

ROLE OF LENDING TO ENHANCE SMALL ENTERPRISES IN INDIA

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ABSTRACT

Micro, Small, and Medium Enterprises (MSMEs) play a vital role in the economic growth and development of countries worldwide. In India, the MSME sector has emerged as a significant contributor to employment generation, innovation, and entrepreneurship. In this blog, we will explore the importance of MSMEs, their role in India's economy, and how MSME loans support small businesses and small businesses in their journey towards success. Traditional lending methods prevent micro-enterprises from accessing credit to grow their operations. As the economy enters the next credit cycle, banks are finding both opportunities and challenges in the market for lending to small and medium-size enterprises (SMEs). Although volumes are growing slowly, most banks are not reaching their full potential. Many still use old business models, rely on legacy processes, and even view SMEs as corporate entities. By failing to meet the needs of these businesses, banks are leaving opportunities on the table.

Keywords: Micro, Small, and Medium Enterprises, loan, bank, economy, business.

1. INTRODUCTION

India's micro-, small, and medium enterprises (MSMEs) sector plays a vital role in the country's economy, contributing to approximately one-third of its GDP. A majority of the sector, approximately 99 percent, constitutes of micro-enterprises, classified as those with investments of up to INR 1 crore and a turnover of up to INR 5 crore. The sector also includes small enterprises, with investments of up to INR 10 crore and a turnover of up to INR 50 crore, and medium enterprises, with investments of up to INR 50 crore and a turnover of up to INR 250 crore. However, micro-enterprises seldom expand or convert into these small or medium enterprises, leading to a phenomenon known as the 'missing middle'.

There is no one-size-fits-all approach to suit every bank and market, but banks that rethink their SME-lending businesses can increase their market share and promote profitable growth. For most banks, this starts by developing a strategy and a clear vision of product offerings and then rendering them for the targeted customers with a streamlined, robust experience. By using advanced analytics and purpose-built processes and infrastructure, banks can make decisions instantly and use risk-adjusted pricing to boot.

The operating model banks need to thrive in this market combines the right technology, new ways of working, and continuous performance monitoring—the components of proven recipes we have seen work for banks in the past. The emphasis on different levers depends on the specific situation.

New trends and new opportunities in SME lending

The economic impact of the COVID-19 pandemic has ended the previous credit cycle and left businesses across the globe reeling. In this new credit cycle, SME lending will be not only one of the most economically important but also one of the most profitable contributors to banking revenues. According to a World Bank report, the world's micro, small, and medium-size enterprises have unmet finance needs of approximately \$5.2 trillion a year, roughly 1.5 times the current lending market for such businesses.

Despite the opportunities that lie ahead, banks often struggle to create the right lending solutions for their SME customers and to cut the cost of serving them. These small and medium-size businesses should be seen as highly sophisticated retail customers. Combining expert judgment and data-driven approaches that can be automated and scaled will cut the cost to serve and the associated risk costs.

Several trends in the postpandemic market will influence how financial institutions can capitalize on SME-lending opportunities:

The use of forward-looking data sources and cutting-edge modeling techniques. More banks across the globe are starting to leverage transaction data, online sales, or telco data to assess SME-lending risks and enhance the performance of credit models.

Technology is now a differentiator

Banks are increasing their investments and integrating tech platforms to adopt a modular approach to SME lending. The most successful of these banks develop their sweet spot and integrate these investments with their existing systems.

Digital engagement is mandatory

In the past, digital engagement was merely “good to have” in SME lending. Now it is mandatory. Increasing the level of digital engagement with customers and reducing the number of manual processes for approval will help retain customers and attract new ones.

A suite of services

Fintech and big-tech companies previously led the disruption in SME lending, but now more banks want to provide a suite of services, including, for example, invoicing and payroll processing. This makes the lending bank a kind of community to help SMEs unlock other problems on their growth trajectory.

The building blocks of the new SME-lending model

In working with our clients in the financial industry, we have discovered many recurring themes that increase the odds of success in SME lending. Using four building blocks—strategy, process, analytics, and operating model—these banks create unique models for profitable growth in this new landscape.

