

Swaminathan J: MSMEs - bridging the credit gap through improving confidence in lending

Speech by Mr Swaminathan J, Deputy Governor of the Reserve Bank of India, at the CEO Forum of the Federation of Telangana Chambers of Commerce and Industry, Hyderabad, 16 November 2024.

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Shri Suresh Kumar Singhal, President FTCCI, Shri R Ravi Kumar, Senior Vice President FTCCI Shri K K Maheshwari, Vice President, FTCCI, Mr. Meela Jayadev, Convenor, FTCCI CEO Forum, Chief Executive Officers gathered here today, ladies and gentlemen. A very good evening to you all.

I am delighted to speak to you today on a topic that has always been close to my heart- the critical role of MSMEs and the importance of building confidence in lending to this vital sector. Over the years, I have had the opportunity to work closely with MSME units, witnessing both their potential and their struggles. In the early days of my career, as a young officer posted in the bustling Peenya Industrial Area, I saw firsthand the energy and resilience that defined MSMEs, as well as the unique challenges they faced. Later, mid-career, my experience deepened while working in the Mid Corporates Group of SBI, where I further understood how access to timely and adequate credit could transform these businesses. These experiences have made me keenly aware of the importance of bridging the credit gap for MSMEs- a task that demands not only innovative solutions but also a firm commitment to fostering confidence among lenders and borrowers alike.

As you are all aware, the MSME sector plays a vital role in our economy, driving entrepreneurship and creating substantial employment opportunities. These enterprises serve as essential support units for larger industries and contribute significantly to the secondary and tertiary sectors. With approximately 6.3 crore units¹, MSMEs contribute nearly a third of India's nominal GDP and account for over 40 per cent of the country's exports². More importantly, they play a crucial role in employment, generating over 22 crore jobs³ and holding immense potential to harness India's demographic dividend. Thus, the MSME sector not only powers economic growth but also uplifts the poor, providing livelihoods and fostering inclusive development across the nation.

Despite the critical role of the MSME sector in the Indian economy, a common grouse that we hear from this segment is that they find it difficult to secure timely and adequate formal credit. This challenge may be on account of factors such as information asymmetry on their financials and business viability, and also on account of limited formalization even today within the MSME sector. Many MSMEs lack comprehensive financial records or credit scores, and in some cases, they may not have sufficient collateral to support the scale of financing they require. These issues result in a substantial gap between the credit needs of these units and the available supply- creating what is known as the credit gap. Five years ago, the Report of the Expert Committee on MSME (Chair: U.K. Sinha) constituted by RBI estimated this credit gap to be between 20 and 25 lakh crore, underscoring the pressing need to address the financial barriers that continue to constrain this vital sector.

RBI Initiatives

On its part, the Reserve Bank of India (RBI) has consistently prioritised the inclusion of MSMEs in the formal financial system through a range of targeted measures. One of the key initiatives is the Priority Sector Lending (PSL) guidelines, mandating a sub-target of 7.5 per cent of banks' adjusted net bank credit for micro enterprises, while all loans to MSMEs qualify under PSL. RBI has also promoted collateral-free lending by requiring banks not to insist on collateral for loans up to 10 lakh for micro and small enterprises (MSEs) and encouraging financial institutions to lend under the CGTMSE scheme which carries zero risk weight for the guaranteed portion of loans.

To address the issue of delayed payment to MSMEs, RBI has introduced several innovations. The Trade Receivables Discounting System (TReDS) facilitates MSMEs' trade receivable financing through electronic platforms. The Account Aggregator (AA) framework and inclusion of GSTN in the AA ecosystem streamline financial data access for MSME lending. More recently, the Unified Lending Interface (ULI), launched as a pilot program in August 2023, allows MSMEs to access tailored, frictionless credit using digital data.

Additionally, RBI has implemented a revival and rehabilitation framework for MSME loans up to 25 crore, providing an on the tap structured mechanism for stress resolution. In line with its commitment to capacity building, RBI also runs the NAMCABS [4](#) program, which familiarises bankers with the specific credit needs of the MSME sector, helping to improve their understanding and support for MSME financing.

These efforts, alongside government schemes like MUDRA and CGTMSE, have significantly improved formal credit to the MSME sector. As of March 31, 2024, credit outstanding by scheduled commercial banks to MSMEs stood at 27.25 lakh crore, reflecting the growing integration of MSMEs into the formal financial ecosystem. It is heartening to note that the outstanding bank credit to MSMEs have registered an annual growth of 12.39 and 20.58 percent, respectively, in the last two financial years.

What can MSMEs do?

While regulatory policies and government schemes have played a crucial role in creating an enabling environment for MSMEs, it is equally important for MSMEs to take proactive steps to build trust and enhance their visibility with lenders. In this context, I have four key suggestions that MSMEs may like to consider for better access to finance as well as improving their financial health.

Embrace formalisation

Firstly, MSMEs should prioritise formalisation. Many MSMEs operate informally, making it challenging for lenders to assess their creditworthiness due to information asymmetry, particularly regarding their financial performance. By registering on the Udyam Portal and filing GST returns, MSMEs can enhance the transparency over their level of business activity and financials. This will enhance their credibility and may qualify them for priority sector lending and government schemes, by reinforcing their trustworthiness in the eyes of financial institutions.

