1.24
Small	51	48.6	0.88	0.11	0.42	1.17
Total	105	100	0.89	0.10	0.61	1.22

Source: Primary Data

- ✓ The small enterprises have more commitment level than small enterprises since they deviate less than micro enterprises.

RESEARCH METHODOLOGY

This study is analytical in nature and makes use of primary data. The questionnaire is designed in a structured manner to get appropriate responses. The respondents are micro & small enterprises located at rural area in and around the Coimbatore district. They are banking with the regional rural banks. The relevant secondary data is collected through the concerned websites and databases. The sampling method used in this study is Stratified Random Sampling. In order to analyze the data and draw conclusions Descriptive statistics and Chi-square test are used.

ANALYSIS OF COMMITMENT LEVEL OF MSE

Descriptive statistics is the discipline of quantitatively describing the main features of collection of information and commonly used to describe the measures of central tendency and measures of variability or dispersion. Measures of central tendency include the mean, median and mode and measure of variability include the standard deviation or variance, the minimum and maximum values of the variables.

Table 5: Turnover of Enterprises and Commitment Level

Turnover of Enterprises	Respondents		Mean	Range		SD
	Nos.	%	Mean	Min	Max	
Low	35	33.4	0.85	0.59	1.07	0.09
Medium	36	34.3	0.89	0.42	1.21	0.11
High	34	32.3	0.92	0.47	1.19	0.12
Total	105	100	0.89	0.42	1.21	0.11

Source: Primary Data

- ✓ The enterprises doing high turnover have lesser commitment level than others.

Chi-square test also referred to as X^2 test and is used to determine whether there is a significant relationship between the expected frequencies and the observed frequencies in one or more categories. This test will show the differences between the expected results and the actual results.

Table 6: Commitment Level of MSE towards borrowing

S.No.	Demographic Variables	X^2 Calculated Value	X^2 Table Value	DF
1	Area of Enterprise	10.06	9.49	4
2	Nature of Enterprise	18.51	9.49	4
3	Age of Enterprise	45.00	12.59	6

Source: Primary Data

H_0 : There is no significant relationship between demographic variables and commitment level of enterprises.

Result: Null hypothesis is rejected in all the demographic variables. It shows that there is significant relationship between commitment level of enterprises and Area, Nature, and Age.

Table 7: Cognizance of MSE towards borrowing

S.No.	Demographic Variables	X^2 Calculated Value	X^2 Table Value	DF
1	Area of Enterprise	3.75	9.49	4
2	Nature of Enterprise	19.49	9.49	4
3	Age of Enterprise	32.48	12.59	6

Source: Primary Data

H_0 : There is no significant difference between cognizance of enterprises and demographic variables.

Result: Null hypothesis is rejected in the cases of nature and age, except area of enterprises. It shows that there is significant difference between cognizance of enterprises and demographic variables (Nature, and Age).

Table 8: Capability of MSE towards borrowing

S.No.	Demographic Variables	X^2 Calculated Value	X^2 Table Value	DF
1	Area of Enterprise	4.23	9.49	4
2	Nature of Enterprise	11.21	9.49	4
3	Age of Enterprise	25.50	12.59	6

Source: Primary Data

H_0 : There is no significant difference between capability of enterprises and demographic variables.

Result: Null hypothesis is rejected in case of Nature, and Age, except area of enterprises. It shows that there is significant difference between capability and the variables (Nature and Age). The capability shows no difference in case of area of enterprises.

Table 9: Credit-score of MSE towards borrowing

S.No.	Demographic Variables	X^2 Calculated Value	X^2 Table Value	DF
1	Area of Enterprise	1.24	9.49	4
2	Nature of Enterprise	7.12	9.49	4
3	Age of Enterprise	4.57	12.59	6

Source: Primary Data

H_0 : There is no significant difference between credit-score of enterprises and demographic variables.

Result: Null hypothesis is accepted in the case of all the variables. It shows that there is no significant difference between credit-score and demographic variables (Area, Nature and Age).

Table 10: Capital of MSE towards borrowing

S.No.	Demographic Variables	X ² Calculated Value	X ² Table Value	DF
1	Area of Enterprise	3.85	9.49	4
2	Nature of Enterprise	14.10	9.49	4
3	Age of Enterprise	31.87	12.59	6

Source: Primary Data

H₀: There is no significant difference between capital of enterprises and demographic variables.

Result: Null hypothesis is rejected in case of Nature, and Age, except area of enterprises. It shows that there is significant difference between capability and the variables (Nature and Age). The capital shows no difference in case of area of enterprises.

Table 11: Collateral of MSE towards borrowing

S.No.	Demographic Variables	X ² Calculated Value	X ² Table Value	DF
1	Area of Enterprise	1.24	9.49	4
2	Nature of Enterprise	7.12	9.49	4
3	Age of Enterprise	4.56	12.59	6

Source: Primary Data

H₀: There is no significant difference between collateral of enterprises and demographic variables.

Result: Null hypothesis is accepted in all the demographic variables. It shows that there is no significant difference between collateral and demographic variables (Area, Nature and Age). The enterprises do not have interest to give collateral during their borrowings.

FINDINGS OF THE STUDY

- ✓ **Commitment Level of Enterprises:** There is a clear indication of significant relationship in commitment level of enterprises towards borrowing and it varies according to area, nature, and age.

Constituents of Creditworthiness

- ✓ **Cognizance:** There exists significant difference in terms of cognizance between variables. It varies according to the nature and age of enterprises. The variable area accepts the hypothesis.
- ✓ **Capability:** The variables such as nature and age show the significant difference and they have the capability in similar way. The variable area accepts the hypothesis.
- ✓ **Credit-score:** It does not show the significance in all the variables. The enterprises do not give importance for the credit-score irrespective of their profile.
- ✓ **Capital:** The variables nature and age show the significance and such enterprises are interested to maintain adequate capital. Other variable area does not show importance in terms of capital.
- ✓ **Collateral:** It does not show any significant difference and it is clear that these enterprises are not interested in providing collateral for their borrowing.

CONCLUSION

The analysis accomplished by the help of statistical tool and it is observed that commitment level of micro & small enterprises is not equal on all the aspect. It differs in each and every status of their profile. Finally it is concluded as they have low commitment level towards borrowing. The constituents of creditworthiness are cognizance, capability, credit-score, capital and collateral which need to be fine-tuned to more extent possible towards the borrowing from rural banks. Cognizance is required more to know about the banking procedures in availing credit from rural banks. The enterprises

which do volume of business normally have capacity to repay credit when we compare to other enterprises. No enterprise bothers about their credit-score which is most important to provide credit facilities by rural banks. The capital is vital part of any business, but it is maintained only according to nature of business and the age of enterprise that exist in the market. In connection with collateral no enterprise is ready to give or pledge the collateral to the bank while borrowing credit for their development of business.

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