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Research Article

# Promoting Digital Marketing and Innovative Lending in MSME Industry

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**ARTICLE INFO** | **ABSTRACT**

Micro, small and medium enterprises play a key role in driving economic activity, innovations, and job creation in most developing and developed economies while working with a low capital base. Timely access to credit at affordable cost is essential for MSMEs to expand their operation and benefit from economies of scale. Micro enterprises that account for almost 99% of all MSMEs do not benefit from economies of scale because of the small size of operation. Availability of finance at minimum cost will help these enterprises expand their operation and also upgrade their technologies to become globally competitive.

Private Banks find it difficult to cater to the MSME segment as it is often very price sensitive. When the banks push the costs of personalized service and non-financial services to customers, it naturally drives up the cost of access to finance. Investments in technology and meeting mandatory compliance requirements of the Central banks are also pushing up the costs (MVIRDC W. T., 2019). Digital lending platforms help to utilize technology and to create unique customized loan products. SMEs are invariably keyed into bigger supply chains, whether as suppliers or customers. Because of the nature of these businesses, they confront various challenges in an emerging economy, one of which is a lack of access to formal means of finance. While providing possibilities for MSME firms to receive timely loans at affordable rates of interest can be a key driver in economic growth, it can also be a successful business opportunity for local/regional and even foreign banks. (Jagtap, 2019).

The presence of risk in loan transactions, particularly in the priority sector where this component is considerably more essential, highlights the fact that the reach of financial services is determined by the collateral that borrowers may give. A lack of collateral impedes the introduction and expansion of formal credit services, restricting the sector's development potential. It will be impossible for strong, viable financial institutions to emerge without an adequate collateral structure. As a result, resolving or minimizing the issue of loan collateral will surely aid in the expansion of MSMEs' financial markets. (MVIRDC, 2019). The aim of this study is to explore the current landscape of digital lending of private banks towards the MSME sectors and also identify various constraints faced by MSMEs while taking loan and to facilitate end to end digital banking solutions to expand their operations and benefit from economies of scale. Additionally, this study also emphasis on how digital bank loans influence the MSME sectors.

**Keywords:** - Micro, Small and Medium Enterprises (MSMEs), Collateral requirement, Private bank finance.

## 1. INTRODUCTION

MSMEs are considered the backbone of the Indian economy. However, the MSME sector faces a major problem in terms of getting adequate credit for expansion of business activities. MSME financing is mainly restricted to bank financing in India where again it is the large organizations that get a preferential treatment. Due to the limited options available for financing, the cost of MSME financing goes up such as in the form of high interest rates. This deters the growth process of MSMEs. About 99 per cent of Indian enterprises belong to the MSME sector. A disruption in their sources of borrowing disrupts the entire business cycle owing to the contagion effect. It also leads to a slowdown in the economy. MSMEs are further suffering owing to the systemic weaknesses in the economy such as lack of basic infrastructure facilities and delays in getting approvals from various authorities (MVIRDC W. T., 2019).

| Sector | Rural | Urban | All |
|---|---|---|---|
| **Micro** | 489.30 | 586.88 | 1076.18 |
| **Small** | 7.88 | 24.06 | 31.95 |
| **Medium** | 0.60 | 1.16 | 1.75 |
| **Total** | 497.78 | 612.10 | 1109.88 |
| **Share (%)** | 45% | 55% | 100% |

**Table1.1**Distribution of employment by type of Enterprises in Rural and Urban Areas (in lakhs)
**Source**: Annual Report 2022-23, Ministry of MSME, GoI

The government is encouraging alternative modes of credit for the MSME sector such as digital financing platforms which are backed by technology-based loan evaluation parameters that automate the application process and accept paperless documentation. These platforms also make the entire process transparent. Thus, with improved digital footprint of MSMEs, the inefficiencies of the informal money lending system are getting eliminated(MVIRDC, 2019).There are around 60 million micro, small and medium-size enterprises (MSMEs) operating in India today, contributing around 30% to India's GDP and employing more than 111 million people (Times, 2019). But a major barrier to their growth has been the ease of getting credit today, around 40% of total MSME credit demand is still served by informal sources of credit. As per the IFC Report 2018, the huge financing gap is pegged at Rs 45 lakh crores out of which 40% will be served by informal credit, 25% through personal loans and only about one- fifth of the total credit demand will be fulfilled by formal credit (Financing Indias MSMEs, 2019). The lack of credit availability not only hinders the MSME growth potential, but it also limits their choice of lender and bargaining power. This is where a new era of lending has dawned. With technology at their disposal and a new business model based on creating ease of business, alternate finance companies have taken this challenge head-on. Their goal is to serve the small and medium businesses of this country without having to make things further difficult when all they need is just credit.

## 2. LITERATURE REVIEW

**Tresnasari, Rini and Zulganef., (2023)** in their paper discusses the importance of Micro, Small, and Medium Enterprises (MSMEs) in the Indonesian economy and the challenges they face. The lack of access to information, particularly market information, and capital issues due to a lack of collateral are some of the obstacles faced by MSMEs. They suggest that MSMEs need legal institutions to boost consumer confidence in their products and services. The COVID-19 pandemic has also affected consumer trends, with more people shifting to online purchases. To maintain MSME performance under unpredictable circumstances, the paper proposes Entrepreneur Marketing (EM) as a conceptual approach that is ideal for implementation in MSMEs. The paper also highlights the importance of digital marketing to reach target consumers swiftly and precisely. The authors emphasize the need for institutional strengthening, entrepreneurship, and digital marketing to improve MSME performance and contribute to the Indonesian economy **(Rini Tresnasari1, 2023)**.
**Khair, Abul, Mohammed., Poranki, Rao, Kameswara., (2023**), in their study stated that COVID-19 pandemic has had a significant impact on people's lives and businesses in India. In particular, micro, small, and medium-sized enterprises (MSMEs) have been hit hard by the pandemic and are struggling to stay afloat. The authors argue that digital marketing practices can help MSMEs increase their sales volume and differentiate themselves from competitors. However, they note that many MSMEs in India face challenges in adopting digital marketing practices, such as a lack of technological competence and inadequate supporting infrastructure. The authors suggest that the public and private sectors collaborate to increase MSME sector computer literacy and the development of related skills. Overall, the paper emphasizes the importance of digital marketing education for MSMEs in India during the COVID-19 pandemic **(Dr.Mohammed Abul Khair, 2023).**
**Mahesh, K. M., P. S. Aithal., Sharma, K. R. S.,(2022)** in their paper claims that, the Open Network for Digital Commerce (ONDC) infrastructure has the potential to promote inclusive and sustainable digital economic growth for SME/MSME sectors. The paper explores the advantages, benefits, constraints, and disadvantages of the ONDC infrastructure using an ABCD listing framework. The authors argue that the ONDC

