Innovations in MSME Financing: Creating Credit History, a Pathway?
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Overview

The Micro, Small and Medium Enterprises (MSME) sector is crucial to the Indian economy. As per the latest MSME annual report by the Ministry of MSME, the size of the sector is 361.76 lakh units, of which 55.34% units are based in rural India. Indian MSMEs provide employment to 805.24 lakh people, and contributed 37.54% to GD in 2012-2013. Moreover, the MSME sector has shown consistent growth over the last few years as shown below:

Challenges for MSMEs to Borrow

The financing needs of the sector depend on the business size, customer segment, and industry and how established the business is. MSME’s tend to rely heavily on debt financing during their starting and growth phases. Though there are many institutions and schemes in place in India to help promote MSME growth, financial institutions still perceive MSME’s as high-risk borrowers. As of 2012-2013, there is a total financial requirement of INR 32.5 trillion in the MSME sector. Formal sources cater to less than one fourth of total MSME debt financing. Of the overall finance demand of INR 32.5 trillion; 78% is either self-financed or from informal sources. Formal sources cater to only 22% of the total MSME debt financing. The sector’s demand for credit is highlighted in the flowchart.

One of the main reasons formal lending institutions perceive MSME’s as high-risk is their lack of credit history and identification documents. One of the schemes implemented by the Indian government in 2005 provides financial assistance to fund a proportion of fees by credit rating agencies that score MSME’s on their credit worthiness. The benefits of this scheme are two-fold – it aims to create awareness amongst MSME’s on their strengths and weaknesses and thus enable them to assess their position in the market, secondly, it helps assess credit worthiness and
recognize how to improve on this. This facilitates them to access credit at cheaper rates and on easier terms by increasing their acceptability with banks, financial institutions, customers/buyers and vendors. In the period from 2005-2015, over 1.10 lakh MSME units\(^3\) have been rated under this scheme. As for the lack of identification documents, there has been a push by the government for MSME’s to register themselves under the Udyog Aadhaar scheme. As of December 2016, over 57 lakh unit MSME’s have registered\(^4\).

**Technology Innovations in MSME Financing**

The use of mobile Internet and smartphones has seen tremendous year on year growth in the past couple of years. Yet, the level of penetration is low, especially in rural areas. It is estimated that only about 9% of the rural population has access to mobile Internet, whereas, 53% of the urban population does\(^5\). The MSME report indicates 45% of MSME units are in urban areas. This provide a large number of customers who can be targeted in the short-run by digital wallets, data captured via smart phones, technology innovations in MSME financing which result from tie-ups between lending institutions and technology providers.

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**Digital footprint based lending**

- **Lenddo**, a credit assessment financial technology company that uses smartphone tracking is expanding its rating services to include microfinance institutions (MFIs) in India. This will cover individual MFI customers who live in urban areas and have an android phone. As an MFI officer uploads the customer’s information, the customer receives a text with a loan application link. Once the customer downloads the application and agrees to share data, Lenddo analyses the customers contacts, SMS’s, call history, and browsing behaviour to give the customer a credit rating which is then shared with the MFI.

**Alternate Data to evaluate credit worthiness**

- As in India organized lending is available only to a lucky few mainly those with high CIBIL scores, India Lends promises to change this by using various relevant data points such as bank transactions, utility payments, etc. to build a comprehensive credit score, even for those who have no previous lending or credit card history. This helps borrowers with no previous access to formal lending to access the formal system.

**Overcoming lack of KYC documents**

- **Swadhaar FinAccess** has facilitated the link between Axis Bank and Airtel Money wherein customers can perform a variety of financial transactions – deposits, withdrawals, and loan repayments through the Airtel Money wallet on their smart phone. The KYC norms on this product are more lax than those with commercial banks. This is especially useful for MSME’s in the unorganized sector that do not have proper KYC documentation.

**Flexible repayment terms**

- **NeoGrowth** focuses on MSME’s, specifically merchants and retailers. It uses a Merchant Cash Advance (MCA) model to target MSME’s wherein it provides credit to merchants in exchange for an agreed upon percentage of future sales made via credit card/debit card. The repayment of the loan depends on the turnover of the MSME’s daily credit/debit card sales. According to their report, 21.4% clients were introduced to the formal credit system for the first time.

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While borrowers in urban areas may be more favourably placed to access these innovations in the short run, it is projected that by 2020, 315 million individuals in rural India will have access to mobile Internet as compared to the current 120 million\(^6\). Thus, as smart-phone and mobile Internet penetration increases, rural India will be able to greatly benefit from these innovations.

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\(^1\) Performance and Credit Rating Scheme for Micro & Small Enterprises, Ministry of MSME Report

\(^2\) http://udyogaadhaar.gov.in/UA/UdyogAadhar-New.aspx

\(^3\) Mobile Internet in India, 2015

\(^4\) Internet usage picks up in rural India, LiveMint, Aug 2016