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ROLE OF BANKS IN SUPPORTING SMALL BUSINESS LOANS

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Abstract: The role of banks in enabling access to finance for small businesses is central to the broader objective of financial inclusion in India. The paper identifies how factors such as lack of collateral, weak financial literacy, and limited awareness of formal schemes hinder the loan process. Based on a sample of 50 businesses, the findings call for reforms in loan processing, education, and personalized banking.

This research paper explores how banks support small business loans in India. Small businesses are vital for economic growth, but they face significant hurdles while seeking financial assistance from banks. A survey of 50 small business owners revealed that collateral demands, limited financial knowledge, and low awareness of government schemes are major barriers. However, strong bank relationships and financial literacy improve loan approval chances. The paper recommends simplifying procedures, promoting government schemes, and offering financial education to empower small businesses.

Small businesses contribute to both urban and rural employment in India, making them critical to inclusive economic development. However, the accessibility and suitability of credit systems for these enterprises remain questionable. Understanding the bank's limitations and how to bridge the financial inclusion gap is necessary to empower MSMEs.

Index Terms - Small Business Loans, Banking Sector, MSMEs, Collateral, MUDRA Scheme, CGTMSE, Financial Literacy, Credit Rationing, Loan Approval.

I. INTRODUCTION

Small businesses play a vital role in India's economic development. They are key drivers of job creation, innovation, and inclusive growth. Despite their strong contribution to the economy, small businesses often face major challenges when it comes to accessing formal financial support.

Key Contributions of Small Businesses:

1. They contribute to over **30% of India's GDP**.
2. They generate **large-scale employment** with relatively low investment.
3. They help in the **equitable distribution of income and regional development**.
4. They drive **grassroots entrepreneurship**, particularly in semi-urban and rural areas.

However, despite their importance, small businesses continue to struggle with **financial constraints**, especially when trying to secure bank loans. Problems such as complex procedures, high collateral requirements, and limited financial knowledge often limit their access to credit.

While digital lending platforms, credit scoring systems, and government-backed schemes like **MUDRA** and **CGTMSE** have attempted to solve these issues, major **gaps remain** in their actual implementation and outreach.

This research paper focuses on identifying these gaps and suggesting practical solutions. By understanding the barriers that small business owners face, this study aims to provide useful insights for:

- **Policymakers** seeking to improve financial inclusion
- **Banks** aiming to build better relationships with small businesses

- **Entrepreneurs** looking for an easier and more supportive loan process summary, this research not only explores the challenges, but also aims to offer **actionable and policy-relevant recommendations** to help bridge the credit access gap for small businesses in India.

II. LITERATURE REVIEW

- 1) **Credit Rationing Theory (Stiglitz & Weiss, 1981)**- Banks often avoid giving loans to small businesses due to the fear of repayment failure, even if high interest is offered. This risk-averse behaviour limits small business access to credit.
- 2) **Collateral-Based Lending Theory (Cole & Wolken, 1995)**- Banks feel more secure lending to businesses that offer collateral. Lack of assets among small businesses leads to high rejection rates.
- 3) **Relationship Banking Theory (Berger & Udell, 1998)**- Long-term and regular banking relationships increase trust, thereby improving loan approval chances for small businesses.
- 4) **Financial Constraint Theory (Beck, Demirgüç-Kunt & Maksimovic, 2008)** -Small businesses, especially in developing countries, struggle with access to credit due to a lack of documents, low credit scores, and rigid bank rules.
- 5) **Government Intervention Theory (Scholtens, 2000)**- Government-backed schemes like MUDRA or CGTMSE encourage banks to lend by sharing the risk, improving loan accessibility for small enterprises.
- 6) **Financial Development Theory (Rajan & Zingales, 1998)**- A strong and inclusive financial system makes loan access easier for small businesses, especially in urban regions with better banking infrastructure.
- 7) **Alternative Financing Theory (Mason & Harrison, 2004)**- When banks deny credit, small businesses can use alternative sources like venture capital, crowdfunding, or fintech platforms to raise funds.
- 8) **Retained Earnings Theory (Carpenter & Petersen, 2002)**- Many businesses prefer using their own profits for growth instead of taking loans to avoid repayment risks, although this limits their expansion speed.
- 9) **Pecking Order Theory (Myers & Majluf, 1984)**- Firms prefer internal funds first, then debt, and equity last. This explains why many avoid bank loans until absolutely necessary.
- 10) **Financial Literacy Theory (Ayyagari et al., 2007)**- Lack of financial knowledge prevents small business owners from applying for or succeeding in getting loans. Educating them can bridge this gap.