infrastructure can democratize and create inclusive growth under one umbrella by supporting smaller local businesses, apps, social media, payments, logistics, big tech e-commerce, and SMEs. The data shows that e-commerce start-ups have raised VC & PE funding for technology adoption, BNLP, B2B, and open network technology provide a huge opportunity backed by the Digital India revolution. The paper also highlights the role of ONDC in the development of MSME and SME sectors, and how increased digital subscribers lead to sustainable development in e-commerce. The contribution of ONDC and other players of e- commerce towards the inclusive and economic growth of the country is also discussed. Overall, the authors believe that the ONDC infrastructure can create a huge window for e-commerce where there is a connection between demand and supply of goods and services for the growth of GDP of the country. The growth rate of e-commerce and also retail E-commerce has been increased from the last 5 years due to the innovation, accessibility, affordability, and reduced monopolistic competition between Digital E-Commerce firms through the introduction of ONDC **(Mahesh K. M., 2022).**

**Gawali, B, Ravindra.,(2021)** The author contends that for Indian MSMEs, embracing digital transformation holds the key to surmounting limitations and bolstering performance. This involves leveraging Information and Communication Technology (ICT) to refine business operations, cut costs, heighten productivity, elevate quality, boost competitiveness, and foster a more customer- oriented approach. The author underscores the significance of instilling digital awareness, knowledge, skills, and a receptive attitude towards risk and change among MSME owners in achieving digital maturity. Moreover, the author points out the hurdles that MSMEs encounter in adopting digitalization, including inadequate digital infrastructure, skill sets, and access to proficient personnel, as well as a shortage of essential technologies essential for a comprehensive business revamp. The author advocates for the implementation of coherent and practical strategies to address these challenges and unlock the full potential of digital transformation in augmenting the standing and performance of MSMEs in India.**(Gawali, 2021**)

**Muhammad, Adam., Mahdani, Ibrahim., Ikramuddina., Hendra, Syahputra.,(2020**) According to the authors of this paper, digital marketing platforms play a significant role in increasing customer satisfaction and loyalty, which in turn can positively impact the economic growth of a community. The study focuses on investigating the role of digital marketing platforms, specifically online media, in supply chain management strategies for SMEs in the creative industries in Aceh province, Indonesia. Through a survey questionnaire and statistical analysis, the study found that digital marketing for supply chain significantly affects consumer satisfaction, and digital supply chain has a significant effect on consumer satisfaction. However, the study also found that product reviews do not significantly affect consumer loyalty. Overall, the authors suggest that SMEs can gain competitive advantages and contribute to regional economic growth by utilizing digital supply chain management practices and prioritizing customer satisfaction and loyalty.**(Muhammad Adam, 2020)**.

**Mishra,Pankaj.,(2019)** The study emphasizes the critical importance for MSMEs to enhance their business forecasting capabilities through the implementation of various strategies. Among these, the adoption of digital technology-enabled platforms stands out as a key measure. This digital evolution of MSME operations is viewed as a comprehensive solution to the challenges confronted by these enterprises. This recognition has prompted government action, with the introduction of the "Digital MSME" initiative specifically tailored for this sector. Additionally, various stakeholders, including financial institutions, are actively involved in providing training and support to empower MSMEs in surmounting the obstacles associated with digital transformation. This research endeavors to analyze the influence of digital transformation on the growth prospects of MSMEs.**(Mishra, 2019)**.

**Gola, K.R., Dharwal, M., Aggarwal P. K., (2019)** In the context of SME financing in Meerut district, it was observed that most of the population favors traditional funding methods such as self-finance or obtaining loans from commercial banks. Additionally, they emphasized the need for simplified financing options to enhance the competitiveness of SMEs, enabling them to make investments in innovative technologies.**(Gola K.R., 2019)**.

**Rajamani, K., Nirmal, Raj (2019)**; in their paper tiltled The Role of Digital Marketing Platforms on Supply Chain Management for Customer Satisfaction and Loyalty in Small and Medium Enterprises (SMEs) at Indonesia, Highlighted was a fundamental conceptual structure that holds potential in bolstering the performance of Micro, Small, and Medium Enterprises (MSMEs). This framework takes into account various pivotal factors that influence the development of MSMEs. The hurdles faced by these enterprises in securing financial resources stem from a diverse array of factors, including attributes of the company, financial obstacles, and decisions related to funding, nature of the business, as well as the proficiency and background of the entrepreneurs.**(Raj, 2019)**

**Shaini,J.S.,(2018)** The research brings us that In recent years, there has been a noticeable uptick in the willingness of banks and financial institutions to support Micro, Small, and Medium Enterprises (MSMEs), leading to an increase in financial aid for this sector. It is evident that MSME promoters often grapple with the challenge of furnishing sufficient collateral, which poses a significant barrier to obtaining financial assistance. The research further indicates that despite the fact that financing MSMEs is both time-consuming and costly, banks still view them as commercially viable and comparatively low-risk ventures. To enhance their support, bankers can enhance their assistance by furnishing comprehensive information to MSME borrowers and guiding them through the entire project lifecycle, from conceptualization to expansion and diversification

