



EVALUATION OF CHALLENGES OF CREDIT RATINGS ENCOUNTERED BY SMALL AND MEDIUM ENTERPRISES

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ABSTRACT:

The Small and Medium Enterprises (SME) sector in India is recognized for its characteristics of low investment requirements coupled with high operational flexibility and mobility in location. According to data from the 73rd round of the National Sample Survey Organization conducted in 2015-16, there are approximately 633.88 lakh unregistered SMEs in India, with 99% of them falling into the micro sector. These enterprises are distributed across various sectors, with 32% engaged in manufacturing activities, 35% in trade, and 34% in other services. In recent years, the MSME sector has emerged as a significant contributor to India's economy, accounting for approximately 36% of the GDP in the fiscal year 2021-22. Moreover, it constitutes a substantial portion of India's total manufacturing output, contributing around 45%, and plays a pivotal role in the country's exports, contributing nearly 40% in value terms. Notably, the sector drives exports in diverse product categories such as sports goods, textiles, handicrafts, leather goods, and more.

KEYWORDS: SMEs, CREDIT RATING, EVALUATION, CHALLENGES

Introduction:

SMEs often find it challenging to compete with larger enterprises due to their size-related limitations and the prevalence of cheap, high-quality products from larger competitors. Barriers such as poor risk management, insufficient feasibility studies, infrastructural deficiencies, and complex labor laws further hinder the smooth operations of SMEs, making them less competitive in export markets. Efforts to alleviate some of these challenges have been made through policy initiatives aimed at promoting credit rating agencies to provide MSME ratings. By enhancing transparency and providing lenders with better insights into the

creditworthiness of SMEs, credit rating can help mitigate information asymmetries prevalent in the sector and facilitate access to finance for SMEs, thereby supporting their growth and contribution to the economy.

This paper aims to investigate the challenges SMEs are facing while availing a credit rating for their enterprise. A sample of 60 respondents were randomly chosen in and around Bangalore and ample scope is given to them to air their opinion regarding the challenges they are encountering while going for rating.

The objective of the Study:

1) To examine the challenges of Credit Ratings encountered by Small and Medium Enterprises (SMEs)

Hypothesis for the Study:

H0: There is a significant difference in the challenges of credit ratings encountered by Small and Medium Enterprises (SMEs)

Testing of Hypothesis:

TO EXAMINE THE CHALLENGES OF CREDIT RATINGS ENCOUNTERED BY SMEs.

H0: The challenges of credit ratings encountered by SMEs are not same.

H1: The challenges of credit ratings encountered by SMEs are same.

SMEs in Karnataka face several challenges when it comes to credit ratings. This study has highlighted some common challenges encountered by SMEs in Karnataka regarding credit ratings. Lenders and credit rating agencies rely on past financial behavior to assess creditworthiness. Without a substantial credit history, SMEs may struggle to demonstrate their ability to repay loans, leading to lower credit ratings or difficulties in accessing. One of the significant challenges SMEs face is having a limited credit history. Many SMEs, especially start-ups and small businesses, may not have a long track record of financial transactions or credit history, making it challenging for credit rating agencies to assess their creditworthiness accurately. Traditional lending institutions often require collateral as security for loans. SMEs, especially those in the early stages of operating with limited assets, may struggle to provide sufficient collateral, leading to lower credit ratings or difficulty in accessing financing.

SMEs, particularly newer or smaller ones, may be perceived as higher risk by lenders and credit rating agencies. This perception can result in lower credit ratings or reluctance from lenders to extend credit, limiting SMEs' ability to access financing for growth and expansion. SMEs must also navigate regulatory compliance requirements related to credit ratings, which can vary depending on the industry, location, and size of the business. Meeting these regulatory obligations adds complexity and cost to the credit rating process for SMEs. The credit rating process can be complex and time-consuming. SMEs may need to provide extensive documentation, and financial statements, and undergo rigorous assessments by credit rating agencies. This

complexity and lengthy process can be daunting for SMEs, especially those with limited resources and expertise in financial management.

