European Economic Letters
ISSN 2323-5233
Vol 13, Issue 5 (2023)
http://eelet.org.uk

Need for Sustainable Financing: Interlinkage Between MSME Sectors Growth and Economic Growth in India

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Abstract
Micro, small and medium enterprises did not witness the required growth in India despite their importance in generating job opportunities, alleviating poverty, and contributing to economic growth, given the different types of traditional financing (commercial banks, private financing institutions) have not provided adequate financing led to their growth. The relationship between sustainable financing and the growth of (MSMEs), and GDP growth, has not been well studied. The focus of this study is to see the nexus between sustainable financing and the growth of micro, small and medium enterprises, and economic growth in India. In line with the design study, a sample of 72 MSMEs was selected who have access to sustainable financing in Bangalore. The data has been analyzed to measure the relationships between financing, MSMEs growth, and economic growth using the correlation test and (OLS) method. The results from the analysis of the current study show that sustainable finance is essential for the growth of micro, small, and medium enterprises and economic growth.
JEL Code: G21, G28, O43

Keywords, Sustainable Financing, MSMEs Growth, Economic Growth.

INTRODUCTION

In recent years, the importance of sustainable financing and the (MSMEs) growth has gained important attention in the context of fostering economic growth and development in India. MSMEs have played a crucial role in the country's economy, contributing to employment generation, innovation, and overall economic output. Sustainable financing practices have emerged as a vital mechanism to support the growth of MSMEs while addressing environmental and social challenges. The link between sustainable financing, MSME growth, and economic growth in India is multifaceted. Firstly, sustainable financing channels capital towards environmentally sustainable MSMEs. Secondly, sustainable financing addresses the social dimension of MSME growth and enables MSMEs to invest in human capital, create employment opportunities, and then inclusive growth fosters social development. Thirdly, the growth of MSMEs through sustainable financing directly impacts economic growth in India.

LITERATURE REVIEW

Begum, S. & Goyal, R. (2023) examines the impact of inflation on the growth of the MSME sector in India using secondary data analysis. The study implied a correlation test and regression analysis to measure the relationship between inflation, manufacturing growth, and Economic growth and the result showed a negative correlation. Begum (2022) conducted a study to measure the effect of the pandemic COVID-19 on the MSME sectors in India through a literature review using secondary data analysis. The result shows a strong negative correlation between the growth rate of the manufacturing sector and the unemployment rate.

Mahesh KM et al. al, (2022) The study aimed to know the role of sustainable financing on economic growth, the study concluded that the Reserve Bank of India supports projects that adopt the green economy Richa Shelley et al. (2020). The research aimed to verify the role of micro, small, and medium enterprises in the growth of the economy and employment and in the export sector. The study also worked to know the nexus of enterprise growth with sustainable development. The

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study Results showed that the enterprise sector has influential contributions to output, export, and economic growth. Verma, & D.K. (2019) in an attempt to investigate whether micro, small, and medium enterprises have an impact on achieving goals of sustainable development or not. Results of the analysis showed that micro, small, and medium enterprises have decisive contributions to achieving sustainable development goals, like alleviating poverty, economic growth, industrial innovation, and infrastructure.

Babita Jha and Preity Bakhshi, (2019), The paper examine the role of Indian banks in promoting sustainable development in India. The study reveals the various contributions and initiatives taken by public and private sector institutions/banks in India. The paper also presents various challenges in the field of sustainable financing in India. Study of Rashid, M.H.U. Waadin, M.; (2018), aimed to reveal sustainable financing practices by banks and non-governmental financial institutions in the economy, the results show that there is progress in the field of sustainable green financing in the Bangladeshi economy, but it is less than the required standards.

Renwick N, Gu J, Xue L (2018). The study directed attention to cooperation between the BRICS countries and the integration of Africa in the area of interments in the energy of renewable and the promotion of financing projects that adopt investment in infrastructure to confront climate change, sustainable development, and equality in energy. The results of the study analysis show that renewable energy is a promising factor for comprehensive green growth. and promoting the shift to sustainable growth practices and policies.

