The Scientific Temper (2024) Vol. 15 (2): 2282-2290
E-ISSN: 2231-6396, ISSN: 0976-8653
Doi: 10.58414/SCIENTIFICTEMPER.2024.15.2.42
https://scientifictemper.com/
RESEARCH ARTICLE

A study on factors influencing lending decisions for MSMEs by scheduled commercial banks in the CGTSME scheme

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Abstract

This study investigates the dynamics of the credit guarantee and technology support for micro, small, and medium enterprises (CGTSME) scheme in India, focusing on how bankers perceive the scheme and how these perceptions influence their lending decisions for MSMEs. Data were collected from public and private sector banks in four major Indian cities over three months using a questionnaire-based survey strategy. Analysis was conducted using partial least squares structural equation modeling (PLS-SEM). The findings indicate that the 5Cs (character, capacity, capital, collateral, and conditions) significantly impact bankers' perceptions of the CGTSME scheme. However, factors such as the creditability of borrowers, availability of financial statements, firm capital size, and guarantee fee payment do not have a significant influence. Interestingly, the margin requirement was found to be a significant factor in shaping bankers' perceptions. Additionally, the study reveals that bankers' perception of the CGTSME scheme significantly affects their lending decisions for MSMEs. These results have important implications for policymakers and banks looking to enhance the effectiveness of the CGTSME scheme and improve access to finance for MSMEs. By understanding the factors that influence bankers' perceptions, policymakers and banks can design more targeted interventions to support MSMEs. Future research could further explore these factors and their impact on bankers' perception and lending decisions, contributing to a deeper understanding of how to support the growth and development of MSMEs.

Keywords: CGTSME scheme, Bankers' perception, Lending decisions, MSME financing.

Introduction

In recent decades, the MSME sector in the Indian economy has emerged as a vibrant and dynamic area (Mari Selvam, 2021), promoting both social and economic development by generating employment opportunities (MSME Annual Report, 2022). This sector is currently divided into manufacturing and service industries and further classified based on investment in plant and machinery into micro, small, and medium enterprises (Satish and Rajamohan, 2018; Elayaraja and Vijai, 2020). The MSME sector plays a vital role in India's economic growth and development (Srivastava, 2020), accounting for nearly 45% of the country's industrial output and 40% of its exports. It provides employment to over 100 million people and makes significant contributions to the nation's GDP (Ministry of Commerce & Industry, 2022). Additionally, MSMEs are major sources of innovation and entrepreneurship, encouraging small businesses to develop new products and services (Singh, 2019; Srinivasan and Lohith, 2017). They are also crucial for regional development, helping to create jobs and spur economic growth in rural areas (Singh *et al*., 2023). The MSME sector is a major source of foreign exchange earnings for India, accounting for nearly 40% of India's exports and helping boost the country's balance of payments (Ministry of Commerce & Industry, 2022). Moreover, MSMEs contribute to the country's social development by providing employment opportunities to people from all walks of life (Gorde *et al*., 2022; Baral, 2013).

MSMEs drive inclusive growth, local demand, and consumption (Latifah *et al*., 2021; Mukherjee, 2018) and have the potential to become the corporate giants and multinationals of the future (Singh and Mallaiah, 2022). Consequently, banks should take pride in serving this sector, as they play an instrumental role in developing these future giants (Deb and Baruah, 2022). In India, MSMEs primarily rely on bank finance for investments in land, buildings,

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How to cite this article: Trivedi, S., Sinha, A., Singh, S. P., Singh, R. (2024). A study on factors influencing lending decisions for MSMEs by scheduled commercial banks in the CGTSME scheme. The Scientific Temper, **15**(2):2282-2290.

Doi: 10.58414/SCIENTIFICTEMPER.2024.15.2.42

Source of support: Nil

Conflict of interest: None.

Received: 21/04/2024 **Accepted:** 25/05/2024 **Published** : 15/06/2024

machinery, working capital, and export receivables financing (Chakrabarty, 2012). Ensuring the timely and adequate flow of credit to MSMEs remains a top public policy priority (Choudhury and Goswami, 2019). Unfortunately, these organizations often feel neglected and overwhelmed due to their limited asset base, which can hinder their growth potential (Dahale *et al*., 2015).