Finally, addressing these challenges requires collaborative efforts from SMEs, financial institutions, policymakers, and credit rating agencies. Enhancing SMEs' financial literacy, improving access to credit information, streamlining the rating process, and developing supportive regulatory frameworks can help overcome these challenges and facilitate better access to financing for SMEs in Karnataka.

1. “Challenges encountered while applying for Loans from Financial Institutions” **Table 1: Challenges encountered while applying for Loans**

| Challenges | | Frequency | Percent | Valid Percent | Cumulative Percent | Sig |
|------------|----------------------------------|-----------|--------------|---------------|--------------------|---------------|
| Valid | Lengthy Process | 24 | 40.2 | 40.2 | 40.2 | 16.409 |
| | Collateral Requirement | 8 | 13.8 | 13.8 | 54.0 | |
| | High-Interest Rates | 17 | 26.5 | 26.5 | 80.5 | |
| | Insufficient Transparency | 6 | 10.6 | 10.6 | 91.1 | |
| | Limited Availability of Products | 5 | 8.9 | 8.9 | 100.0 | |
| | Total | 60 | 100.0 | 100.0 | | |

Source: Primary Data, SPSS Output

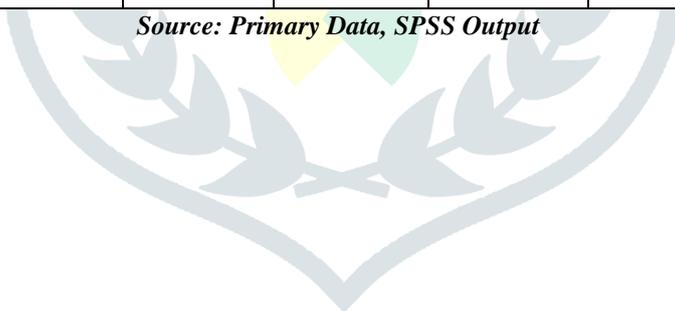
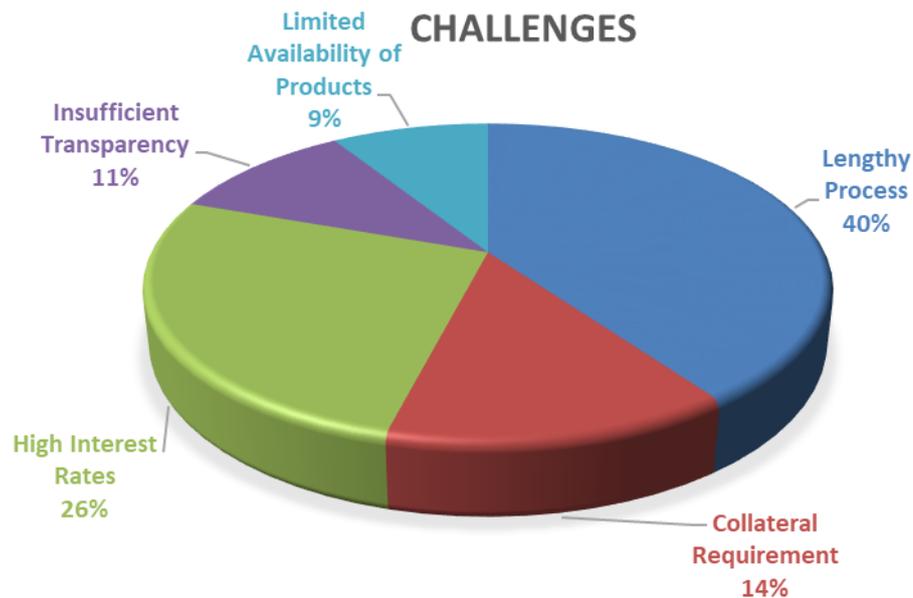


Chart 1: Challenges encountered while applying for Loans

By reviewing the tabulated data and accompanying pie chart, it's apparent that among the 60 respondents from SMEs

