



WORLD TRADE CENTER®
MUMBAI



Enhancing MSME Competitiveness through Digital Modes of Financing





Bharat Ratna Sir M. Visvesvaraya

(15 September, 1860 - 14 April, 1962)

FIFTY YEARS AND COUNTING

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MVIRDC became a member of the World Trade Centers Association, New York, in 1971 and established the World Trade Center Mumbai, which is the first World Trade Center in India. MVIRDC, having spearheaded the movement of World Trade Centers in India with the establishment of WTCs at Bhubaneswar, Goa and Jaipur, is assisting MSMEs in these regions through various Trade Research, Trade Promotion, Trade Infrastructure including Commercial Offices, Business Center, Trade Facilitation Services and Trade Education Programmes.

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Foreword

वित्त राज्य मंत्री
भारत सरकार
MINISTER OF STATE FOR FINANCE
GOVERNMENT OF INDIA

20 DEC 2021

India's banking sector is at the crossroad of a tectonic revolution with the advent of digital technologies. The first wave of digital revolution in the financial sector began with the leveraging of the Aadhar database to attain financial inclusion by opening Jan Dhan bank accounts for millions of people, who were hitherto untouched by banking services. The next wave of digital revolution was led by start-up companies and the National Payments Corporation of India (NPCI) that made cashless retail payment a reality through UPI on smartphones.

We are in the third wave of the digital revolution in the banking industry, where start-up enterprises leverage the power of Big Data to offer collateral free loans to millions of micro, small and medium enterprises (MSMEs). As we step into this new phase of digital revolution, we will witness a paradigm shift in the banking practice with the conventional, time consuming way of credit appraisal giving way to paper-less, seamless and instant loan approval process through new age credit metrics. MSMEs who have sound cash flows stand a chance to access instant credit through formal sector at competitive interest rates without having to produce collateral.

I strongly feel that this wave of digital revolution will enable our millions of MSMEs to grow in size and scale and become globally competitive. For years, access to credit, which was a major constraint for these MSMEs to grow their business and fulfill their growth aspirations, will no longer be a stumbling block to growth. I sincerely hope that this wave of disruption will increase the potential growth rate of the Indian economy from the current 6.0-6.5% to at least 7-8% and also be a force multiplier for employment and export growth.

To support this transition, we need a coordinated strategy among financial sector regulators, central and state governments, start-up ecosystem, financial

institutions, academia and other stakeholders. I am happy to mention that India has already taken a landmark step in this journey by launching Open Credit Enablement Network (OCEN) amidst the peak of pandemic in 2020. OCEN will serve as a promising platform for MSMEs to access credit at the most competitive interest cost.

The government and the Reserve Bank of India have, in recent months, taken proactive steps such as relaxing guidelines on factoring by NBFCs, launching framework for Account Aggregators and promoting innovation in fintech sector. India has already taken measures to develop an efficient electronic invoice discounting market, with the launch of regulatory guidelines for Trade Receivables Discounting System (TReDS) in 2014. At the same time, we still have miles to go in attaining the true potential of this new age receivable financing solution.

I am happy that MVIRDC World Trade Center Mumbai has prepared this study at this critical juncture when the digital technologies redefine India's MSME lending landscape. The study covers the impact of new age technologies on lending products such as factoring, bill discounting and other forms of working capital finance. I am confident that the content of this study will create awareness and promote further public discussion on the future roadmap of India's digital revolution in the MSME lending sector.

With regards,



(Dr. Bhagwat Karad)

Preface

Finance is the lifeline that sustains the various activities of an economy. Timely access to finance at affordable interest rate is one of the key determinants of business sustainability, especially for micro, small and medium enterprises (MSMEs). Often, MSMEs fail to sustain the production cycle and meet new sales orders owing to liquidity constraint arising from the huge backlog in their receivable accounts. Trade receivables are a major component of the current assets of MSMEs and hence there is a need to devise a system for efficient conversion of these current assets into cash, so that these enterprises get liquidity on time to continue their business processes.

Today, a large section of the MSME sector is left out of the banking system, which is the predominant channel of formal credit in the country. The last decade has witnessed strong growth in MSME credit with the advent of alternative lending institutions such as micro finance companies, factoring institutions and other NBFCs. Despite the entry of new financial players, many MSMEs continue to be deprived of timely access to finance to sustain their operations. According to a 2018 report by IFC, MSMEs face as high as Rs. 25 lakh crore credit gap, which can be viably addressed by financial institutions.

The dawn of the fourth industrial revolution holds immense promise in bridging this mammoth credit gap confronting MSMEs. Especially, cutting edge technologies such as artificial intelligence, big data analytics and blockchain have the potential to revolutionize the traditional process of identifying viable borrowers, assessing credit risk, delivering credit and collecting repayment dues. The entire credit cycle from loan application to disbursement, which used to take several days, will be shortened to a matter of few minutes with the advent of digital technologies. New age fintech companies as well as big tech companies will be the vanguard of this credit revolution.

As the fintech industry matures in the coming years, I hope to see fruitful partnerships between traditional lenders and the new age fintech platforms to usher in an efficient, paper-less credit disbursal process. The ongoing revolution will bring tailor-made loan products based on the unique working capital needs of different segments of trade and industry. More importantly, digital technologies such as big data analytics will improve credit risk assessment tools, promote cash-flow based lending, obviate the need for collaterals, while at the same time, reduce default risks.