The primary challenge faced by MSMEs is the lack of access to credit at reasonable interest rates and in a timely manner (Sagara *et al*., 2021; Khatri, 2019; Rana and Tiwari, 2014). This difficulty arises due to banks' high-risk perception when lending to MSMEs and their insistence on collateral, which these businesses often lack (Biswas, 2014). This issue is particularly pressing for first-generation entrepreneurs. To address this challenge, the Government of India launched the credit guarantee fund scheme for micro and small enterprises (CGMSE), which offers collateral-free credit to the micro and small enterprise sector (Mund, 2020; Kumar *et al*., 2009; Yadav, 2014). Both existing and new enterprises are eligible for coverage under this scheme, which came into effect on January 1, 2000, and was formally launched on August 30, 2000. Eligible institutions include scheduled commercial banks (Public Sector Banks, Private Sector Banks, and Foreign Banks) and select regional rural banks classified as 'Sustainable Viable' by NABARD. The scheme's main objective is to provide access to finance for small businesses. Under the scheme, the government guarantees loans given to small businesses by banks and financial institutions (Bhatt, 2021; Yadav, 2013).

The scheme also extends access to credit for small businesses that cannot provide collateral for loans (Sheikh and Saxena, 2020; Parida and Pradhan, 2022). Through the scheme, the government guarantees loans provided to small businesses without collateral (Deveshwar and Yadav, 2022; Ghosh, 2014). This assistance enables small businesses to obtain finance at lower interest rates and longer repayment periods (Yadav, 2012), aiding MSMEs in growing their businesses and creating more jobs (Acharya, 2019). Given that lending decisions fall under the purview of bankers, their perception plays a crucial role in the decision-making process under the CGTSME scheme. This study explores the factors affecting the perception of bankers and how it influences lending decisions. As limited research is available on this topic, this study bridges the gap by examining the factors influencing bankers' perception and its impact on lending decisions, thus contributing to the existing literature. The findings of this study will aid bankers and MSMEs in formulating their strategies.

Literature Review and Hypotheses Development

5C's and perception of bankers towards CGTSME scheme

The 5C's of credit and bankers' perception toward the credit guarantee and technology support for micro, small, and medium enterprises (CGTSME) scheme are two significant aspects of the banking industry (Boushnak *et al*., 2018). The 5C's of credit are a critical tool used by banks to assess a borrower's creditworthiness (Muhammad and Melemi, 2021). These 5C's—character, capacity, capital, collateral, and conditions—significantly influence bankers' perception of the credit guarantee scheme for micro and small enterprises (CGTSME). Character refers to the borrower's reputation and trustworthiness (Ahmed and Malik, 2015). Capacity relates to the borrower's ability to repay the loan, which bankers assess by examining their income and expenses (Mot *et al*., 2012). If a potential borrower demonstrates a stable income and the ability to manage expenses, bankers are more likely to view them favorably and approve their loan application (Ibtissem and Bouri, 2013).

Conversely, bankers may be less likely to approve their loan application if a potential borrower has an unstable income or cannot manage expenses (Njeru *et al*., 2017). Another key factor is capital, which bankers evaluate by assessing the borrower's assets and liabilities (Orichom and Omeke, 2021). If a borrower possesses sufficient assets and demonstrates the ability to manage liabilities, bankers are more likely to view them favorably and approve their loan application (Boffey and Robson, 1995). Conversely, if a potential borrower lacks sufficient assets or fails to demonstrate control over liabilities, bankers may view them unfavorably and deny their loan application (Fatemi and Fooladi, 2006).

Character is another factor in determining bankers' perception of the CGTSME scheme. Bankers assess the character of potential borrowers by examining their past credit history and their ability to repay loans (Galak *et al*., 2011; Ravina, 2019). If a potential borrower has a good credit history and demonstrates an ability to repay loans, bankers are more likely to view them favorably and approve their loan application (Hunter and Walker, 1996). Conversely, if a potential borrower has a poor credit history or fails to demonstrate their ability to repay loans, bankers may view them unfavorably and potentially deny their loan application (Butler *et al*., 2017).

