

MSMEs- The cornerstone of India's vision of a \$5 trillion economy



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Micro, Small and Medium Enterprises (MSMEs) form majority of businesses worldwide. In India, MSMEs account for ~30% of India's Gross Domestic Product (GDP) and over 45% of the exports. The heterogeneity in size, nature, market & credit access etc., shapes the uniqueness of the Indian MSME sector. Right from small merchants / artisans to mid-sized manufacturing & exporting entities, MSMEs are at the core of the value chain of Indian economy. These entities, through their operations,

provide employment and livelihood opportunities to millions of people thus impacting, directly and indirectly, the social fabric of the nation. Hence, the sustenance and growth of such entities is not only an economic imperative but also socially significant and relevant.

Aside from the significant contributions at a national level, the MSME sector also fosters a great sense of local community building and are therefore generally seen in clusters in a particular region and industry. These small businesses play a critical role in providing job opportunities to the regional population.

Another dimension of the MSME sector is the vibrant startup ecosystem that has been instrumental in igniting the entrepreneurial spirit of the nation. The success stories of emerging unicorns in India are motivating entrepreneurial ventures, supported by the Startup India initiative of GoI and VC/PE firms providing essential venture / equity funding.

The present economic conditions of recovering domestic economy, India's transformation to a global manufacturing hub, push towards capital expenditure, improving capacity utilisation etc., are poised to position the MSME sector at the centre of the ongoing journey towards a \$ 5 trillion economy. However, the key question that requires to be addressed is how to enable MSMEs achieve their unrealised potential?

'Access to finance'- Key to unlocking the MSME value-

Despite the notable role played by the MSME sector in the development of the Indian economy, several long-standing challenges have impeded the realisation of full potential of the sector, one of which being 'access to finance'. The informal nature of entities puts these small enterprises at a disadvantage in accessing formal finance from Banks and other regulated financial intermediaries. Absence of relevant data/ documents or the minimal data available being disaggregated, conservative outlook of lenders towards the sector with lending largely being collateral

based, relative higher processing times etc., are few of the constraints hindering the integration of informal entities in the MSME sector with formal lending institutions. Further, access to capital markets by MSMEs / listing on SME exchanges is underpenetrated in India that may be on account of MSMEs shying away from growth to continue to avail benefits extended to the sector. Other reasons may include vulnerability to macroeconomic shocks impacting valuations of SMEs and lack of awareness regarding the procedure / processes of listing on exchanges. It is important to make SMEs aware of the advantages of SME exchanges since listing norms for SMEs on these bourses are less stringent and designed to encourage SMEs for listing. Research indicates that SMEs listed in SME exchanges have better profitability ratios, return on assets, Debt-equity-ratios etc., when compared with smallest 25% of firms listed in main board¹.

Apart from the above challenge of access to finance, MSMEs are also challenged by access to markets, ease of doing business, integration with global value chain etc. In this regard, the concerted efforts of Government of India (GoI) in addressing the challenges faced by small businesses are worth highlighting. GoI is reducing compliance burdens by phasing out redundant regulations / paperwork, decriminalisation of minor offenses, permitting self-certification and ushering transparency through technology adoption / digital platforms. The Union Budget, 2023-24 also underscores GoI's intent on facilitating businesses and enabling their unbridled growth. The Jan Vishwas Bill to amend 42 Central Acts, PAN as the common business identifier for all digital systems, Unified Filing Process to obviate the need for submission of repetitive information to various government agencies etc., among other initiatives, are all aimed at facilitating trust-based governance. The recently introduced Foreign Trade Policy is also expected to provide a boost to the MSME sector, supporting its integration with Global Value Chain and strengthening the role and share of MSMEs in India's exports. Innovative solutions pioneered by State Governments such as One District, One Product (ODOP) have also provided necessary push to the exports of the states with MSMEs being key beneficiaries of such initiatives.

Circling back to the key challenge of 'access to finance', one significant achievement of GoI has contributed immensely in reimagining lending to the MSME sector. The foundation laid by GoI in the form of Public Digital Infrastructure- 'India Stack', is a robust and unrivalled digital infrastructure that has promoted innovation in financial services and furthered the agenda of financial inclusion. The various digital rails of India Stack are now the foundation of creative tools being developed for improving flow of credit to the MSME sector. The solutions have not only eased access to credit for the MSME sector but have also enriched the MSME credit underwriting by lenders. Digital lending has promoted faster processing of loans, accelerated digitization and improved efficiency and cost of credit for the MSMEs.

The emergence of Fintechs and the unique tech-based lending model is improving the reach of financial services to larger population and remote areas. Fintechs are actively sourcing New to Credit Customers. Analysis by Credit Bureaus suggest that Fintech companies are catering to MSME borrowers, with credit score <700, when compared with other lenders². The Fintech lending models have also got a fillip from the increasing use of digital payment apps and the growing proclivity of younger generation for e-commerce and online payment solutions. Estimates suggest that India's digital lending market was worth \$ 270 billion in 2022³ and the Indian Fintech market is expected to reach \$1 trillion in Assets Under Management by 2030⁴.