phases. **(Shaini J.S., 2018).**
**Sudhakar, D., Bushan., Nagarjuna, Kattepogu., Raj, Arokia, D.,(2017)**in their paper indicated regarding MSMEs in India play a critical role in the country's economic growth and are essential for inclusive growth and entrepreneurship. However, these businesses face challenges in terms of global competitiveness and technology upgradation. The paper explores how digital branding and marketing assistance can help MSMEs upgrade their technology and compete in the global market. The authors provide insights and strategies for MSMEs to improve their operations and maximize their production output, quality of the product, better communication system, meeting global standards, getting nearer to the target customers, and reaching global competitiveness. The paper concludes that it is essential for MSMEs to concentrate on branding themselves by adapting advanced and upgraded technology to stand in the global arena competing with MNCs and large- scale organizations **(Dr. Bushan D. Sudhakar, 2017)**.
**Gupta,V., Saini, J.S., (2016)** The study investigated the market-driven pricing performance of initial public offerings (IPOs) from Small and Medium Enterprises (SMEs) listed on the BSESME platform from its inception until the close of 2015. The results indicated that the size of the IPOs on the BSESME platform varied from 1.19 to 42.48 crore, with an average size of 7.1036 crore. While approximately 79% of the IPOs experienced underpricing on their listing day, only a small fraction (specifically, 5 out of 107) exhibited exceptional performance by yielding more than a 50% gain at listing. (J.S., 2016).
**Kannan,A.S., Sudalaimuthu,S.,(2014)** in their paper provides an overview of the economic significance of MSMEs in India, highlighting the challenges faced by these businesses, includingaccess to finance, infrastructure, marketing, training and education, and regulatory burden. The paper examines various government initiatives implemented to support MSMEs, including schemes at both the federal and regional levels. Financing issues are found to be a core problem for MSMEs, and the study analyzes the trend of bank financing to MSMEs in India, which has averaged 21.72% in Total Bank Credit over the recent 7 years from 2007 to 2014. The paper concludes by emphasizing the need to enhance bank funding to MSMEs and recommends that the Indian banking industry increase its share of finance to the MSME sector to ensure further improvements in their contributions to the economy, including job creation, export potential, GDP addition, and better standards of living for millions of families **(A.S. KANNAN, 2014).**
**Ghimire., Abo., (2013)** The study underscored the significant hurdle of insufficient funding encountered by MSMEs. The researcher also pointed out that a majority of businesses (60%) experienced setbacks in securing loans from banks, with micro enterprises (88%) being the most adversely affected, while only 10 percent of rejected applications belonged to small enterprises. Moreover, newly established firms (0-2 years in operation) faced outright rejections, underscoring the influence of age in the loan approval process by bankers. Ultimately, the study concluded that challenges associated with inadequate collateral and a dearth of financial information were primary impediments for SMEs seeking bank loans. **(Abo, 2013).**
**Jayaraman K. & Ismail I. et.al (2013)** the study highlights a crucial issue faced by SMEs, namely the difficulty in securing adequate financing, which significantly hinders their ability to sustain operations. Therefore, it is imperative to thoroughly investigate this challenge. One of the primary reasons behind the hesitation of banking and financial institutions in providing funds to SMEs is the absence of sufficient collateral and a strong track record for the company. Consequently, SMEs find themselves with a restricted range of financing options. Furthermore, the research indicates that collateral, being a more quantifiable and concrete metric, holds greater significance compared to factors like management and character assessment, which are more subjective and abstract in nature.**(et.al, 2013)**.

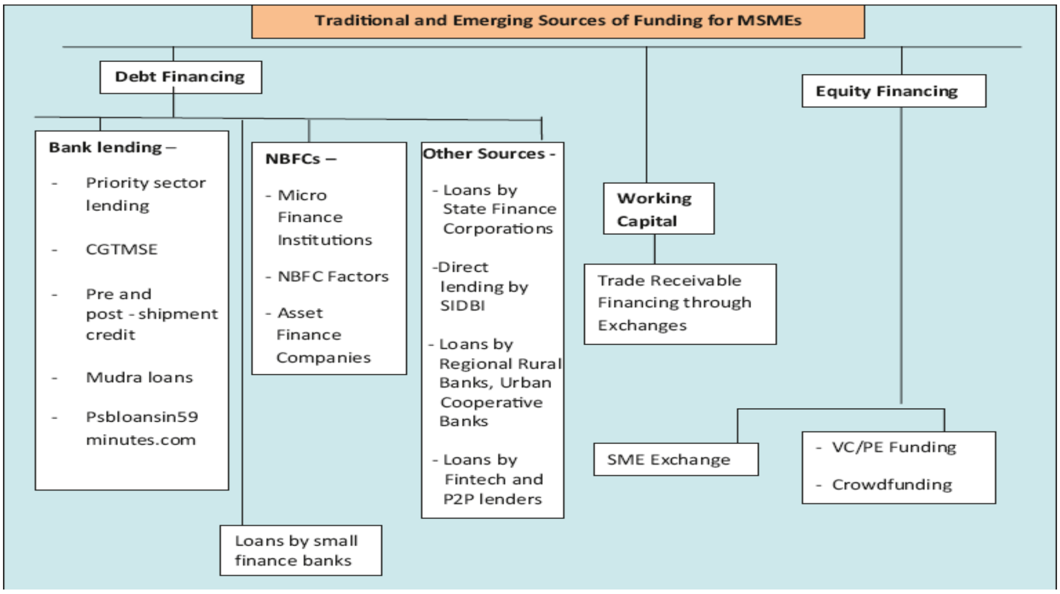


**Fig. 1.1, Source**: MVIRDC World Trade Center Mumbai

**Bose, B.,(2013)** The paper underscores the challenges faced by small and medium enterprises (SMEs) in securing adequate credit for both their long-term assets and day-to-day operational needs. It strongly advocates for a balanced approach, advocating the fusion of equity and debt financing to prevent SMEs from becoming excessively leveraged. The author highlights that the lack of transparency in information hinders financial institutions from extending loans to micro, small, and medium enterprises (MSMEs). Additionally, the heightened reliance on individual proprietors in the case of sole proprietorships amplifies the perceived risk for funding their ventures. The proposal to utilize platforms like CIBIL to enhance the symmetry of credit information is suggested as a means to reduce the cost of financing and provide financiers with a clearer distinction between viable and unviable projects. (B, 2013).

## 3. RESEARCH METHODOLOGY

This research study tried to investigate the role of Private Banks in digitally financing MSMEs and providing end to end digital products and various challenges faced by MSME in getting timely working credit. The study used both quantitative and qualitative data which helped the researchers to gain in depth understanding of the issues that impact the funding of MSMEs by private banks post COVID-19 pandemic. Quantitative method helped the researchers to identify current market scenario underlying digital banking finance for MSMEs and the credit risk exposure the private bank faces as a result. Open and closed ended questionnaires were used in the research study. A thorough study and synthesis of academic research articles, databases, and well-known studies was conducted. In order to gain a fundamental understanding of the landscape of digital lenders supporting MSMEs in India, publicly available data from the SIDBI MSME Pulse Reports and the Ministry of MSME Annual Reports were studied. The literature review includes non-academic publications as well, such as studies from management consultancies, because there is limited academic literature on this subject matter. The analysis of the literature helped identify the costs a lender incurs when extending loans.

