



# Role Of Fintech In Bridging The Credit Gap; In Context Of Indian Msmes

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## ABSTRACT

The MSMEs sector contributes 30% to Indian GDP and support 11.1 crore jobs, with a 42% increase in budget allocation for FY 2023-24. Despite being pivotal component of Indian economy and effective medium of financial inclusion, the lack of financial deepening has been a grave issue before MSMEs. This study outlines the credit gap in Indian MSMEs and describes how fintech, by creating proprietary alternative credit evaluation models, helps tackle the mentioned problem. The study considers descriptive and qualitative research methodologies to examine the issue and validates its findings.

**Keywords:** Fintech, Digital lending, Digital Financial Inclusion, Indian MSMEs

**JEL classification:** G21, G23, G28, L26, O33, Q01

## 1. Introduction

In India, MSMEs are the key sector for advancing the economy, society, and sustainability. In India, there are within 55 and 60 million MSMEs (micro, small, and medium-sized enterprises), actively contributing to 30 percent GDP of the country and providing employment to 11.1 crore people in the country (Economic Survey, 2022). MSMEs are recognized as a growth engine for promoting equitable development in the modern corporate environment (Sachdev et al., 2021). Compared to the industrial sector overall, the MSME sector has expanded more quickly.

By FY26, MSMEs are projected to expand at a compound annual growth rate (CAGR) of 11%, boosting the economy. Despite this expected growth and being one of the foundations of the Indian economy, MSMEs is still overwhelmingly found in the unorganized sector. The Micro, Small, and Medium-Sized Enterprises in India has an ongoing credit shortfall despite being the subject of various legislative attempts (Shankar, 2021). More than 60% of MSMEs rely on expensive informal sources of finance because they lack access to formal credit (The Hindu Business line 2022).

Due to the worldwide economic crisis of 2008 and the use of cutting-edge technical innovations like artificial intelligence, fintech has begun a new era, data analytics and social media (Lee and Shin2018). The term "fintech," which stands for "financial technology," basically describes the use of technology to offer different financial services (Gupta et al., 2023). In the last five years, fintech in India has expanded quickly and has the ability to do so even more quickly. Digital platforms are provided by fintech companies to lenders so they can offer credit facilities. Recently, the amount disbursed and the number of new loan accounts opened in the

FinTech sector have both grown quickly(Jhariya et al., 2023)Fintech services also make simpler for SMEs to borrow money at lower rates of interest, enabling them to cover their business needs. They simplify the user experience and expedite loan applications, enabling borrowers to get their money more rapidly. With the ability to alleviate MSME credit-related issues digital lending in India provides a number of advantages over traditional lending(Gupta et al., 2022a).

India now boasts the fifth-largest economy in the world and expected to grow to \$5 trillion in the following two to three years; the MSME sector played a critical role in making it as the fifth largest in the world (KPMG report, 2022).The government intends to boost the share of MSMEs in GDP from 30% to 50%. This expectation is made clear by government programmes like Make in India, Aatmanirbhar Bharat, and Vocal for Local, among others, which seek to boost confidence in India's micro, small, and medium-sized businesses. But the segment suffers from vast credit gap. This gap can be close by Fintech .Micro, Small, and Medium-Sized Enterprises (MSMEs) can operate their businesses with greater ease thanks to FinTech's convenient services, which help them overcome issues with funding and financial convenience (Lestari et al., 2020). This study outlines the Credit gap in Indian MSMEs, causes related credit gap from buyer and supplier perspectives and emerging digital lending services that use fintech as a way to help MSMEs in India survive and flourish. To make it simpler, the study mix descriptive and qualitative research methodologies to examine the issue, establish the study's goals, and validate its findings.

