

MSMEs: Catalysts for India's Viksit Bharat \$5 Trillion Economy Goal



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Micro, Small, and Medium Enterprises (MSMEs) hold a vital position in the Indian economy, with approximately 63 million enterprises, growing at a projected compound annual growth rate (CAGR) of 2.5% to reach 75 million in coming years and contributing around 30% to India's Gross Value Added (GVA). The total addressable credit gap of MSMEs in India was estimated to be INR 26 trillion in 2018 by the World Bank/IFC. However, MSME credit

penetration in India stands at about 52% and is lowest among its Asian peers — China (185%), South Korea (175%), and Vietnam (126%), representing a supply of approximately INR 14 trillion in formal credit. Nearly 48% of the debt demand from MSMEs was estimated to be un-addressable. This is primarily because many of these businesses are not financially viable, or they prefer being funded by non-transparent informal sources that end up charging high rates of interest. To bridge the financing gap, India can aim to increase credit penetration to over 80%. Historical trends are favorable, with annual ground-level credit disbursement to the MSME sector growing at a healthy CAGR of 12-15% between FY15 and FY23. Nonetheless, MSMEs face significant challenges, such as access to formal credit and delayed payments, leading to working capital issues.

Key Interventions and Enablers

To overcome these challenges and enable MSMEs, several key interventions and enablers can be implemented:

Collaboration with Financial Institutions

- **Sector-specific Cash-flow Based Lending Products:** Collaborate with financial institutions like NBFCs, fintech companies, and MSME-focused organizations to create lending products tailored to specific sectors.

Adoption of Account Aggregator and Open Credit Enablement Frameworks

Data-backed Unsecured Credit: Out of the total of 63 million MSMEs in India, approximately 12%, or around 7.7 million, are considered digitally mature brands, while the remainder is at varying stages of digitization.

- Promote the adoption of the Account Aggregator framework and Open Credit Enablement framework to facilitate the delivery of data-backed unsecured credit to MSMEs.

Leveraging Cooperative Banks

- **Capitalizing on MSME Credit Schemes:** Utilize the extensive network of cooperative banks to capitalize on MSME credit schemes like the Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) and Pradhan Mantri MUDRA Yojana (PMMY).

Policy Mandates for Trade Receivables Discounting System (TReDS)

- **State Government and PSU Purchases via TReDS:** Implement policies mandating state governments, state PSUs, and Urban Local Bodies to use TReDS for purchases. Encourage large state-based corporates (with turnover exceeding Rs. 500 crore) to onboard TReDS.

Short-term Unsecured Credit Access

- **Credit Card Programs with Subsidized Interest Rates:** Enable micro and small enterprises to access short-term unsecured credit through specialized credit card programs with subsidized interest rates, such as weaver credit cards modeled after the Kisan Credit Card.

State-level Credit Guarantee Funds

- **Focus Sectors and Themes:** Establish state-level credit guarantee funds targeting specific sectors (e.g., food processing, textiles), segments (e.g., women-owned enterprises), and themes (e.g., technology upgradation, sustainability) in partnership with development finance institutions like NABARD, SIDBI, and ADB.

Ease of Doing Business

- **Formalization of Micro and Small Enterprises:** Drive the formalization of micro and small enterprises through GST registration and Udyog Aadhaar to make financing more accessible.
- **Data and Technology Infrastructure:** Create robust data and technology infrastructure for seamless KYC, onboarding, and transferring benefits, such as establishing DigiLocker for MSMEs for easy authentication.
- **Digitization of Records:** Accelerate the digitization of records for various physical assets (e.g., land, property, vehicles) to enable digital verification and lien marking.
- **Skilling Support:** Provide skilling support to MSMEs to draft business plans, access credit, and achieve post-credit business success, thereby instilling confidence in financial institutions to lend further.

Addressing Working Capital Needs

More than 70% of the finance requirement by MSMEs is for working capital, which is typically required on-demand,

has shorter tenures, and involves lower amounts. However, less than 25% of MSMEs are formally registered, with a significant portion operating in the retail sector. This makes it challenging for banks and other lenders to ascertain creditworthiness and extend loans without collateral or other guarantees. Providing MSMEs digital lending and alternative need-based financing options such as supply chain financing, invoice discounting, securitization of MSME credit, and cash flow-based lending are some of the key ways of improving access to working capital for this sector.

Proposed Solutions for Working Capital Finance

- **Streamlined Credit Assessments:** Develop and adopt streamlined credit assessment processes that utilize alternative data sources, such as transaction history and digital payment records, to evaluate the creditworthiness of MSMEs.
- **Digital Lending Platforms:** Enhance digital lending platforms to provide quicker and more efficient access to working capital loans, reducing the reliance on traditional collateral-based lending.
- **Flexible Loan Products:** Design flexible loan products that cater to the unique needs of MSMEs, offering shorter tenures and lower amounts to match their working capital requirements.
- **Government-backed Guarantees:** Expand government-backed guarantee schemes to cover a larger portion of working capital loans, mitigating the risk for lenders and encouraging more credit flow to MSMEs.

MSMEs are pivotal to India’s ambition of becoming a \$5 trillion economy. By focusing on key interventions and enablers, including collaboration with financial institutions,

adoption of digital frameworks, leveraging cooperative banks, policy mandates for TReDS, short-term credit access, state-level credit guarantee funds, and ease of doing business initiatives, MSMEs can overcome existing challenges and contribute significantly to economic growth. A concerted effort involving government support, regulatory reforms, and private sector innovation is essential to unlock the full potential of MSMEs in driving India’s economic progress.

UGRO Capital understands this and resonates deeply with its belief that ‘**MSME Accha Hai**’. As a DataTech Lending platform, is dedicated to “Solving the Unsolved” small business credit gap in India through its extensive distribution reach and data-tech approach. The company’s strength in data analytics and robust technology architecture enables the creation of customized sourcing platforms for each channel. Key initiatives include the GRO Plus module, which has revolutionized intermediated sourcing, the GRO Chain supply chain financing platform with automated end-to-end approval and invoice flow, the GRO Xstream platform for co-lending with upstream and downstream integration with fintechs and liability providers, and the GRO X application that delivers embedded financing options to MSMEs. The credit scoring model, GRO Score (3.0), utilizes an AI/ML-driven statistical framework to risk-rank customers, revolutionizing MSME credit by providing on-tap financing similar to consumer financing in India. UGRO has successfully implemented the co-lending model prevalent in the West through partnerships with over 10 large public sector banks and NBFCs, building a substantial off-balance-sheet asset base of more than 46% of its AUM via the GRO Xstream platform. By the end of FY24, we have serviced over 100,000 customers, reached an AUM of 9000+ crores and aim to capture 1% market share over the next three years.