### 3.1 Research Objective

The rise of technology-enabled innovations in financial services is a significant and relatively unfamiliar phenomenon that incorporates a number of changes, such as the role of information technology, customer behavior, ecosystems, and regulations in the financial services industry. The innovations in fintech have transcended the spectrum of financial services; this research brief examines the current landscape of digital lending to India's MSME sector.

The role private banks play in digitally financing MSMEs and to recognize the impact of such loans on the private sector banks are the main objective of this research study.

Specific objectives of the research study are mentioned below:

- ❖ The extent at which private banks digitally financing MSMEs;
- ❖ How private sector banks identify possible constraints MSMEs are facing and provide end to end digital banking solutions;
- ❖ Impact of digital bank loans on MSMEs,

### 3.2 Research Design

Questionnaire and secondary research methods were used for this research which determined the participation level of private sector Banks in digitally financing the MSMEs in India. Researcher data has been gathered from the directors and managers of MSMEs who have obtained bank finance majorly working capital loans. Staff of the department responsible for Business Finance/SME Banking of selected banks operating in the study area also provided information for the study.

Open and closed ended questionnaire, telephonic and video interview which were mainly covering the main purpose of the research study were prepared and used to gather data from all the sampled MSMEs. Both primary and secondary sources of data were used for the purposes of this study. The research used raw data from the relationship manager of private sector bank and directors of MSMEs which added the value for achieving the overall objectives of the study. Researchers have made effort ingathering and analyzing primary data as well as secondary data and interpretation drawn from the research in conclusion. The qualitative research approach was also adopted in the research. With the relevance of multiple resources vital to the authenticity of this research, two primary sources of method were used: questionnaires and interviews. These data collection methods have been proven useful in presenting detailed information which was needed for the research study.

The decision to utilize the self-administered questionnaire approach was motivated by its cost- effectiveness compared to conducting interviews. This method allows for the inclusion of a sizable number of participants, enabling the collection of extensive data within a shorter timeframe and at a reduced expense. While there is a higher likelihood of participants discontinuing their involvement in the research during the response process, the privacy and anonymity afforded by this method encourages more authentic responses. Moreover, the reduced pressure on participants was viewed as a more effective means of encouraging their full participation. The research employed both semi-open-ended questions and closed ended questionnaire, semi-ended placed no limitations on participants responding to the questions, respondents mentioned their own experience in dealing with the private sector bank. This method allowed participants to discuss numerous possibilities of improving the digital transactions with bank that would not have been possible in closed-ended questionnaire. The researchers tried to avoid the presentation of extensive data that could possible overrate the authenticity of the research study because the research have collected the data from directors/managers of MSMEs and their experience towards private bank credit as well as the credit impact it created on their businesses.

### 3.3 Sampling Size

Total 60 samples have been selected for the research study. Major portion of these samples were 45 directors/managers of MSMEs and 15 relationship managers of 5 major private banks operating in the study area. However, in view of this research and other constraints; only 5 of major private sector bank were selected in the study area. They include; HDFC Bank, Kotak Mahindra Bank, Axis Bank, IDFC First Bank and ICICI Bank. They were chosen because they are the largest private sector banks financing MSME in the country. They all have their headquarters in Mumbai, India. Further study was conducted to determine the various types of loans that these lenders offer to their customers. This was supplemented with data from publicly available reports and other secondary sources (including the official websites of digital lenders). In addition, a schematic depicting a typical end-to-end digital lending process was developed based on the literature review and market analysis.

## DIGITAL LENDING AND MARKETING MODEL IN INDIA

### Definition of Digital Lending and Marketing

The digital lending environment is highly complicated and constantly evolving. Globally, digital lending models are shaped by various market structures, regulatory contexts, and consumer needs. For the purposes of this study, 'digital lending' refers to the process of providing loans that are applied for, disbursed, and monitored via digital channels. Lenders employ digitized data to make credit choices and establish intelligent consumer involvement in this process. (Accion, 2018).

This concept encompasses three key elements of digital lending, namely the use of digital channels, the utilization of digitized data, and a specific emphasis on digital customer experience and engagement. The research also focused on fintech entities operating within the digital lending sector and providing services known as 'digital credit'. Digital credit refers to the entirety of credit transactions enabled by online lending platforms that are distinct from those managed by conventional banks. The G20 Global Partnership for Financial Inclusion revealed that conventional institutional frameworks are progressively incorporating alternative digital data to inform their lending assessments. Based on this established criterion, it is feasible to categories digital lenders into the subsequent overarching classifications. (Bertsch, 2019).

**Marketplace lenders** which are non-bank digital lenders that originates loans by making use of intermediary platforms. The platforms digitally access and make use of alternative data to substitute for conventional data or to enhance it.

a) Tech, e-commerce, and payment giants are businesses that offer loans and other financial services by leveraging the myriad alternative data points available through their platforms or other partnerships. These businesses typically begin as online marketplaces, search engine providers, e-commerce platforms, social networks, etc.

b) Supply chain platforms offer financing for transactions involving buyers and merchants trading and cooperating along the supply chain. Platforms for financing the supply chain offer financing based on invoices or receivables, payables, inventory, etc., as well as the source of funds.

c) Mobile-data-based lending models provide small-ticket loans based on credit scores derived from mobile calling patterns, mobile transactions, e-money use, and deposits, in addition to credit history.

d) In digital bank models, incumbents are directly engaged in developing their own alternative lending systems, either by opening their APIs to third-party service providers or by partnering with alternative lenders. The IFC also classified digital lenders into distinct archetypes based on the source of their funds, as follows:

a) **Marketplace lenders**, those who acted as intermediaries connecting borrowers to institutional or even retail credit suppliers;

b) **Balance sheet lenders**, those who took on the risk of lending themselves, often as NBFCs, and

c) **Marketplace hybrid lenders**, entities that offered loans both directly from their own balance sheets in addition to offering marketplace funding options (IFC, 2018).

Research indicates that there are estimated 2000 fintech start-ups in the country, with over 300 being digital lenders. The source of financing was the dominant basis for analysing the models of digital lenders, as identified through literature.