New-age digital technologies such as the Trade Receivables electronic Discounting System (TReDS), and Open Credit Enablement Network (OCEN) and Account Aggregator (AA) frameworks have the potential of reducing the time and cost, and enhancing the speed of sanctioning working capital loans. Given that these services can transform the entire process of credit-delivery, and aid MSMEs in industries ranging from agro, manufacturing and processing to services such as hospitality, retail and healthcare, the sector calls for increased thrust and development support.

As India steps into this dynamic era of digital finance, MVIRDC WTC Mumbai has prepared a study on the impact of this credit revolution on trade credit among MSMEs. The study has been conducted with extensive interaction with experts from academia, financial institutions, fintech entrepreneurs and technology evangelists. The study is an attempt to assess recent developments in the area of digital finance and it proposes a roadmap for the future evolution of the digital finance industry, to consolidate the gains achieved in MSME financing. We hope this in-depth study will serve as a useful source of reference for policymakers, financial sector regulators, academia and industry.



Dr. Vijay Kalantri
Chairman
MVIRDC World Trade Center Mumbai

Executive Summary

Digitization of the business processes of micro, small and medium enterprises (MSMEs) can provide a major fillip to the mission of Digital India, as these enterprises account for 30 per cent of the country's economy and 45 per cent of manufacturing output. Digitization will not only reduce cost and improve productivity of these enterprises, but will also improve their access to instant finance. The rapid progress in digital technologies holds immense promise to deliver just-in-time finance to MSMEs, who are quite often handicapped to compete in the global market because of poor access to credit on time. Specifically, the advent of artificial intelligence and data analytics will reduce documentation burden for loan application, improve credit risk assessment and shorten the loan processing cycle.

A major advantage of digital technologies is that they enable creditors and borrowers to work in a trusted environment. By digitizing his business processes, the operations of a small enterprise borrower become more transparent, and it inspires the trust of lending institutions as they can digitally monitor the records of cash flows and payments of the borrower before and after credit disbursal. More importantly, the facility to authenticate genuinity of the borrower through digital KYC, and online verification of the purchase order and tax compliance records of the borrower, infuses an element of confidence among prospective lenders. Remote monitoring of cash flows enables lending institutions to understand better the cash flow cycle of the borrowing unit, and accordingly, offer customized loan products with flexible repayment options. Thus, digital technologies can transform the traditional role of financial institutions from mere lenders to active partners supporting the long term business growth of small scale units.

As we step into this transformative age of digital revolution, MVIDC WTC Mumbai has conducted a study to explore the recent developments in digital technologies, and how they facilitate working capital finance, especially receivables finance in India. The study is divided into three major segments. The first segment offers an overview of the evolving fintech ecosystem in India and how it promotes access to credit for MSMEs, who have so far majorly relied on informal sources of funding. This section highlights that the key drivers of digital finance in India are availability of cheap smart phones, affordable high-speed data plans, convenience of transacting through the digital mode and a tech-savvy young population. This section also provides a snapshot of the two types of fintech platforms, one being a pure marketplace that links borrowers and lenders (or investors), without taking credit risk on their balance sheets. The other type of fintech platform is one that assumes credit risk by lending from its own balance sheet. Often, these platforms are also called new age non-banking finance companies.

The second section of this study explores the advantage of Trade Receivables electronic Discounting System (TReDS), which is a digital platform on which the invoices of MSME suppliers can be financed at competitive discount rates by participating banks and NBFCs. The advent of TReDS has given rise to a new era in the factoring service, under which MSMEs can encash their account receivables by selling their invoices to factoring institutions.

The third segment of the study analyses the benefit of Open Credit Enablement Network (OCEN), which is a set of standard Application Program Interfaces (APIs) developed by the think tank Indian Software Product Industry RoundTable (ISPIRT). The objective of OCEN is to democratize the lending business by enabling any business entity, on which millions of people transact, to become a loan service provider (LSP).

The study offers actionable policy recommendations to promote further innovation in digital finance for the benefit of MSME borrowers, who are under-served by the conventional credit market. The study has benefited from the valuable insights from experts in the field of academia, financial institutions and fintech start-up enterprises. The study is intended to be a useful source of reference for academicians, policymakers and members of industry.