## 2. Literature Review: Related studies

**Table 1: Literature Review**

Area	Focus	Reference
Economic development that is inclusive and sustainable, as well as government initiatives and digital innovation for MSMEs	This study looks at numerous programmes that promote economic growth, including Atmanibhar Bharat, Startup India Seed Fund, Startup India SAMRIDH, and ECLGS. It also discusses how important ONDC, OCEN, and NDEA are for advancing fintech and e-commerce as well as productivity.	(K. M. et al., 2023)
Fintech adoption, Indian MSMEs	The analysis demonstrates the MSME sector acceptance of and preferences for financial technology and find out the MSMEs have a high acceptance rate of financial technology.	(Gupta et al., 2022b)
Digital technology, Indian MSMEs Ecosystem	The digital ecosystem offers MSMEs end-to-end solutions for access to financing, payments, and skill development. WhatsApp and Facebook, two digital media platforms, have improved the viability of e-commerce products and services. The Government's Fintech and Capacity Building Schemes, ONDC, E-marketing Place (GeM), Udyam Registration, GST Portal, and MSME Samadhan.	(Buteau, 2021)
Potential of alternative tools to finance MSMEs	According to the study, there are various chances for banks and other alternative avenues/tools to finance MSMEs. Favorable government policies and an improving legal framework create a favourable business environment for MSME financing.	(Maiti, 2018)

## 3. Research gap

According to numerous assessments, digital novelty is crucial for the social and economic development of the nation. Indian MSMEs are increasingly accepting of technology (Fintech). However, this study identifies the effects of several fintech-based digital solutions on credit demand fulfillment of MSMEs.

## 4. Objectives of the study

1. To identify the gap between credit demand by MSMEs and supply by financial institutions in India.
2. To identify and discuss the reasons behind credit gap in Indian MSMEs.
3. To study the role of Fintech in facilitating MSME finance through digital lending models.

## 5. Methodology of the study

In order to achieve the goals of this research, this study uses secondary data and a descriptive research design to understand how Fintech impacts MSMEs. Data was gathered from a variety of reputable publications, newspapers, working papers released by reputable organisations, and official government reports, among other sources.

## 6. Analysis and Discussion

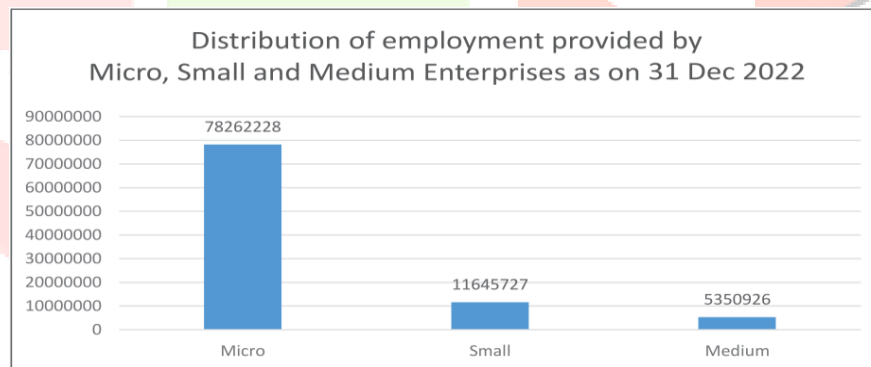
### 6.1 Role of MSMEs in Job creation

MSMEs are a thriving and dynamic sector of the Indian economy, helping to promote entrepreneurship and open up job opportunities at reduced capital costs, which in turn promotes economic and social growth. The MSME industry is responsible for creating 11.10 crore jobs in both rural and urban areas of the country, according to the 73rd round of the National Sample Survey (NSS), which was carried out between 2015 and 2016. These jobs include 360.41 lakh careers in production, 0.07 lakh jobs in non-captive power production and transmission, 387.18 lakh occupations in trade, and 362.82 lakh occupations in other services. Micro businesses have been the largest employers, accompanied by small and medium-sized businesses as shown in table 2 & figure 1 (MSME annual report, 2022-23).