- Lengthy approval processes leading to delays (40%):** A significant percentage of SMEs, comprising 40%, identified lengthy approval processes as a major challenge when applying for loans. Lengthy approval procedures can result in delays in accessing much-needed capital, hindering SMEs' ability to seize growth opportunities, meet financial obligations, or address immediate operational needs.
- High-interest rates (26%):** Another notable challenge reported by SMEs, representing 26%, is the issue of high interest rates associated with loans from financial institutions. High-interest rates can significantly increase the cost of borrowing for SMEs, impacting their profitability, cash flow, and ability to repay loans. SMEs may find it challenging to absorb high-interest expenses, particularly in competitive or challenging market conditions.
- Stringent collateral requirements (14%):** A considerable percentage of SMEs, accounting for 14%, cited stringent collateral requirements as a barrier when applying for loans. Financial institutions often require SMEs to provide collateral as security against the loan, which may include assets such as property, equipment, or inventory. SMEs may struggle to meet these collateral requirements, especially if they lack sufficient tangible assets or are unwilling to risk their personal assets.
- Insufficient transparency in loan terms (11%):** A significant portion of SMEs, also representing 11%, highlighted insufficient transparency in loan terms as a challenge during the loan application process. Lack of clarity or transparency in loan terms can lead to misunderstandings, disputes, or unexpected costs for SMEs, eroding trust and confidence in financial institutions. SMEs may seek greater transparency and clarity in loan agreements to make informed borrowing decisions.
- Limited availability of suitable loan products for SMEs (9%):** Lastly, a minority of SMEs, comprising 9%, reported facing challenges due to the limited availability of suitable loan products tailored to their

needs. Financial institutions may offer a limited range of loan products specifically designed for SMEs, potentially overlooking the diverse financing requirements and preferences within the SME sector. SMEs may struggle to find loan products that align with their business objectives, growth plans, and risk profiles.

In conclusion, the data shed light on the multifaceted challenges that Small and Medium-sized Enterprises (SMEs) face when applying for loans from financial institutions. These challenges encompass lengthy approval processes, high-interest rates, stringent collateral requirements, insufficient transparency in loan terms, and limited availability of suitable loan products.

Addressing these challenges necessitates collaborative efforts between financial institutions, policymakers, and SME stakeholders. By streamlining approval processes, reducing interest rates, relaxing collateral requirements where feasible, enhancing transparency in loan terms, and diversifying loan products to better suit SME needs, stakeholders can create a more conducive environment for SME financing.

Moreover, fostering innovation in financial products and services, promoting financial literacy among SMEs, and providing targeted support and resources can empower SMEs to navigate the loan application process more effectively and access the funding they need to thrive and expand their businesses.

This distribution underscores contrasting responses, with the majority of SMEs highlighting challenges related to lengthy approval processes causing delays in loan applications and resulting in disappointments. The data illustrates a diverse range of challenges encountered by SMEs in Karnataka regarding credit ratings. The obtained significance value of **16.409** from the ANOVA analysis indicates a significant diversity in challenges encountered by SMEs in Karnataka concerning loan applications from financial institutions. Consequently, this outcome leads to the **acceptance of the null hypothesis** as initially stated.

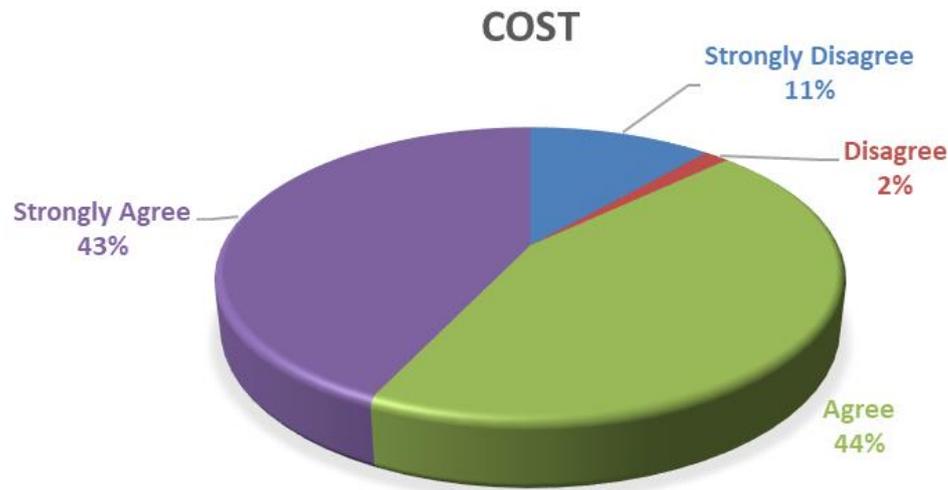
2. “Cost of obtaining a Credit Rating is a hindrance for SMEs”