Parvadavardini & VIVE,)2016) study aimed to verify the concept and practices of green financing and economic growth, and found that sustainable financing is an investment program that takes environmental considerations and promotes welfare and justice in society. Soundarrajan, P., & Vivek N. (2016). The purpose was to shed light on future challenges and opportunities in sustainable financing in the emerging Indian economy. gaps, lack of awareness, and the role of different providers of sustainable finance to focus on transformation, adoption of other production and process technology to maximize energy conservation and support economic growth.

Vinay Kumar (2017) Investigating the effect of MSME growth on overall economic development in India. The projects are complementary to large industries and contribute effectively to economic development by increasing the domestic product, generating work, and exporting. Durrani, A, et al. (2020). A survey was conducted by 18 central banks back in the Asia-Pacific region on scaling up financing sustainability and actions in addressing climate and environmental risks. The results show that this topic is highly significant in the study area. Fernandez, C.I., et al. (2021). The objective is to know the shift towards employing technological developments in the field of green economy and thus promoting growth and sustainable development. The results show that employing technology in the use of sustainable growth has positively affected economic growth.

RESEARCH METHODOLOGY

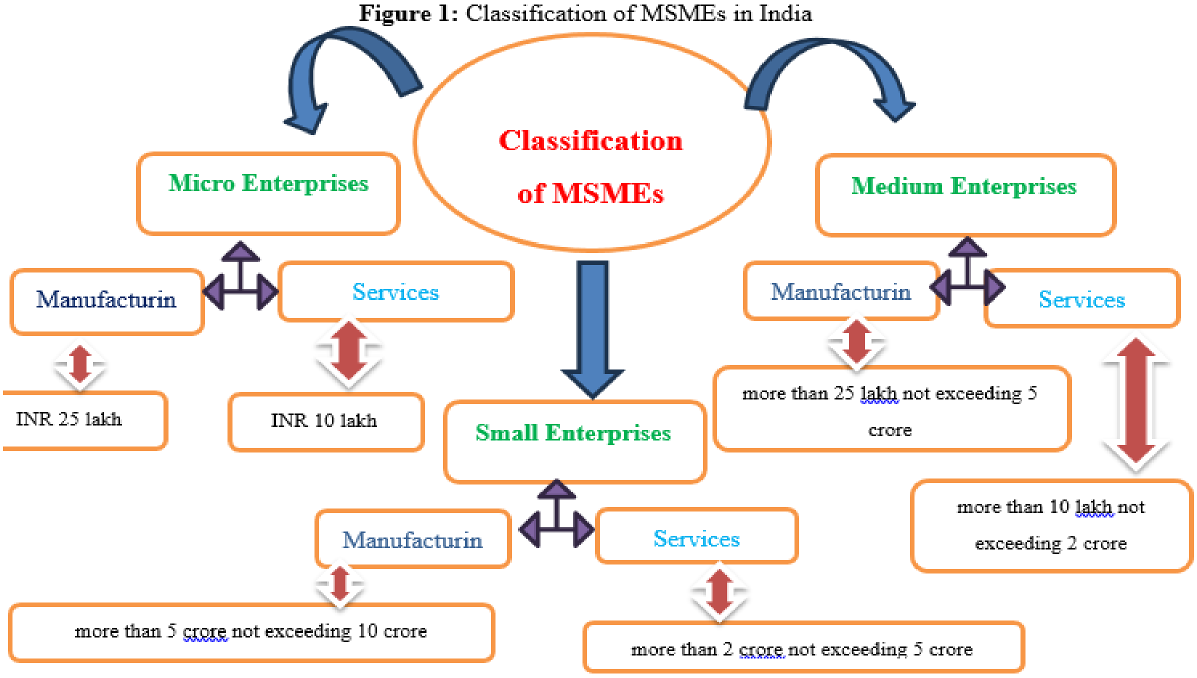
The current study focused on understanding the structure of MSME sectors in India and to analyse the need for sustainable financing in the growth of MSME sectors leading to India's economic growth. The current study is based on both primary and secondary data analyses. The primary data were collected through structured questionnaires from 72 enterprises and secondary data were gathered from several published reports. Descriptive analysis, correlation, and OLS model have been used to achieve the objective of the study. Both SPSS and EViews programs were used as supportive analytical tools.