Key Policy Recommendations

- TReDS platform should be made a unified payments platform for all MSME vendor payments by private corporate / PSU buyers, so that there is digital track record to monitor timely payments by these buyers.
- Reverse factoring should be encouraged as an exclusive segment on the TReDS platform to enhance the credibility of the buyer in making timely payments, while mitigating supply chain disruptions.
- RBI may provide a sub-limit for banks' TReDS exposure under the priority sector lending norms.
- Banks may be advised to set up reasonable limits for TReDS in addition to the existing limits sanctioned to corporate buyers.
- RBI may revise capital adequacy norms for banks' TReDS exposure to new customers.
- In order to enhance liquidity for discounted bills under the TReDS platform, a secondary market to trade such bills should be introduced.
- A TReDS 'Second Window' should be created for integration of TReDS platform with GSTN e-invoicing portal.
- E-commerce companies can be permitted to set up their own financing units and offer bill discounting solutions to vendors listed with them.
- Wider adoption of the OCEN (Open Credit Enablement Network) and Account Aggregator (AA) frameworks should be encouraged to expand access to factoring. To reduce risks, e-liens can be set up to trap cash flows for repayment.
- The maximum permissible credit that can be disbursed based on Aadhar eKYC should be increased from the current limit of Rs. 60,000 annually.
- Foundational KYC should be introduced to allow a new lender to rely on another scheduled commercial bank's KYC to disburse a loan to the existing KYC-compliant account.
- One of the major challenges with lending to non-individuals is ascertaining who is authorized to sign a loan agreement. For private limited and public limited companies a board resolution is required to be attached to the loan agreement. One way to overcome this procedure is to create the position of a "nodal officer" who can be authorized by the company to digitally sign loan agreements in a non-repudiable fashion.
- UPI eMandate limit should be increased to enable collections for small ticket loans.

Acknowledgement

MVIRDC WTC Mumbai sincerely acknowledges the contribution of experts from academia, financial institutions and fintech industry for sharing their valuable insights to this study. Particularly, we appreciate the perspectives shared by Mr. Kailashkumar Varodia, Chief Financial Officer, Receivables Exchange of India Ltd., Dr. Savita Shankar, Independent Researcher and Lecturer, School of Social Policy and Practice, University of Pennsylvania, Mr. Sundeep Mohindru, Chief Executive Officer, M1xchange and Mr. Hrushikesh Mehta, Chief Evangelist – CredAll, Volunteer – iSPIRT.

Research Team (MVIRDC World Trade Centre Mumbai):

The Research Study has been conducted by Ms. Dhara Tolia, Manager, Research and Trade Promotion and Mr. Raja Narayanan, Manager, Research and Trade Promotion. The study has been designed by Mr. Abhishek Parab, Creative Designer.

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MSME FINANCING: AN OVERVIEW



MSME Financing: An Overview

MSMEs are considered the backbone of the Indian economy. They constitute 99 per cent of all enterprises, generate about 45 per cent of the manufacturing output, about 40 per cent of exports, and are a major contributor to employment in the economy. Despite such an outstanding performance, they face financing challenges. According to a report released by the International Finance Corporation (IFC) in 2018, the estimated demand for finance from the MSME sector in India is Rs. 87 trillion, of which demand for debt capital is pegged at Rs. 69 trillion and demand for equity capital is estimated at Rs. 18 trillion. About 70 per cent of the debt demand (roughly Rs. 48.5 trillion) represents the demand for working capital finance.

The government has announced sops to the MSME sector such as lowering the corporate tax rate, initiating schemes like CGTMSE and the Pradhan Mantri Mudra Yojana, setting up a portal to fast-track loans for MSMEs by reducing the turnaround time from 20-25 days to just 59 minutes and other credit support to MSMEs, which are a step towards relieving the cash crunch of MSMEs. However, the sector requires much greater handholding, especially since the financing options are very limited for Indian MSMEs, other than for technology or knowledge startups.

MSME financing is mainly restricted to bank financing in India, where again it is the large organisations that get a preferential treatment. This, despite the fact that MSMEs have a low share in the total non-performing assets (NPAs) of banks. Due to the limited options available for financing, the cost of MSME financing goes up in the form of high interest rates. This deters the growth process of MSMEs.

The government's attempts to formalise the informal sector, such as through the introduction of GST, have

their own challenges such as digital illiteracy of the sector. However, the huge data that is available to the government since GST implementation and the advent of disruptive technologies can benefit MSMEs provided they adopt the new technologies, skill their manpower and specialise to be a part of the value chain.

Increased digital footprint can allow MSMEs to benefit from collateral-free loans provided by fintech companies. Alternative modes of credit such as digital financing platforms, which are backed by technology-based loan evaluation parameters, 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.

The key lies in identifying the needy businesses and handholding them even in the absence of proper book-keeping practices and absence of tax filings. This can be done through financial targeting with the help of fintech companies. This will also ensure that only deserving entities, that are less likely to default, get financial assistance.

With increased mobile penetration, individuals and firms leave a huge digital footprint of their transactions such as payments, remittances and choices. These enable fintech firms to make informed decisions about the credit-worthiness of these firms and offer credit within a short span of time. Factors such as availability of cheap smart phones, affordable high-speed data plans, convenience of transacting through the digital mode and a tech-savvy young population enhance the possibilities of the evolution of a dynamic fintech sector in India. Increased digital footprint also allows MSMEs to benefit from collateral-free loans provided by fintech companies.

FINTECH CREDIT



Fintech Credit

Conventional banking services such as Letter of Credit, bank guarantees, pre-shipment and post-shipment credit have largely benefitted enterprises in the formal system who have sound booking keeping practices. However, the advent of fintech revolution has the potential to bring these banking services to micro and small scale enterprises with sketchy financial records. Fintech companies play an important role in bringing credit services to small scale enterprises at low transaction cost by leveraging cutting-edge technologies.