Collateral refers to any assets that can be used as security for a loan, providing reassurance to lenders (Feder *et al*., 1988). It is commonly required by banks when lending money to SMEs. The CGTSME scheme grants SMEs access to collateral-free loans, which can benefit businesses lacking the necessary assets to secure a loan (Mund *et al*., 2020; Bhatt, 2021). However, this can be a point of concern for bankers who may be hesitant to lend money without any form of security (Rahman and Varghese, 2010; Jimenez *et al*., 2009). This can lead to a negative perception of the CGTSME scheme, as bankers might view it as a riskier option compared to traditional loans (Srivastava, 2022). Previous studies claim that the 5C's significantly impact bankers' perception of the CGTSME scheme (Muhammad and Melemi, 2021; Peprah *et al*., 2017; Baiden, 2011; Ahlberg and Andersson, 2012). These studies confirm the importance of the 5C's, which are standard factors in the banking sector for lending decisions (Figure 1). Therefore, we state that, *H1*. 5C's have a positive impact on the perception of bankers towards CGTSME scheme

Creditability of borrowers and perception of bankers towards CGTSME scheme

The credit guarantee scheme for micro, small, and medium enterprises (CGTSME) is a government-backed initiative designed to provide credit to small businesses (Deveshwar and Yadav, 2022). The scheme aims to help small businesses access credit from banks and other financial institutions while also providing lenders with protection against default (Yadav, 2012; Kannan and Sudalaimuthu, 2014). Although the scheme has been successful in assisting small businesses in securing credit (Acharya, 2019), there are still some issues with its implementation, such as bankers' perceptions of borrowers and the borrowers' credibility (Ghosh, 2014).

The credibility of borrowers is a key factor in determining whether they will be approved for a loan (Athaide and Pradhan, 2020; Chen and Xu, 2019). Banks and other financial institutions assess a borrower's creditworthiness by examining their credit history, income, assets, and other factors (Mittal and Raman, 2021). A borrower with a good credit history and steady income are more likely to receive loan approval (Gupta *et al*., 2018). However, borrowers with poor credit history or insufficient income may face challenges in obtaining loan approval (Singh and Singh, 2014).

Bankers' perceptions of the CGTSME scheme are also crucial in determining whether borrowers will be approved for loans (Mehrotra *et al*., 2018). Bankers may view the scheme as too risky or overly complex, which can lead to hesitance in taking on the associated risk (Suryakumar and Thirunavukkarasu, 2018). Furthermore, bankers may consider the scheme costly due to the fees associated with loan approval. This may cause bankers to be reluctant to approve loans under the CGTSME scheme, even if the borrower is otherwise creditworthy. Therefore, we stated that, *H2*. Creditability of borrowers have a positive impact on the perception of bankers towards CGTSME scheme

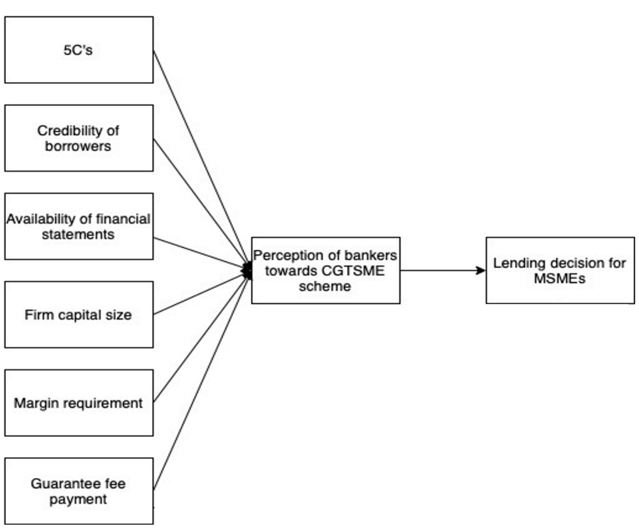

Figure 1: Conceptual framework

Availability of financial statements and perception of bankers towards CGTSME scheme