RESULTS

Structural Framework of the Micro, Small, and Medium Enterprises in India

The classification criteria of MSMEs in India: The sector of enterprises in India has been classified based on the size of the capital for each project into three sectors, the micro-enterprises, small enterprises, and medium enterprises, the same has been depicted in figure 1.

Figure 1: Classification of MSMEs in India

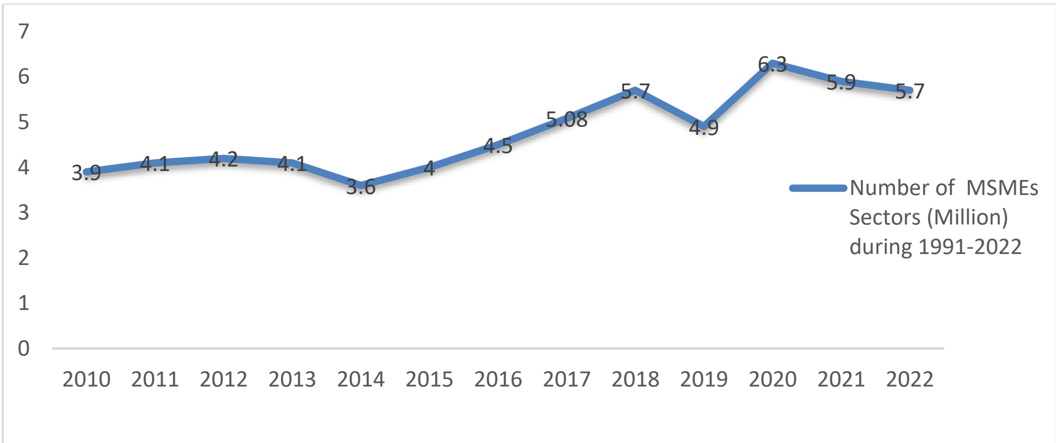


Sources: Ministry of MSMEs

It's important to note that these criteria are subject to change, and it's always recommended to refer to the latest guidelines provided by the government for the most accurate information on MSME classification.

Trend Analysis of the Number of Micro, Small, and Medium Enterprises in India (2010-2022): The growth of micro and small enterprises in the Indian economy has been significant over the years. The sector enterprises played an important impact on the economic development of India by providing employment opportunities, promoting entrepreneurship, and contributing to the growth of the GDP.

Figure 2: Number of MSMEs in India for the period of 2010-2022



Sources: Annual Reports of the Ministry of MSMEs

Through the data presented in Figure 2, it is shown that the number of MSMEs in the Indian economy is growing steadily, and the main reason for the increase in the number of MSMEs is due to the support policies and initiatives by the government to enhance the growth of MSMEs. These include providing financial assistance, access to credit, technology upgrade schemes, infrastructure development, skills development programs, and streamlining of regulatory procedures.

Distribution of the Enterprises based on Demography: The distribution of MSMEs is not uniform and varies based on several factors such as location, industry, and economic development

European Economic Letters
ISSN 2323-5233
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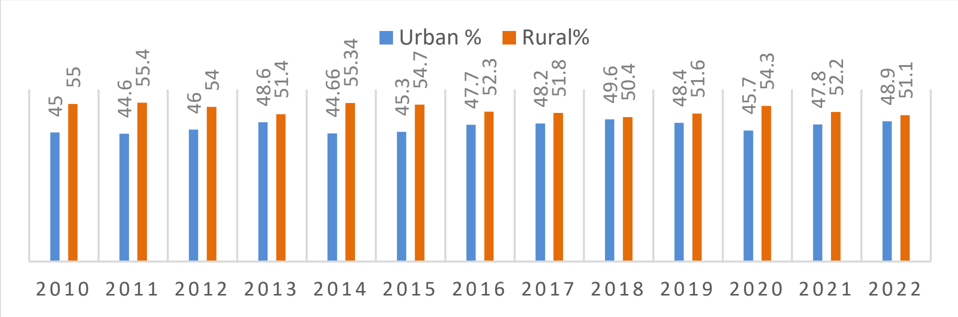
http://eelet.org.uk