While there is no universal definition of fintech credit, it can be broadly defined as lending activity that is enabled by electronic platforms by new age technology start-up enterprises. Recent years have witnessed sharp growth in credit to small scale enterprises through emerging platforms such as mobile apps, peer-to-peer (P2P) and marketplace platforms, invoice trading etc. Typically, the entire process of credit service, right from loan application to credit risk assessment to loan disbursement is paperless, digital and less time consuming than conventional loan process. Fintech credit has acquired different nomenclature in different countries, some of which are: digital finance or internet finance and the players are called peer to peer lenders, marketplace lenders or loan-based crowdfunders, depending on the platform they use.

There are two types of fintech platforms, one is a pure marketplace that links borrowers and lenders (or investors), without taking credit risk on its balance sheet. These credit platforms deploy artificial intelligence and machine learning to browse digital footprint of borrowers and assess their creditworthiness. Such data may include the utility payment history of the borrowers, their cashflow statements, tax payment records, online banking transactions, social media behavior and sometimes even psychometric assessments. Besides assessing the credit worthiness of borrowers, such platforms also offer other services such as monitoring the borrowers after disbursement of loan and collecting loan on the repayment dates and distributing the same to lenders. The main source of revenue for these platforms is fee income for the service that they offer to investors. The other type of fintech platform assumes credit risk by lending from its own capital. Often, these platforms are also called new age non-banking finance companies.

According to the Bank for International Settlement (BIS), which acts as a bank for most Central Banks across the world, fintech credit and big tech credit are the emerging alternative forms of credit. A research paper published by experts from BIS shows that the total fintech credit volume across the globe is estimated to have grown from a mere USD 9.9 billion in 2013 to USD 223 billion by 2019.

Factors Driving Fintech Lending

Huge unmet credit demand of small firms

There are more than 60 million micro, small and medium enterprises in India and majority of them rely on informal sources to meet their credit needs. The unmet credit demand of MSMEs is Rs. 25.8 lakh crore (IFC 2018)

Rising operational cost of conventional banking

It is cost-effective to deliver financial services such as credit appraisal, lending and loan collection through digital platforms, rather than through physical branches.

Favourable regulatory policy

Reserve Bank of India and Government of India are supporting innovation in digital financial services by setting up regulatory sandbox, encouraging digital payment through UPI, launch of IndiaStack, issuance of guidelines for Account Aggregators etc.

Key Technology Drivers of Fintech Lending

Smartphone Revolution

The mass popularity of smartphone has enabled provision of banking facilities such as payment, deposit and lending through mobile apps. Mobile apps have been a key enabler in providing banking services to previously unbanked population in rural areas. The only requirement is that the rural area should have robust internet connectivity to facilitate mobile transactions.

Distributed Cloud

The emergence of cloud-based IT services enables cost-effective sharing of computing resources and digital platforms. Fintech companies leverage these shared platforms to bring out innovative financial products and services to customers.

Unified Payment Interface (UPI) has revolutionised mobile payment industry in India by providing a common infrastructure for all payment service providers to launch their unique products.

Similarly, the upcoming OCEN (Open Credit Enablement Network) will provide a common digital infrastructure upon which banks and other fintech companies can launch their digital lending products.

