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CMA Bhawan, 84, Harish Mukherjee Road, Kolkata- 700 025

Phones : (033) 2455-6666/9999/3418/5957, 6533-1075/6456-3600/01/02/03, 6450 4305

Fax No. : (033) 2455-7920 E-mail : eirc@icmai.in Website : www.eircoficmai.com

Digital Initiatives and Financial Architecture of MSME Sector in India

CMA Arindam Banerjee

Faculty - Finance and Accounting, Birla Institute of Management Technology, Greater Noida
arindam20011@gmail.com

Introduction :

Over the years, the Micro, Small and Medium Enterprises (MSME) sector in India has emerged as a highly dynamic and vibrant sector of the Indian economy. MSMEs not only play an important role in providing huge employment opportunities at relatively lower capital cost compared to big size industries but also help in industrialization of rural & industrially backward areas. This reduces regional imbalances, and assures a more equitable distribution of national income and wealth. MSMEs also play a complementary role to large industries as ancillary units and the contribution of this sector is enormous, as far as the socio-economic development of the country is concerned. The growth in terms of employment and investment may be viewed in fig 1 below:

Fig 1: Performance of MSME sector in terms of employment and Investment

Sl. No.	Year	Total Working Enterprises (in lakh)	Employment (in lakh)	Market Value of Fixed Assets (₹ in crore)
I	II	III	IV	V
1	2006-07	361.76	805.23	868,543.79
2	2007-08*	377.36	842	920,459.84
3	2008-09*	393.7	880.84	977,114.72
4	2009-10*	410.8	921.79	1,038,546.08
5	2010-11*	428.73	965.15	1,105,934.09
6	2011-12*	447.64	1,011.69	1,182,757.64
7	2012-13*	467.54	1,061.40	1,268,763.67
8	2013-14*	488.46	1,114.29	1,363,700.54
9	2014-15*	510.57	1,171.32	1,471,912.94

* - Projected.

Source: Ministry of MSME

MSME sector also makes a significant contribution to India's GDP, exports and employment.

The growth story is depicted in fig 2 below:

Fig 2: Share of MSME sector in GDP and total manufacturing output

(at 2004-05 prices)

Year	Gross Value of Output of MSME Manufacturing Sector (₹ in crore)	Share of MSME sector in total GDP (%)			Share of MSME Manufacturing output in total Manufacturing Output (%)
		Manufacturing Sector MSME	Services Sector MSME	Total	
2006-07	1198818	7.73	27.40	35.13	42.02
2007-08	1322777	7.81	27.60	35.41	41.98
2008-09	1375589	7.52	28.60	36.12	40.79
2009-10	1488352	7.45	28.60	36.05	39.63
2010-11	1653622	7.39	29.30	36.69	38.50
2011-12	1788584	7.27	30.70	37.97	37.47
2012-13	1809976	7.04	30.50	37.54	37.33

Source: Ministry of MSME Annual Report (2015-16)

It can be clearly visible from fig 1 and fig 2, that despite of increase in number of enterprises and quantum of employment, the share of MSME manufacturing output in total manufacturing output remained stagnant, even declined a little over the years.

The two key reasons for this stagnation could be:

- Lack of digitization and use of technology by MSME sector
- Deficit of structured and organized financing options available to MSME sector.

One of the key reasons behind it could be lack of structured and quality financing option available to MSME sector. Access to quality financing is always an issue with MSME sector in India. For thousands of micro, small, and medium enterprises spread across India, the problem of reaching an organized financial sector is always a problem. Sometimes, it really becomes very difficult to arrange credit for small enterprises. Creation of a structured digitised ecosystem and financial architecture is absolutely essential for facilitating a congenial environment for MSMEs in India. This paper

deliberates on the key issues related to the digitization and financial architecture of MSME sector in India.

Key problem on MSME Financing

Pursuant to the Budget Announcement for FY2014-15, regarding setting up of a Committee to examine the financial architecture for the MSME sector the Department of Financial Services, Ministry of Finance appointed a Committee under the chairmanship of Mr. K V Kamath.

The committee identified the following key issues:

- **Equity as a source of financing is underutilised and the prevalence of investment by venture capital and angel investors is low:** In developed countries, the MSME sector often taps the capital market through equity route. In India, the scenario is different. Here MSMEs mostly rely on friends & family as sources of equity. The reason could be a long-winding process of equity issues along with the involvement of cost and lack of awareness.
- **Delayed payment from buyers:** Markets are often dominated by large corporate players. The terms for payments are often decided by them. This creates huge problem for them in operating and attaining optimum performance.
- **Lack of utilisation of the available credit guarantee and insurance schemes:** MSME sector is facing capacity constraints and conditions that limit eligibility. Hence, many a times the organizations are failing to utilize even available facilities on credit guarantee and insurance schemes
- **Lack of adequate information availability:** MSMEs are often not aware of the facilities and benefits especially available to them from the government.
- **Difficulty in credit risk assessment:** Banks and financial institutions often face difficulty is assessing the credit risk of an enterprise.
- **Lack of organizational structure and non-corporate nature:** Overall, the outreach to MSMEs, on-boarding as customers, building up of transaction & credit history and scaling up the utilisation of various schemes

available is challenged by the lack of formal legal structure/non-corporate nature of much of the sector.