## DIGITAL LOANS AVAILABLE TO MSMES IN INDIA

This section builds on extensive desk research on the different types of digital loans offered to MSMEs. The figure displays the various loans along with a few of their features. The loan features were compiled from various company websites and aggregated to arrive at a range.

| Digital Loans and their features | | | | |
|---|---|---|---|---|
| **Loan Type** | **Credit Range (In INR)** | **Interest Rate** | **Collateral** | **Repayment Tenure (IN Month)** |
| **Business Loan** | 25,000-5 crore | 12-28% | Secured and Unsecured | 1-48 |
| **MSME Loans** | 2 lakhs – 5 crore | 7.3-27% | Secured and Unsecured | 1-84 |
| **Working Capital** | 50,000-50 crores | 7.3-22% | Secured and Unsecured | 1-84 |
| **Term Loans** | 50,000-10 crores | 7.5% onwards | Secured and Unsecured | 1-60 |
| **Supply Chain Finance** | 10 lakhs – 5 crore | 1-3% | Secured | 1-4 |
| **Merchant Cash Advance** | 1 lakhs – 1 crore | 15-18 % | Unsecured | 6-36 |
| **Franchise Finance** | Upto 50 lakhs | 14-28% | Secured and Unsecured | 12-48 |
| **Purchase Finance** | 5 lakhs -75 lakhs | 1-3% | Unsecured | 18-36 |
| **Equipment Finance** | 50,000-30 lakhs | 16-28% | Hypothecation | 24-84 |

**Table 2, Source:** Secondary data collected from publicly available sources includes banks and fintech websites

### Types of loans offered by digital lenders in India

This section briefly describes the types of loans identified in Figure 2 and offers examples of providers that offer these loans. Please note that there are lenders who offer more than one type of digital loan, and more lenders than cited in the examples for each product. This is not an exhaustive list.

**A. Business Loans and MSME Loans:** These are loans provided to businesses to cover various expenses related to their operations. These loans can be tailored to the specific needs of the enterprise and may be offered with or without the need for collateral.

**B. Working Capital:** Working Capital loans are utilized by businesses to fund their day-to-day activities. They can be secured with collateral or unsecured.

**C. Term Loans:** These loans are extended to MSMEs for purposes such as expanding their capacity, making capital expenditures, and acquiring fixed assets.

**D. Supply Chain Finance:** This type of financing focuses on providing immediate working capital to businesses to offset any disruptions caused by delayed payments. It enables MSMEs to receive upfront payments on their invoices, often known as 'supplier finance' or 'reverse factoring'.

**E. Merchant Cash Advance:** Merchant Cash Advance is an advance that businesses can obtain based on their receivables. They have the option to make small daily payments based on their daily credit/debit card transactions.

**F. Franchise Finance:** This digital loan is designed to assist both new and established franchises in meeting their business financing needs, including working capital, inventory, and royalty fees.

**G. Purchase Finance:** Purchase finance provides credit that businesses can use at the point of purchase. It combines the features of both payment and credit, offering an alternative to distributor financing, particularly in sectors like manufacturing and infrastructure. This type of financing aligns with the cash flow cycles of these sectors. Neo Growth, for instance, extends purchase financing to service providers, traders, and manufacturers who buy raw materials and trading goods from large corporate firms or their channel partners.

**H. Equipment Financing:** Equipment Financing gives businesses the option to use machinery, vehicles, or other equipment on a rental or lease basis.

## DIGITAL LENDING PROCESS

Digital lending encompasses a set of steps conducted by a financial institution to offer credit electronically. These stages comprise customer onboarding, assessment and analysis for approval, fund allocation, and repayment management, all in alignment with the fundamental concept of "digital lending." Within this framework, there exists a focus on engaging the customer to elevate their satisfaction, streamline operations, and explore avenues for additional product offerings.

A schematic outlining the end-to-end digital lending process in India was developed using this fundamental knowledge of the stages involved in offering a digital loan. It lists the acts, characters, and steps necessary at each stage of the journey of digital lending. Semi-structured interviews with practitioners helped to validate the schematic. The diagram's columns reflect the relevant actors, while the rows represent particular milestones in the digital lending process. The actions taken at each stage of the lending process are shown in each cell in the customer and digital lender columns. The parties that the digital lender may use at each stage of the lending process are listed in the column labeled Third Parties.

**A description of the digital lending process in India**

The following is a description of the digital lending process towards the MSME segment, centered on the practice of the seven lenders who were interviewed for this study.

**Customer Acquisition:** The initial phase of digital financing involves securing customers. Digital financiers may reach out to potential clients through either direct or indirect channels. Direct methods include using platforms like SMS and advertising on social media. Alternatively, lenders can establish partnerships with data-rich entities like mobile network operators or e- commerce platforms to tap into existing customer segment data. There's also the option of indirectly obtaining customer data by purchasing access through a contractual agreement. Feedback from industry professionals in India suggests that the customer acquisition process is a blend of technology-driven methods and personalized interactions, rather than being entirely digitized.

The customers were seen to be sourced mainly through the following methods:

**A. Brick and mortar branch:** The lenders depend on their tangible assets such as branch establishments and their team of loan officers or relationship managers to acquire borrowers. These relationship managers aid clients throughout the onboarding procedure.

**B. Channel partners**: Lenders also depend on collaborations with e-commerce platforms, aggregators, or online marketplaces (like Amazon, Flipkart, etc.), mobile wallet providers, and entities involved in the supply chain (such as machinery manufacturers and distributors of Fast- moving Consumer Goods) to acquire potential borrowers.

**C. Direct Selling Agents (DSA):** Authorized Direct Selling Agents (DSAs) serve as intermediaries who refer potential borrowers to the lender for their services.

**Referrals** from current borrowers of the digital lender, and

**Repeat loans** to borrowers that have already been serviced by the lender.

During the customer onboarding procedure, the verification of the potential customer's identity can be facilitated through either the team responsible for customer relations, credit, or sales who initially engage with them, or by utilizing third-party service providers specialized in conducting Know Your Customer (KYC) checks.

**D. Appraisal and Analytics:** Digital lenders employ a combination of conventional and non- traditional data sources for their assessment process. Traditional sources encompass financial documents, business plans, and credit scores from bureaus. Alternative data encompasses bank statements, in-depth financial analysis (including income, expenses, outstanding payments, etc.), call records, digital transactions (like invoices and point-of-sale data), and even information from social media. This alternative data is particularly valuable for individuals with limited or no credit history. The validation of this data is conducted through various means, including face-to- face interviews, physical checks of the business, and cross-referencing with buyers or suppliers. These lenders typically utilize their own specialized algorithms and risk models to evaluate the creditworthiness of applicants based on the gathered information. Additionally, they may collaborate with external vendors, like API aggregators, verification agencies, valuation firms, and fraud prevention units, for specific functions.

