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# Role of Co-Operative Banks in the Development of Small and Medium Sized Enterprises (SMEs) in India

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***Abstract***

- ***Purpose: The research intends to study the reason(s) that why do co-operative banks finance the SMEs with fewer formalities or documentation despite the fact that they are smaller institutions than the commercial banks***
- ***Design: To study this, exploratory research design would be used, taking into consideration, primary data would be collected from the professionals like Bankers***
- ***Finding: Co-operative banks check the business plan, establishment of the business and they consistently check the profitability of the business. They also rely on the credit ratings, given by the credit agencies and thus, lend to the SMEs with fewer formalities***
- ***Originality/ Value: Until now, researchers have not looked upon the reason(s) for the fewer formalities carried out by co-operative banks to lend to the SMEs***
- ***Keywords: Co-operative banks, Development of SMEs, Interest Rates, Financing***

## I. INTRODUCTION

SMEs contribute nearly 29% to the Indian GDP which makes it an important part of the economy. It employs nearly 40% of the population. Government campaigns, like "Make in India", promote the growth of the SMEs which envisions meeting the domestic and global demand for various goods and services. The foreign investments would be deployed to improve the infrastructure of the SMEs which would help to meet the demands of the investors.SMEs would ultimately create more employment opportunities. The MSME ministry is working to reform the sector, which would raise its contribution from 29% to 50% in the Indian GDP.

### *A. Objective*

To ascertain the influence of financing from Co-operative Banks in the growth of SMEs

### *B. Hypothesis*

1) *H0:* Financing from Co-Operative Banks without many formalities/paperwork did not lead to the growth of SMEs
2) *H1:* Financing from Co-Operative Banks without many formalities/paperwork led to the growth of SMEs

## II. REVIEW OF LITERATURE

### *A. Co-operative Banks*

Co-operative banks play an important role in the development of the under-developed countries through mobilization of resources and their allocations in various avenues(Rani & Rashi, 2010). Co-operative banks lay more emphasis on the credit worthiness of the purpose rather than the credit worthiness of the person(Parkash & Parvesh, 2019). Though the process to get loans from co-operative banks is less stringent than the commercial banks but it is a lengthy process(Gupta & Jain, 2012).

Customers prefer loans from co-operative banks due to the easy repayment and fewer formalities(L., 2013). The improved service quality helps to increase members' participation(Hidayati, Hanif, & Pradesa, 2016). Though the co-operative banks are more stable than the commercial banks due to the difference in their business scales but that does not reduce the risk among the co-operative banks( Oanea & Diaconu, 2014). Co-operative banks uphold a key position in the economy as they play a decisive role to support the credit provision to the local borrowers(Coccorese & Shaffer, 2018).

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### B. Development of SMEs

The commercial banks avoid giving loans to SMEs due to their inability to repay the loans(Sen & Ghosh, 2005). SMEs play an important role in the economy due to the employment potential and regional dispersion(Salwan, 2012). It is difficult for SMEs to achieve sustainable enterprises, due to shortage of resources(Hsu, Chang, & Luo, 2017). The role of SME development remains ad hoc in most of the countries and is not integrated with economic growth models which are used to guide the economic policy in the countries(Mathew, 2013). The SMEs can participate in regional economic integration to increase their productivity and competitiveness(Kyophilavong, Vanhnalat , & Phonvisay, 2017). The credit ratings have been started for the SMEs for their credit assessment, which reduces time and enhances cash flows(Muninarayanappa, Nirmala, & Fatin, 2018). In order to increase the competitiveness of the SMEs, it is important to enhance the protection and promotion of IPRs, development of broadband infrastructure and industrial parks, and financial provision for Research and Development(Vineles, 2017).

### C. Interest Rates

Co-operative banks are the substitutes for the moneylenders who provide adequate and timely loans, both, for short term and long term at reasonable rate of return(Kolhe, 2020). But at the same time, poor lending policies are the reason behind the failure of co-operative banks(Sharma, Sahu, Agarwal, & Mishra, 2020). Asset Liability Management and Risk Management Practices have enabled the banks to anticipate the impact of interest rate risk and liquidity risk within the deregulated environment(Anant, 2020). Policy-induced interest rates affect the net profit margins and thus banks have to switch to an expensive mix of funding sources(English, Heuvel, & Zakrajšek, 2018).