Innovations driven by new-age Fintechs /NBFCs and rapid adoption of digital systems / automation in processes by banks and other financial intermediaries are improving the flow of credit to the MSME sector. For example, leveraging analytics and various digital data points spread across a company's operations, such as credit scores of MSMEs by Credit Bureaus, Goods and Services Tax (GST) returns, Income Tax returns, transaction data from UPI / PoS terminals, sales via e-commerce platforms, etc., a 360-degree view of a MSME borrowers is achievable. Additionally, due to advanced data analytics supported by the use of AI/ML and the digital pathways mentioned above, financial institutions are moving to scorecard-based risk assessment of MSME borrowers enabling objectivity and increasing the efficiency of lending to the MSME sector. Such an approach has sparked renewed interest in lending to the MSME segment, which has traditionally been viewed as risky by lenders.

GST returns offer rich data and can be instrumental in bridging the information asymmetry for the MSME sector. Data analytics for cashflow assessment of MSMEs basis GST has enabled quick turnaround of loans for MSMEs. Another advantage of the fast-growing digital lending landscape is the extension of financial products via non-financial platforms i.e., embedded finance. Bigtech / large e-commerce platforms can analyse the inventory, receivables etc., to extend finance to small businesses through lending partners. It is estimated that embedded banking for SMEs could capture up to 26% of global SME banking revenue by 2025⁵. Also, embedded finance options have the potential to push up sales / revenue of businesses including MSMEs.

However, digital financial services are relatively easily accessed by larger MSMEs that are filing GST and / or IT returns and have bank statements. The informal sector (that forms a substantial portion of the MSME sector) faces challenges in connecting with formal institutions and reaping the benefits of such technological advancements. The percolation of the digital payment services i.e., UPI to remote areas, lower income groups, merchants, street vendors etc., is providing headway in breaking the information asymmetry challenge for the informal MSMEs. For instance, PMSVANidhi scheme of Gol for extending credit to street vendors provides for incentives for undertaking digital transactions by street vendors, thus nurturing the connect of such businesses with digital ecosystems. The Fintech / Bigtech / Neo-banks are leveraging data of UPI / QR code payments to extend credit facilities to the merchants. Going forward, the

expansion of the scope of UPI by permitting operation of pre-sanctioned credit lines at banks through the UPI can contribute to the growth of businesses, including small enterprises. For instance, the proposed credit lines shall not only provide boost to the customer / retail purchases, the same can also become a medium for easier purchase of raw materials, bridge working capital requirements etc.

The Open Credit Enablement Network (OCEN) & Account Aggregator (AA) framework shall be other significant additions to the layers of India Stack. These additions shall enable formal credit to flow at a relatively faster pace to the most vulnerable groups, particularly small businesses, with shorter repayment periods if desired. These platforms shall also provide financial institutions with an opportunity to reach large groups at lower cost of services / distribution. The Open Network for Digital Commerce (ONDC) is also providing opportunities to small entrepreneurs to participate in booming e-commerce space thus eliminating barriers to entry. With ONDC facilitating all service providers at one place including logistics services, the platform truly possesses the potential to revolutionise digital commerce, both domestically and internationally. The trifecta of AA framework, OCEN and ONDC can intensify the integration of small entrepreneurs into the formal lending and market environments, thereby reducing operating costs.

The support provided by Gol to the Indian startup ecosystem has positioned India as the third largest startup ecosystem in the world, behind USA and China. Gol initiatives such as Fund of Funds for Startups (FFS) of DPIIT, Self-Reliant India Fund, Startup India Seed Fund Scheme, Credit Guarantee Scheme for Startups etc., have led to the flourishing startup ecosystem. SIDBI has also been creating an enabling ecosystem for startups through support to venture capital funds and new fund managers, focussed on MSMEs and startups. The SIDBI Fund of Funds for Startups of DPIIT, Gol, amounting to Rs 10,000 crore has transformed the landscape of startup and Venture Capital ecosystems by catalyzing four times that amount through the AIFs. SIDBI has also developed the Startup India Investor Connect Portal to bring together startups and investors on a single platform, thus democratising access to finance by startups located anywhere including Tier 2 cities and beyond. The Bank is also working towards filling the funding gaps in pre-seed / ideation stage startups in collaboration with incubators. The Bank has also initiated a Venture Debt program for startups having funding needs between two rounds of equity capital / in need growth capital without significant dilution.

SIDBI at the forefront of digital interventions for MSMEs-

SIDBI has been a leader in developing several digital interventions / platforms for facilitating finance and other services for the MSME sector. Initiatives such as StandUp India Portal, Udyamimitra Portal, 'PSBLoansin59minutes' and TReDS platform, facilitate credit and handholding support to various sections of the MSME sector.

