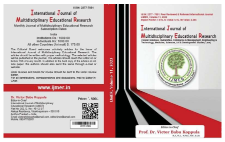

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NBFCS AND MSME FINANCING IN INDIA: BRIDGING THE CREDIT GAP (2014–2019)

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) in India face persistent credit constraints that limit their growth and long-term viability. Traditional financial institutions have largely neglected the sector due to rigid lending practices, collateral demands, and the perceived risk of informal borrowers. Between 2014 and 2019, Non-Banking Financial Companies (NBFCs) emerged as key financiers for MSMEs by providing faster, flexible, and tailored financial solutions. This paper examines the contribution of NBFCs to MSME financing during this period, highlighting their outreach expansion, product innovations, and regulatory and operational challenges. Using secondary data from RBI and industry sources, it also offers policy suggestions to strengthen NBFC participation in MSME development and enhance financial inclusion. The findings underline the strategic role NBFCs play in promoting MSME-led economic growth in India.

Keywords: NBFCs, MSMEs, Credit Access, Financial Inclusion, Lending Innovation, Policy Reform

1. Introduction

The Micro, Small, and Medium Enterprises (MSME) sector is central to India's economy, contributing nearly 30% of GDP and employing more than 110 million people. MSMEs play a vital role in inclusive development by generating employment in rural and semi-urban areas and serving as drivers of innovation and exports. However, MSMEs have long struggled with inadequate access to formal credit. Institutional lenders often consider MSMEs high-risk due to the lack of formal financial records, insufficient collateral, and inconsistent cash flows.

Between 2014 and 2019, Non-Banking Financial Companies (NBFCs) significantly expanded their role in bridging this credit gap. NBFCs offered MSMEs customized loan products, faster processing times, and greater accessibility, especially in regions underserved by traditional banks. Their technological innovation and operational agility made them ideal partners for informal and first-time borrowers. This paper analyzes how NBFCs transformed MSME financing during this five-year period, the challenges they faced, and policy directions to enhance their contribution.

2. Objectives

1. To analyze the role of NBFCs in MSME financing in India during FY14–FY19.
2. To explore opportunities created by NBFC interventions in MSME growth.
3. To identify the challenges faced by NBFCs in MSME lending.
4. To suggest policy measures for enhancing NBFC participation in MSME development.

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3. Research Methodology

The research uses a descriptive and analytical framework based on **secondary data** sources, including:

- RBI Annual Reports (2014–2019)
- Ministry of MSME data and reports
- CRISIL, CARE Ratings, and SIDBI research publications
- Industry analyses and relevant academic articles

4. MSME Sector in India: Overview (2014–2019)

4.1 Growth and Importance

The MSME sector, as per the Ministry of MSME's FY2019 data, included more than 63 million enterprises and contributed about 29.7% to the GDP. The sector also accounted for approximately 48% of India's exports and provided employment to over 110 million people, making it the second-largest employer after agriculture.

4.2 Key Government Initiatives

Several schemes and regulatory frameworks were introduced to support the sector:

1. MSME Development Act (2006): Continued to guide MSME classification and support.
2. Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGTMSE): Offered collateral-free credit guarantees.
3. MUDRA Scheme (2015): Provided microcredit under three categories—Shishu, Kishore, and Tarun.
4. Startup India and Digital India (2016 onwards): Encouraged digital onboarding and access to credit for new ventures.
5. Stand Up India Scheme (2016): Targeted credit for women and SC/ST entrepreneurs.

Despite these, credit penetration remained low, with an estimated 60% of MSMEs relying on informal finance due to lack of documentation and credit history.

5. Role of NBFCs in MSME Financing

5.1 Increasing Credit Share

RBI data shows that the NBFC sector's share in total credit outstanding rose from 13% in FY14 to 16% in FY19. MSME-focused NBFCs recorded annual credit growth rates of over 20% in certain segments, outpacing scheduled commercial banks, which remained cautious due to asset quality pressures.

5.2 Lending Innovation and Flexibility

NBFCs differentiated themselves by offering:

1. Invoice discounting and purchase order financing

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2. Equipment leasing and supply chain finance
3. Unsecured working capital loans based on cash flow projections
4. Use of alternate data from GST filings, utility bills, and transaction history

Notable examples include Lending kart, Capital Float, and Neo Growth, which offered digitally processed loans using proprietary credit scoring models and real-time analytics.