Figure 3: Distribution of MSMEs between Rural and Urban Areas

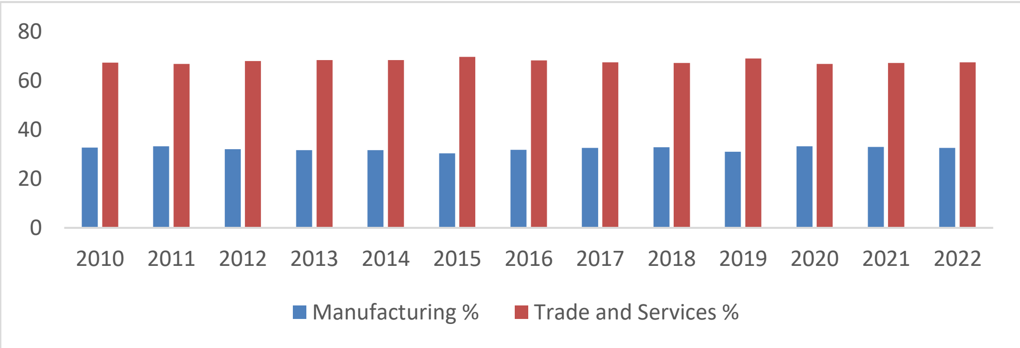


Sources: Annual Reports of the Ministry of MSMEs

Figure 3 shows that most of the projects are distributed in rural areas at a rate slightly larger than in urban areas. Therefore, economic policies and plans work to develop the rural community and improve livelihoods through the establishment of projects that help generate job opportunities in the countryside, thus alleviating poverty and improving the quality of life. Reducing rural migration to cities.

Sector-wise Distributions of Estimated MSMEs: In India, MSMEs are classified into two categories based on the nature of their activity: manufacturing firms and service establishments.

Figure 4: Sector-wise Distributions of Estimated MSMEs



Sources: Annual Reports of the Ministry of MSMEs

Through the data contained in the figure 4, it is clear that the services and trade sector constitutes the largest percentage the interest of enterprises sector, and this can be attributed to several reasons. Shift towards a service-based economy: Many economies around the world have undergone a structural transformation from being primarily manufacturing-based to service-based. This shift by factors like advancements in technology, and changing consumer preferences. The result service sector has expanded significantly, leading to its larger size compared to the manufacturing sector. the manufacturing sector's value-added contribution in individual countries may appear smaller compared to the broader value generated by the service sector.

Role of Sustainable Financing on the MSME's Growth and Economic Growth

Sustainable financing, micro, small, and medium enterprises growth, and economic growth are interconnected and mutually reinforcing. Sustainable financing refers to financial practices and mechanisms that support environmentally and socially responsible initiatives while promoting long-term economic viability. MSMEs, on the other hand, are a critical component of any economy, contributing significantly to employment generation, innovation, and economic growth.

Effect of Sustainable Financing on MSMEs Growth in India

Sustainable financing plays a crucial role in providing capital and resources to MSMEs that adhere to sustainable practices. It involves investment in businesses that prioritize environmental sustainability, social responsibility, and good governance. By providing access to funding and resources, sustainable financing helps MSMEs adopt cleaner technologies, reduce their ecological footprint, enhance their social impact, and improve operational efficiency. This, in turn, can lead to increased competitiveness, market access, and resilience for MSMEs.

The economic activities sector is considered an essential pillar in comprehensive development, as it is one of its most important inputs, through its ability to generate job opportunities, reduce the poverty rate, contribute to stimulating economic growth, and provide local markets with goods and services. However, there are still legitimate questions about the sources of financing for investment in the micro and small enterprise sector and its long-term sustainability.

Funding is considered one of the main pillars on which projects rely to finance their operations and fulfill their current and future obligations in light of the limited financial resources and the growing needs of projects.

Thus, the sources of sustainable financing for micro, small, and medium enterprises in India will be identified, and how this type of financing affects the growth of the sector and thus the overall economic growth or what is called sustainable growth.

Sources of Financing for the Micro, Small, and Medium Enterprises Sector

Sustainable financing is a recent trend applied in the economy to correct the problem of lack of financing and maintain its continuity for the sustainable growth of the micro, small, and medium enterprises sector to achieve sustainable growth in the economy.

Sustainable financing: A set of diverse and stable financial mechanisms that contribute to maintaining the growth momentum of the micro, small, and medium enterprises sector to achieve sustainable economic growth.