Table 2: Number of MSMEs Projected (Activity-wise)

Broad Activity Category	Employment (in lakh)			Share (%)
	Rural	Urban	Total	
(1)	(2)	(3)	(4)	(5)
<b>Manufacturing</b>	186.56	173.86	360.41	32
<b>Electricity*</b>	0.06	0.02	0.07	0
<b>Trade</b>	160.64	226.54	387.18	35
<b>Other Services</b>	150.53	211.69	362.22	33
<b>All</b>	<b>497.78</b>	<b>612.10</b>	<b>1109.89</b>	<b>100</b>

Source: MSME Annual Report (2022-23)



Source: MSME annual report (2022-23)

Figure 1: The Distribution of jobs offered by MSMES

### 6.2. Credit Gap in Indian MSMEs

India has made a lot of efforts to direct money from financial institutions and Banks towards the SMEs market, since 1969. The creation of specific institutions (such as National Institute for Micro, Small, and Medium Enterprises, National Small Industries Corporation, SIDBI, Micro Units Development & Refinement Agency Ltd ) for the promotion, development, and financing of small businesses; directed lending under the priority lending programme; demonetization; the Digital India Movement; the Government e-Market platform; the Trade Receivables Electronic Discounting Scheme (TReDS); Goods and Services Tax Network(GSTN); the Digidhan Mission; and the recognition and regulation of Fintech companies are among these. The real flow of credit from banks and other financial institutions, however, continues to be extremely low. The table 3& 4

reveals that, in contrast to the expansion in credit to all sectors, commercial banks' lending to MSMEs is extremely low and has increased at the slowest rate in the last six years.

Table 3: Commercial Bank Loan Outstandings for the Last Six Years, till 2021

Commercial Bank Loans Outstanding (End of March) for the last Years, till 2021						
Loan Outstanding as at the end of March (INR Lakh Crores)						
Sector	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
Non-food credit	65.47	70.94	76.88	86.33	92.12	96.62
Agriculture and allied activities	8.83	9.92	10.3	11.11	11.58	13.00
Industry (Micro and small, medium and large)	27.31	26.8	26.99	28.86	29.05	29.18
Services	15.41	18.02	20.50	24.16	25.95	26.31
Personal Loans	13.92	16.20	19.08	22.21	25.54	28.14
Of the total non-food credit loan given to micro and small enterprises, medium and large enterprises						
Micro and small enterprises	8.48	9.02	9.96	10.48	10.80	11.07
*Micro and small (manufacturing enterprises)	3.71	3.70	3.73	3.76	3.82	3.84
*Micro and small (service enterprises)	4.76	5.32	6.23	6.72	6.99	7.23
Medium	1.15	1.05	1.04	1.06	1.06	1.36
Large	22.44	22.05	22.23	24.04	24.18	23.98

Source: RBI (2021b)

Table 4: Growth in credit from Commercial Banks to Various Sectors during Last Six Years Ending 2021

