

## ACCESS TO CREDIT FOR INDIAN MSMEs

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Today, India's MSME sector is made up of millions of enterprises. Not only is this poised as the growth engine of the country's economy, but it also provides large-scale employment in rural and urban areas. This stance is further strengthened by the Government's various financial inclusion schemes such as the [Budget 2019's](#) additional benefit for GST-registered MSMEs. Pegged at an allocation of INR. 350 crores for 2% interest subvention, applicable for fresh as well as incremental loans, this is bound to usher in a monumental change in the sector. However, the MSME sector still faces a wide credit gap, primarily due to the lack of awareness amongst MSMEs about loan opportunities and credit eligibility. A study commissioned by the International Finance Corporation (IFC) pegs this gap to be a whopping [INR. 16.66 lakh crore](#), with more than [80%](#) of MSMEs not receiving any formal financing. As MSMEs gear up to avail government schemes and capitalise on loan offers, they need to be made aware of their [opportunities to access funds](#) within the formal lending landscape. Earlier, banks and non-banking financial companies considered it risky to lend money to MSMEs. Lenders expected small businesses to showcase strong financial structures, diversified businesses and long-term goals. These were difficult for MSMEs to present, especially because they lacked formal accounting systems or even securities to offer as collateral. MSMEs couldn't demonstrate themselves as being as credit-worthy as large enterprises.

Credit bureau records exist for three types of borrowers. First, commercial borrowers that get loans as legal entities (proprietorships, partnerships and private firms). Second, consumers who get individual loans. And third, micro-finance borrowers. By TransUnion Cibil data, there are 9 million unique commercial borrowers. Further, there are an estimated 14-16 million consumers with commercial-vehicle and business loans. These seem to be MSMEs. According to MFIN, there are 58.3 million unique micro-finance borrowers. Industry experts suggest that at least 25% of them are MSMEs. Thus, 34-36 million MSMEs already have access to formal credit.

India's 27-29 million MSMEs without any access to formal credit form the long tail of MSME credit demand. Such borrowers may be expected to have, at best, the debt capacity of an average micro-finance borrower, which is about ₹30,000. This translates to credit demand of no more than ₹1 trillion. Recall that borrower intent is a major driver of closing the estimated credit gap of ₹8-15 trillion.

## Paving the way for faster access to loans for MSMEs

The micro, small and medium enterprises (MSMEs) have played a significant role in the India growth story as reflected in the share of the total credit growth the MSME industry has seen lately. The latest MSME Pulse Report jointly published by TransUnion CIBIL and SIDBI in **March 2019** shows that the MSME sector's credit exposure (as of December 2018) now constitutes 23% of the overall exposure to businesses

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Given the importance of MSMEs to India's economy, we cannot take forever to solve it. We need coordinated efforts by stakeholders such as the government, lenders, credit bureaus, fintech players and various voluntary groups. There is a cautionary tale in India's efforts to develop a corporate bond market (CBM). It has been almost two decades in the making, and everything from credit default swaps to interest derivatives were thrown in to achieve it, but with limited impact. To ensure that MSME lending does not go the way of our CBM, efforts must be directed at solving well-identified problems. A 'hammer looking for a nail' approach of force-fitting available solutions to misunderstood problems will not work. So that we do not misallocate stakeholders' resources, let's first try to size up and understand the MSME-funding problem.

But that tide is quickly changing. Because of a growing need for credit in order to help them grow and expand, MSMEs realise that they need to demonstrate a healthy past credit behaviour in order to get bigger loans from lenders.

Following points can be noted for better information and deep analysis to access to credit -

1. **Credit access is better than widely perceived:** As per the MSME ministry, India has 63.3 million MSMEs. The upper end has firms with revenues of above ₹250 crore. The lower end has single-person operators like grocers and everything in between from commercial vehicle owners to village craftsmen. Popular narratives suggest that only 6-10 million MSMEs have formal access to credit, but there is much to suggest that this might be an under-estimate.
2. **MSME credit gap:** Among MSMEs with credit access, the formalization of their balance sheets would be a major driver of credit growth. While sourcing bank loans, many MSMEs also borrow from informal sources for their 'cash' transactions. Formal accounts only have transactions captured by goods-and-services-tax data systems. Greater formalization could see MSME demand for formal credit jump by 30-50% (i.e., by ₹8-15 trillion), though this will have to be largely driven by a regulatory push and the intent of borrowers to avail formal loans.