In recent past, SIDBI has pivoted towards digital lending and is repositioning itself to become a leader in tech-driven solutions for the MSME sector. SIDBI has delivered several digital interventions aimed at the diverse

needs of the MSME ecosystem. Few of these recent digital initiatives are-

i. **Formalisation of Informal Micro Enterprises (IMEs) through Udyam Assist Platform (UAP)-**

The aspirations of enhancing MSME contribution to GDP and exports necessitates integration of micro / informal entities with formal channels that can be achieved through digitalisation. In a bid to enable formalisation of the high informality present in the MSME sector, MoMSME and SIDBI launched the Udyam Assist Platform to enable formalisation of Informal Micro Entities (IMEs) and establish credit & market connect for such enterprises. IMEs with an Udyam Assist Certificate shall be treated as Micro Enterprises under MSME for the purposes of PSL classification. Formalisation of informal sector is expected to bring them within the reach of institutional finance and various Government schemes. The platform has already facilitated registration of over 30 lakh IMEs. There is potential to extend Udyam registration to more than 6 crore IMEs.

SIDBI is also working on extending working capital/revolving credit through UPI to the IMEs registered through the UAP. The same is likely to establish stronger credit connect with formal credit institutions apart from creating digital trail for the beneficiaries and would pave way for growth of IMEs.

Formalisation project would have multiplier effect on IMEs resulting in exponential growth of these IMEs and much higher contribution towards national GDP.

ii. **GST Sahay Project-** SIDBI, in association with

Online PSB Loans Ltd (OPL) and iSPIRT, has developed a reference GST Sahay App using the Open Credit Enhancement Network (OCEN) and Account Aggregator (AA) frameworks for providing 'on tap' invoice-based financing (cash flow based) for small value credit to micro enterprises. The app journey is paperless and covers the entire credit life cycle from origination to repayment. It uses trade information from GSTN, Bank information through AA, Credit bureau status, etc., and also other components of India Stack like e-sign and e-stamping, e-NACH mandate, etc. to achieve paperless process. Collateral free/unsecured small value loans to Micro Enterprises basis GST invoices will encourage more and more Micro enterprises to come under GST framework and would result in growth of the Micro Enterprises.

iii. **FIT (Finance, Income and Trade) Rank-** Under the mentorship of SIDBI, CIBIL along with Online PSB Loans Limited (OPL), have launched FIT rank

leveraging the power of GST, Bank Statements, and Income Tax returns (ITR) information to provide a ranking model for MSME lending. The ranking model uses machine learning algorithms to arrive at probability of an MSME becoming a non-performing asset (NPA) in the next 12 months based on its financial, income, and trade data on a scale of 1 to 10 with FIT Rank 1 for the least risky MSME and FIT Rank 10 for the most at-risk MSME. Each FIT rank corresponds to a Probability of Default (PD) and the higher the FIT Rank, the lower is the PD associated with the MSME.

FIT Rank triangulates information from multiple sources to provide a unified view of financial, income and trade data for an MSME, enabling improved risk differentiation and sharpened credit underwriting for MSME loans. SIDBI has recently introduced credit product basis the FIT Rank to accord sanction through a Straight Through Processing mode. This is expected to further boost digital lending and flow of credit to the MSME sector. FIT Rank would improve the quality and speed of extending credit thereby enabling growth of MSMEs.

The above interventions of SIDBI, and several other interventions under development, are expected to improve the credit flow to the underserved / unserved MSMEs and give impetus to their growth. These interventions shall play a pivotal role in making informal / small entities key players in the vision for the Indian economy.

Unlocking access to finance for MSMEs shall be key in enabling MSMEs to become the cornerstone of the \$5 trillion economy. The ongoing digital revolution along with the commitments of GoI to enhance ease of doing business shall be fundamental in channelising large scale investments for economic development of which the MSME sector shall be one of the key beneficiaries. Further, the continuous need-based improvements in the credit dispensation processes of MSME sector shall also enhance the flow of credit and production capacities of the MSMEs.

We are witnessing a point of inflection in lending towards the MSME sector. Technology has been the fulcrum in altering the perception towards financing MSMEs. However, the benefits of such movements are yet to be absorbed fully by the sector, particularly by the informal micro enterprises. Therefore, conscientious efforts need to be undertaken and encouraged to reach the enterprises operating in the farthest corners of the country. Towards this end, SIDBI stands committed to innovate and undertake interventions to reach the last mile and support the MSME sector that forms the bedrock of the nation.

¹ SME Exchanges in India: Empirical Analysis of Firm Attributes and IPO Characteristics | RBI Working Paper Series

² Fintech-led Digital Lending: Coming of Age | Experian

³ Invest India

⁴ Seven Key Trends shaping the future of FinTech Industry | EY

⁵ Embedded finance for SMEs | Accenture