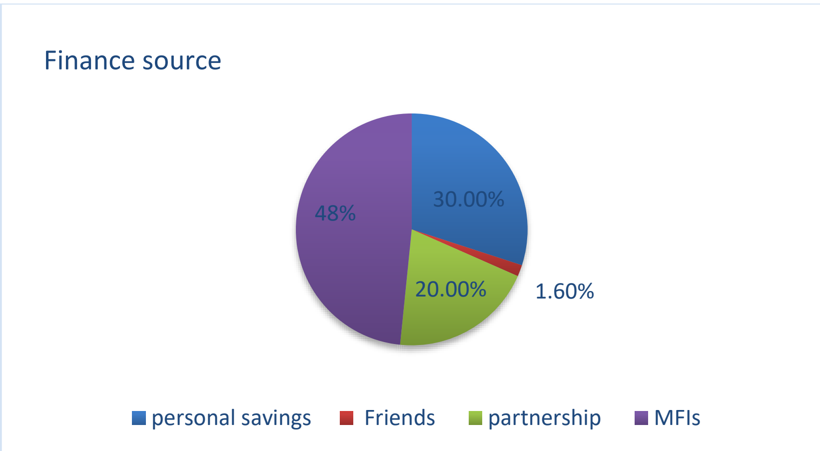
Sustainable Funding Sources: By analogy, sustainable financing can be viewed as identifying different sources of financing, governmental and non-governmental, and working to direct them optimally towards enabling micro, small, and medium enterprises to affect in life individuals and society in a sustainable way.

The main problem facing MSMEs lies in accessing financing sources and their sustainability in light of the lack of financial resources, thus achieving sustainable financial stability in the long term.

The concept of sustainable financing is linked to the diversification of the credit portfolio of the MSME sector, which enhances its growth and positively impacts economic growth. Funding sources for micro, small, and medium enterprises can be identified as follows.

Sources of Sustainable finance	percentage
personal savings	30.00%
Friends	1.60%
partnership	20.00%
MFIs	48.00%

Figure 5: Respondents of MSMEs



Source: Survey Data

Internal Sources: Personal Savings: Many MSMEs start with the personal savings of the entrepreneur or their family members.

Retained Earnings: MSMEs can reinvest their profits to finance their growth and expansion. Friends and Family: Entrepreneurs often raise funds from friends and family members who believe in their business ideas.

Partners' Contribution: In the case of partnership firms, partners contribute funds based on their agreed-upon terms.

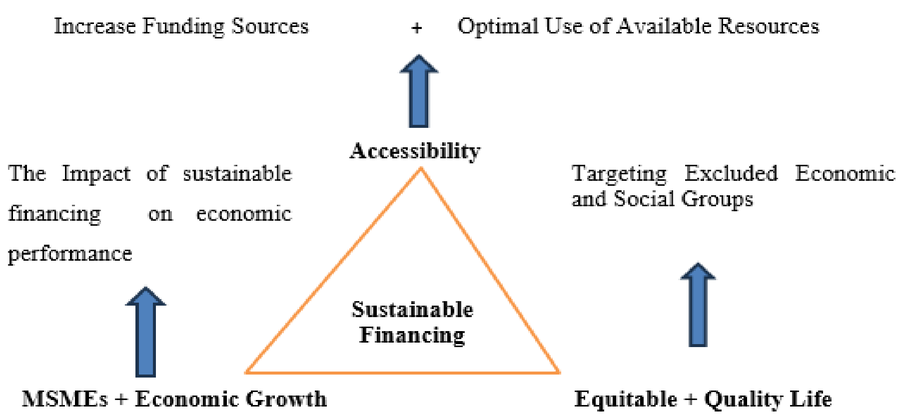
External Sources: Bank Loans: MSMEs can avail themselves of various loan schemes offered by commercial banks, regional rural banks, and cooperative banks. These include term loans, working capital loans, and loans under government schemes like Pradhan Mantri Mudra Yojana. Microfinance Institutions (MFIs): MFIs provide small loans to MSMEs, especially those in rural areas or belonging to marginalized sections of society, without requiring collateral. Non-Banking Financial Companies (NBFCs): NBFCs offer a range of financial products such as loans, leasing, factoring, and asset-based financing to MSMES and Government Schemes.

