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Government can set up task force to promote supply chain finance for MSMEs

Micro, small and medium enterprises (MSMEs) provide jobs to 110 million people, or 40% of the non-farm workforce, contribute 25% to India's services GDP and 33% to manufacturing output. Digitization of financial services holds promise for inclusive economic development, with greater access to credit for MSMEs, whose financial needs have not been fulfilled by the banking system. According to a survey by the Asian Development Bank in 2019, the major reasons for MSMEs not being able to access bank credit are: 1. Lack of sufficient collateral, 2. they are viewed as completely unsuitable for support and 3. lack of sufficient KYC (know your customer) data. Also, banks don't find this segment of borrowers profitable enough to process their loan applications.

A report, titled Connected Commerce, released by NITI Aayog last week highlights the roadmap for promoting inclusive economic growth through digitization of financial services. The report notes that economic growth in countries such as China, South Korea and recently Vietnam have been fuelled by increase in flow of credit to the private sector, which is reflected in the rising private credit to GDP level in these countries. In India, private credit to GDP ratio is still low compared to these countries, which has hindered economic growth in India. There is a growing need for our industry to be supplied with the necessary liquidity, the report points out. To promote credit flow to the private industry, the role of fintech companies has been highlighted in the report.

The report has identified lack of formalization of MSMEs as one of the impediment to their access to institutional credit. In order to promote formalization of MSMEs, the NITI Aayog report suggests digitizing registration and compliance process for labour, tax filings, environment, health, safety and other statutory compliance.

The report points to global best practices in digitizing compliance, such as in Singapore where traders can obtain all necessary import/export related permits or certificates and customs declarations through the single window platform "TradeNet".

The report suggests the government to strengthen the peer to peer (P2P) lending industry in India, where there are already 19 P2P lenders, who have so far facilitated more than Rs. 500 crore worth of loans. Specifically, Reserve Bank of India can promote electronic contracting for P2P transactions, that will prompt borrowers to honour their loan obligations legally. Also, the RBI should strengthen compliance requirements for mandatory reporting on payment defaults, so that this will create data on credit history of borrowers, which will be available for all the players in the industry for basing their future lending decisions.

Another issue flagged by the report is the slow adoption of digitization by small enterprises. Access to formal credit is restricted to only 10% of small businesses because of lack of data in the absence of digitization of these enterprises. In order to address data gap, the report has suggested allowing eligible fintech companies to access Account Aggregators and GSTN (Goods and Service Tax Network) for efficient and seamless loan disbursal to MSMEs and retail borrowers.

Supply chain finance is one of the ways to fulfill the credit needs of MSMEs. The report identifies two main reasons for the slow adoption of supply chain finance, namely, difficulty in onboarding MSMEs digitally, and getting buyers to accept receipts on a digital portal for supply chain finance.

The report suggests the government to set up a task force for promoting supply chain finance. This task force should examine innovative ways of MSME financing by using non-traditional data to determine credit histories of borrowers and models for providing early stage financing. The task force should also lay out roadmap for transition to rating-based models for data-driven credit risk assessments and propose other measures to promote supply chain finance.

Addressing last mile gap in digital financial inclusion

Although the report notes progress in digital financial inclusion in rural areas through the opening of Jan Dhan bank accounts and direct cash transfer to the bank account of government scheme beneficiaries, the report points to gaps at the last mile. The break in the digital financial flow comes at the last mile where account holders have to withdraw cash or write physical checks for their end use, the report points out.

To address this last mile gap, India needs to create a strong acceptance infrastructure to ensure that merchants are able to accept digital payments and support the transition from cash to digital payments. In this regard, the report calls for acceptance infrastructure that accepts and support customer payments made through mobile phones, cards, bank accounts, and comprise dedicated point of sale (PoS) devices, mobile PoS apps, and QR-code systems, among others.

One of the recommendations made by this report is to encourage non-banks to build acceptance infrastructure, allow payment schemes to induct non-banks as associate members, and thereby become active members of the acceptance ecosystem.

Notifications

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