



MSMEs For Resilient National Economy

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This article is based on **MSMEs are hit by risk-averse banks** which was published in The Hindu Business Line on 17/08/2021. It talks about the issues related to the MSME sector and the way forward.

The Prime Minister's dream of a **USD 5-trillion Indian economy by 2025** along with effective **financial inclusion** and sustainable economic outcomes is premised on investment from both domestic and foreign investors. Government expenditure can only provide a stimulus, but cannot alone take India to PM's goal.

For domestic private investments to happen, the role of timely, adequate and quality (low cost) credit cannot be overstated, particularly during the current times when Covid-19 induced stress is maximum on almost all industries.

With the recent change in the definition, more than 95 per cent of Indian companies are bought under the definition of MSMEs. However, the need of the hour is to identify the issues MSMEs face today and rectify urgently.

Issues With MSMEs

- **Issues of Access to Credit:** Most of the MSMEs are in rural and semi-urban areas where access to credit is extremely limited.
 - They are vulnerable to predatory moneylenders and often fall into a cycle of debt.
 - Lack of access to finance and timely credit support in business has been a long-standing issue for these MSMEs.
- **Under Severe Debt:** Due to difficulties faced in seeking loans and working capital from banks and delay in receiving government payments and tax refunds, most of the MSMEs are under severe debt.
- **Dependence on Informal Sources:** According to a study, there is an overall debt demand of Rs. 69.3 trillion of which 84% is financed by informal sources such as moneylenders, family, friends, chit funds.
 - Formal sources such as commercial banks, NBFCs and government institutions cater to a mere 16%.

- **Majority of Firms are Small:** More than 80% of these MSMEs are in the micro and small category.
 - The benefits of the government's emergency line credit, stressed asset relief, equity participation and fund of funds operation are not able to reach them.
- **Issue of Credit Assessment:** Banks employ various methods to limit risk by better assessment of the creditworthiness of individuals or firms, MSMEs included.
 - While determining creditworthiness, there are two errors that are common — **False Acceptance of a bad applicant and False Rejection of a good applicant.**
 - The former error is detrimental for banks and increases risk while the latter impacts financial inclusion and economic growth itself.
 - To keep **NPAs** down, many credit worthy individuals are denied loans by banks.
- **Lack of Paperwork or Digital Footprint** for small MSMEs, a factor which holds them back from being integrated into the formal economy and deprives the MSMEs to take advantage of the formal credit system.
- **Technological Disruption:** India's MSME sector is based on obsolete technology, which hampers its production efficiency.
 - The emergence of new technologies like Artificial Intelligence, Data Analytics, Robotics and related technologies (collectively called as Industry Revolution 4.0) is a bigger challenge for MSMEs than for organized large-scale manufacturing.

Way Forward

- **Focused Regulatory And Structural Changes:** It will improve access, ease the transition to the formal sector and increase consumer education and protection.
 - In the long term, once these regulatory issues are addressed, sanctioned loans will be disbursed more easily and private investment will be boosted, creating a **virtuous cycle for MSMEs** in the country.
- **Minimise the False Rejections of Good Applicants:** Routine audits of all loan applications on random sampling basis must be undertaken by **RBI** and administrative action taken against malafide omissions resulting in unethical denial of loans to deserving MSMEs.
- **Creation of Independent Regulator:** Given the growing importance of the data economy, it is paramount that the government creates an independent body which can advise and provide consultancy to MSMEs and enable them to grow in this new, digital world.
- **Use of Technology:** The traditional bank lending system by banks is based on financial statements and collateral of the borrower. With increased availability of data from several sources, including GSTN, income tax, credit bureaus, etc., it is now possible to appraise the MSME loan proposals expeditiously by doing due diligence online.

- **Upgrade Infrastructure Utilities:** There is an urgent need to upgrade infrastructure utilities (like water, power supply, road/rail) for any enterprise to run its operations successfully.
 - Moreover, entrepreneurs need to develop quality conscious mindsets embedded in the organisational culture.
 - Sensitisation and handholding of MSMEs at different and upgraded levels of certification is the need of the hour.

Conclusion

MSMEs are the backbone of a resilient national economy. Prioritising their development is critical to the future of the country. The government has come out with a variety of enabling mechanisms over the last few years.

India needs more such measures, especially in the current environment. The next decade will be the metamorphosis of India from an emerging power to an established economic powerhouse and MSMEs will be an important cog in the wheel on this journey.

Drishti Mains Question

MSMEs are the backbone of a resilient national economy. In the light of the given statement discuss the issues faced by the MSMEs.