Continuing with embracing formalisation, MSMEs should maintain comprehensive and accurate financial records which is essential for seeking credibility with lenders. MSMEs should adopt proper accounting practices, ensuring their financial records, such as income statements, balance sheets, and cash flow statements are accurate and reliable. Having financial statements prepared by certified professionals and audited by qualified auditors shall further bolster their credibility.

Along with formalization, adopting digital payment systems like UPI and online banking creates a digital footprint of financial transactions, making it easier for lenders to assess financials of the firm. Digital payments also improve cash flow management, offering MSMEs greater control over their finances and helping them maintain a clear financial record.

Credit Discipline

Secondly, MSMEs should strive for greater credit discipline which starts with careful selection of the appropriate credit product suited to their requirements and cash flows. MSMEs should familiarise themselves with different credit products such as term loans, working capital loans, overdrafts, and invoice discounting to match them with their borrowing needs. It is vital to tailor borrowing to business cycles and avoid over-leveraging. Comparing terms across lenders and negotiating for better interest rates and repayment options can result in more favourable credit terms. Further, building and maintaining a good credit score is fundamental for accessing formal financing. MSMEs should ensure timely repayment of loans and bills, which reflects positively on their credit history.

It is also important to use the bank funds for the purposes for which it was borrowed. Sometimes, however, it is noticed that working capital funds are diverted for other purposes. A few have been found to be not investing their equity fully or diverting funds borrowed from banks to purposes outside of their businesses. Many a times, unplanned and improperly funded capacity or market expansions have become a major source of stress, impacting the credit history and thereby the credibility with their banks. All of these are eminently avoidable, doing business ethically and prudently helps overcome such short-sighted actions.

Capacity Building

Thirdly, MSMEs must invest in capacity building to strengthen their operational and financial management skills. Financial literacy programs help entrepreneurs understand credit appraisal processes, banking norms and government support measures, making them more confident borrowers. Skill development workshops on topics like compliance, bookkeeping, and market trends equip them to better manage their businesses and finances.

MSMEs can leverage the ecosystem for capacity building and financing. Engaging with industry bodies and trade associations provides MSMEs with mentorship, funding opportunities, and market linkages. Collaborating with incubators and accelerators can

offer access to training, networking, and funding. Additionally, fintech solutions that use alternative credit scoring based on sales patterns or supplier feedback can help MSMEs secure funding more effectively.

Fourthly, MSMEs should prioritise the use of TReDS which provides a platform to access working capital by discounting invoices raised to larger buyers. Pursuing buyers to also onboard onto TReDS ensures smoother transaction processing and timely payments. By integrating TReDS into their operations, MSMEs can unlock liquidity, improve cash flows and build stronger trust with lenders.

I understand that there are a few bankers also present amongst us today. While the RBI engages with the banking community separately, particularly under the Standing Advisory Committee on MSMEs, I would like to take this opportunity to reinforce the importance of improving financing for MSMEs. Bridging the credit gap is not merely about supporting the growth of individual MSMEs; it is about empowering a sector that forms the backbone of a resilient and dynamic economy. With improved access to finance, MSMEs will be better positioned to drive innovation, create jobs, and uplift communities across the country. This is a critical step towards building a more inclusive and sustainable future for India. Therefore, I would urge bankers to work collaboratively with MSMEs to build trust, enhance credit discipline, and ensure that they are equipped with the financial tools needed to succeed.

In conclusion, the development of the MSME sector requires the collective effort of all stakeholders-government, regulatory bodies, the financial sector, trade associations, and even larger corporates. Despite its pivotal role in driving economic growth, the sector faces numerous challenges, including delayed payments, infrastructure constraints, limited access to formal finance, low technology adoption, and a shortage of skilled labour. The RBI has taken significant steps to address these issues, promoting financial inclusion, easing access to credit, and advocating for digitalization. While the RBI and the government have established a robust policy framework, including priority sector lending, collateral-free loans, digital platforms like TReDS, and capacity-building initiatives, it is equally important for MSMEs to make the most of these opportunities. Going forward, sustained collaboration among all stakeholders will be crucial to ensuring the continued growth and resilience of this vital sector.

With that, I would like to express my sincere gratitude to the Federation of Telangana Chambers of Commerce and Industry for inviting me to Hyderabad to speak on such an important topic. I compliment the Federation for such a well-coordinated event.

Thank you.

¹ Ministry of Micro, Small and Medium Enterprises. (2023). Annual report 2023-24. Retrieved from <https://msme.gov.in/sites/default/files/FINALMSMEANNUALREPORT2023-24ENGLISH.pdf> (p. 23).

² Ministry of Micro, Small and Medium Enterprises. (2024, July 22). Contribution of MSMEs to the GDP [Press release]. Press Information Bureau. Retrieved from <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2035073>

³ Udyam Registration Portal (Data as on November 12, 2024) <https://udyamregistration.gov.in/Government-India/Ministry-MSME-registration.htm>

⁴ National Mission for Capacity Building of Bankers