Role of digitization in fostering growth of MSME sector

One of the major weaknesses of MSME sector is lack of use of technology. Many of the drawbacks mentioned above may be addressed successfully by using technology. The Kamath Committee also recommended creation a financial architecture for the MSME sector that would use technology driven platforms to drive inclusion in financing of the large number of MSMEs which do not have access to credit. This will facilitate realisation of the 'Make in India' goal as articulated by the Prime Minister and be in consonance with the Government's 'Digital India' mission.

Digitization not only helps the MSMEs in smooth synchronization of transactions, but also facilitates financial inclusion of organizations in the informal sector. Use of online registrations Using the Udyog Aadhar and bank account, the National MSME Portal may link/ identify MSMEs for the purpose of (i) credit guarantee & insurance schemes (ii) other government benefits (iii) requisite central, state & local approvals for setting up & operating businesses (iv) credit bureaus (v) an effective receivables financing platform, and (vi) financial intermediaries. All these entities/ schemes would leverage the formalisation of MSMEs achieved through the Udyog Aadhar and bank account, including the benefits which can flow into this account as a direct benefit transfer (DBT) for small business, to enhance outreach. In due course, technology & connectivity should be leveraged to bring these processes online and straight through as far as possible. This would be in consonance with the Government's vision of a Digital India. Appropriate changes in statutes would encourage MSMEs to gain the benefit of limited liability by adopting suitable legal structures. This will also encourage the MSMEs to adopt equity route for larger financing.

Steps taken by government towards digitization

The ministry of MSME has already taken few important steps towards digitization:

- **Creation of E-Office:** E-Office initiative has been introduced to achieve paperless office in the Ministry. Movement of e-files has been started and digitalization

of existing physical files for converting the same into electronic files has been completed.

- **Mobile Friendly Website:** The website of the Ministry and Office of the DC MSME has been made mobile friendly. With this, entrepreneur friendly content can be easily accessed through any mobile and tablet <http://msme.gov.in> and <http://dcmsme.gov.in>
- **Development of online softwares:** Following online softwares are developed by ministry of MSME
- PPS (Physical Performance of Plan Schemes) (<http://msmedi.dcmsme.gov.in/DcWebManager/userlogin.aspx>)
- EET (Energy Efficiency Technology Up-gradation) (http://nmcp.dcmsme.gov.in/Admin/EET_Userlogin.aspx)
- MY MSME App (MSME Helpline) (Android App & Desktop Version) (<http://cluster.dcmsme.gov.in/helpline/welcome.html>)
- Single login online Application Schemes (Desktop Version & Android App) (<http://msmedi.dcmsme.gov.in/dcsmseapp.aspx>)

Steps taken by banks towards digitization

The banking industry also rose up to the occasion, and is taking several fresh steps towards digitization of MSME space:

- **Quick application processing:** With digitization, the application processing time has shortened drastically. This removes a major bottleneck in SME financing.
- **Less processing cost:** With lesser time for processing,

the cost has also got reduced.

- **Cloud based credit scoring:** Credit assessment is always a major challenge for MSME sector. Enhanced technology now enabled the banks to make credit scoring backed by big data analytics. The scores are now more accurate at a lesser cost, and also enabling the MSME sector for faster loan.
- **Highly automated pricing and decision making:** Banks now have the power of real time data analytics. They can collate data from various sources e.g. social media, credit bureaus, and online banking data.
- **Dedicated Mobile apps:** Banks are also creating dedicated mobile apps for MSME customers. This helps the MSME customers always remain in touch with their bankers

Conclusion

Micro, Small and Medium Enterprise (MSMEs) are part of the ecosystem, which is getting changed by the digital revolution. The new trends in MSME financing too are getting influenced by digital revolution. This includes analytics based lending, peer to peer lending and various other variants. Government has also undertaken several initiatives towards achieving the goal of Digital India, and Make in India.

Even the conventional modes of financing are getting better enabled through the use of technology. The regulations and infrastructure is also enabling far more easier and effective funding especially around ARP and supply chain. There is similar improvement happening on a host of trade, Forex, and transaction based solutions which are facilitating financing to MSMEs much more effectively and competitively.