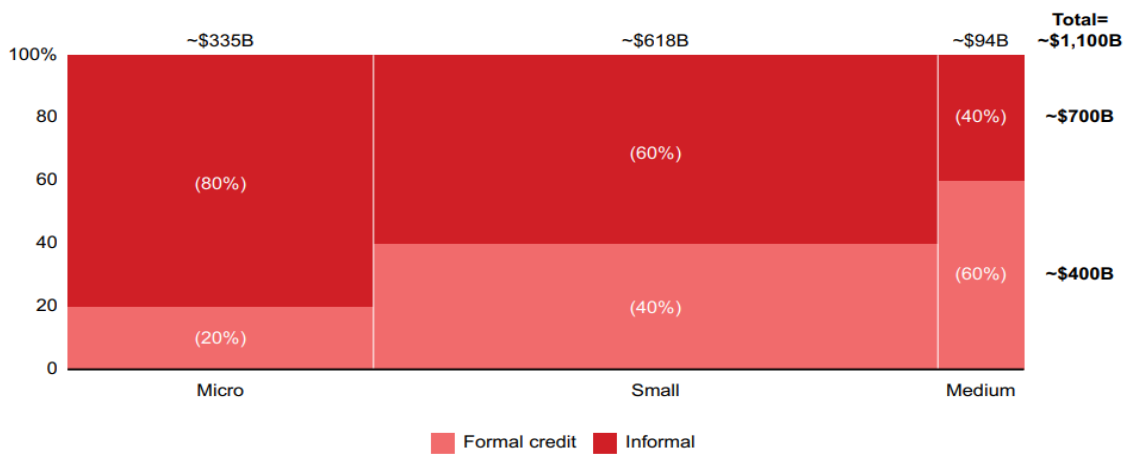
Growth in Credit from Commercial Banks to Various Sectors during Last Six Years Ending 2021					
Sector	2016-2017 (%)	2017-2018 (%)	2018-2019 (%)	2019-2020 (%)	2020-2021 (%)
Non-food credit	8.36	8.37	12.29	6.70	4.89
Agriculture and allied activities	12.4	3.81	7.87	4.18	12.27
Industry (Micro and small, medium and large)	-1.86	0.73	6.91	0.67	0.44
Services	16.95	13.77	17.81	7.42	1.37
Personal Loans	16.36	17.8	16.36	14.99	10.18
Micro and small enterprises	6.42	10.47	5.15	3.13	2.48
*Micro and small (manufacturing enterprises)	-0.47	0.88	0.67	1.68	0.53
*Micro and small (service enterprises)	11.79	17.12	7.83	3.93	3.54
Medium	-8.72	-1.07	2.62	-0.75	28.84
Large	-1.74	0.78	8.16	0.58	-0.81

Source: RBI (2021b)

The IFC study has found that MSMEs in India have a total funding requirement of 87.87 lakh crore, of which 69.3 lakh crore is debt and 18.4 lakh crore is equity. 58.4 lakh crore of debt (81%) is raised from informal sources, and the addressable credit gap is 25.8 lakh crore (IFC, 2018). In 2019, RBI estimates that there is a 20–25 trillion rupee credit deficit for MSMEs. Various government programmes and initiatives have been taken place. Despite these efforts, by the middle of 2021, MSMEs were struggling due to a Rs 30 lakh crore credit deficit (BFSI, 2022).

But now, as per the Blink Invest Research and Niti Aayog reports for 2022, MSME sector in India has a credit gap of INR 25 trillion and a liability call of 69.3 trillion INR, increasing at an 11.5% CAGR. Only 40% of the sector's credit demands, according to one assessment, were being met through official credit channels like banks. Furthermore, these routes were inaccessible to five out of six MSMEs as shown in figure 2 (Bain & Company report, 2022).

Split of debt demand (FY22)



Source: India Fintech Report 2022: Sailing Through Turbulent Tides

Figure 2: Formal Credit Gap in Indian MSMEs in 2022

Without formalization, it is not only challenging to measure the employment and income metrics for these enterprises, but they also fail to qualify for government social programmes and subsidies.

### 8. Causes of Formal credit gap in Indian MSMEs

There are several causes for this exclusion as shown in table 2.

Table 5: Causes of formal credit gap in MSMEs from Supplier and borrower perspectives

### 9. Role of Fintech in bridging the gap:

Supplier perspectives	Borrowers perspectives
<ol style="list-style-type: none"> <li>MSMEs are viewed as a risky proposition by financial institutions due to their inability or unwillingness to repay loans, leading to loan default or non-repayment (Lakkol et al., 2022)</li> <li>Information asymmetry between banks and MSMEs is a big issue because of the lack of comprehensive financial records maintained by Indian MSMEs, leading to banks being reluctant to lend to them (Uddin et al., 2022) Saxena &amp; Sahoo, 2022)</li> <li>MSMEs in India lack tangible assets and credit histories, which causes traditional lenders to turn down many loan applications.(Fintech led digital landing report 2023)</li> <li>Due to MSMEs' inability to keep up with correct accounting and collateral, banks incur higher costs when extending credit, which discourages lenders from establishing credit connections (Saxena &amp; Sahoo, 2022)</li> </ol>	<ol style="list-style-type: none"> <li>Few lenders are ready to offer MSME loans in semi-urban and rural areas of India, which adds to an expanding credit gap in the country's MSME sector (Manikandan and SkilledIndia, 2022).</li> <li>MSME owners frequently lack financial literacy and are unaware of available loan sources, required documents, and borrowing procedures.(Anshika &amp; Singla, 2022)</li> <li>MSMEs require working money immediately, but conventional financial institutions take too long to approve and distribute loans, making them inappropriate for their requirements.(Khatri, 2019a)</li> <li>Due to a patriarchal society, a lack of collateral, and gender inequality, Indian women entrepreneurs confront a credit gap that results in a 16% loan refusal rate.</li> </ol>

