



## Sources of Finance for Micro Enterprises

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### ABSTRACT

Micro-enterprises, despite their significance in the economy, often face challenges in sustaining their businesses. This chapter delves into the strategies micro-enterprises employ to effectively manage their finances and ensure their sustainability in the market. First and foremost, micro-enterprises focus on cost management by meticulously analyzing expenses across all aspects of their business operations. By streamlining operations, negotiating favorable terms with suppliers, minimizing wastage, and optimizing resource allocation, they can maintain competitive pricing, preserve profit margins, and enhance overall financial stability. Additionally, effective cash flow management is critical for their survival. Micro-enterprises closely monitor cash inflows and outflows, forecast future revenue and expenses, and implement strategies to accelerate receivables and manage payables.

By maintaining healthy cash flow, they can meet day-to-day operational needs, seize growth opportunities, and weather financial challenges. Micro-enterprises also allocate resources towards customer acquisition and retention efforts to sustain their market presence. They

invest in targeted marketing initiatives to attract new customers and expand their customer base, while also focusing on delivering exceptional customer experiences to drive repeat business and increase customer lifetime value. Furthermore, micro-enterprises prioritize innovation to differentiate themselves in the market and meet evolving customer needs.

By harnessing technology, micro-enterprises can streamline operations, access new markets through online channels, and enhance the overall customer experience. Lastly, micro-enterprises may form strategic partnerships and alliances with other businesses, suppliers, or industry stakeholders to leverage complementary strengths and resources. These collaborations enable them to expand their reach, reduce costs, and mitigate risks, ultimately enhancing their competitive position and driving sustainable growth and profitability in the market. By adopting a holistic approach to financial management and market strategy, micro-enterprises can navigate challenges, capitalize on opportunities, and achieve long-term success in competitive markets.

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### INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) are essential components of India's socio-economic fabric, contributing significantly to various aspects of economic development, including employment generation, GDP growth, and entrepreneurship promotion. The classification of MSMEs in India is based on two primary criteria: investment in plant and machinery (for manufacturing enterprises) or equipment (for service enterprises) and annual turnover.

**Micro Enterprises** are characterized by their small scale of operations, limited resources, and typically fewer than 10 employees. These enterprises operate on a small scale, often with minimal capital investment and limited assets such as machinery, equipment, and infrastructure. Despite their size, micro enterprises play a crucial role in the economy, particularly in providing employment, fostering entrepreneurship, and supporting local economic development, especially in rural and semi-urban areas. However, they face challenges such as limited access to finance, technological constraints, infrastructure deficiencies, and regulatory compliance burdens.

**Small Enterprises** represent an intermediate category of businesses, larger than micro-enterprises but smaller than medium-sized enterprises. These enterprises typically employ more than 10 but fewer than 50 people and have relatively modest capital investment and asset size. While they operate on a larger scale compared to micro-enterprises, they still face constraints such as limited access to finance, market competition, regulatory compliance burdens, and technological adoption challenges.

**Medium Enterprises** are significant players in the business landscape, employing more than 50 but fewer than 250 people. These enterprises have a moderate level of capital investment and asset size, operating on a larger scale compared to both micro and small enterprises. They play a crucial role in driving economic growth, employment generation, innovation, and

technology adoption. However, medium enterprises face challenges such as access to finance, market competition, talent management, and regulatory compliance burdens.

In conclusion, the MSME sector in India is diverse and dynamic, playing a crucial role in driving economic growth, employment generation, innovation, and local development.

However, MSMEs face various challenges, including access to finance, market competition, regulatory compliance, and technological adoption, which need to be addressed to unleash their full potential.

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## LITREATURE REVIEW

Micro, Small, and Medium Enterprises (MSMEs) in India face a multitude of challenges that significantly impact their growth, sustainability, and competitiveness. One of the primary

challenges is the limited access to finance, as many MSMEs struggle to secure timely and adequate funding from formal financial institutions. This difficulty arises due to stringent collateral requirements, lack of credit history, and bureaucratic hurdles, leading MSMEs to rely on expensive informal sources of financing. Moreover, technological obsolescence is a significant issue, with many MSMEs operating with outdated technologies and lacking resources for research and development. Infrastructure constraints further impede their growth, including inadequate physical infrastructure and limited digital infrastructure, hindering efficiency and productivity.

In addition to financial and technological challenges, MSMEs also face a complex regulatory environment, with compliance burdens adding to their administrative costs. Skill shortages and human resource challenges, coupled with limited market access and competition from larger enterprises, exacerbate their difficulties. MSMEs are also highly vulnerable to external shocks, such as economic downturns, natural disasters, and supply chain disruptions, due to their limited financial buffers and operational resilience.

