

## Revolutionizing MSME Financing: The Role of Open Banking in Driving Growth

### A Closer Look at Credit Access and Growth in India

- Financing for Indian MSMEs has been challenging in recent years.
- Informal and owner-occupied loans are common due to limited access to formal credit channels.
- Scheduled commercial banks have increased credit to MSMEs by 71% in eight years.
- Quarterly MSME disbursements have doubled, indicating growth in payments.
- MSME loan accounts receiving credit grew by 201% from FY15 to FY21 but declined in FY22.
- The government's ECLGS provided support during the pandemic with a significant number of approved loans.
- Micro enterprises benefit the most from bank credit, showing growth in loan accounts and amounts.
- Informal sources and personal proprietor loans are still prevalent for MSME borrowing.
- Open banking initiatives, digital payments, and data sharing platforms improve credit access.
- Technologies like UPI and the Account Aggregator network simplify processes and enhance credit assessment.
- Democratizing data and digital investments can drive inclusive socioeconomic development.
- MSMEs have significant growth potential and contribute significantly to India's economy.

### Struggles and Disparities in MSME lending in India

1.93 crore micro units received 45% (Rs 9.78 lakh crore) of the total loan amount given to MSMEs in FY23 (through December), 16.83 lakh small businesses received 34% (Rs 7.34 lakh crore), and 3.20 lakh medium-sized businesses received only 20% (Rs 4.37 lakh crore).

The GSTN was added as a Financial Information Provider under the Account Aggregator architecture with the goal of facilitating cash flow-based lending to MSMEs.

In the last eight years, scheduled commercial banks' credit MSMEs has increased by 71%.

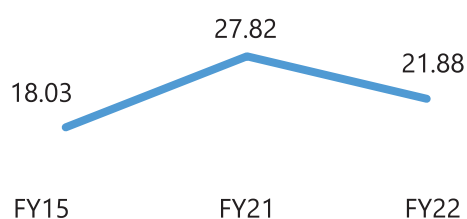
According to the RBI's most recent monthly data on sectoral deployment of bank credit, priority sector loans by value made to MSEs by scheduled commercial banks increased by 13% YoY in February 2023 compared to an increase of 11.4% YoY in February 2022. In February of this year, MSEs used bank credit of Rs. 15.61 lakh crore, compared to Rs. 13.81 lakh crore in February of previous year and Rs. 15.34 lakh crore in January of 2023.

The amount of credit given to medium-sized businesses increased by 12.4% in February, from Rs 3.47 lakh crore to Rs 3.90 lakh crore. 3.93 lakh crore was allocated to medium units in January 2023.

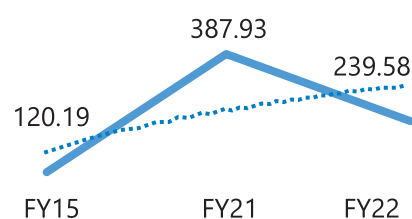
Quarterly MSME disbursements have increased by two times. From 2.69 lakh crore rupees in Q2 FY22, payments witnessed a significant increase compared to 1.69 lakh crore rupees in Q1 FY22. This growth continued with 3.03 lakh crore rupees in Q3 FY22 and further rose to 3.25 lakh crore rupees in Q4 FY22.

The number of MSME loan accounts that received credit increased by 201% from 1.39 crore in FY15 to 4.20 crore in FY21 but decreased to 2.64 crore MSMEs in FY22 despite growth in the loan amount.

Small enterprises loan accounts (lakh crore)