Inter-linkage between the Sustainable Financing Goals with Development Strategies

Micro, small, and medium-sized enterprises need to increase their ability to respond to an ever-changing economic environment and to adapt to the requirements of the domestic and international markets that are increasingly driven by technology. Therefore, countries that seek to develop the enterprise sector in light of financial constraints need to search for sustainable financing strategies.

The methods of sustainable financing consistent with the objectives of development programs are pivotal when determining the priority of financing, and the makers of financing policies must consider four main objectives, as expanding the scope of benefit by reaching out to the economic and social groups that are excluded from the formal financing sector. Seeking to raise the quality of life for the poorest groups and to promote the growth of economic projects. Promoting social justice through the redistribution of national income. Work on developing sectors of micro, small, and medium enterprises within available resources. The following figure shows linking the objectives of sustainable financing with development strategies.

Figure 6: Objectives of Sustainable Financing



Source: Survey Data

Descriptive Analysis

The dependent and independent variables for the current study are discussed below:

Independent variable

- Financing.

Dependent variables

- Micro, Small, and Medium Enterprises Sectors (Brunt Variable): MSMEs Growth
- Growth rate economic: GDP

Table 1: Descriptive Statistics

	financing	GDP	MSMES
Mean	49.22000	6.800000	5.300000
Median	42.76000	6.800000	5.100000

Maximum	105.8500	9.100000	9.700000
Minimum	15.43000	3.900000	4.100000
Std. Dev.	29.39714	1.477047	1.465151
Skewness	0.456528	-0.252099	2.231616
Kurtosis	2.069531	2.366637	7.473904
Jarque-Bera	0.920532	0.354989	21.63214
Probability	0.631116	0.837366	0.040020
Sum	639.8600	88.40000	68.90000
Sum Sq. Dev.	10370.30	26.18000	25.76000

Source: Output of EViews 10.

Table No. 1 consists of 72 Micro, Small, and medium companies that are supposed to have a loan portfolio from different financing sources, whereas a loans portfolio for MSMEs consists of four main sources: Personal savings, Friends, Partners, and Microfinance Institutions.

The results showed that the main source of financing is from microfinance institutions, personal savings, partners, and friends by a lesser percentage.

The average loan portfolio during the study period reached (4.9%), with the highest value (of 105), with the smallest value (15.4%), with the growth rate of micro, small, and medium projects as a result of financing (5.3%) annually, while the average growth rate of GDP was (6.8) as a result of the growth of the Micro, Small and Medium enterprises sector.

Correlation between Financing with MSMEs Sector Growth, and GDP Growth

Table 2: Correlations Between Study Variables

		GDP	Financing	MSMEs
Pearson Correlation	GDP	1.000	.69	.523
	Financing	.69	1.000	.612
	MSMEs	.523	.612	1.000
Sig. (1-tailed)	GDP	0	.038	.033
	Financing	.038	0	.013
	MSMEs	.033	.013	0
N	GDP	72	72	72
	Financing	72	72	72
	MSMEs	72	72	72

Source: Output -IBM SPSS Statistics

Based on the results of the table, we can describe the correlation between finance and the MSMEs growth in India as a moderately positive correlation and it can be estimated correlation at 61.2%, so when the MSMEs incorporate finance into their operations, MSMEs can improve their competitiveness, access new markets, manage risks, can enhance and contribute to a more and inclusive economy.

The finance variable has a positive correlation with GDP growth, which was estimated at 69%, it's important to know that finance has an effect on economic growth.

The MSME's growth has a potential positive correlation with GDP growth in India, where it was a correlation of 52.3%, so the development, and support of MSMEs through favorable policies, access to finance, skill development, and infrastructure will continue to be crucial for India's and inclusive economic growth.

