Policy on Credit Rating for MSMEs

Why in News

The government is in the process of **formulating a policy on credit ratings** for **micro, small and medium enterprises (MSMEs)** to help investors and other players take an informed decision.

- The government plans to start **digital data-based credit system.**

Key Points

- **Challenges with the current system-**

    - **Under-served:** MSMEs have remained largely **under-served by Financial Institutions** despite their contribution to the economy.
    - **Creditworthiness:** It is a **difficult task** for banks and financial institutions **to assess the creditworthiness, choosing enterprises with good CIBIL score, detailed audited financial statements or have assets to offer as collateral.**
    - **Availability of Finance: Service-oriented SMEs** are **unable to mortgage their equipment against loans** like the manufacturing sector, posing a challenge for them to avail finance.
    - **Credit Flow:** There is a **gap in the availability of funds to the SMEs and the government's focus on increasing credit flow** to this segment which needs to be filled up.
- **How will the digital data-based credit system help the sector?**

    - Alternative credit scoring based on digital data gives the lender a **more holistic view of a borrower's creditworthiness and associated risks for credit underwriting.**
    - New sources such as **transaction data and surrogate data like utility payments, bill payments** give a **detailed view of the business.**
    - **Deploying credit underwriting mechanisms** powered by advanced technologies such as **Artificial Intelligence (AI), machine learning and data analytics** can provide **useful insights.**
    - Each of the **data points can be treated as variables for credit appraisal** and can be **assigned specific weightage depending on the nature of the businesses** within the overall MSME segment.

Source: TH

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