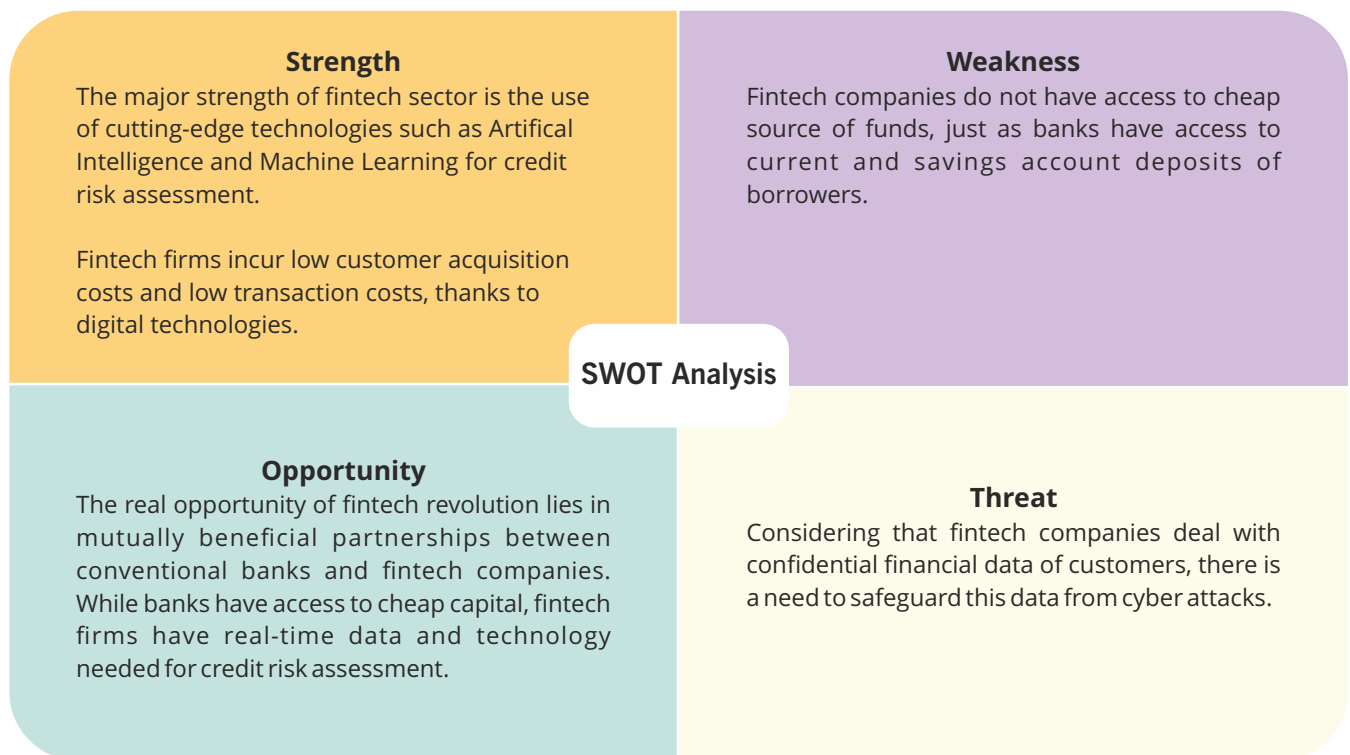
Blockchain Technology

The distributed ledger technology enables processing of trade finance by replacing paper-based letter of credit with smart contracts. Already, large banks such as Bank of America, Merrill Lynch and HSBC have experimented with blockchain technology to process cross-border trade finance.

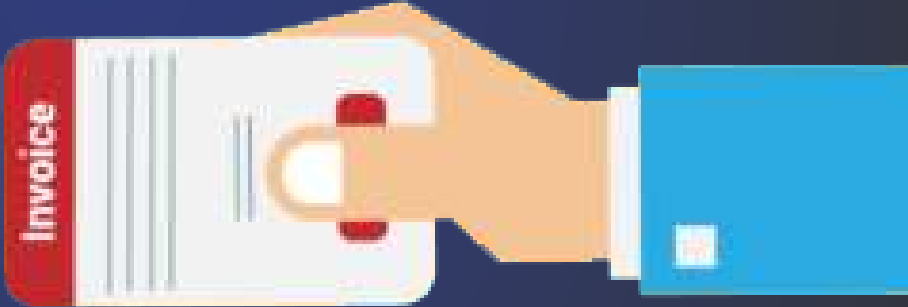
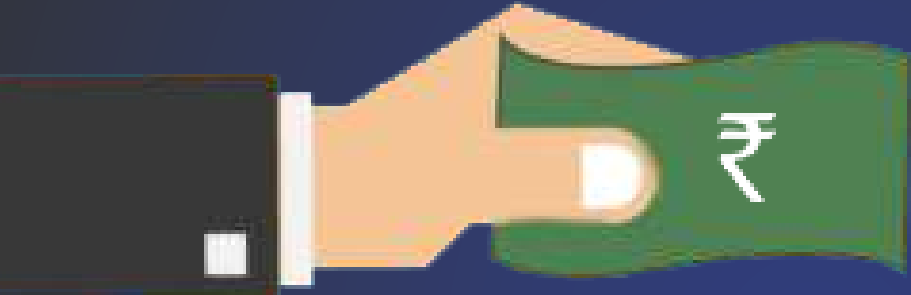
SWOT Analysis

Fintech platforms provide unsecured credit to MSMEs, who are unable to raise credit from the formal credit channels such as banks and non-banking finance companies. Often, it becomes a challenge to assess the creditworthiness of these borrowers as they do not have any credit history. Fintech platforms deploy advanced technologies such as artificial intelligence and machine learning to assess the creditworthiness of borrowers

based on digital footprint of these borrowers. Even conventional banks and non-banking finance companies do not deploy these advanced technologies to measure the creditworthiness of borrowers. Fintech companies also perform psychometric tests, in some instances, to assess the credibility of the potential borrower. The following chart highlights key strength, weakness, opportunity and threat confronting the fintech industry.