One of the key elements in the success of a business is the function of credit in maintaining and growing it. There is vast formal credit gap in Indian MSMEs sector as per Bain &Company report,2022.Fintech

contribute to addressing this issue by developing proprietary alternative credit evaluation models that analyse the credit worthiness of small firms by way of mobile-friendly applications, enabling a better understanding of their roles and difficulties. resulting in the creation of distinctive lending solutions that increase the MSME's access to financing (Buteau, 2021).

Due to market opportunities, reframed problem statements, the migration and distribution of profit pools, and the availability of equity financing, fintech is at a golden spot. Currently, 25–30% of Fintech funding is going towards digital lending as shown in figure 3.

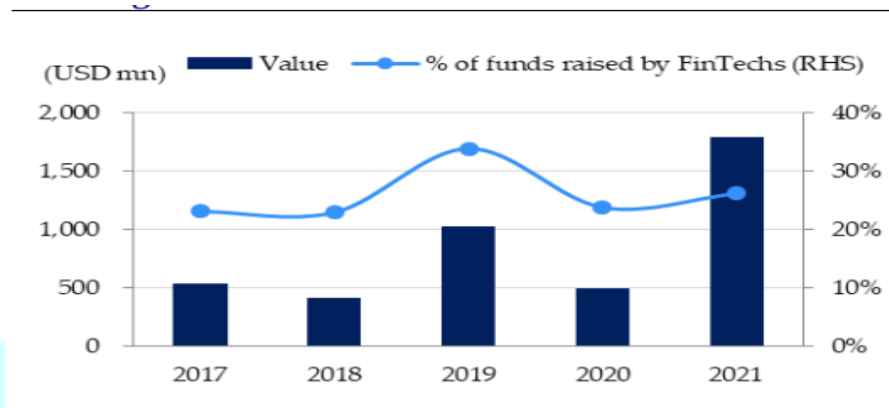


Figure 3: Fintech funding towards Digital Lending

Source: Fintech Playbook: Buy Now Pay Later-De-mystifying the tablestakes (by HDFC securities, Jan 2022 report)

Notably, FinTechs have excelled at connecting with NTC (new to credit) borrowers. Figure 4 illustrates the importance that FinTechs can play in extending credit coverage among India's MSMEs by showing that the proportion of NTC borrowers for FinTechs is three times higher than for private banks, NBFCs, and public sector banks (BCG report, 2018).

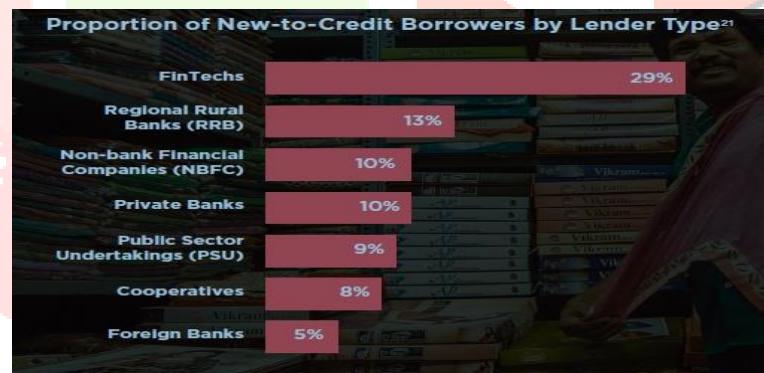


Figure 4: The proportion of first-time credit users by type of lender

Source: Credit Disrupted Digital MSME lending in India (BCG& Omidyar Network report, 2018)

Prior to the pandemic, MSMEs were not very digitally savvy, but unanticipated events (like COVID-19) compelled the employment of technical resources. As per a survey result, many MSMEs are aware of the benefits of digital financing and how it may streamline their business operations as shown in table 6 (BCG report, 2018).