The use of these levers to reimagine SME lending can have a significant impact on the bottom line. Higher conversion rates and increased margins can boost revenues by 10 to 15 percent. Digitizing the customer journey and touch-time reductions can yield operational-efficiency gains of 20 to 30 percent. Finally, by enhancing risk models and making decisions in more consistent way, banks can reduce the risk of nonperforming loans (NPLs) by 10 to 25 percent.

Since there is no universal solution to credit-lending models, banks and lenders must identify and design the lending process to align with their aspirations and business objectives. To chart the most optimal transformation journey for their missions and markets, banks should consider key elements across the four building blocks (see sidebar “Four building blocks to small and medium-size enterprise credit-lending transformation”).

Strategy

As banks set out to find a strategy to meet their needs, they should consider several factors, including target segments, SME pain points, and the best ecosystem model. In many countries, SME markets have their local intricacies, but they also share commonalities that make scaling up across borders easier from a cost and go-to-market standpoint.

One key element is to lock in the target client segment and value proposition so that the bank can grow profitably. To determine the suitable design options for each dimension, banks must consider objectives, segments, customers, products, regions, processes, and channels. By asking questions and identifying targets in each dimension, they can then use the most effective design options. An understanding of the pain points that the SMEs in the target segment experience then helps the bank create a product and coverage model. These products should be explicitly targeted to the SMEs’ pain points at each phase, from launch and growth to connecting with the community.

A further component of the strategy is determining what role partners can play in the SME-lending model. Establishing the right ecosystem partnerships can help banks create unique forms of data access and a captive customer base through unique product offerings. The partners can help the banks develop the best and most distinctive product offerings by more effectively targeting subsegments and innovating and by thinking like an SME.

One European bank, for example, has partnered with an e-commerce marketplace to provide a flexible digital-lending solution to merchants that sell on its platform. The bank did so to target the subsegment of small businesses migrating toward the online space.

Streamline the process

From the end-to-end digitization of the credit process to the creation of clear segmentation rules, maximizing the efficiency of the SME-lending process can help banks generate more opportunities and to close more loans. Now, more than ever, banks must reimagine the SME customer experience. The most frequently noted pain point for SME borrowers across the globe is uncertainty and delayed time to funding. Automated lending can significantly streamline processes. By redesigning and digitizing a significant portion of the customer journey, banks can substantially enhance the SME experience.

Rethinking legacy policies and processes can also help streamline lending. Many of these policies and methods have multiplied organically over time and no longer meet the needs of today’s SME customers. By clearly segmenting rules by credit details, risk, policy, and complexity, banks can refine their swim lanes to extend automated processing and assessment where feasible and to reserve manual expert review for complex, high-value cases. The best policies and processes enable banks to increase their straight-through processing of customers and to route only a carefully sized and selected proportion of applicants through manual checks.

Redesigning the credit memo and credit-decisioning process with standardized documentation also significantly enhances the efficiency of the process. By creating a single source of truth, a bank can automate data retrieval for

decision making with a digital signature and track changes for the next actor. This process vastly accelerates underwriting with decision making, enhances the experience of relationship managers, ensures a complete audit trail, and typically reduces “time to yes” by 50 percent (and significantly more in situations characterized by repeated information requests to customers, triggered by manual-review processes). For example, an emerging-market bank, keeping in mind the customer experience, recently redesigned its processes to offer preapproved loans in minutes to its small-business customers using the bank’s mobile app.