Financial statements are essential documents that provide an accurate picture of a business's financial health (Das, 2016). These statements offer a comprehensive overview of a company's assets, liabilities, and equity, as well as its income and expenses (Deveshwar and Yadav, 2022). By analyzing these documents, investors and lenders can make informed decisions about investing in or lending to a business (Bose, 2013). Moreover, financial statements can help businesses identify areas where they can improve operations and increase profitability (Bhatt, 2021). Financial statements are particularly important for small and medium-sized enterprises (SMEs) (Maini, 2019). Since SMEs typically lack access to capital markets, they rely heavily on bank loans to finance their operations (Choudhury and Goswami, 2019). Thus, accurate and up-to-date financial statements are essential for securing bank financing (Sharma, 2011). Banks use financial statements to assess SMEs' creditworthiness and determine whether they are a good investment (Srivastava, 2022). Banks may be hesitant to lend to SMEs without access to reliable financial statements. financial statements provide information about a business's liquidity position, which helps bankers assess the ability of the business to repay loans on time (Aggarwal, 2016). Financial statements also provide details on a business's assets and liabilities, helping bankers determine whether the assets can be used as collateral for the loan (Maini, 2019). Therefore, it is clear that financial statements play a crucial role in shaping bankers' perception of the CGTSME scheme. Therefore, we stated that, *H3*. Availability of financial statements have a positive impact on the perception of bankers towards CGTSME scheme

Firm capital size and perception of bankers towards CGTSME scheme

The size of a firm's capital is a key factor in determining the success of a business (Pervan and Visic, 2012). Firms with larger capital bases have more resources to invest in research and development, marketing, and other activities that can drive growth and success (Akram *et al*., 2021). Moreover, a larger capital base can provide a buffer against losses and help the firm stay profitable during challenging times. Conversely, firms with smaller capital bases may struggle to invest in activities that promote growth and success (Das, 2016).

If bankers positively perceive the CGTSME scheme, they may be more inclined to provide financing to small businesses (Mund, 2020). A firm's capital size is an important factor in shaping bankers' perception of the CGTSME scheme (Parida and Pradhan, 2022). Generally, bankers perceive larger firms with more capital as more reliable and trustworthy and are more likely to receive favorable terms when applying for a loan. Conversely, smaller firms with less capital are viewed as riskier investments and may face higher interest rates or stricter repayment terms (Bhatt, 2021; Sinha, 2012). Larger firms often have access to alternative sources of financing, such as venture capital or private equity, which further enhances their chances of receiving favorable terms from bankers (Deveshwar and Yadav, 2022; Bose, 2013). In contrast, smaller firms with less capital may be subject to higher interest rates or stricter repayment terms (Bhalla and Kaur, 2012). This is because banks perceive them as riskier investments and are less willing to offer them favorable terms compared to larger firms (Choudhury and Goswami, 2019). Moreover, smaller firms may lack access to additional financing sources, such as venture capital or private equity, which can further hinder their ability to secure favourable loan terms from banks. Therefore, we stated that, *H4*. Firm capital size has positive impact on the perception of bankers toward CGTSME scheme

Margin requirement and perception of bankers towards CGTSME scheme

The margin requirement for the CGTSME scheme is crucial in shaping bankers' perception of the scheme (Yadav, 2014). The margin requirement is the portion of the loan amount that the borrower must pay upfront, usually expressed as a percentage of the total loan (Mund *et al*., 2020). This upfront payment serves as a safeguard to cover potential losses from borrower default (Jain *et al*., 2015). For the CGTSME scheme, the margin requirement is set at 15%, which is lower than the margin requirement for other loan schemes (Ghosh, 2014). This lower margin requirement facilitates MSMEs' access to credit from banks, enhancing bankers' perception of the scheme (Gautam, 2017; Yadav, 2013). Lowering the margin requirement improves the scheme's appeal by making credit more accessible to MSMEs and increasing their chances of obtaining financing from banks. Therefore, we stated that, *H5*. Margin requirement have a positive impact on the perception of bankers towards CGTSME scheme