### Performance of Micro Enterprises in India in the Last 5 Years

Micro-enterprises play a crucial role in India's economy, with over 63 million micro-enterprises accounting for approximately 99% of the total enterprises in the country as of 2019. These enterprises are distributed across urban and rural areas, providing significant employment opportunities, particularly in sectors such as agriculture, manufacturing, and services.

Despite challenges such as limited access to formal finance, mixed growth trends, and sectoral performance variations, micro-enterprises contribute substantially to India's GDP, primarily through the informal sector. The government has implemented various policies and programs to support micro-enterprises, including financial incentives and capacity-building initiatives like the Pradhan Mantri Mudra Yojana (PMMY).

### Law and Regulations Applicable to MSMEs in India:

The Micro, Small, and Medium Enterprises Development (MSMED) Act, 2006, provides the legal framework for the classification, registration, and promotion of MSMEs in India. It

defines MSMEs based on investment in plant and machinery (for manufacturing enterprises) or equipment (for service enterprises) and turnover. The Act mandates timely payments to MSMEs by buyers and provides various incentives, credit facilities, and support measures for their development.

### Key Sections of the MSMED Act:

1. **Classification of Enterprises (Section 7):** MSMEs are classified into micro, small, and medium enterprises based on investment and turnover.
2. **Registration of MSMEs (Section 8):** Enables voluntary registration of MSMEs through the Udyog Aadhaar portal, providing access to benefits such as credit facilities, subsidies, and government schemes.
3. **Credit Facilities (Section 15):** Mandates banks to prioritize MSMEs in providing credit and establishes the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to facilitate collateral-free credit.
4. **Reservation Policy (Section 16):** Mandates the government to formulate policies for the reservation of products manufactured by MSMEs in government procurement.
5. **Delayed Payment to MSMEs (Section 22):** Ensures timely payment to MSMEs by buyers and imposes penalties for delayed payments.
6. **Facilitation Councils (Section 29):** Establishes Micro and Small Enterprises Facilitation Councils (MSEFCs) at the district level to address disputes related to delayed payments.
7. **Penalty for Contravention (Section 33):** Stipulates penalties for non-compliance with the Act's provisions.

**Taxation Reliefs for MSMEs:** MSMEs in India enjoy various tax benefits and incentives aimed at reducing the tax burden, promoting entrepreneurship, and encouraging investment in the sector.

- **Lower Income Tax Rates:** Small businesses with turnover below a certain threshold benefit from lower income tax rates.

- **Presumptive Taxation Scheme (Section 44AD):** Allows eligible MSMEs to declare income at a prescribed rate without maintaining detailed books of accounts.
- **Investment Allowances (Section 32AC):** Provides deductions for investment in new plant and machinery.
- **Startup Tax Benefits:** Startups recognized under the Startup India initiative can avail tax holidays, exemptions, and capital gains tax benefits.
- **Exemptions on Capital Gains (Section 54GB):** Exemptions on long-term capital gains tax when proceeds are invested in eligible MSMEs.
- **GST Composition Scheme:** Allows MSMEs to pay lower GST rates with reduced compliance requirements.
- **Customs Duty Exemptions:** MSMEs engaged in manufacturing or exporting goods benefit from customs duty exemptions or concessions.
- **Deductions for Research & Development (Section 35(2AB)):** Provides weighted deductions on eligible R&D expenses.
- **Employee Welfare Benefits:** MSMEs offering employee welfare benefits can claim deductions under various sections of the Income Tax Act.

These legal provisions and taxation reliefs aim to create a conducive environment for MSMEs, fostering their growth, development, and competitiveness in India's business landscape.

#### Sources of Finance for Micro Enterprises in India:

Micro enterprises in India have various sources of finance available to them, catering to their specific needs and circumstances.

1. **Self-Funding:** Many micro entrepreneurs initially fund their businesses through personal savings or contributions from family and friends. Personal savings accumulated over time through regular contributions from income, bonuses, or windfalls are commonly used to cover startup costs, purchase inventory, or sustain operations during the early stages of ventures.
2. **Microfinance Institutions (MFIs):** MFIs provide small loans, typically without collateral, to individuals and groups, including micro entrepreneurs. Microloans and group lending are common services offered by MFIs, tailored to meet the working capital needs of micro enterprises, including purchasing inventory, equipment, or raw materials.
3. **Government Schemes and Programs:** The Indian government offers various schemes and programs aimed at supporting micro enterprises and promoting entrepreneurship. These include subsidized loans, grants, and other financial assistance programs administered by government agencies at different levels.
4. **Bank Loans:** Micro entrepreneurs can access credit from commercial banks and regional rural banks. Working capital loans, term loans, equipment financing, and trade finance facilities are some of the specialized loan products tailored to the needs of micro enterprises.
5. **Non-Banking Financial Companies (NBFCs):** NBFCs provide financial services to micro enterprises, offering loans, leasing, factoring, and other financial products tailored to their needs.
6. **Venture Capital and Angel Investors:** Venture capital firms and angel investors may provide equity financing to promising micro enterprises with high growth potential, in exchange for an ownership stake in the business.
7. **Crowdfunding:** Crowdfunding platforms enable micro entrepreneurs to raise funds from individuals or organizations through online platforms, using various models such as rewards-based crowdfunding, donation-based crowdfunding, debt crowdfunding, or equity crowdfunding.