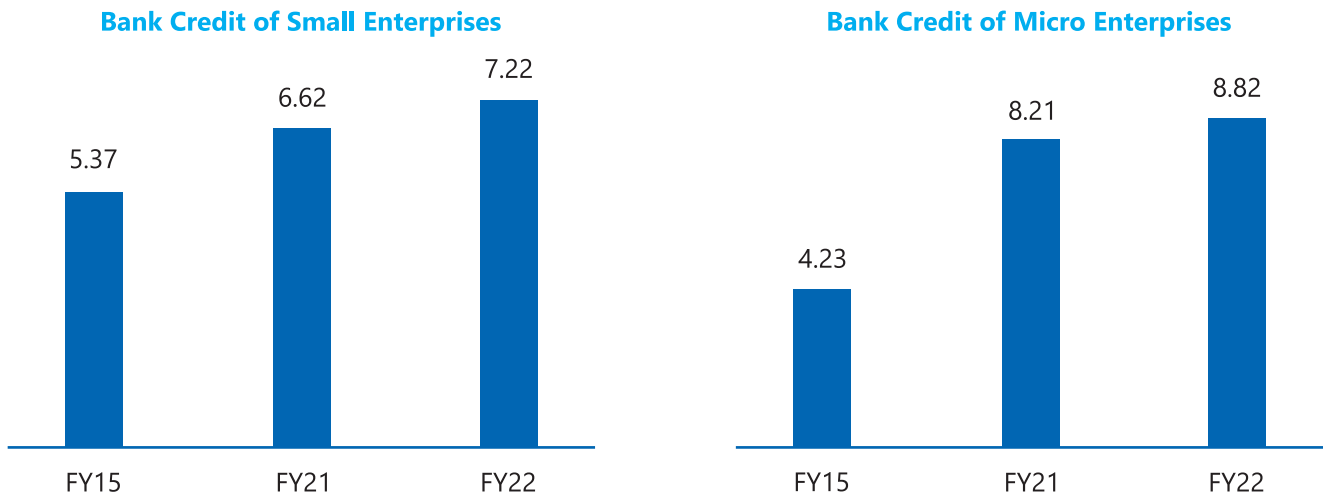


Micro enterprises loan accounts (lakh crore)



Despite the Covid epidemic, banking institutions had provided MSMEs and independent contractors with loans under the government's Emergency loans Line Guarantee Scheme (ECLGS), which was introduced in May 2020. As of December 31, 2022, the plan had approved 1,19,27,348 loans totalling Rs 3,60,539 crore, according to figures given by Verma in February of this year in the Parliament. Maximum loans were issued in FY21 with 95,41,572 loans totalling Rs 2,36,999 crore and in FY22 with 23,00,424 loans totalling Rs 99,377 crore. Up till the end of December in FY23, 85,352 loans totalling Rs 24,162 crore were approved.

The maximum beneficiaries of the bank credit were micro enterprises with loan accounts jumping from 120.19 lakh involving Rs 4.23 lakh crore in FY15 to 387.93 lakh involving Rs 8.21 lakh crore in FY21. In FY22, the loan account volume dropped to 239.58 lakh even as the amount grew to Rs 8.82 lakh crore. In comparison, only 18.03 lakh small enterprise accounts raised Rs 5.37 lakh crore in FY15 while in FY21, 27.82 lakh accounts raised Rs 6.62 lakh crore in FY21. In FY22, 21.88 lakh small enterprises raised Rs 7.22 lakh crore.

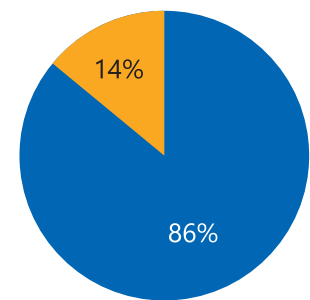


MSMEs in India struggle to obtain and afford loans despite producing nearly a third of the nation's GDP and employing over 11 crore people. The sole MSME sector accounts for 26.83 percent of India's GDP.

However, the growth, almost 40% of MSME borrowing is made through the informal market, where interest rates are at least twice as high as those in the legal market. Another 25% of MSME borrowing is made through personal proprietor loans, which are invisible.

- Out of over 6.4 crore MSMEs in India, the report said only 14 per cent have access to credit. While the overall finance demand by MSMEs was pegged around 195.5 lakh crore with a 3.8x debt-to-equity ratio, the total demand for debt-based finance was approximately 154.4 lakh crore.

Because 47% of the debt demand originates from "enterprises which are not financially viable or prefer financing from informal sources," it is projected that this demand cannot be met. Thus, only 28.9 lakh crore of the remaining loan demand, or 81.9 crore, was met by formal credit lenders such as commercial banks, state banks, and NBFCs.



Msme Having Access To Credit

## Democratizing Access To Financial Data

Digital payments in India have undergone a revolution thanks to advancements in open API-led platforms like the UPI and rising smartphone usage. The RBI's most recent announcement about pre-approved credit on UPI can help neglected groups access credit even more.

Democratising access to information is proven to be a game-changer as well. The adoption of the Account Aggregator network is revolutionising financial transactions and accelerating and lowering the cost of lending by enabling secure and consent-based financial data sharing between clients and regulated financial institutions. Customer journeys are improved, and regulated lenders are more competitive as a result of the GSTN's participation as a financial information supplier in the Account Aggregator network.

These changes have a number of advantages. They make client consent processes simpler, provide access to GST data that enables risk-based pricing and cashflow-based lending, levels the playing field for competitive lending, and provides value-added services based on regular data flows. To improve credit assessment and close the current MSME lending gap, banks and NBFCs must combine existing and new data sources, such as GST and e-invoice data.

## Outlook

The future of open banking's contribution to the expansion of MSMEs in India looks bright. Despite difficulties in obtaining credit, MSMEs are being helped by positive developments like collateral-free loans, credit guarantee programmes, and the adoption of digital payments.

Digital transactions have been revolutionised by the incorporation of open APIs and platforms like UPI, and the Account Aggregator network makes secure data sharing for improved credit assessment possible. The lending gap can be closed by utilising new data sources like GST and e-invoice data.

These programmes, along with the government's encouragement and focus on technology adoption, point to a positive future for MSMEs. Although there are still difficulties, the emphasis on open banking and digital investments has the potential to change the financing environment and support MSME growth, which is crucial for India's economy.



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