Table 6: An Increasing Level of Readiness for Digital Lending in MSMEs

77 % of MSMEs	Claimed that they feel at ease sharing data digitally;
75 % of MSMEs	Claimed that they feel at ease with regard to submitting an online application
57 % of MSMEs	Claimed that they feel at ease with regard to granting lenders online access to account statements
30 % of MSMEs	If ready support was offered, they would feel more comfortable using digital lending.
Over 60 % of MSMEs	Anticipate to adopt digital payments within the next three years, which is more than double the current rate.

Source: Credit Disrupted Digital MSME lending in India (BCG& Omidyar Network report, 2022)

Various digital lending platforms have stepped in to finance MSMEs over the past few years (Kumar et al., 2021). These models are shown by figure 5.

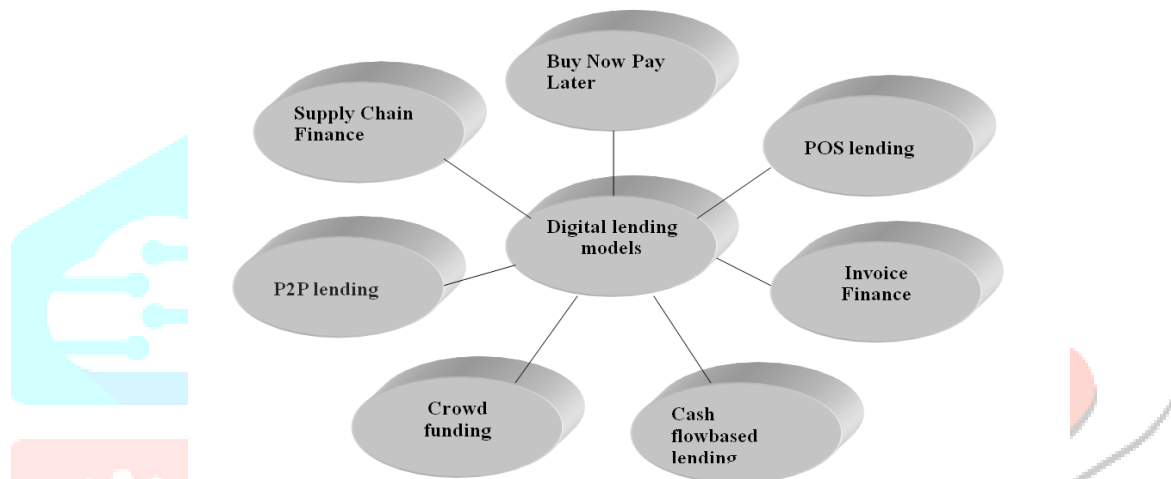


Figure 5: Emerging Digital Lending Models

Source: Fintech for the Underserved, PwC & ASSOCHAM Report (Sep 2021)

**(i) Supply Chain Finance:** Supply Chain Finance or ‘supplier finance’ or ‘reverse factoring’ (Investopedia, n.d.) offers businesses quick operating capital to offset delayed payments, allowing MSMEs to get paid earlier and upfront for invoicing (IFC & Intellectap, 2018). Fintech has differentiated themselves from banks by launching multiple solutions such as Warehouse receipt finance, Invoice discounting, Capex discounting (to finance the purchase of equipment) with the help of some technological innovation like API-enabled services, analytical enablement and block chain etc (PwC analysis). Lending Cart, Capital Float, and Hero Fincorp are some Fintech companies in India that provide supply-based finance to MSMEs in India.