FACTORING



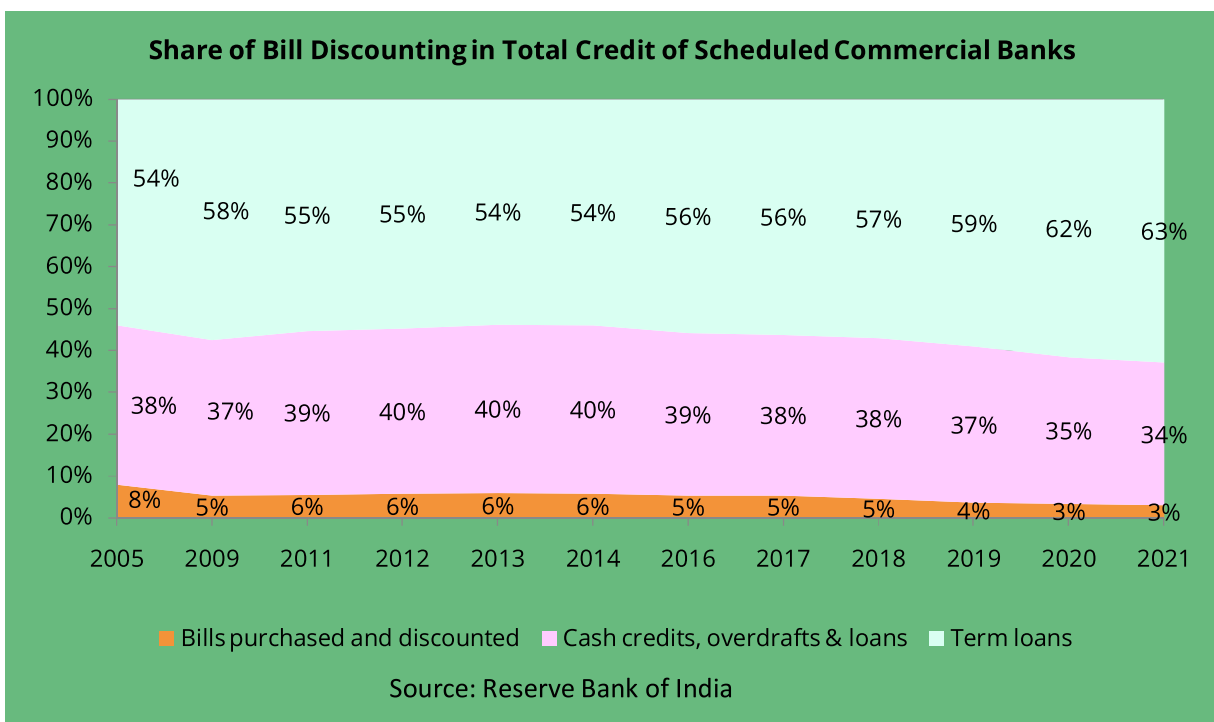
Factoring

The total credit of the banking sector can be divided into working capital loans and term loans. Working capital loan includes bills discounted and cash credit/overdraft facilities. As the following chart shows, the share of bills discounted and cash credit/overdrafts and loans in the total advances of banks has declined from 46 per cent in 2005 to 37 per cent by 2021. Since banks are focusing more on term loans, we need alternative sources of finance such as fintech, big tech, TReDS, OCEN etc. to enhance provision of working capital finance to MSMEs.

The government has taken several steps in the recent period to improve flow of finance to MSMEs. In a landmark legislative initiative, Government of India passed the Factoring Regulation Act 2011 to provide a legal framework for receivable financing system in India. This Act contains key provisions on invoice financing and the eligible institutions that can offer factoring services in

India. However, under this provision, only those financial institutions could register as NBFC-Factors with RBI for whom factoring is a core business activity.

An institution would be eligible for factoring license if it derives at least 50 per cent of its income from factoring services or if it invests at least 50 per cent of its assets in a factoring business. As a result of this stringent provision, barely seven institutions showed interest to be registered as a factoring company. Therefore, the growth of the factoring sector was hindered by this regulation and subsequently a need was felt to relax the eligibility criteria so that more and more institutions can register as NBFC-Factors and cater to the ever growing demand for trade credit from MSMEs. As a consequence of this realisation, Government of India amended the Factoring Regulation Act 2011 to allow any NBFC to be registered as a factoring company in 2021.



Trade Receivables electronic Discounting System (TReDS)

The key to keep the trade cycle moving for MSMEs lies in identifying and adopting innovative working capital financing solutions, that reduce the time and costs involved in availing these loans. The Indian government has initiated some timely reforms such as encouraging registration on the Trade Receivables electronic Discounting System (TReDS), a factoring platform, wherein MSMEs can now get a better rate for discounting their bills receivable from competitive bidding of banks for the same on the TReDS exchange.

Trade credit is the fuel that keeps the wheels of the economy running. The different legs of an economic activity, viz. procurement of raw materials, production, distribution, wholesale and retail will be paralyzed if working capital is not made available to the players involved in these activities in the form of trade credit. Often, SMEs do not have enough liquidity to maintain production process to meet fresh sales or export orders if they do not receive payments from buyers for the goods or services already delivered. Receivable finance or factoring is a prominent tool to meet this gap in working capital. In fact, the practice of extending trade credit has been in existence since the early days of human civilization, in its primitive form among traders in Mesopotamia in 2000 B.C., before the modern day factoring evolved in Britain in the 14th Century A.D.

In India too, the bill discounting system was practiced in the form of Hundies, which is the local version of commercial bills written in vernacular languages. The Reserve Bank of India has taken several measures to modernize the Indian bill discounting system to support timely access to receivable finance for small and medium enterprises. Despite these efforts, cash credit/overdraft was the principal mode of working capital finance as it accounted for 70 per cent of the total bank credit until the year 2000. Bill discounting and factoring, as a form of working capital finance, accounted for hardly 10 per cent of the total bank credit. Even after 2000, factoring did not become a mainstream instrument of working capital loans, especially for micro, small and medium enterprises (MSMEs).

