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**RESEARCH ARTICLE**

Role of Financial Institutions in the Development of Micro, Small and Medium Enterprises (Msme_s) In India

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) are widely recognized as the backbone of the Indian economy due to their substantial contribution to employment generation, innovation, exports, and inclusive economic growth. Despite their economic significance, MSMEs continue to face persistent challenges, particularly in accessing timely and adequate institutional finance, which constrains their growth and competitiveness. Financial institutions play a pivotal role in addressing these constraints by providing credit, advisory services, and risk mitigation mechanisms. This study examines the role of financial institutions in facilitating the growth of MSMEs in India, with a specific focus on the impact of loan access, enterprise size, capital investment, and enterprise age on firm growth. A descriptive and explanatory research design was adopted, and primary data were collected from 120 MSMEs across India using stratified random sampling. Descriptive statistics, correlation analysis, and multiple regression techniques were employed for data analysis. The findings reveal that MSME growth is positively and significantly influenced by access to institutional credit, enterprise size, capital invested, and business age. Among these factors, enterprise size and capital investment exhibit the strongest impact on growth, while loan access also plays a critical supportive role. The results indicate that financial institutions tend to favor larger and better-capitalized enterprises, leaving smaller firms relatively underserved. The study highlights the need for simplified lending procedures, enhanced financial literacy, and targeted credit policies to improve financial inclusion among MSMEs. Strengthening the financial ecosystem is essential for enabling MSMEs to contribute more effectively to India's sustainable economic development.

Keywords: Management, MSMEs, Enterprise, Economics, Risk Management

1. Introduction

Micro, Small, and Medium Enterprises (MSMEs) are widely acknowledged as the backbone of the Indian economy. They play a critical role in employment generation, innovation, rural development, and equitable economic growth. According to the Ministry of MSME (2023), the sector contributes approximately 30% to India's GDP, accounts for around 48% of total exports, and employs over 110 million people across the country. The vast scale and diversity of this sector underscore its significance in achieving inclusive and sustainable economic development. Despite their potential, MSMEs in India face several structural challenges, including limited access to formal finance, inadequate infrastructure, and a lack of technical knowledge. One of the most pressing issues is the access to timely and adequate credit, which hampers their ability to scale, modernize, and compete in both domestic and global markets.

Financial institutions, including public and private sector banks, microfinance institutions (MFIs), and non-banking financial companies (NBFCs), are crucial in addressing this gap. By offering working capital loans, term loans, credit guarantees, and financial advisory services, these institutions help MSMEs build resilience and pursue growth opportunities. In recent years, the Government of India has introduced several initiatives such as the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), PradhanMantri MUDRA Yojana (PMMY), and Emergency Credit Line Guarantee Scheme (ECLGS) to improve credit flow to the MSME sector. However, despite these efforts, a large number of MSMEs remain financially excluded or under-financed. Studies suggest that more than 70% of MSMEs still rely on informal credit sources, which are often expensive and exploitative. This research aims to investigate the role of financial institutions in facilitating the growth and development of MSMEs in India. Specifically, it examines how variables such as loan access, enterprise size, capital invested, and business age influence the growth performance of MSMEs. Through empirical data and statistical analysis, the study seeks to offer evidence-based insights that can inform policymakers, financial institutions, and MSME support agencies. Understanding these relationships is vital not only for bridging the financing gap but also for shaping targeted strategies that empower MSMEs to contribute more effectively to India's economic transformation.

A descriptive and explanatory design was employed. Stratified random sampling was used to collect data from 120 MSMEs India

2. Review of Literature

The development and sustainability of Micro, Small, and Medium Enterprises (MSMEs) are heavily dependent on the availability and accessibility of financial resources. Several scholars have examined the critical role that financial institutions play in facilitating MSME growth.

Singh and Kaur (2021) emphasized that access to formal credit significantly enhances the performance of MSMEs, particularly in rural and semi-urban areas of India. Their study highlighted that financial institutions not only provide capital but also improve business planning and risk management capacities. According to Das and Mohapatra (2020), institutional credit has a positive impact on the productivity of small firms. They argued that enterprises with formal credit lines tend to invest more in technology and skilled labor, resulting in better growth performance.