### D. Financing

The SMEs have to go through strict mortgage requirements while lending from commercial banks(Duan, Han, & Yang , 2009). SME Finance refers to catering to the financial needs of the Small and Medium sized Enterprises. Financial deepening helps to create jobs and this partly happens through expanding SME finance(Beck, 2013). A higher degree of concentration of the banking industry, leads to an increased cost of financing for SMEs(Galli, Mascia, & Rossi, 2017). The reputation of the SMEs have a direct impact of the microfinance institutions(Appiah, Ampeah, & Agbenyo, 2019).

The bankers consider two aspects of the loan in their credit decision, namely, interest rate on the loan and the credit risk on the loan. Interest rate affects the risk of loan due to the given factors. First, is adverse selection, highly risky projects accept the higher interest rate and second, moral hazard, as the borrowers who have been granted the loan, might indulge in more risky projects to earn higher returns and pay out the higher interest to the banks(Dubal, 2015). But at the same time; co-operative banks are liberal enough to finance these SMEs at lower interest rates which attracts these SMEs. Co-operative banks generally use the soft information for the purpose of financing the SMEs, which includes the business plan, ideas, opinions, rumours, economic projections, statements of management's future plans and the market commentary.

Thus, co-operative banks provide more loans to SMEs as compared to large domestic and foreign banks, which ultimately benefit the SMEs as they have to bear lower cost of capital(Hasan, Jackowicz, Kowalewski, & Kozłowski, 2014). It is laid down that SMEs generally prefer financing from the co-operative banks for the purpose of working capital requirements, research and development, basically those who are in sustenance stage, i.e., they have moved beyond a start-up but are still not an enterprise(Singh & Wasdani, 2016).

## III. RESEARCH METHODOLOGY

Exploratory Research Design is used to collect the primary data for the use in the research.

### A. Research Gap

The researchers have researched about the financing prospects for the SMEs, such as lending from commercial banks, foreign banks, co-operative banks, etc. and SMEs prefer co-operative banks irrespective of the reason that co-operative banks charge higher interest rate. The research gap identified here, is, that why do co-operative banks lend to the SMEs with fewer formalities or documentation as compared to the commercial banks.

Thus, this research paper would try to identify the reason(s) for lending by the co-operative banks to the SMEs with fewer formalities or documentation.

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## IV. DATA ANALYSIS

The following questionnaire was floated among the professionals i.e. Bankers, CAs and Economics Professors.

*A. Questionnaire*

*1) Name*

_____

*2) Designation*

_____

*3) Gender*

*a)* Female
*b)* Male
*c)* Transgender

*4) Do co-operative banks finance Small and Medium sized Enterprises (SMEs)?*

*a)* Yes
*b)* No

*5) What attracts SMEs to co-operative banks, instead of commercial banks? (Select all that apply)*

*a)* Lower interest rates
*b)* Fewer formalities
*c)* Easy availability of loans
*d)* Easy repayment options
*e)* Other _____

*6) Why do co-operative banks lend with fewer formalities or documentation than commercial banks?*

_____

*7) Do co-operative banks lead to the development of SMEs?*

*a)* Yes
*b)* No
*c)* Maybe

*8) Do you see co-operative banks as the competitors of commercial banks?*

*a)* Yes
*b)* No
*c)* Maybe

The questionnaire was circulated among more than 100 professionals (including Bankers, CAs and Economics Professors) out of which 58 responded.

Their responses have been recorded and given below.




Fig. 1

In Fig.1, all the respondents had agreed to the fact that co-operative banks finance the SMEs

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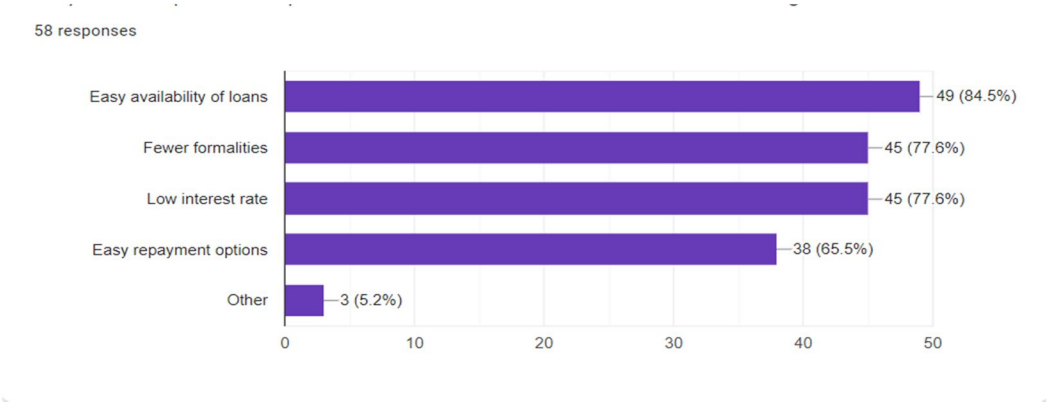