2. ANALYTICS

Banks frequently still drive decisioning through a monolithic infrastructure and rarely envision developing analytical models for cross-functional use. By taking a modular approach with legacy and new data sources, they can unlock the true potential of the available data by using analytics for other cross-functions, such as sales, marketing, and pricing. Capturing real-time credit insights from transactions and sales will enable banks to enhance the performance of their credit models significantly. Establishing a modular framework for SME credit models also enables banks to build predictive models sequentially with expanding data. This modern architecture offers many advantages over traditional methods: for example, it allows banks to leverage information for each client’s decision making and to enhance the existing decision engine with expanding data. Banks can use these credit models not only for instant decisioning but also for cross-selling opportunities. In addition, banks can reimagine SME credit lending through dynamic, risk-adjusted pricing and limit setting. SME lending depends on bespoke offerings catering to unique customer needs and thus requires an advanced pricing engine to help relationship managers anchor negotiations at a suitable price range. A European bank, for example, put in place a modular design for model architecture, using forward-looking real-time data on merchants’ customer feedback to review and reassess the limit and pricing on a regular basis.

Operating model

Although strategy, process, and analytics can help identify new SME-lending opportunities, banks must also identify the right operating model and supporting infrastructure to put things into practice. The target model must include service operations and new ways of working with a centralized credit authority to adjust business models, increase regulatory preparedness, enhance effectiveness, and improve efficiency. Banks also need to base their IT architecture and technology options—from legacy to next-gen ones and from specialized to full-suite platforms—on their current loan book and scale-up aspirations. Redesigning the end-to-end process does not necessarily imply a greenfield IT approach; a new front end can be built on top of the existing core banking IT. Nonetheless, some players have opted for a greenfield cloud-native stack. Banks are also partnering with fintech players to revitalize offerings and digitize processes across the SME-lending value chain. Digitizing the performance monitoring of not only the portfolio but also of the core models, the relationship manager’s workbench, and the overall business allows banks to gain capital efficiency, to make staff more efficient by reducing the time it spends extracting and reporting on data, and to reduce the number of defaults by ensuring timely action on, for instance, model corrections and the performance of clients.

A pure digital SME-lending player

Consider the case of a large European bank that saw both challenges and opportunities in the lending market as a result of changing customer needs, the fintech disruption, and other competitive pressures. To capitalize on the new opportunities, the bank designed and built an entirely separate pure digital player in only nine months. Moving quickly to launch ensured speed to market and preempted competitors in the emerging business. The fully digital SME-lending bank offered instant decisions—funding within 24 hours and loans of up to €250,000 in a wholly digital format. It enjoyed a customer growth rate two times faster than the segment as a whole and had a customer satisfaction score of more than 70. Sixty percent of the new customers came from competitors, and the digital bank was recognized as the most desired bank for SME lending in the bank’s home market. This seamless new customer experience offers a transparent view and a fully digital application process that takes only 15 minutes (see sidebar “Example of a seamless customer experience for lending”). From there, the customer can digitally sign the contract, receive the funds within 24 hours, and manage the entire loan online, just like a retail customer.

3. CONCLUSION

The MSME sector in India plays a critical role in driving economic growth, employment generation, and entrepreneurship development. Small businesses and small businesses within the MSME sector contribute to innovation, regional development, and balanced economic growth across the country. MSME loans play a pivotal role in supporting small businesses and small businesses in their journey towards success. These loans provide access to capital, facilitate business expansion, promote technical upgrades, enable skill development, and offer support during challenging times. Moreover, government initiatives and schemes further bolster the role of MSMEs by providing financial assistance, collateral-free credit, and entrepreneurship promotion programs. There is no better time than now

for banks to build up their credit offerings. By working across silos—that is, between the business, risk, IT, and other supporting functions—departments can collaborate on adopting new strategies that take a holistic approach to the market's business opportunities. By optimizing strategies, processes, analytics, and operating models, banks can set themselves up for successful change and be ready to capitalize on emerging growth in SME lending.

Banks should now embark on a modernizing journey by analyzing various aspects of the current business, especially these:

- current pain points in the credit process and the way the bank functions
- quantitative benchmarks of efficiency and effectiveness and how the bank stacks up against peers and its own aspirations
- credit capabilities and the critical gaps banks should focus on
- the short- and long-term value at stake for the transformation journey
- a road map with the vision and the sequencing of the initiative for maximum benefits and ease of implementation

4. REFERENCE

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