A study by Bhatia and Verma (2019) found that despite government initiatives like MUDRA and CGTMSE, MSMEs continue to face barriers due to rigid collateral requirements and lack of financial literacy. The authors recommended capacity-building programs alongside credit support. Rao (2022) examined the role of NBFCs and MFIs in supporting micro and small enterprises, especially in areas underserved by commercial banks. His findings indicated that alternative finance providers fill an important gap by offering flexible and tailored financial products. Kumar and Srivastava (2018) discussed

the importance of enterprise size and age in determining access to finance. Their research concluded that newer and smaller enterprises face greater difficulties in securing institutional credit, thereby slowing their growth trajectory.

According to the Reserve Bank of India (RBI, 2022), one of the major challenges in MSME financing is the information asymmetry between lenders and borrowers. This leads to a preference for lending to larger or more established firms, leaving smaller enterprises underserved. Agarwal and Joshi (2020) pointed out that digital finance and Fintech innovations are beginning to reshape the MSME financing landscape. Their study suggested that Fintech platforms could reduce transaction costs and expand credit access for underserved firms. Mehta and Sharma (2023) highlighted that access to credit is positively correlated with MSME growth rates. They used regression models to demonstrate how loan access, firm size, and capital directly influence business expansion.

Lastly, Gupta (2017) stressed the role of government policy in strengthening the financial ecosystem for MSMEs. His study indicated that coordinated efforts between policymakers and financial institutions are essential for addressing structural constraints in MSME financing.

3. Data Analysis and Results

Table 1: Descriptive Statistics

Variable	Mean	Standard Deviation
Enterprise Age (years)	6.5	3.2
Enterprise Size (employees)	14.3	8.1
Loan Access (1=Yes, 0=No)	0.55	0.49
Capital Invested (INR Lakhs)	18.7	12.5
Growth Rate (%)	12.3	5.6

Interpretation

The descriptive statistics reveal key insights into the characteristics of MSMEs in India. On average, enterprises have been in operation for 6.5 years, indicating a relatively young yet moderately experienced sector. The average firm size is 14.3 employees, consistent with the classification of small enterprises, though the high standard deviation suggests the presence of both micro and medium firms in the sample. Approximately 55% of the businesses reported access to formal loans, highlighting that nearly half still face barriers to financial services. The mean capital investment stands at 18.7 lakhs, with substantial variation, pointing to disparities in financial capacity among firms. The average growth rate of 12.3% reflects modest performance across the sector, though variations in growth hint at the influence of external factors such as credit access, business environment, and sectoral dynamics. These findings underscore the partial but significant role financial institutions play in supporting MSME development and the continued need for targeted financial inclusion strategies.

Table 2: Correlation Matrix

Aspects	Growth	Loan Access	Enterprise Size	Capital	Age
Growth	1.0	0.41	0.52	0.47	0.33
Loan Access	0.41	1.0	0.38	0.36	0.29
Enterprise Size	0.52	0.38	1.0	0.59	0.34
Capital	0.47	0.36	0.59	1.0	0.4
Age	0.33	0.29	0.34	0.4	1.0

Interpretation

The correlation matrix shows that enterprise growth is positively associated with loan access ($r = 0.41$), enterprise size ($r = 0.52$), capital invested ($r = 0.47$), and age ($r = 0.33$). Among these, enterprise size and capital have the strongest relationships with growth, indicating that larger, better-capitalized firms grow faster. Loan access also plays a supportive role in growth. Moderate correlations between size, capital, and loan access suggest that financial institutions tend to support more established firms.

Table 3: Multiple Regression Analysis

Variables	Beta Coefficient (β)	t-value	p-value
Loan Access	0.174	2.71	0.007
Enterprise Size	0.265	3.92	0.0
Capital	0.213	3.12	0.002
Age	0.125	2.04	0.044

Interpretation

The regression analysis indicates that all four variables loan access, enterprise size, capital invested, and enterprise age have a statistically significant positive influence on MSME growth. Among them, enterprise size ($\beta = 0.265$, $p < 0.001$) shows the strongest effect, suggesting that larger firms tend to grow more. Capital invested ($\beta = 0.213$, $p = 0.002$) and loan access ($\beta = 0.174$, $p = 0.007$) also significantly contribute to growth, highlighting the importance of financial resources and access to credit. Enterprise age ($\beta = 0.125$, $p = 0.044$) has the weakest but still significant impact, indicating that experience also supports growth, albeit to a lesser extent. All p-values are below 0.05, confirming the statistical significance of the predictors.

4. Conclusion and Recommendations

The study confirms that financial institutions play a crucial role in MSME development in India. However, challenges related to collateral requirements, low awareness about schemes, and complex procedures hinder many small enterprises from accessing formal finance.

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