

EVENT REPORT

# Webinar on Empowering MSMEs

## UNLOCKING ECONOMIC OPPORTUNITIES



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# Webinar on Empowering MSMEs: Unlocking Economic Opportunities

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# 1 INTRODUCTION

The Micro, Small, and Medium Enterprise (MSME) sector forms the backbone of India's economy, playing a pivotal role in sustainable growth, job creation, enhancing trade, developing entrepreneurial skills, and boosting export earnings. With their agility and dynamism MSMEs have been instrumental in promoting inclusive growth, fostering innovations, and reducing regional disparities, thereby contributing to a more balanced and equitable economic development. Despite their significant role, MSMEs in India have yet to achieve their full potential, primarily due to inadequate access to timely and appropriate credit. To address this pressing issue, the government has introduced several positive initiatives aimed at enhancing credit accessibility for MSMEs, including the Emergency Credit Line Guarantee Scheme (ECLGS) and the Credit Guarantee Trust Fund for Micro and Small Enterprises. By empowering MSMEs, we could harness tremendous growth and redefine the nation's economic trajectory.

In view of the significant credit gap within the MSME ecosystem, The Dialogue hosted a conference titled **"Empowering MSMEs: Unlocking Economic Opportunities"** on September 12th, 2024. This event focused on the

current landscape for financing of MSME in India. During the keynote address and subsequent panel discussion, experts shared their insights on the persistent challenges that MSMEs face in accessing credit and explored the potential role of digital lending, fintech, and regulatory reforms in addressing these issues.

**The keynote address was delivered by Dr. Fauzia Khan, Member of Parliament, Rajya Sabha.** Following this, the panel discussion titled "MSME Credit Access and Fintech Innovations" was moderated by Mr. Kazim Rizvi, Founding Director, The Dialogue. The panel featured the following esteemed speakers:

- Mr. Alok Mittal, CEO and Co-founder, Indifi Technologies
- Mr. Gautam Ganjawala, Senior Partner, AZB & Partners
- Mr. Jatinder Handoo, CEO, Digital Lenders Association of India (DLAI)
- Dr. Tanu M. Goyal, Senior Fellow, Indian Council for Research on International Economic Relations (ICRIER)

The following themes emerged from the panel discussion:

## 2 CONTRIBUTION OF MSMEs AND THEIR STRUGGLE FOR FORMAL FINANCE

The central theme of the discussion revolved around the challenges and opportunities related to financing for MSMEs in India. Key obstacles to accessing credit were examined, including collateral requirements, low financial literacy, and a reliance on informal lending channels. The panellists also highlighted potential solutions to enhance access to formal credit for MSMEs, particularly for marginalised and socially disadvantaged groups.

It was emphasised that MSMEs are a significant contributor to the Indian economy, accounting for approximately 30% of the nation's GDP.<sup>1</sup> Furthermore, MSMEs provide employment to 62% of the workforce in the business sector.<sup>2</sup> Despite being a key driving force in the economy, these enterprises face severe underutilisation of credit schemes. A mere fraction of eligible businesses has benefited from initiatives like the Pradhan Mantri Mudra Yojana (PMMY). The primary reasons for this underutilisation include a lack of awareness, cumbersome loan application processes, and excessive compliance requirements.

According to the 2022 report by the Lok Sabha Standing Committee on Finance, the credit gap in the MSME sector is estimated to be between 20 to 25 lakh crores.<sup>3</sup> Additionally, India lags in MSME credit penetration, with only 14% compared to 50% in the US and 37% in China.<sup>4</sup> The situation is exacerbated by the fact that nearly 47% of MSME credit demand remains unmet.<sup>5</sup> Consequently,

many MSMEs resort to various informal modes of credit, which imposes an additional cost burden on them.

During the discussion, the panel identified several reasons for the inadequate access to formal finance for MSMEs. Key issues include a lack of collateral, low financial literacy, improper documentation, and insufficient infrastructural support. One panellist emphasised that banks often hesitate to extend credit to MSMEs due to the risk of loans becoming non-performing assets (NPAs). Instead, they prefer to lend to existing customers with established credit histories and lower perceived risks, further widening the credit gap for MSMEs.

A significant topic of discussion was the underutilisation of various schemes by MSMEs. The panellists noted that initiatives like the Pradhan Mantri Mudra Yojana (PMMY), Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), the Open Network for Digital Commerce (ONDC), and the Open Credit Enablement Network (OCEN) (Open Credit Enablement Network) often remain underutilised. This underutilisation can be attributed to high eligibility thresholds, intricate application processes, and operational inefficiencies. The panellists suggested that eliminating artificial barriers and introducing a simplified onboarding process for new MSME clients could effectively address this issue.