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## RESEARCH METHODOLOGY

The methodology adopted for data collection was through internet, a questionnaire was not conducted for data collection. The report describes the steps taken to ensure data validity and reliability of the information collected for the topic that is on financial sector and portfolio

management. The study adopts an exploratory research design to gather information from various online sources and gain insights into the research topic.

The data collection process starts with online Search using search engines and online databases to identify relevant sources of information related to the research topic. Multiple reputable sources were consulted to ensure accuracy and reliability of the collected data, then careful consideration was given to the selection of websites to ensure the credibility and authenticity of the information collected.

Then relevant data and information were extracted from the identified online sources. The collected data encompassed both qualitative and quantitative information, including statistics and case study.

The qualitative data collected was thoroughly analysed, analysis is made with conclusions and annexures. Key themes and patterns were identified to develop a comprehensive understanding of the topic.

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## RECOMMENDATIONS

Based on the findings of this research, several recommendations can be proposed for micro enterprises

### 1. Microfinance Institutions (MFIs):

MFIs provide small loans, savings, and other basic financial services to the low- income population, including micro-enterprises.

Examples include:

KS Microfinance, Bandhan Bank, Ujjivan Small Finance Bank

### 2. Pradhan Mantri Mudra Yojana (PMMY):

PMMY provides loans up to Rs. 10 lakhs to non-corporate, non-farm small/micro- enterprises. Loans are categorized into three categories: Shishu (up to Rs. 50,000), Kishore (from Rs. 50,001 to Rs. 5 lakhs), and Tarun (from Rs. 5,00,001 to Rs. 10 lakhs).

### 3. Bank Loans:

Various banks provide specific loan schemes for micro-enterprises.

Examples include: State Bank of India (SBI), ICICI Bank, HDFC Bank

### 4. Government Schemes:

There are several government schemes aimed at supporting micro-enterprises financially, such as:

Prime Minister's Employment Generation Programme (PMEGP)

Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) National Small Industries Corporation (NSIC) schemes

### 5. Venture Capital and Angel Investors:

Micro-enterprises with high growth potential can seek investment from venture capital firms or angel investors.

Examples include: Indian Angel Network, Mumbai Angels, Venture Catalysts

### 6. Crowdfunding Platforms:

Micro-enterprises can also explore crowdfunding platforms to raise capital Examples include: Ketto, Milaap

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## CONCLUSION

In conclusion, understanding and leveraging the diverse sources of finance are paramount for the sustainable growth and success of micro-enterprises. These small-scale businesses face unique challenges in accessing financial resources, yet they play a crucial role in driving economic development, fostering innovation, and creating employment opportunities, particularly in emerging economies.

By exploring various sources of finance, including traditional banking services, microfinance institutions, government-sponsored programs, venture capital, crowdfunding platforms, and community-based initiatives, micro-enterprises can access the capital needed to start, operate, and expand their ventures. Each source offers its advantages and considerations, allowing micro-enterprises to tailor their financing strategies to their specific needs and circumstances.

Moreover, micro-enterprises must adopt prudent financial management practices to effectively utilize the funds obtained from these sources. This entails careful budgeting, cost control, cash flow management, and strategic investment decisions. By maximizing the efficiency and effectiveness of their financial resources, micro-enterprises can enhance their competitiveness, resilience, and long-term sustainability in the market.

Furthermore, policymakers, financial institutions, and support organizations have a vital role to play in facilitating access to finance for micro-enterprises. They can design and implement policies and initiatives that promote financial inclusion, expand access to formal financial services, and provide targeted support to underserved micro-entrepreneurs, particularly women, youth, and marginalized communities.

In essence, the quest for diverse and accessible sources of finance is essential for unlocking the potential of micro-enterprises, driving inclusive economic growth, and advancing sustainable development goals. By fostering an enabling environment and empowering micro-entrepreneurs with the financial tools and resources they need, we can harness the transformative power of small-scale businesses to create a more prosperous and equitable future for all.

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