5.3 Expanding Rural and Semi-Urban Outreach

NBFCs focused on Tier II and Tier III cities, leveraging mobile technology, agent-based models, and partnerships with local aggregators. This enabled the inclusion of first-time borrowers, such as shopkeepers, micro manufacturers, artisans, and traders, many of whom were excluded from the formal banking ecosystem.

6. Opportunities for NBFCs

6.1 Surge in Credit Demand

The growing MSME base demanded customized and timely access to:

1. Working capital
2. Fixed capital (equipment, infrastructure)
3. Short-term bridge loans for seasonal business cycles

NBFCs met this demand by offering low-ticket, high-frequency credit products.

6.2 Risk Aversion of Banks

Following rising NPAs and stricter Basel III norms, many banks, particularly public sector banks (PSBs), became risk-averse. NBFCs capitalized on this gap by lending to MSMEs that banks deemed too risky or non-viable.

6.3 Technological Edge

NBFCs adopted early-stage fintech platforms to streamline loan origination, automate underwriting, and improve customer service. Examples include:

1. e-KYC and Aadhar-based onboarding
2. Integration with GSTN, Bureau data, and e-signatures
3. Loan approval and disbursal within 48–72 hours

6.4 Policy-Induced Opportunities

While most MSME schemes were bank-centric, NBFCs indirectly benefited from:

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1. GST implementation (2017): Encouraged formalization, creating a new customer base
2. Digital India: Improved digital literacy and documentation among MSMEs

7. Challenges Faced by NBFCs

7.1 Regulatory Complexity

NBFCs operated under evolving and layered regulation, including:

1. Capital adequacy requirements
2. Exposure norms
3. Reporting compliance

Smaller NBFCs especially struggled with regulatory unpredictability and lack of policy consistency.

7.2 Asset Quality Risk

Lending to informal or under-documented MSMEs increased the risk of default. Many borrowers lacked financial discipline or had seasonal revenues, resulting in:

1. Higher NPAs compared to bank portfolios
2. Difficulty in enforcing loan recovery, especially without collateral

7.3 Funding Limitations

NBFCs could not accept public deposits (except for a few), making them dependent on:

1. Bank borrowings
2. Debenture issuance (NCDs, CPs)
3. Securitization

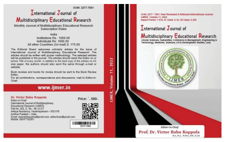
Funding costs remained 5–6% higher than banks, reducing competitiveness.

7.4 Limited Access to Government Schemes

Most government credit guarantee schemes like CGTMSE were primarily designed for banks. NBFCs were often excluded or faced higher guarantee fees, making it harder to offer unsecured credit at competitive rates.

8. Policy Recommendations

To enhance NBFC participation in MSME credit delivery, the following policy measures are recommended,



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8.1 Expand CGTMSE Eligibility

Include NBFCs formally within the CGTMSE scheme, with parity in guarantee cover and fee structure as banks. This would reduce lending risk and promote unsecured financing.

8.2 Enable Bank-NBFC Partnerships

Encourage **risk-sharing partnerships** such as **on-lending** and **portfolio buyouts** between banks and NBFCs. These existed informally during the period but needed regulatory clarity and standardization.

8.3 Access to Refinance Lines

Open up refinancing facilities via SIDBI or NABARD specifically for MSME-focused NBFCs. This would help lower cost of funds and improve liquidity.

8.4 Support Technological Innovation

Provide incentives to NBFCs investing in:

1. Credit scoring tools
2. AI-driven fraud detection
3. End-to-end digital lending platforms

These innovations can improve MSME risk assessment without heavy documentation.

8.5 Build Financial Literacy

Government and industry bodies can collaborate with NBFCs to deliver MSME awareness programs on formal credit, digital compliance, and financial planning—especially in semi-urban and rural markets.

9. Conclusion

Between 2014 and 2019, NBFCs emerged as vital players in MSME financing, offering agile, tech-enabled, and borrower-centric credit solutions. They filled crucial gaps left by banks and extended credit to traditionally excluded segments. Despite regulatory, funding, and asset quality challenges, NBFCs significantly contributed to financial inclusion and entrepreneurship in India's real economy.

Going forward, enabling policies, improved access to funding, and regulatory clarity are essential to sustain and expand the role of NBFCs in supporting India’s dynamic and diverse MSME sector. Their continued evolution will be key to realizing the vision of a self-reliant and inclusive economic model.

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