**E. Loan Sanction:** After evaluating the borrower's creditworthiness, the lender determines the loan amount, repayment duration, and interest rate. If the borrower accepts the offer, they will incur a processing fee, typically ranging from 1% to 3% of the loan amount.

**F. Disbursement:** Customers typically prefer receiving funds through cashless methods like real-time gross settlement (RTGS) and National Electronic Fund Transfer (NEFT). These disbursements are typically directed to the customer's bank account, although in some cases, funds may also be disbursed to the customer's mobile wallet.

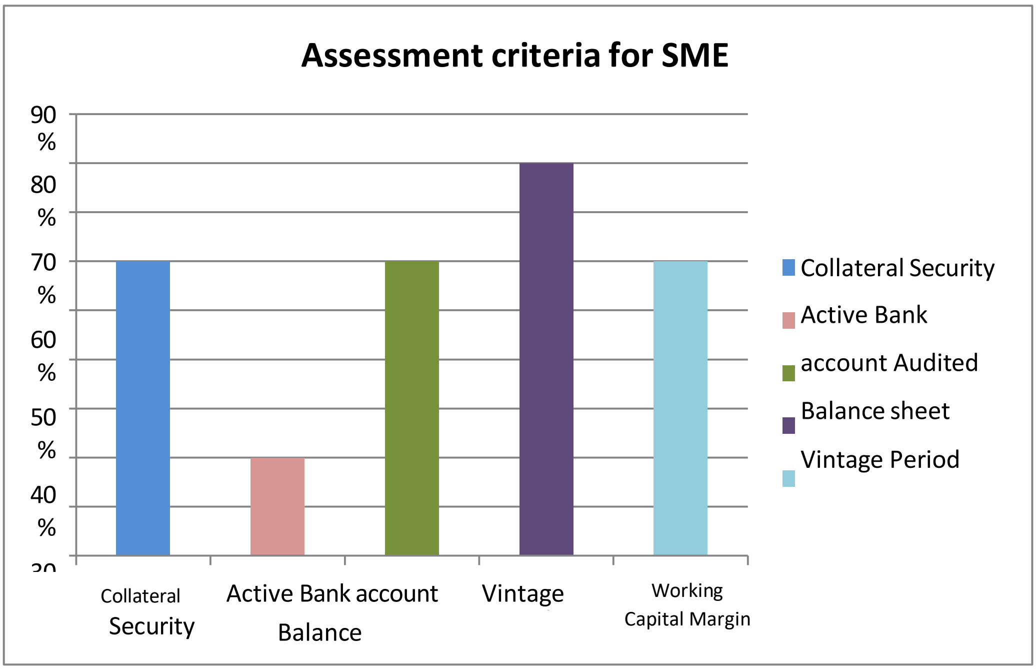
**G.**

**H. Collection:** Digital lenders utilize their data and advanced algorithms to proactively design an effective collection process. The repayment is typically facilitated through methods like automatic clearing house (ACH) payments or post-dated cheques (PCDs), although alternatives such as cash, Unified Payments Interface (UPI), and digital wallets are also available. The collection process generally involves three stages: (1) Initially, a reminder for repayment is conveyed via SMS, WhatsApp, or through a call center representative; (2) If there is a delay in repayment, the customer is then contacted by a relationship manager; (3) Finally, the collections team, which may be either in-house or a third-party entity, serves as the third point of contact.

## 4. DATA ANALYSIS

Data has been collected from two different groups for the interview which was namely private sector Banks and MSMEs. Five major private sector banks were selected for the research study and 45 SMEs which are managed by the Banks relationship managers were participated in the study. Collected data were analyzed and presented using descriptive statistics method which includes tabular percentages, line graphs, pie charts and bar graphs.

Relationship and product managers from the selected private sector banks were asked to show the coverage to which the SMEs working capital requirements are relevant in assessing the firm eligibility for granting digital loans to SMEs.




**Graph 4.1, Source**: -Data collected from Relationship Manager of the selected banks (2023)

Graph 4.1 summarizes the major digital loan eligibility criteria to find out the eligibility of SMEs in qualifying for a digital working capital loan. The finding shows that three banks representing (60%) said an SME should have a collateral security and two banks representing (20%) percent said the SME should have active bank accounts. Also, 3 banks representing (40%) percent said an audited account is needed for calculating firm turnover. Four bank representing (80%) said at least two years vintage period is mandatory as minimum eligibility for qualifying as well as two selected bank (66%) said working capital margin contributions from firm portfolio are some of the major loan eligibility criteria for qualifying digital SMEs loans.

| Key Schemes of Ministry of MSME, Government of India, to Promote Institutional Finance to the Sector | |
|---|---|
| Credit Linked Capital Subsidy Scheme | Under this scheme, government offers capital subsidy upto 15% to micro and small enterprises that are accessing institutional finance for upgrading their technologies |
| CGTMSE | Under this scheme, the government offers guarantee to micro and small enterprises accessing credit upto Rs. 2 crore from eligible banks and financial institutions |
| Interest Subvention | Under this scheme, government offers 2% interest subvention for all GST registered MSMEs, on fresh or incremental loans. Under certain conditions, exporters are eligible for increase in interest rebate from 3% to 5% |
| Prime Minister's Employment Generation Programme (PMEGP) | Under this scheme, the government offers margin money or subsidy to individual entrepreneurs and other beneficiaries for accessing loans from eligible financial institutions. The scheme is applicable for projects costing up to Rs.25 lakhs (for manufacturing units) and Rs.10 lakhs (for service units) |
| Interest Subsidy Eligibility Certificate (ISEC) Scheme | Under this scheme, government subsidises interest cost for loans to Khadi and Polyvastra institutions |
| Coir Udyami Yojana* | Under this scheme, the government provides credit linked subsidy to intended beneficiaries for setting up coir units |
| National SC/ST Hub | Under this scheme, government offers 25% capital subsidy to micro and small enterprises in the SC-ST category for technology upgradation |