The first factoring company, SBI Factors was established in 1991 to provide receivable finance for small and medium enterprises and this was followed by many other players entering the factoring sector. Despite this, the

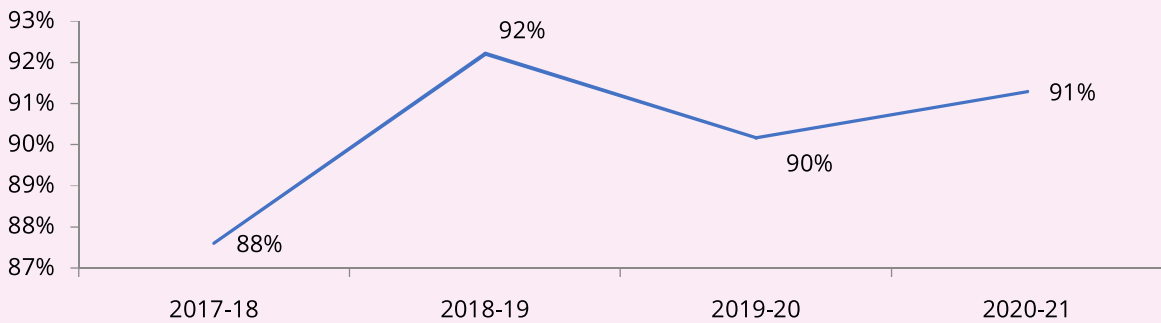
formal factoring industry could cater to hardly 10 per cent of the total account receivables of MSMEs as most of them continued to depend on cash credit or overdraft arrangements with banks.

In this context, Small Industries Development Bank of India (SIDBI) and the National Stock Exchange of India (NSE) launched Trade Receivable E-discounting Engine (NTREES) in December 2009 for electronic discounting of receivables of MSMEs. However, this system did not ensure efficient price discovery for receivables as SIDBI was the sole financier on this platform and there was no competition among lenders to bid discount rates for receivables. As an improvement to this platform, RBI proposed the concept of Trade Receivable e-Discounting System (TReDS) and issued operational guidelines for the TReDS exchanges, in 2014.

TReDS is an electronic platform where the invoices of MSME suppliers are uploaded on the platform so that participating banks and NBFCs can compete to discount these receivables, for efficient price discovery. This electronic platform is an interface among three key stakeholders, viz. MSME sellers, Private corporate / PSU buyers and banks/NBFCs. This mechanism enables MSME suppliers to access trade credit at attractive discount rates, determined by a transparent electronic auction mechanism. Also, the payment risk is shifted from the MSME supplier to the discounting bank as TReDS allows financing of trade receivables on a 'sans recourse' basis.

Currently, there are three electronic platforms offering without-recourse receivable financing under the TReDS framework in India. These are: Receivables Exchange of India, M1xchange and Invoicemart. All these three platforms began operations in 2017. According to data released by RBI, the number of invoices uploaded and financed through the three TReDS electronic platforms grew 62 per cent in 2020-21, with a success rate of 91 per cent. The success rate is defined as the proportion of invoices financed out of total invoices uploaded on the three platforms. Since the introduction of the TReDS platform, this success rate has improved from 88 per cent to 91 per cent as can be seen from the following graph.

Success Rate* under the TReDS platform



Source: RBI

Note: *Success rate is defined as proportion of invoices financed out of total invoices uploaded

Despite this visible improvement in invoice financing, we have miles to go in meeting the trade credit gap of MSMEs. There are more than 60 million MSMEs in India, many of whom are outside the formal credit system. In the coming years, the success of the TReDS system will be tested by how far it is able to meet the trade credit needs of these MSME suppliers who are left out of the formal

credit system. TReDS system can attain the goal of inclusive finance only if it can onboard more and more private corporate / PSU buyers on its platform. Therefore, as the number of private corporate / PSU buyers registering on the TReDS platform increases, the number of MSME suppliers who will benefit from this platform will also increase.

Without-Recourse Financing for MSMEs

TReDS provides without-recourse financing for MSME sellers, wherein financiers see the strength of the buyers and not the credit rating of the MSMEs, while discounting

their bills receivables. Competition among financiers on the TReDS platform leads to improved price discovery, and lowering of discounting costs for MSMEs.

Kailashkumar Varodia, Chief Financial Officer, Receivables Exchange of India Ltd

Factoring Bill amendment will now enable NBFCs other than the seven RBI-licensed NBFC Factors previously allowed. The guidelines from RBI are awaited. This increased competition in the factoring business has increased the potential usage and adoption by MSMEs of the country and helped them have access to formal sources of credit on TReDS. In recent years, digital lending has been able to service the problem areas of the MSME ecosystem fairly efficiently. TReDS platform specifically provides recourse free, trusted receivables payments to MSMEs within 48 hours which has helped smoothen their working capital cycle. An increase in invoice discounting volume on the platform mirrors a higher speed of financing and revival for MSMEs.

**Savita Shankar, Independent Researcher and Lecturer, School of Social Policy and Practice,
University of Pennsylvania**

The strain on MSMEs' cash flows because of Covid-related lockdowns has accentuated the need for quick conversion of MSMEs' trade receivables into cash by expanding their access to factoring services.

As is well known, factoring turnover in India has remained at low levels and constitutes only 2.6 per cent of MSME credit lines. Even though TReDS has the potential to handle a throughput of INR 1 trillion, at present the total transaction amount is reported to be only about 15 per cent of the amount.

One fundamental problem is that many MSME customers are not interested in participating in TReDS platforms. As factoring requires that the payments are settled in a timely manner, companies that habitually delay payments may avoid putting their invoices on the TReDS platform.