Fig. 2

In Fig. 2, the majority of the respondents have considered the factors like easy availability of loans, fewer formalities, and easy repayment options, as the reasons that why do the SMEs prefer financing from co-operative banks as compared to commercial banks

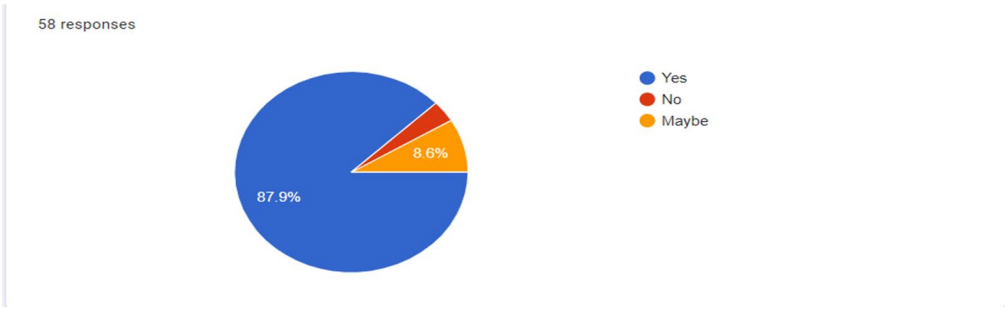



Fig. 3

In Fig. 3, the majority of the respondents agree that co-operative banks help the development of SMEs

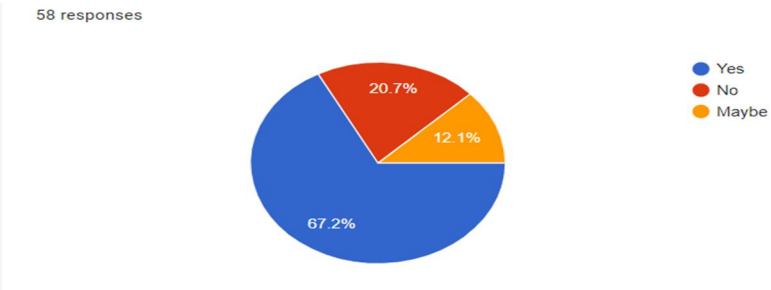



Fig. 4

In Fig. 4, nearly 67.2% of the respondents see co-operative banks as the competitors of commercial banks

From the survey which was conducted, it is evident that the co-operative banks lend to the SMEs with fewer formalities. According to the professionals, the co-operative banks look out for the business plan, the establishment of the business over the years, and consistently check over the profits they made previously, in order to check the profitability and paying capability of the SMEs. The co-operative banks also rely upon the ratings of the credit agencies and therefore, grant loans to the SMEs without many formalities, on the basis of the credit reports, given out by the credit rating agencies. Apart from these, the running cost of the co-operative banks is low and they are left with huge cash crunch which can be loaned out, so the loans are easily available. Thus, the co-operative banks fuel their fund raising capability. Also, the co-operative banks do not charge compound interest which makes the loan inexpensive as compared to that from commercial banks and gives co-operative banks a competitive edge over the commercial banks.

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## V. FINDINGS AND CONCLUSION

The research paper helped to find out the reason(s) that why do the co-operative banks lend with fewer formalities or documentation. The co-operative banks look out for the business plan, the establishment of the business over the years, and consistently check over the profits they made previously, in order to check the profitability and paying capability of the SMEs. The co-operative banks also rely upon the ratings of the credit agencies and therefore, grant loans to the SMEs without many formalities, on the basis of the credit reports, given out by the credit rating agencies. The co-operative banks are having cash crunch which they lend out so that they could earn an income out of it, thus, loans are easily available. The co-operative banks do not charge compound interest which makes the loans inexpensive as that from the commercial banks. Thus, the co-operative banks fuel their fund raising capability. Also, easy repayment options, make the co-operative banks an attractive avenue of getting funds, for the SMEs. Thus, co-operative banks play a vital role in the development of SMEs in India by providing them funds with fewer formalities.