Estimating the OLS Model for the Impact of Financing with MSMEs Sector Growth and its Effect on economic growth Rate

Table 3: Estimating the OLS Model

Dependent Variable: GDP				
Method: Least Squares (Gauss-Newton / Marquardt steps)				
Date: 07/10/23 Time: 12:30				
Sample: 2010 2022				
Included observations: 72				
GDP=C(1)+C(2)*Finance + C(3)*MSMEs				
	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	0.047291	2.917672	0.016209	0.9874
C(2)	0.018256	0.016341	1.117185	0.0200
C(3)	1.534955	0.664020	2.311610	0.0434
R-squared	0.534260	Mean dependent var		6.815385
Adjusted R-squared	0.225111	S.D. dependent var		1.484838
S.E. of regression	1.307069	Akaike info criterion		3.572626
Sum squared residual	17.08431	Schwarz criterion		3.702999
Log-likelihood	-20.22207	Hannan-Quinn criterion		3.545829
F-statistic	2.743049	Durbin-Watson stat		2.246291
Prob (F-statistic)	0.002277			

(T) values are significant at the level of 5% for each of the variables of the micro, small, and medium projects, and financing. This means that the MSME's growth and finance positively affect GDP growth, where increasing sustainable financing by 1% will lead to increasing GDP growth by 1.8%.

The R-Squared value is estimated at 52%, and this means that the changes in the variables of the estimation model are likely that the interpretation of 52% of the changes in economic growth, while the remaining percentage is due to other factors that have not been introduced into the model.

DISCUSSION

Sources of Sustainable Financing in India

The concept of sustainable financing has occupied the interest of economic policymakers and stakeholders with regard to ensuring that projects requesting financing adopt the idea of bearing aims to refocus financial activities around environmental, social, and governance (ESG) principles as a result of doing business. The concept of sustainable finance is associated with sustainable development and refers to the financing of small and medium enterprises (SMEs), particularly in the agricultural and food sectors or large farmers' cooperatives. They are usually production and manufacturing enterprises. We call this financing sustainable because the companies are either certified under an organic or sustainable program, or we know the financing facility will help the company develop into a sustainable business.

India is actively working on various sources of sustainable financing to support its economic growth while ensuring environmental and social responsibility. It started issuing green bonds with the aim of using the bond proceeds to finance activities of a sustainable nature. Between 2015-2020, it managed to raise more than (16.3) billion dollars and it constituted about 0.7 percent of all bonds issued in the Indian financial market. Some of the major sources of sustainable finance in India include:

Renewable Energy Funds: India is promoting the idea of renewable energy projects through funds such as the National Clean Energy Fund (NCEF) and the Green Energy Corridor project. These fund funds are allocated to finance projects that take into account renewable energy infrastructure development plans, such as solar energy and wind energy projects.

European Economic Letters
ISSN 2323-5233
Vol 13, Issue 5 (2023)
http://eelet.org.uk

Green Bonds: Green bonds are a financial instrument that allows investors to finance environmentally friendly projects. India issues green bonds to raise funds for sustainable initiatives such as renewable energy, energy efficiency, and climate change mitigation projects.

Sustainable Development Goals (SDG) Bonds: SDG Bonds are designed to finance MSMEs whose activities are aligned with the United Nations Sustainable Development Goals. In India, SDG bond issuances have gained momentum to fund projects that tackle poverty, healthcare, education, clean water, and other development goals.

Corporate Social Responsibility (CSR) Funds: As per the Indian Companies Act 2013, companies are required to set aside a portion of the profits on CSR activities. Many companies have directed their CSR funds towards sustainable development projects, including education, healthcare, and environmental conservation.

Impact Investing: Impact investors allocate capital to businesses and projects intending to create positive social and environmental impacts, along with financial returns. India has seen a growing interest in impact investing, which has resulted in funding projects that address issues such as clean energy, waste management, and sustainable agriculture.

Green and Sustainable Banking Initiatives: Some Indian banks have adopted green banking practices, which include promoting sustainable projects, offering green loans, and encouraging environmentally responsible practices among their clients.

Microfinance Institutions (MFIs): MFIs in India provide financial services to low-income individuals and small businesses. Some MFIs focus on funding sustainable projects that promote improved livelihoods, adoption of renewable energy, and environmental conservation.

Venture capital and private equity: Emerging companies are increasingly attracting capital and private equity investments toward projects and sectors that take environmental and social responsibility in their activities.

Government Initiatives and Subsidies: The Indian government offers various incentives and financial aids to encourage sustainable enterprise practices, particularly in the sectors of renewable energy and agriculture.

These sources play the continuous flow of funding for projects that adopt the idea of environment and society, which stimulates sustainable growth and thus sustainable economic development.