III . OBJECTIVES

This study was conducted to understand the role of banks in supporting small business loans and identifying the key barriers that business owners face during the process. The research focused on evaluating both the operational banking system and the effectiveness of financial literacy and government schemes.

Primary Objectives:

- To examine the **current practices and procedures** banks follow while offering small business loans.
- To identify the **major challenges** that small business owners face in getting their loans approved.
- To assess the **impact of financial literacy** on loan success rates.
- To evaluate the **awareness and usage** of government-backed loan schemes like MUDRA and CGTMSE.
- To recommend **practical improvements** banks can adopt to increase loan accessibility and support for small businesses.

The study utilized a mix of **closed-ended and open-ended questions** to gather both quantitative data and qualitative insights. The survey was shared via **WhatsApp groups, email**, and other digital platforms. Respondents represented diverse industries, including **retail, textiles, agriculture-based ventures, IT services, and small-scale manufacturing**. The collected responses were **analyzed statistically** to identify patterns and develop informed conclusions, even from a modest sample size.

IV. METHODOLOGY AND RESEARCH DESIGN

This research is based solely on **primary data** collected through a structured Google Form survey. The objective was to understand how banks support small business owners and what challenges these owners face during the loan process.

A **descriptive research design** was used, supported by **exploratory research**. This helped in identifying real-world patterns and relationships among variables like loan approval, collateral requirements, financial literacy, and awareness of government schemes.

Steps Followed:

- A 22-question Google Form was created, covering topics like loan experience, banking relationships, and awareness of government loan schemes.
- The survey was shared digitally via WhatsApp business groups and email.
- Data was collected from 50 valid respondents across different sectors like trading, manufacturing, and services.

Sample Characteristics:

- Respondents included shopkeepers, service providers, and small manufacturers.
- Businesses ranged from 2 to 15 years old.
- Locations covered both urban and semi-urban areas of India.

Tools Used:

- Google Forms for collecting responses.
- Microsoft Excel for organizing and analyzing data.
- Basic descriptive and correlation analysis to interpret patterns and insights.

This methodology helped capture real-world insights directly from small business owners who are actively involved in managing their banking and loan processes.

V. KEY FINDINGS

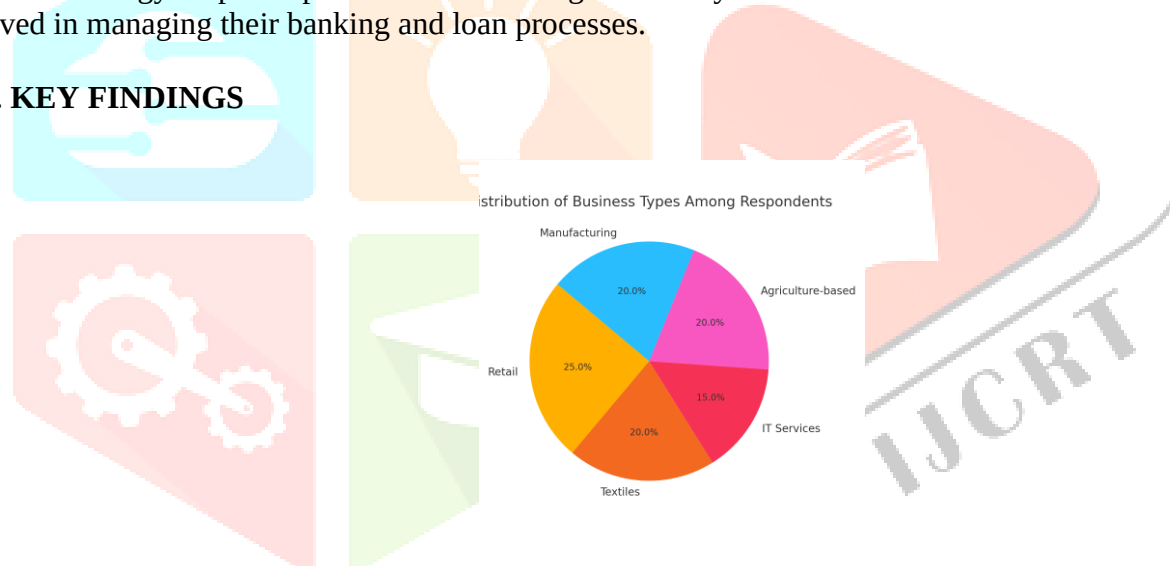


figure 1: distribution of business types among respondents.

A study revealed several important findings based on the responses of 50 small business owners across India:

Loan Challenges and Collateral:

- About **90% of businesses were asked to provide collateral**, which made it difficult for many to qualify for loans.
- **Collateral requirements** remain one of the biggest hurdles in getting financial support from banks.