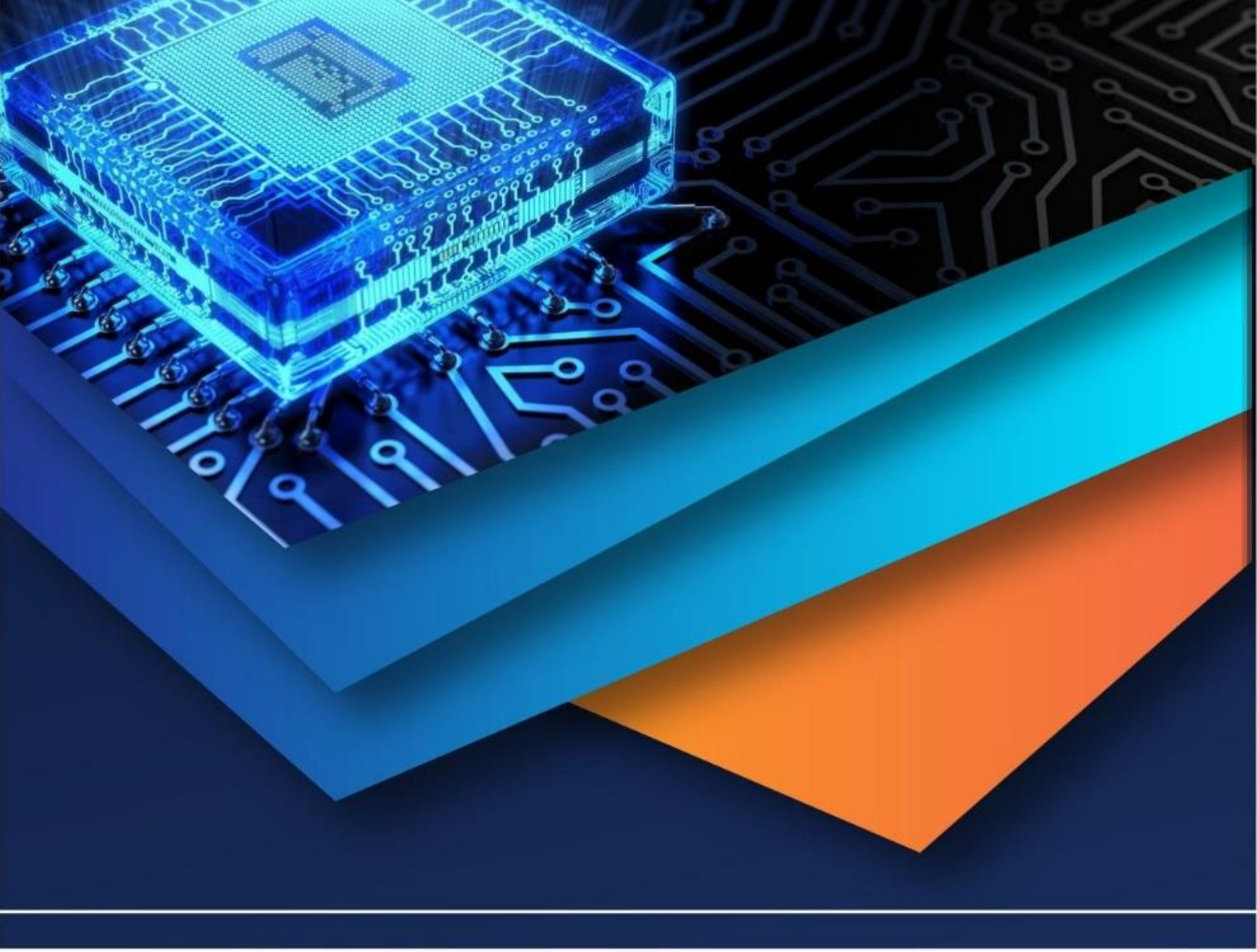
### *A. Further Research Directions*

The researchers can take this research further by looking for the in-depth methods of how the co-operative banks study the businesses for the purpose of financing them.

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