**Figure 2, Source:** - MVIRDC World Trade Center Mumbai

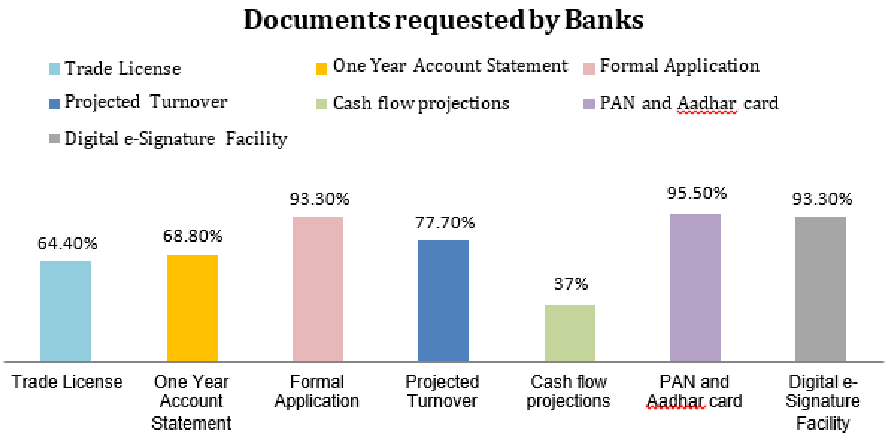
Collateral security and turn over eligibility are the two basic eligibility standard for SMEs loans application in private sector banks. Action in his study stated that lack of collateral is a reason given by most banks for not granting loans to SMEs(Accion, 2018).However, central government schemes like CGTSME and ECLGS provides security guarantee to banks towards financing MSMEs (Figure 2). Existing references of the bank clients is used by the banks in identifying potential SMEs which are part of existing large group promoters. Thus, the large corporate group in a way becomes a personal/corporate assurance for the SME in case of default and this gives security to the bankers. It is the researchers' belief that superior corporate references enhance trust between financers and SMEs.

Lack of quality data/credit history is also one of the main obstacles for banks in lending to SMEs. This result is presented when two out of five banks (40%) mentioned lack of credit history and one out of five selected banks placed lack of quality papers such as Audit reports, GST data, ITR etc. Furthermore, "credit score is low or delayed in past payments (SMA 2 or 3)" which was highlighted by three banks(60.0%) positioned this issue and one out of five banks. Lack of authentic data/paperwork was highlighted by banks as the vital hindrance to SME digital lending, successes by low credit score or with no history. Thus, lack of authentic/verified data of SME may prevent banks from granting digital working capital credit to the SME segment. As a result, information asymmetry in the financial system creates problems on two fronts, namely adverse selection and moral hazard.

| Steps | Customer | Digital Lending | Other Parties |
|---|---|---|---|
| **Customer Acquisition** | Directly apply for a loan through a technology platform Submits E-KYC for verification | Acquire customer thorough<br>1. Direct channels (digital marketing SMS etc., or<br>2. Indirect Channels (e commerce) | Direct Selling Agents Digital Process Enablers |
| **Appraisal and Analytics** | Uploads all required data as per checklist Provide consent to access data | Access creditworthiness by credit department, CIBIL score, turnover, cash flow statements and other data | Valuation an Legal agencies, Credit scoring and verification, Fraud Control Units |
| **Loan Sanction** | Pay processing fees and other charges Accept sanction letter | Loan amount sanctioned with interest rate, PF and other sanction conditions | Digital process enablers for e-signatures and offer acceptance |
| **Disbursement** | Receive loan from bank account through NEFT, RTGS etc., | Disburse loan from bank account through NEFT, RTGS etc., | Third party checks address details (RIC), ITR fillings, etc., |
| **Collection** | Repay loans through automatic clearing | Monitors timely repayments | Monitoring agency Collection |

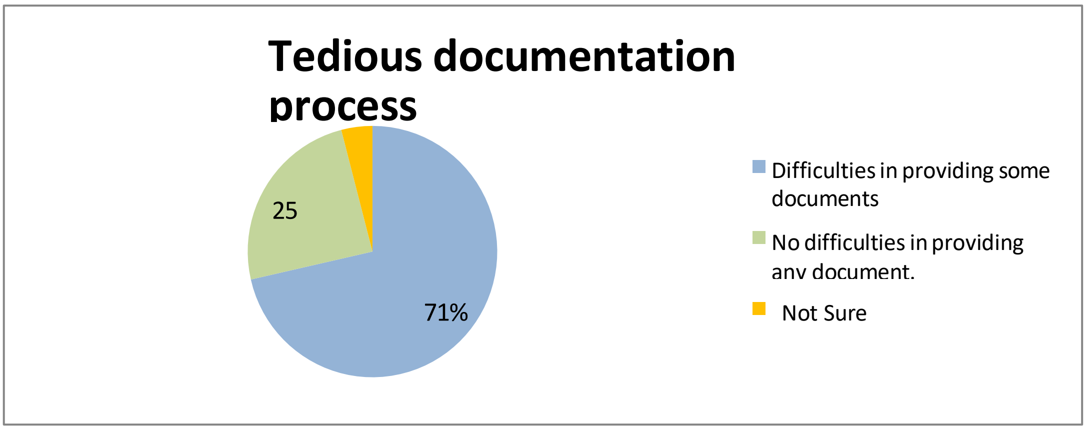
| | | | |
|---|---|---|---|
| | house or PDCs | | agency |

**Table 4.1Source: -**Digital Lending on based of inputs received from Relationship Manager of Banks and banks websites references



