WHAT SOCIO-ECONOMIC FACTORS DETERMINE AVAILING BUSINESS LOANS THROUGH FORMAL V/S INFORMAL CREDIT SOURCES: A STUDY OF SMALL BUSINESSES IN INDIA

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ABSTRACT

In the pursuit of poverty alleviation, economic development, and employment growth, understanding the pathways to economic freedom and entrepreneurship becomes paramount. This paper delves into the socio-economic factors influencing access to formal credit for small businesses in India, focusing on the interplay between informal entrepreneurship, financial constraints, and institutional support. Formal institutions bolster the entrepreneurial endeavours via providing credit at reasonable cost. Using data from the IHDS-2 dataset for the year 2011-12, our study examines the impact of education, gender, age, community membership, asset holdings, political networks, industry affiliation, and caste, along with other factors on access to formal credit via Heckman-Probit model to control for the sample selection bias. Our findings direct us that individuals with any level of education are more likely to access formal credit sources for business compared to those with no education. Females exhibit lower likelihood of accessing formal loans than males. Belonging to Other Backward Classes, Dalit, or Muslim decreases access to formal credit. Having a social network with politicians increases access significantly, and membership in self-help groups or credit/savings groups also enhances access. Conversely, residing in metro or other urban areas decreases access compared to less developed villages, and being in the service sector increases access compared to manufacturing. Limited confidence in banks increases access. The empirical findings and subsequent policy recommendations contribute to the discourse on fostering inclusive economic opportunities and addressing the challenges faced by the informal sector entrepreneurs running small businesses in emerging economies like India.