<sup>1</sup> Press Information Bureau. (2023, December 11). Contribution of MSMEs to the Country's GDP [Press release]. <https://pib.gov.in/PressReleaseSelfFramePage.aspx?PRID=1985020>.

<sup>2</sup> McKinsey Global Institute. (2024, May). A microscope on small businesses: Spotting opportunities to boost productivity. <https://www.mckinsey.com/mgi/our-research/a-microscope-on-small-businesses-spotting-opportunities-to-boost-productivity#/>

<sup>3</sup> Standing Committee on Finance. (2022, March). Strengthening Credit Flows to the MSME Sector: Forty Sixth Report. [https://loksabha-docs.nic.in/lsscommittee/Finance/17\\_Finance\\_46.pdf](https://loksabha-docs.nic.in/lsscommittee/Finance/17_Finance_46.pdf).

<sup>4</sup> Ernst & Young. (2023, September). Unleashing Potential: The Next Phase of Digital Lending in India. [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_in/topics/digital/2023/09/ey-the-next-phase-of-digital-lending-in-india.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/digital/2023/09/ey-the-next-phase-of-digital-lending-in-india.pdf).

<sup>5</sup> Ernst & Young. (2023, September). Unleashing Potential: The Next Phase of Digital Lending in India. [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_in/topics/digital/2023/09/ey-the-next-phase-of-digital-lending-in-india.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/digital/2023/09/ey-the-next-phase-of-digital-lending-in-india.pdf).

# 3 DIGITAL LENDING AND FINTECH AS THE FUTURE OF MSME FINANCE

The discussion highlighted the growing importance of digital lending in addressing the challenges faced by MSMEs. Although still in its nascent stage, digital lending has the potential to significantly benefit the MSME sector. It can enhance credit accessibility and simplify the process of obtaining information. Additionally, digital infrastructure can streamline loan applications and increase transparency in the approval and rejection processes. One panellist noted that technology-based lending models are already making an impact, with over 50% of new MSME customers in the past 12 months accessing credit through fintech platforms.

The key digital lending approaches suggested by the panellists include:

- **Data-Driven Lending:** Ecosystems such as the Account Aggregator (AA) framework and the upcoming Unified Lending Interface (ULI) have the potential to revolutionise MSME financing. Lenders can utilise digital transaction data from MSMEs to assess their creditworthiness. Additionally, data related to cash flow and other non-financial sources aid lenders in customer profiling, claim processing, and credit scoring. However, it is important to note that the current scope of data available through AAs and ULI is limited, which restricts the ability to fully leverage digital footprints for credit underwriting.
- **AI and Machine Learning:** Artificial Intelligence (AI) and Machine Learning (ML) models can enhance operational and procedural efficiencies in the credit evaluation process. AI can be used in credit modelling to develop customised and augmented financial products for MSMEs. Furthermore, AI-based technologies can facilitate customer due diligence and KYC processes, particularly in cases where there is a lack of traditional financial data. However, it is crucial to ensure the responsible and ethical use of AI in the MSME lending model. There will be a significant need to monitor and update the AI algorithms to address potential vulnerabilities that may arise from prolonged use. Human oversight will be essential to handle complex and ambiguous circumstances.

The panel emphasised the need for aggregated financial data to enhance MSME credit access. It was suggested that integrating and streamlining data channels to ensure interoperability and standardisation of financial data would create a more comprehensive and cohesive dataset. Additionally, one of the panellists proposed converting physical collateral into informational collateral. This innovative approach would allow MSMEs to secure credit based on data-driven assessments, rather than relying on traditional asset-based methods. By leveraging financial and non-financial data, this model can significantly improve access to credit for MSMEs.

## 4 THE ROLE OF REGULATORY FRAMEWORKS IN SHAPING MSME FINANCING

The panel discussed the current regulatory framework governing MSME financing and its crucial role in shaping the future of credit accessibility for MSMEs. It was highlighted that addressing the shortcomings in the existing regulatory framework is essential for improving the flow of credit to MSMEs. For instance, the Rs. 5 crore minimum Net Owned Fund (NOF) requirement for NBFCs to be registered as an NBFC-Factor under the Factoring Regulation Act, 2011,<sup>6</sup> has created an artificial barrier to smooth credit flow. One panellist suggested that removing the requirement for NBFCs to operate exclusively as factoring businesses under this Act could significantly improve credit availability and support the growth of small and micro businesses. Such regulatory adjustments could unlock greater financial opportunities for MSMEs and enhance their overall contribution to the economy.

The discussion emphasised the importance of a favourable regulatory environment to boost the flow of credit to MSMEs. Currently, the

Digital Lending Guidelines (DLG) regulate digital lending services, with a focus on protecting consumers from unfair lending practices. However, the consumer-centric nature of these guidelines limits their scope, especially when it comes to accommodating innovative fintech models, such as financing sellers on e-commerce platforms. This creates challenges in fully leveraging digital ecosystems for credit growth.