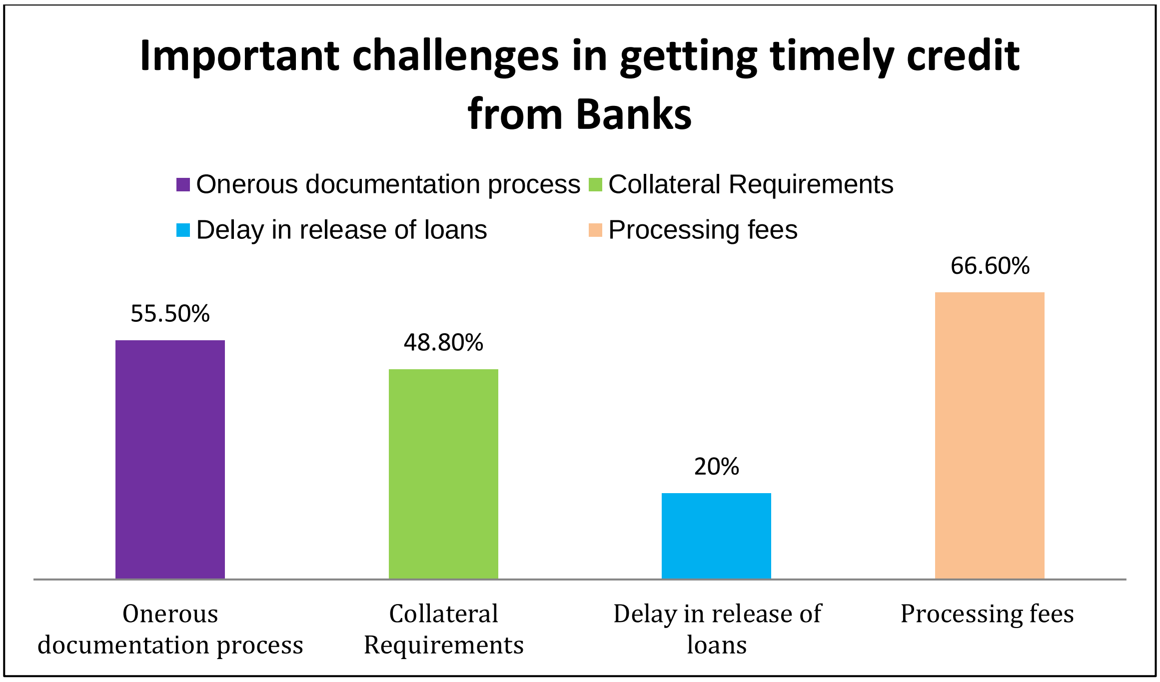

**Graph 4.2, Source: -** Data collected from Relationship Manager of the selected banks

The graph represents documents banks documentation requirement as part of process in digital application in SMEs. Data reflects that 29 responses (64.4%) said trade license/MSME certificate (UDYOG Aadhar) of business registration as SME proof are requested as part of the loan application. The finding of this study also reflects that 31 out of 45 responses (68.8%) said banks request for one year account statement or sanction the loans. Also, (93.3%) said formal loan request letter required for digital financing. Other documentation requirement by private sector banks are projected turnover (77.7%), cash flow projections (37%), PAN and Aadhar card (95.5%) and digital documentation of the same application can be processed with digital e-signature (93.3%) with e-stamping facility provided by government and third parties vendors. Business registration license, firm bank statement and formal loan application form for physical/digital financing are three most requested documents asked by selected private sector bank.




**Graph 4.3, Source of information: -** Data collected from field.

From the above pie-chart (71%) of the MSME respondents have said that they faced difficulties in providing some or other documents that were required as per of the credit department norms of private sector banks in their digital loan process like provisional balance sheet, other bank account statement, legal documents etc. Besides, (24.4%) of SMEs respondents has mentioned that, there was no any difficulty in providing document requested by the banks. The research suggests that 71% of faced issued in getting timely credit which represents a significant number and this is major issue since it impede the SMEs in getting digital lending.




**Graph4.4,** Source: SME Field Data

Graph 4.4 explains major constrains faced by MSMEs while getting timely credit from private sector banks. It was observed that more than half of respondents mentioned onerous documentation process, 25 out of 45 (55.5%) mentioned high rate of interest charged by banks even after presenting relevant documents. Moreover, close to half (48.8%) of the respondents ranked collateral as major hurdle in getting loans. Whereas, delay in release of digital loans by private sector banks had less than 9 out of 45(20%). Processing fees also had with more than 30 out of 45 respondents which makes it major constraint that impedes SMEs from getting digital loans from their respective private sector banks.

It can be analyzed from the research study that, arduous documentation process, collateral requirement and delayed digital loan disbursement are the major factors that hampers SMEs to get digital working capital loans. Collateral requirement positioned at uppermost issue. The research also highlights the issue of high interest rate charged by banks which is also a major barrier lending digital SME bank loan. However, selected banks product and business team argued that SME loan default or delay in paying interest of their working capital loans were result of such stringent process related which constraints timely financing SMEs. This outcome of the study highlights the major issues faced by MSME sector in general so that key policy makers and government could address such weaknesses in the MSME sector which can be solved by adopting digital technology prevalent in current scenario. Data such as Income tax Returns (ITRs), Audit reports or Goods and Service Tax (GST) can be fetched automatically from the system and send to banks credit department for loan application process resulting timely disbursing the loans. Digital loan process thus helps the MSME sector in providing the digital solution though formalizing the loan process, reducing the time in getting disbursement of loans and also enhancing the authenticity of data needed by banks directly from the government channels which reduces manipulation of data in the area of credit risk management.

## CONCLUSION

The research has reviewed relevant literature of published papers in MSME sector as well as other information available through websites, journals and online resources in order to draw the framework for the study. While previous literature focused on banks neglected MSME towards funding, recent studies highlighted that financial institutions are actively funding the MSME sector and digital financing. However, constraints such as collateral requirement, high rate of interest, processing fees, onerous documents process and delay in lending loans are inhibiting further development of the SME sector. There is the need of the hour that leading banks and policy makers tackle these constraints; a gap which this work tried to highlight through MSME digital financing with the help of recent development in technology. About 75 percent of interviewed private sector banks mentioned that more than half of their loan books allotted to the MSMEs sector and this segment largely contributes (about 65%) to the total interest. Furthermore, it can be right to mention from the collected data that bank finance was the most important sources of funds for MSMEs and more than 75 percent of the loans utilized by MSME towards fulfilling their working capital purpose. Mandatory collateral requirement by banks could be granted to MSMEs with the help of government security or schemes such as CGTSME.

However, personal guarantee and other forms of documents (non-fund based loans) were accepted by most of the private sector banks in place of the traditional commercial or residential property as collateral. The researchers suggest for the adoption of a flexible approach to the lending process as majority of firms turnover has been affected by COVID pandemic. Repayment arrangements have been made with the help of offering moratorium period and ECLGS scheme (Emergency Credit Line Guarantee Scheme) to provide the interim relief and to meet the turn over requirements of the SME affected industry. Amortization of MSME bank loan must not be promoted for longer duration which will affect firm credit profile, increase banks non-performing assets (NPAs) books and loan delinquency for the SME sector.

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