Table 2: Cost of Obtaining a Credit Rating

| Cost | | Frequency | Percent | Valid Percent | Cumulative Percent | Sig |
|-------|-------------------|-----------|--------------|---------------|--------------------|---------------|
| Valid | Strongly Disagree | 7 | 11.4 | 11.4 | 11.4 | 29.114 |
| | Disagree | 1 | 1.5 | 1.5 | 12.9 | |
| | Agree | 27 | 44.2 | 44.2 | 57.1 | |
| | Strongly Agree | 25 | 42.9 | 42.9 | 100.0 | |
| | Total | 60 | 100.0 | 100.0 | | |

Source: Primary Data, SPSS Output

Chart 2 : Cost of Obtaining a Credit Rating



By reviewing the tabulated data and accompanying pie chart, it's apparent that among the 60 respondents from SMEs

- **Strongly Agree (43%) and Agree (44%):** The majority of respondents, totalling 87%, either strongly agree or agree that the cost of obtaining a credit rating is a hindrance for SMEs. This suggests that a significant portion of respondents perceive the cost associated with credit rating services as a significant barrier for SMEs. The high percentage of respondents agreeing underscores the widespread concern about the financial burden imposed on SMEs by the cost of credit rating services.
- **Disagree (2%):** A negligible percentage of respondents, comprising only 2%, expressed a disagree stance regarding the cost of obtaining a credit rating as a hindrance for SMEs. This suggests that a very small minority of respondents, possibly indicating a lack of strong opinion or awareness about the issue.
- **Strongly Disagree (10%):** A minority of respondents, accounting for 10%, Strongly disagreed that the cost of obtaining a credit rating is a hindrance for SMEs. This suggests that some respondents do not perceive the cost of credit rating services as a significant barrier for SMEs, possibly due to factors such as their access to financial resources, the perceived value of credit ratings, or the availability of alternatives for assessing creditworthiness.

The overwhelming agreement among respondents regarding the cost of obtaining a credit rating as a hindrance for SMEs reflects a widely held perception within the surveyed population. This perception is likely driven by various factors, including the financial constraints faced by many SMEs, the potential impact of credit rating costs on operating budgets, and the perceived value proposition of credit ratings relative to their cost.

This distribution highlights contrasting responses, with the majority of SMEs believing that the cost of obtaining a credit rating is a hindrance and creates obstacles for their business growth. However, some SMEs hold differing opinions on this statement. The obtained significance value of **29.114** from the ANOVA analysis indicates a significant diversity in challenges encountered by SMEs in Karnataka regarding the cost of obtaining a credit rating as a hindrance. **Consequently, this outcome leads to the acceptance of the null hypothesis as initially stated.**

Hypothesis Result of examining the challenges of Credit Ratings encountered by SMEs in Karnataka.

Table 3: Hypothesis Result of examining the challenges of Credit Ratings encountered by SMEs

| Hypothesis | Statement | Result | Sig |
|---|---|-----------------|---------------|
| The challenges of credit ratings encountered by SME's are not same. | Challenges encountered while applying for Loans from Financial Institutions | Accepted | 16.409 |
| | The cost of obtaining a Credit Rating is a hindrance for SMEs | | 29.114 |

Conclusion: Challenges in accessing loans from financial institutions, compounded by the high cost of obtaining credit ratings, pose significant hurdles for SMEs in India and globally. These businesses grapple with limited access to finance, a complex regulatory environment, a lack of awareness about available resources, and a fragmented lending ecosystem. To spur growth and entrepreneurship, India must streamline lending processes, enhance financial inclusion efforts, provide targeted government support, and leverage technology to create a more conducive environment for SME lending, ultimately offering a ray of hope for aspiring entrepreneurs seeking to thrive in the competitive global landscape.