Furthermore, recent restrictions on how cash flows from payment gateways can be settled have added complexity. There is a lack of clarity regarding the use of these funds to settle loan accounts. One panellist suggested that allowing the resettlement of invoices and enabling cash flow to serve as collateral for loan repayment could help significantly reduce the credit gap faced by MSMEs, providing them with more flexible and accessible financing options.

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<sup>6</sup> Reserve Bank of India. (2023, October 19) *Master Direction (Non-Banking Company – Scale Based Regulation) Directions, 2023*. [https://www.rbi.org.in/Scripts/BS\\_ViewMasDirections.aspx?id=12550](https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12550)



## 5 CLOSING THE CREDIT GAP FOR WOMEN-LED MSMEs

A significant portion of the discussion focused on the challenges faced by women-led MSMEs in accessing credit. One panellist emphasised that the socio-economic constraints faced by MSMEs are often exacerbated for women-led businesses. Despite representing approximately 20% of the MSME sector in India, these enterprises receive only 20% of the total credit extended to MSMEs, revealing a substantial gender gap in financial inclusion. The panel stressed the need for targeted interventions to close this gap and improve access to finance for women entrepreneurs. Several measures were proposed, including simplified loan applications, reduced loan qualifications, minimal collateral requirements, and prioritised financial literacy and training programs specifically for women. Additionally, tech-based lending has been particularly advantageous for women entrepreneurs, with some fintech companies

reporting a higher percentage of loans granted to women compared to traditional lenders. Empowering women-led MSMEs is crucial, not only to tackle gender disparities but also to accelerate growth within the MSME sector. As digital lending emerges as the future of MSME financing, the right reforms and support could foster a prosperous and sustainable ecosystem for women entrepreneurs.

## 6 FUTURE DIRECTIONS: CO-LENDING, PHYGITAL SYSTEMS, AND A DIGITAL FUTURE FOR MSMEs

The panellists unanimously agreed that the future of MSME financing lies in digital lending, with technology, regulations, and awareness serving as the three key drivers to bridge the MSME credit gap. The Reserve Bank of India's co-lending model, introduced in 2020, has shown the effectiveness of public-private partnerships in extending credit, particularly by reducing the risk of non-payment in high-risk priority sectors. To scale credit accessibility there is a need for a robust digital infrastructure coupled with personalised support mechanisms.

Phygital systems, which combine physical and digital channels, can be instrumental in helping MSMEs navigate the complex landscape of government schemes, credit lines, and fintech solutions. Models like the AA, Digital Public Infrastructure (DPI), and the Unified Lending Interface (ULI) can further support secure and efficient data exchange among various financial institutions, enabling seamless and transparent digital lending for MSMEs.

The development of a comprehensive Self-Regulatory Organisation (SRO) framework can play a pivotal role in fostering a more conducive environment for fintech growth and experimentation. Greater awareness among entrepreneurs and MSMEs about initiatives like regulatory sandboxes is crucial, as these platforms enable MSMEs to assess the benefits and risks of new financial products, fostering a culture of innovation and collaboration within the financial sector. In essence, the combination of SROs and regulatory sandboxes can play a significant role in improving credit accessibility for MSMEs.

The conference concluded with the observation that a personalised approach in MSME financing, coupled with greater ICT penetration and supportive digital infrastructure, will be the core catalyst in unlocking the full potential of India's MSME sector.

# 7 ACTION POINTS

Based on the discussion, the following points summarise the path forward to increase MSME credit penetration:

- **Expanding Digital Lending by Leveraging Data**
  - Integrating systems such as AA and ULI to enhance data-driven lending by utilising non-financial data (e.g., transaction history, cash flow) for more accurate credit profiling.
  - Deploying emerging AI/ML models to streamline credit evaluation, profiling, and loan approvals.
- **Fostering an Incubatory Regulatory Regime**
  - Revisiting restrictive requirements like the Rs. 5 crore minimum NOF criterion under the Factoring Regulation Act, 2011, and broadening the scope of the Digital Lending Guidelines (DLG) to include innovative fintech models.
  - Implementing innovative regulations, such as allowing cash flows to settle loan accounts, and establishing a robust SRO framework to encourage an evolving fintech landscape with necessary safeguards.
- **Strengthening Co-Lending Models and Phygital Systems**
  - Leveraging co-lending models to expand access to credit for high-risk MSMEs, and utilising phygital systems to simplify loan approval processes and improve credit accessibility for MSMEs.
- **Boosting Awareness and ICT Penetration**
  - Prioritising financial literacy programs and simplifying loan application processes through ICT to bridge the credit gap, particularly for women-led MSMEs.
  - Promoting awareness of government schemes and digital financial tools, while ensuring the development of strong digital infrastructure to facilitate seamless data exchange and transparent lending.



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