Awareness and Usage of Government Schemes:

- Around **66% of respondents were aware of schemes** like MUDRA and CGTMSE.
- However, **very few actually applied** for these schemes, highlighting a **gap between awareness and action**.
- The low application rate was due to confusion about eligibility, lack of personal guidance, and **language barriers**.

Financial Knowledge:

- Owners who understood key terms like **EMI, interest rates, and documentation** were more likely to get loans approved.
- **Financial literacy played a critical role** in loan success and confidence during the application process.

Bank Relationships:

- Business owners with **long-term and active current accounts** had smoother experiences with loan processing.
- These relationships created more **trust and credibility** in the eyes of the banks.

Banking System and Experience:

- **Private banks** were seen as faster, more responsive, and easier to approach, especially for digital procedures.
- **Public sector banks**, on the other hand, were reported to be slower and more paperwork-heavy.

Other Observations:

- Many business owners **did not apply** for available schemes **despite being aware of them**, due to fear of rejection or unclear instructions.
- Some participants faced **language-related difficulties** and said they needed better guidance from bank staff.

Limitations in Collected Data:

- No detailed data was collected about **loan amount, repayment rates, or post-loan impact**, which could have provided deeper insights.

Also, due to time constraints, **no in-person interviews** were conducted — this could have added more depth to the responses.

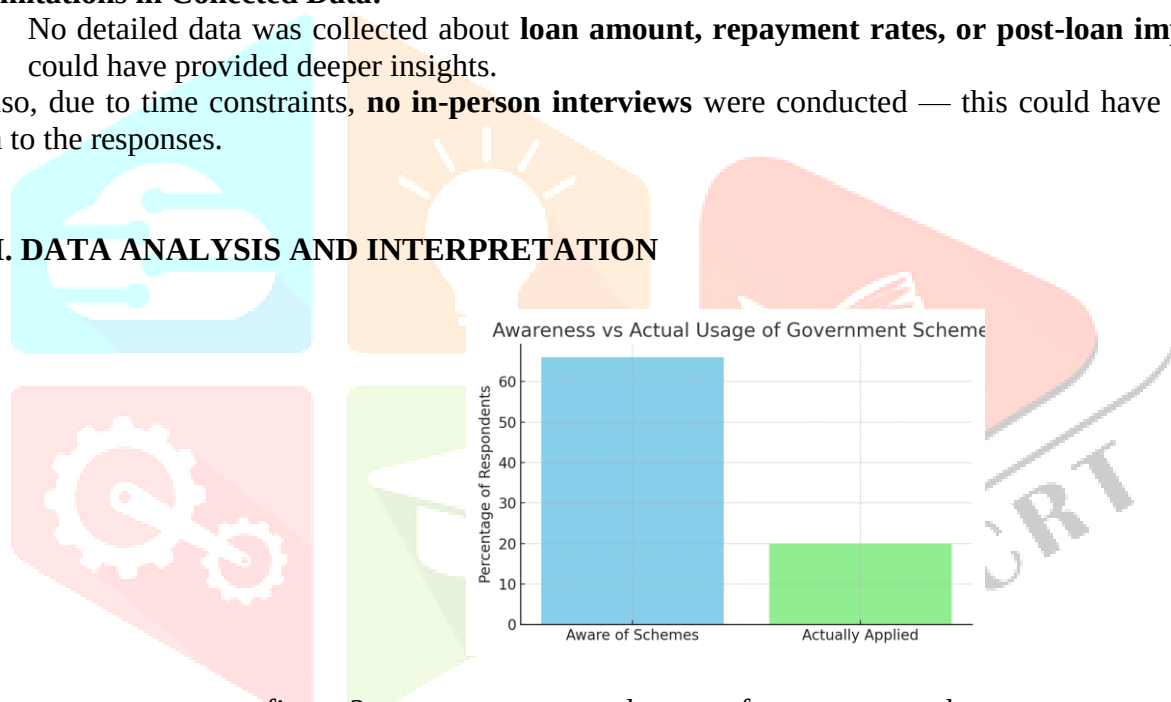
VI. DATA ANALYSIS AND INTERPRETATION

figure 2: awareness vs actual usage of government schemes

The responses collected from 50 small business owners were analyzed using basic statistical tools, such as frequency tables, cross-tabulations, and visual graphs. This helped in identifying key patterns related to loan approval, financial awareness, and the role of banking support.