**(ii) P2P lending:** P2P Lending is "the use of an online platform that matches lenders with borrowers in order to provide loans that are typically unsecured" according to Dhawan (2018). The major goals of P2P lending companies are to influence society and make credit more accessible to MSME and small business owners ((P2P Lending and the MSME Sector Teerna Chatterjee, n.d.)) The P2P acceleration is also becoming more conceivable with India having 504 million active internet users, or 40% of those who are over the age of five (Mishra and Chanchani, 2020). Some well-known P2P lending platforms in India are I2i financing, faircent, finzy, i-lend, LenDen club, and PaisaDukan ((Khatri, 2019)).

**(iii) POS lending:** POS lending has already gained traction in a number of international areas, including Australia, India, and Europe. The BlinC Invest research claims that by 2025, there should be a million POS terminals, up from the current 10% POS penetration rate in the MSME Sector.

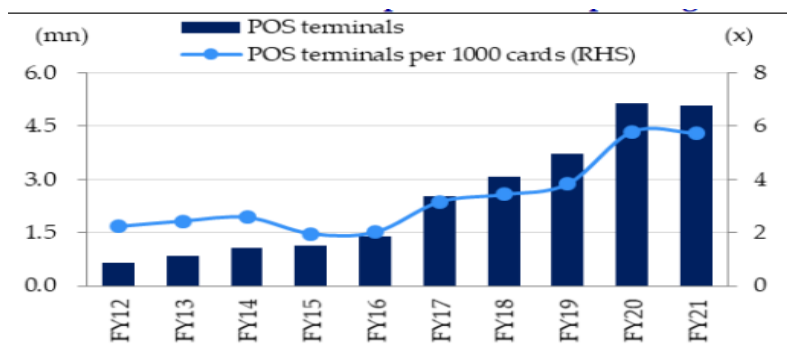


Figure 6: POS terminal penetration rate

Source: Fintech Playbook: Buy Now Pay Later-De-mystifying the tablestakes (by HDFC securities, Jan 2022 report)

**(iv) Buy Now Pay Later:** The term "BNPL" refers to the postponed payment option offered at checkout (online or offline), which includes interest-free credit periods (15d–45d), no-cost EMIs (Pay-in–3/4), and EMI financing. Due to growing e-commerce and the adoption of digital payments, India's Buy-Now-Pay-Later (BNPL) is positioned as a source of gateway credit and is expected to reach USD56 billion by FY26 (or 5% of digital P2M payments). According to a data and analytics firm's survey Global Data November 2022, The BNPL market is projected to generate transaction values of \$4.9 billion in 2022 and grow at a CAGR of 32.5% to \$15 billion by 2026 (The Financial express 2023). Some major BNPL players with their lending partner is shown by figure 7.

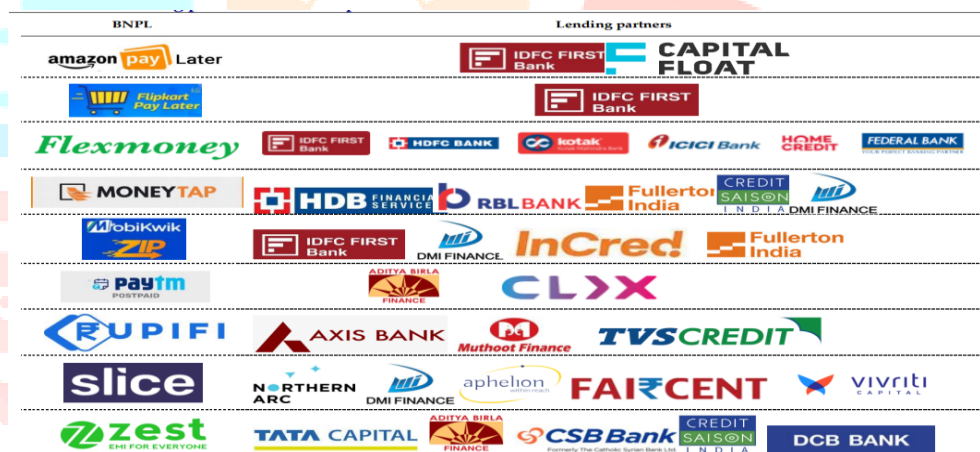


Figure 7: Major BNPL players and their lending partner

Source: Buy Now Pay Later-De-mystifying the tablestakes (Jan 2022 report)