3. **New-to-credit (NTC) MSMEs**: The problem they face is longer timelines for loan approval more than outright rejection. According to a report published by TransUnion Cibil, India adds 0.6-0.8 million NTC commercial borrowers each year. Even for products such as business loans (usually unsecured), an estimated 20-25% are NTC who get credit on the basis of tax return documents and bank statements. Large lenders as well as some fintech firms with proven techno-analytical abilities to use this data, plus alternate data, to underwrite loans. To the extent that lenders have to consider fraud and credit risk, field investigations are a critical aspect. The efficiency in offering loans to new borrowers depends on the lender's level of sophistication.
4. **Some need to renew focus, while others need to refocus and recalibrate**: Available credit and know-your-customer information is leveraged by avante-garde lenders to digitize the process of lending to MSMEs. Thus, the speed of approvals and quality of decisions are driven by their investment in digital systems.

While the available credit data infrastructure can surely be enhanced, its current state is not a constraint in itself. However, the range of MSME loan products needs to widen. Loan products of tenures less than 3-6 months are usually unavailable to them, for example. MSMEs need a wider set of credit options. Small businesses also tend to lack collateral to put up for loans. Leading Indian non-banking finance companies have been successful in unsecured business lending. However, for banks to move en bloc towards unsecured business lending would require greater regulatory encouragement.

5. **50.7 million MSMEs in India have no access to formal credit: ACCA report**

A decline in economic activities during lockdowns has threatened business continuity for many small businesses, making MSMEs one of the worst-hit sectors. Despite the government announcing several measures to enhance credit availability to stressed MSMEs, nearly 50.7 million enterprises (80 per cent of the 63.4 million MSME's in India) lack access to traditional lending channels, a report from the Association of Chartered Certified Accountants said. ACCA noted that the credit gap of USD 380 billion (as per the WHO estimates) for Indian MSMEs has significantly increased in the last five years. Credit from Non-Banking Financial Corporations (NBFC), which significantly contributed to the growth of the sector, had dropped by 30 per cent as on March 2019.

The COVID-led decline in the revenues across sectors now poses an existential crisis for many businesses, impacting their viability for next 6-12 months with the shortage of capital flow as the main challenge, ACCA's Global COVID Survey 2020 pointed out.

A decline in economic activities during lockdowns has threatened business continuity for many small businesses, making MSMEs one of the worst-hit sectors. While the existing challenges have significantly worsened, new problems noted. It added that non-essential businesses have taken a worse hit during the lockdown, with many opting for loan moratoriums announced last year.

Due to the lack of access to low-cost formal credit from traditional sources, MSMEs operate out of what is referred to as India's shadow economy, where they are funded by informal sources such as friends and family, or moneylenders who often charge high rates of interest or fail to maintain proper records.

The absence of credit history, especially for New to Credit (NTC borrowers, makes it even more difficult for small businesses to receive funding, thereby widening the sector's credit gap. the research report pointed out.

## **6. Fintech or Alternative Lending models**

Fintech or Alternative Lending models that leverage technology to utilize alternative data such as GST (Goods and Services Tax) that allows an insight into business parameters such as inputs, value, place of business, amount of taxes levied to derive information about business book size, assess financial risk appetites and gauge capacity to service further debt obligations. Utility bills, bank account statements are some other data points that are used.

Fintech lenders offering invoice financing as a short-term working capital facility based on unpaid invoices of MSME clients/customers to help in solving liquidity related challenges in the short term.

Peer to Peer (P2P) lending model that is a digital marketplace connecting borrowers with lenders allowing quick access to low cost loans.

Cluster financing model approach to lending is intended to provide a full-service approach to cater to the diverse needs of MSME business units operating in a particular region and within a distinct, well defined business cluster such as leather making or food processing. Financial service providers have been using this approach to identify clusters and organize them by similar data points that allows for predictability around businesses' capacity to service debt, risk profiles and product needs.