Important Observations:

- Business owners who understood basic banking terms like **EMI, credit score, interest rate, and loan documentation** had a much **higher success rate** in getting their loans approved.
- Businesses with **long-standing and active current accounts** were more trusted by banks and experienced faster processing.
- A **lack of awareness about collateral-free schemes** (such as MUDRA or CGTMSE) prevented many eligible business owners from even applying for loans.
- **Public sector banks** were often reported as requiring more paperwork and having slower procedures compared to **private banks**, which were seen as more digital and customer-friendly.

Understanding These Patterns:

- **Financial literacy** reduces confusion and fear among business owners when dealing with banks.
- A strong, long-term **relationship with banks** builds mutual trust and improves approval chances.
- Many small business owners require **step-by-step guidance** to understand how to properly apply for loans and take advantage of government support schemes.

Strategic Recommendations from the Analysis:

- Banks should include **digital literacy and basic finance training** as part of their customer support, especially for first-time borrowers.
- Bundling loan offerings with optional sessions on **bookkeeping, tax filing (GST), and business planning** can empower borrowers to make informed decisions.
- Banks can also **partner with NGOs, small business mentors, or private training providers** to enhance outreach and better support applicants through the loan journey.

VII. LIMITATIONS

While this study offers valuable insights into the role of banks in supporting small business loans, it also has some limitations that should be considered:

Sample and Data Limitations:

- The sample size was limited to **50 respondents**, which may not represent the full diversity of small businesses in India.
- **Convenience sampling** was used, meaning participants were selected based on accessibility and willingness rather than random selection.
- Most responses were collected from urban or semi-urban areas through digital platforms, excluding businesses without internet access.

Response and Research Design Limitations:

- All responses were **self-reported**, which may include biases or inaccuracies based on personal memory or perception.
- The study did not collect detailed data on **loan amounts, repayment behavior, or business outcomes after loan disbursement**, which limits the ability to assess long-term impact.
- **No face-to-face interviews** or field visits were conducted, which could have added richer, more in-depth insights to the data.

These limitations suggest the need for larger, more diverse studies in the future, potentially using mixed research methods to capture both quantitative trends and qualitative experiences.

VIII. RECOMMENDATIONS:

Based on the findings of this study, several practical recommendations can be made for banks, policymakers, and support organizations to improve the small business lending process:

For Banks:

- Conduct regular training workshops for small business owners to explain the loan process and available schemes.
- Assign **relationship** managers to guide applicants through documentation and scheme eligibility.
- Simplify the **paperwork and documentation** requirements, especially for micro and first-time borrowers.
- Offer optional **training modules** with loans on topics such as digital banking, tax filing (GST), and business planning.
- Promote **digital literacy and financial education** to help business owners become more confident borrowers.

For Outreach and Scheme Awareness:

- Use **SMS alerts, posters, local events, and social media** to promote government-backed schemes like **MUDRA** and **CGTMSE**.
- Provide **multilingual and simplified instructions** to address language barriers and make processes more inclusive.
- Partner with **NGOs, local business mentors, or financial literacy organizations** to extend outreach and pre-application support.

For Policy Makers and Government:

- Encourage banks to **reduce dependency on collateral** by increasing participation in credit guarantee schemes.
- Monitor and evaluate the **real-world implementation** of loan schemes to ensure they are accessible and effective.

These steps can create a more supportive ecosystem for small businesses, transforming banks from procedural institutions into trusted financial partners that enable growth, innovation, and inclusive economic development.

IX. CONCLUSIONS

This study aimed to understand how banks support small business owners in India and what obstacles these entrepreneurs face while applying for loans. The insights gathered from 50 small business owners revealed important patterns in their experiences, challenges, and expectations from the banking system.

Key Findings Recap:

- Many small business owners struggle with excessive **paperwork, collateral requirements, and complex documentation**.
- Those who had **long-term relationships** with banks were more likely to receive support and get their loans approved smoothly.
- Business owners with a **better understanding of financial terms** like EMI, interest rates, and required documents experienced fewer hurdles in the loan process.
- While schemes like **MUDRA** and **CGTMSE** are designed to improve loan access, a large number of respondents were either unaware of them or unsure how to apply.

Conclusion:

Banks play a critical role in empowering small businesses, but the current loan process often acts as a barrier instead of support. To truly assist small business owners, banks must work towards:

- **Simplifying loan procedures** and reducing unnecessary document demands.
- **Actively guiding applicants**, especially first-time borrowers, through the entire loan journey.
- **Promoting government loan schemes** more effectively using simple, multilingual communication.
- **Organizing training sessions** on financial literacy, digital banking, and basic business finance.

With these efforts, banks can become true partners in growth for small businesses. Improving access to credit will not only boost entrepreneurship but also contribute significantly to job creation and India's overall economic development.

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