**(v) Invoice Finance:** Businesses utilise invoice finance to borrow against payments due from customers to cover their operational expenses. As a result, companies can grow their operations. Small msme are getting aid from a number of invoice finance fintechs to release funding based on their invoices (Pwc, 2021). Invoice finance is changing the game for MSMEs, as seen by recent governmental measures like The Factoring Regulation (Amendment) Bill, 2021 and the requirement that all businesses with revenue of more than Rs. 500 crores register with TReDS (Finezza, 2022). Also, in its monetary policy review, the Reserve Bank of India (RBI) increased the mandate limit for the National Automated Clearing House (NACH) from Rs 1 crore to Rs 3 crore for settlements relating to the Trade Receivables Discounting System (TReDS), an invoice discounting system for MSMEs (Financial express, 2023).

**(vi) Crowd funding:** Crowd funding is the method of allocating capital from investors to MSMEs via digital and social media channels (Rani and Katoch, 2020). The entire economy has been fundamentally revolutionized by crowd funding, and India is no exception. For start-ups and small businesses in India, crowd funding is the greatest and most promising solution (Karthikeyan, 2020). Crowd funding enables MSMEs to circumvent the lengthy and onerous process of paperwork, documentation, and frequent bank visits (Kumar, 2023). For this, a



variety of forms of crowdsourcing are employed, including donation-based, incentive-based, equity-based, and debt-based models (Rani and Katoch,2020).Kick Starter, Indiegogo, Causes, Patreon, Gofundme, CircleUp, Lending Club are some newest platforms for crowd funding MSMEs.

**(vii) Cash flow based lending:** In this model, lenders evaluate a company's credit worthiness based on its anticipated cash flows. Sellers on e-commerce platforms are one example of this concept in action. Small businesses can get financing through such platforms since they partner with lenders to offer loans to merchants based on their gross merchandise value trends and platform sales. The recommendation of U.K. Sinha Committee on MSMEs' 2019 states that banks use this approach was accepted (RBI in 2019). Lenders employ a range of techniques to assess a company's cash flows, including information from the GST, e-commerce transactions, information from forums in which the company participates, information on the firm's supply chain, etc. (Shankar ,2021).

## 10. Conclusion:

Micro, small, and medium-sized businesses (MSMEs) are crucial to any country's economic and social growth, particularly those in developing nations((Saha, 2023). In India,MSMEs contribute 30% of GDP, support 11.1 crore jobs, and play an essential role for the sustainability of the country's economy.But, the sector suffers from vast credit gap and has less access of credit from formal sources due to several reasons such as lack of collateral loan, high risky proposition, information asymmetry.Fintech has emerged as a new era due to the world financial crisis and the use of technology to offer different financial services. This paper focused on the importance of Fintech based solutions in MSMEs development. And concluded that currently 25% to 30 % of Fintech funding is going towards digital lending. Digital platforms are provided to lenders to offer credit facilities, making it easier for SMEs to borrow money at lower rates of interest and simplify the user experience. There are various emerging digital lending services (such as Supply chain finance, P2P lending, POS lending, crowdfunding, BNPL etc.) that use fintech as a way to help MSMEs in India survive and flourish. Digital lending is a most rapidly expanding fintech segment in India, expected to reach \$350 billion in revenue by 2023. It can unwind a strong culture of formalisation, resulting in economic benefits. The study recommends that in order to drive financial inclusion of entrepreneurs in MSMEs. The government should offer incentives, training, and digital infrastructure to MSMEs to boost their adoption of fintech, digitalization, implement strong laws and regulations to combat financial fraud.

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