Traditional microfinance business models implemented by NBFC (Non-Banking Financial Companies) MFIs (Microfinance Institutions), Small Finance Banks using Joint Liability Group (JLG) model, to provide collateral free loans to low income segments primarily from the micro and small enterprise categories. The JLG model is also primarily constituted by women members of the households that operate the enterprises seeking credit from financial institutions.

## **7. MSMEs' Access to Credit Now Easier Than Ever Before**

In India, the CIBIL Rank & Company Credit Report (CCR) indicates a company's creditworthiness and helps lenders evaluate an entity more objectively. A high CIBIL Rank might mean better interest rates and faster turnaround time from some lenders.

The CIBIL Rank summarises the Company Credit Report (CCR) — a record of a company's credit history based on data submitted by lending institutions across India — in one number. It places a business' financial health on a scale of ten to one, with one representing the highest chances of securing a loan. Among companies that have been sanctioned loans, about 70% had a CIBIL Rank between four and

one. Currently, CIBIL Rank is available for companies with current credit exposure between Rs 10 lakhs and Rs 50 crores.

CIBIL Rank & CCR has the potential to make formal lending to MSMEs a smoother process for both borrowers and lenders. It is facilitating faster loan approvals and discounted interest rates for MSMEs with a good Rank. So, how can MSMEs maintain a healthy CIBIL Rank?

Taking only as much loan as required can help a company steer away from debt traps that can negatively impact credit health. Further, paying back creditors on time and avoiding defaulted or late payments can go a long way in showcasing financial discipline. It is important to keep monitoring the company's credit health regularly to ensure credit access whenever required.

#### **8. We must study the MSME credit gap before we can fix it**

In this growing economy, driving MSMEs' access to formal sources of finance at affordable rates is an imperative, but lending institutions are still apprehensive about the commercial viability of a loan, and the resulting information asymmetry impacts the turnaround time in obtaining finance. Thus, MSMEs in need of immediate finance are forced to explore other sources for access to credit.

In an endeavor to correct this information asymmetry and anomaly, TransUnion CIBIL had launched the CIBIL Rank in March 2017. The Rank is a part of the Company Credit Report (CCR) — a summary of a company's credit profile. While the CCR is available for all commercial entities which have borrowed from the formal lending industry, the Rank is only available for those entities whose overall exposure is in the range of INR 10 lakhs - INR 50 crores. The Rank is based on 24 months of account history data (shared by different lenders), which provides unbiased insights pertaining to the credit behavior of MSMEs, so that other lenders can evaluate a business entity more objectively, efficiently and consistently.

The ranking is broadly influenced by the following parameters:

- 1. Repayment Behavior**
  - a. Timeliness of past payments
  - b. Amount overdue
  - c. Delinquency status
- 2. Liquidity Profile**
  - a. Rate of utilization of funds
  - b. Missed payments
- 3. Firmographics**
  - a. Vintage of credit relationships (with any lender)

Business owners can now check their company's CCR and Rank to get started:

1. Fill in the details as required in the form such as name and address of the company, contact details of the company and applicant, PAN number and other details and additional information.
2. Make a payment of Rs 3,000 via debit/credit card, net banking or cash card.
3. After making the payment, CIBIL assigns a unique Registration ID and Transaction ID which will be mailed to the registered email ID. The ID can be used to access the next steps.
4. Upload KYC documents.

Not only is the Rank solving the information asymmetry conundrum, but is also helping lenders make unprejudiced credit decisions while ensuring eligible MSMEs have a cheaper and faster access to funds. State-owned lender, Bank of Baroda, recently announced a pioneering move in facilitating credit at lower interest rates for MSMEs who have a good Rank. This innovative risk-based pricing of loans will not only drive access to cheaper finance, but will also control the quality of portfolios for banks and credit institutions.

An MSME business' growth strategy and expansion plans depend on the company's access to credit. This, in turn, is influenced by their credit ranking, thus rendering the CIBIL Rank as **the** rank that lenders and MSMEs can bank on.