Challenges and Issues in Sustainable Financing

Recent literature and international experience indicate that sustainable financing policies are becoming increasingly important over time. Practices in the Indian context have also shown that there is awareness among SMEs in adopting compliance with environmental and social risks in plans to set up new projects or expand existing ones and that the sustainable financing industry is thriving. However, there is still a long way to go to adopt an integrated strategy with regard to sustainable finance in India due to several major issues and challenges:

The high cost of issuing sustainable financing bonds: Despite the guarantee of green financing bonds, their issuance is still high in cost compared to other types of bonds such as government bonds and corporate bonds with the same maturity period due to the uncertainties surrounding this type of investment, as it is often There is a lack of information (lack of identical information) related to this type of investment and the high risks in this type of investment.

Maturity mismatch in green projects: Compared to other types of investments, this type of investment requires longer periods to recover the cost of financing compared to other types of projects because the uncertainty with the length of the recovery period plays a role in raising the cost of green financing.

Lack of a unified definition of the concept of sustainable financing: The lack of a comprehensive and unified definition of the concept of green financing, along with the absence of information and transparency by companies regarding practices of an environmental and social nature, leads to receiving false signals by investors and thus makes the cost of obtaining financing expensive.

Existence of an emerging market for green finance in India: Compared to developed markets, the Indian market is still weak in responding to sustainable financing, as trading of green financing bonds is still on a limited scale compared to other types of bonds, as trading of green bonds began in 2015 and represents about (7%) of the total trading bonds in the Indian stock market, and the total sustainable financing bonds reached (5000) bonds in 2020, and the total proceeds amounted to (5000) billion US dollars in 2018.

Developing the infrastructure for the sustainable financial bond trading market: The bond trading market in India occupies a prominent position among the bond trading markets at the local and global levels, but the sustainable financing bond trading market does not exceed 7%, which explains the existence of great promising opportunities for the growth of demand for this type of bond, for green bond trading industry to thrive requires an integrated approach between investment policies and related initiatives that embrace green bonds at the state level and at the level of India as a whole, removing information asymmetries.

Government Initiatives on Promoting Sustainable Financing

The government of India recognizes the importance of sustainable finance as a tool for shifting towards sustainable development. The government has developed many policies and rules to promote sustainable practices for projects and to link these rules to environmental, social, and governance standards. The rules include obligating micro, small, and medium enterprises to prepare reports and show transparency about the practices of the activities while adopting environmental and social standards in return for obtaining tax exemptions for investment, thus integrating the standards of financing sustainability while achieving the requirements of transparency in the practices of environmentally and community-friendly activities.

The government in India is working to enhance the sustainability of financing through a set of measures, including:

Disclosure: The government adopts mechanisms that accelerate the transition towards a more sustainable and inclusive economy through sustainable financing, linking the requirements for access to sustainable financing by addressing environmental and social issues. With the growth of the sustainable finance industry, it is expected that this industry will have a positive impact on sustainable growth, sustainable development, and building a safer future for future generations.

The government has launched several initiatives with regard to promoting sustainable growth, such as Made in India, Digital India, the shift towards smart cities, and the Atal Mission for urban renewal and transformation. Action programs have been developed for these initiatives that open new horizons for investors toward the transition to sustainable financing. Promoting sustainable economic development tools through sustainable financing provides an opportunity to address climate problems and scarcity of natural resources and to achieve social justice in development.

CONCLUSION

The current study emphasized the importance of sustainable financing in the MSME's growth which will lead to economic growth further. It is evident from the extensive literature review that MSMEs contribute to India's GDP as the sector is one of the major exporters. The relationship between sustainable financing, MSME growth, and the growth rate of the economy is interconnected and mutually reinforcing. Sustainable financing refers to financial practices and mechanisms that support environmentally and socially responsible initiatives while promoting long-term economic viability. MSMEs, on the other hand, are a critical component of any economy, contributing significantly to employment generation, innovation, and economic growth.

Sustainable finance can provide MSMEs with access to capital, capacity building, risk mitigation, market access, and reporting frameworks. By incorporating these recommendations, financial institutions, governments, and other stakeholders can empower MSMEs to grow sustainably, contribute to economic development, and address economic and social challenges.

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