Guarantee fee payment and perception of bankers towards CGTSME scheme

The guarantee fee payment is a key factor in the success of the CGTSME scheme (Mund *et al*., 2020; Rahman and Varghese, 2010). Borrowers pay this fee to the bank to secure the loan (Bhatt, 2021). The guarantee fee helps to mitigate the risk associated with the loan and ensures that the bank can recover its money if the borrower defaults (Shrimali, 2020; Das, 2013). Without this fee, banks would be unable to offer loans to small businesses. The guarantee fee also signals the borrower's commitment to repaying the loan (Ghosh, 2014). If a borrower is unwilling to pay the fee, it suggests a lack of seriousness in repaying the loan (Gadhavi, 2014). This helps reduce the risk of default and provides banks with more confidence that they can recover their money in the event of borrower default. Therefore, we stated that, *H6*. Guarantee fee payment has a positive impact on the perception of bankers towards CGTSME scheme

Perception of bankers under CGTSME scheme on lending decision for MSMEs

Bankers' perception of the CGTSME scheme and their lending decisions for MSMEs are influenced by various factors. One key factor is the risk associated with lending to MSMEs (Talaulikar and Hegde-Desai, 2015). Banks are often hesitant to lend to MSMEs due to the higher risk of default associated with these loans (Panigrahi, 2012). However, the CGTSME scheme offers banks a guarantee against potential losses from defaults, thereby reducing the risk of lending to MSMEs (Bhatt, 2021). This guarantee makes the scheme appealing to banks and encourages them to extend credit to MSMEs. Therefore, we stated that, *H7*. Perception of bankers under CGTSME scheme on lending decision for MSMEs

Research Methodology

This study examined the factors influencing bankers' perception of the CGTSME scheme. Additionally, we assessed how bankers' perception of the CGTSME scheme impacts their lending decisions. We used self-reported responses from a questionnaire to test our conceptual framework for this purpose.

A questionnaire-based survey strategy was adopted to collect the data because it allows for data collection in a shorter amount of time (Ponto, 2015). Therefore, this strategy was appropriate for testing the conceptual framework. All responses were based on a five-point Likert scale. This study used the purposive sampling technique to collect data from respondents. For data collection, participants were contacted either personally or by phone. The study and survey were conducted in public and private sector banks operating in four major metropolitan cities in India: Delhi, Mumbai, Chennai, and Kolkata. Survey data were gathered at different bank branches from July 2022 to September 2022. The data were analysed using partial least squares structural equation modelling (PLS-SEM) to test the hypotheses, and the results were interpreted accordingly.

Questionnaire Development

To develop the questionnaire, the 5C scale was adopted from Tilahun (2018), while the credibility of borrowers was measured using a scale from Al-Rawashdeh *et al*. (2013). The availability of financial statements was assessed using scales from Fatoki (2014), Youssef (2014), Gamage (2014), and Zeneli (2014). The size of firm capital was measured using a scale from Boushnak *et al*. (2018), margin requirement from Mund (2020), and guarantee fee payment from Mund (2020) and Rahiman (2010). The perception of bankers and lending decisions were measured using scales from Rahiman (2010). All responses were recorded based on a five-point Likert scale.

Data Analysis

Reliability and validity assessment

In this section, reliability and validity issues have been examined using the PLS algorithm. First, the factor loadings of latent variables were analyzed and found to be acceptable, significant, and greater than the threshold limit of 0.7, as per Wong (2013), as shown in Table 1. Cronbach's alpha and composite reliability (CR) were used to assess the reliability of constructs. Following Chaudhary's guidance (2018), all constructs' reliability was greater than the cutoff value of 0.7, confirming scale reliability, as shown in Table 2. Additionally, CR values ranged between 0.863 and 0.925, indicating higher reliability and confirming convergent validity, based on the examination of Cronbach's alpha and composite reliability (Chin *et al*., 2014).

The average variance extracted (AVE) values of all items were greater than 0.5, confirming convergent validity. Discriminant validity was examined using the Fornell-Larcker criterion (Henseler *et al*., 2014), by ensuring that the square root of AVE values was greater than inter-item correlations, as shown in Table 3 (Chin, 1998). Thus, validity issues were validated. Multicollinearity was assessed by estimating the variance inflation factor (VIF), which ranged from 1.339 to 2.289, indicating the absence of multicollinearity in the data sample. The model's fitness was also evaluated according to Browne and Cudeck (1992). The analysis demonstrated acceptable fit, with an RMSEA of 0.081, a chi-squared statistic of 6649.89, and a goodness of fit index (GFI) of 0.897.

Hypotheses testing

We tested the proposed hypotheses using structural equation modelling. The hypothesized model includes eight constructs designed to test seven hypotheses. Figure 2 illustrates the output of the structural model with bootstrapping for direct effects, and path coefficients along with t-values are displayed in Table 3. First, the impact of the 5Cs on bankers' perception was assessed and found to be significant ($\beta = 0.230$, $p = 0.02$). This supports H1, indicating that the 5Cs significantly impact bankers' perception of the CGTSME scheme. However, the creditability of borrowers (H2), availability of financial statements (H3), firm capital size (H4), and guarantee fee payment (H6) did not significantly impact bankers' perception of the CGTSME scheme. On the other hand, margin requirement significantly impacted

Table 1: Measurement model assessment

Variable	*Items*	*Loadings*	*α*	*CR*	*AVE*
5C's (5C)	5C1	0.809	0.848	0.891	0.621
	5C2	0.798			
	5C3	0.805			
	5C4	0.802			
	5C5	0.723			
Creditability of borrowers (COB)	COB1	0.772	0.908	0.925	0.578
	COB2	0.785			
	COB3	0.791			
	COB4	0.729			
	COB5	0.722			
	COB6	0.776			
	COB7	0.799			
	COB8	0.773			
	COB9	0.777			
Availability of financial statements (AOFS)	AOFS1	0.810	0.847	0.891	0.621
	AOFS2	0.838			
	AOFS3	0.779			
	AOFS4	0.783			
	AOFS5	0.728			
Firm capital size (FCS)	FCS1	0.887	0.745	0.887	0.797
	FCS2	0.898			
Margin requirement (MR)	MR1	0.872	0.786	0.875	0.701
	MR2	0.852			
	MR3	0.784			
Guarantee fee payment (GFP)	GFP1	0.798	0.837	0.901	0.753
	GFP2	0.864			
	GFP3	0.935			
Perception of banker (POB)	POB1	0.854	0.775	0.860	0.754
	POB2	0.882			
Lending decision (LD)	LD1	0.834	0.764	0.863	0.678
	LD2	0.841			
	LD3	0.794			

Table 2: The outcome of hypothesis testing (direct effect)

Hypotheses	Path	Path coefficient	Standard error	t-static	Test outcome
1	5C→POB	0.230	0.088	2.606	Supported
2	COB → POB	0.089	0.109	0.819	Not supported
3	AOFS → POB	0.157	0.117	1.344	Not supported
4	FCS → POB	-0.026	0.088	0.302	Not supported
5	MR → POB	0.294	0.117	2.516	Supported
6	GFP → POB	-0.023	0.182	0.124	Not supported
7	POB → LD	0.594	0.046	12.851	Supported

Table 3: Discriminant validity

Constructs	*5C*	*AOFS*	*COB*	*FCS*	*GFP*	*LD*	*MR*	*POB*
5C	0.788							
AOFS	0.745	0.788						
COB	0.709	0.729	0.760					
FCS	0.567	0.673	0.639	0.893				
GFP	0.781	0.745	0.730	0.709	0.868			
LD	0.593	0.587	0.557	0.484	0.678	0.823		
MR	0.664	0.711	0.668	0.686	0.826	0.610	0.837	
POB	0.582	0.574	0.566	0.452	0.588	0.594	0.581	0.868

Note: Correlation is significant at 0.05, figures in italics represent square root of AVE

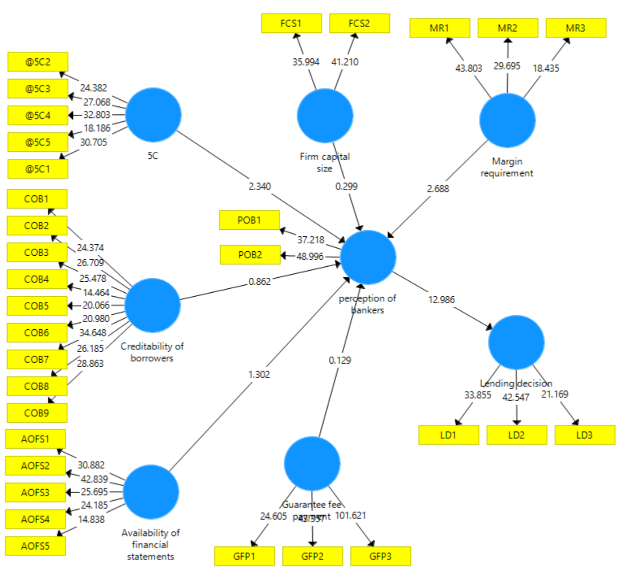

Figure 2: SEM model

bankers' perception of the CGTSME scheme (H5) (β = 0.294, p = 0.007). Furthermore, bankers' perception of the CGTSME scheme significantly impacted their lending decisions for MSMEs (H7) (β = 0.594, *p* = 0.000).

Discussion and Conclusion

The study's findings offer valuable insights into the factors shaping bankers' perception of the CGTSME scheme and its impact on lending decisions for MSMEs. (Boushnak *et al*. 2018). The significant influence of the 5Cs on bankers' perception underscores the importance of traditional credit assessment factors in evaluating the viability of MSMEs for loans. However, the lack of significant impact from factors such as creditability of borrowers and availability of financial statements suggests that other considerations may outweigh these factors in bankers' decision-making processes (Character, Collateral, Capacity, Capital, and Conditions). The finding that the margin requirement significantly influences bankers' perception highlights the importance of loan terms and conditions in shaping their views on the scheme. Nkuah *et al*. (2013) suggest that policymakers should carefully consider these aspects when designing financing schemes for MSMEs to ensure they are attractive to banks and facilitate access to credit for small businesses Bouazza *et al*. (2015).

The study's results also emphasize the crucial role of bankers' perception in influencing their lending decisions for MSMEs. A positive perception of the CGTSME scheme was found to lead to more favorable lending decisions, highlighting the need for efforts to improve bankers' understanding and awareness of such schemes. Policymakers and banks can use these findings to enhance the design and implementation of MSME financing schemes, ultimately improving access to finance for this important sector of the economy Tilahun (2018).

In conclusion, the study provides valuable insights into the factors influencing bankers' perception of MSME financing schemes and their lending decisions. By understanding these factors, policymakers and banks can develop more effective strategies to support MSMEs, ultimately contributing to their growth and development. Further research could explore additional factors that may influence bankers' perception and lending decisions, providing a more nuanced understanding of how to enhance access to finance for MSMEs.

Implications

The study's findings have several implications for policymakers, banks, and MSMEs. Policymakers can use these insights to design more effective financing schemes for MSMEs, considering factors such as the 5Cs and margin requirements to make the schemes more attractive to banks. Banks can improve their lending decisions by focusing on these factors and enhancing their understanding of MSME financing schemes. MSMEs can benefit from increased access to finance and better terms under these schemes, which can support their growth and development. These implications can contribute to a more robust financial ecosystem for MSMEs, fostering economic growth and job creation.

Limitation and Future Scope

One limitation of the study is its focus on a specific geographical area and banking context, which may limit the generalizability of the findings to other regions or types of financial institutions. Additionally, the study's reliance on self-reported data from a questionnaire could introduce response bias or social desirability bias, potentially impacting the validity of the results. Furthermore, the study's cross-sectional design limits the ability to establish causal relationships between variables.

Future research could address these limitations by including a more diverse sample of banks and financial institutions from various regions and contexts. Longitudinal or experimental designs could be employed to better understand the causal relationships between variables over time. Additionally, future studies could incorporate objective measures of variables, such as financial performance data, to complement the self-reported data and enhance the robustness of the findings.

Acknowledgment

I would like to express my deepest gratitude to Dr. Rajiv Verma for their invaluable guidance and support throughout this research. I am also thankful to my colleagues and friends for their encouragement and assistance.

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