Plans to make it mandatory for large public sector enterprises to register on the platform may not be effective if the companies register but do not use it actively. Unless more invoices come into the platform the transaction volumes may not go up much. Specific strategies aimed at increasing the volume of invoices on TReDS need to be pursued.

Sundeep Mohindru, Chief Executive Officer, M1xchange

Advancing TReDS platform for discounting of invoices for capturing the entire supply chain ecosystem, including both MSMEs and non-MSME sellers, of a corporate buyer:

A corporate seller (B-rated) does not get a good bill discounting rate, nor does he get additional bill discounting limit, basis his merit / balance sheet / collateral. On the TReDS platform, as he will put up the invoice for his corporate buyer, basis the goodwill of the buyer and acceptance of invoice on the platform, the banks will discount his invoice at the rate of interest that his corporate buyer enjoys. This will be a huge relief for the B-rated corporate seller and will in turn improve his cash flow.

Growth Drivers: De-duplication of invoices and credit insurance for factoring entities

Technological advancements such as blockchain have enabled seamless integration of TReDS exchanges, thereby ensuring that the same bill cannot be discounted on more than one exchange. This reduces the risk of

financing the same bill several times. Similarly, credit insurance has given financiers a cushion against potential defaults by buyers, thereby enhancing the attractiveness of the TReDS platform.

Kailashkumar Varodia, Chief Financial Officer, Receivables Exchange of India Ltd

Seeing the potential usage of the blockchain technology, in 2018, the TReDS platforms introduced it to the system with MonetaGo. TReDS adopted the blockchain technology for de-duplication of invoices, while maintaining confidentiality. Blockchain technology was being used only for crypto currencies so far. However, by implementing MonetaGo, we have a tool for mitigating systemic risk. This enables all the 3 exchanges to work together seamlessly without need to share any specific data. It will indeed make integration seamless. Whether it will have an impact on cost of factoring is something for the future to unfold.

Credit insurance is usually opted by the financiers in case the buyer is low rated. Providing finance against an invoice where the buyer is low rated has its risk and hence the cost of financing is higher. Without insurance, liquidity for low rated buyer is difficult and hence with credit insurance, even if the cost of financing is higher, it creates liquidity for low rated buyers.

Savita Shankar, Independent Researcher and Lecturer, School of Social Policy and Practice, University of Pennsylvania

Several initiatives to boost factoring have been announced recently. Factoring law amendments have permitted nearly 9,000 non-bank finance companies to participate instead of only seven. This should help expand the pool of funds available for factoring. The process of registering charges with CERSAI has also been made easier with intermediaries being allowed to register transactions. This will reduce the chances of multiple financing of the same invoice. The revised guidelines on trade credit insurance for those providing factoring services is likely to attract more players to the factoring market.

POLICY SUGGESTIONS TO ENHANCE TReDS UPTAKE



Policy Suggestions to enhance TReDS uptake

While the new-age digital solutions such as TReDS and OCEN / AA frameworks, offer promising opportunities to ease the working capital requirements of Indian MSMEs, the system is fraught with challenges that inhibit their uptake. With a view to

address these challenges, MVIRDC World Trade Center Mumbai undertook a survey of experts in the domain, who suggested policy measures to improve the factoring and working capital financing space in India. Following is a gist of the same:

Creation of a unified payments platform for all MSME vendor payments by a PSU

Integration of private corporates' / PSUs' payment platforms with the TReDS platforms can bring in greater transparency and check delays in payments by these

enterprises. This is critical to ensure efficient rolling of MSMEs' working capital for smooth conduct of their business activities.

Sundeep Mohindru, Chief Executive Officer, M1xchange

TReDS platform should be made a unified payments platform for all MSME vendor payments by a PSU. This will save the PSU corporate the administrative trouble of bifurcating payments / tracking for discounting / making changes in ERP. They just need to upload all the vendor payments through TReDS.

The vendors will know the status of their bills outstanding and can choose to discount accepted bills. This would also help various government and other regulatory departments and rating agencies as TReDS would become the one single point source of information for all vendor payments and any delays / defaults of the corporate to pay the MSME on time (delayed payments) can be tracked through TReDS reports.

Today PSUs don't approve bills well on time, as a result MSMEs are not able to discount invoices and payments are over delayed. As corporates (especially PSUs) will route payments through TReDS, whether the bills are discounted or not, TReDS will be able to create trail of delay in payment from due date by the corporate. For example, if the PSU corporate receives invoice from vendor on Nov 1st and due date for invoice is Dec 15th, we observe that this invoice is approved after Dec 15th and payment is already delayed. The MSME cannot, therefore, discount this invoice. If the PSU releases direct payment to the MSME through TReDS settlement mechanism, the exact date of payment will be recorded and delays can be tracked.

Reverse Factoring

This mechanism, wherein the buyer (private corporate / PSU) takes lead in getting its MSME vendor's bill discounted on the TReDS platform, enhances the credibility

of the buyer in making timely payments, while mitigating supply chain disruptions. Hence, it should be encouraged.

Kailashkumar Varodia, Chief Financial Officer, Receivables Exchange of India Ltd

A Reverse Factoring transaction begins when a Buyer uploads an invoice on the platform, on behalf of the Seller and creates a Factoring Unit (FU). An FU contains necessary details of the invoice in digital format which is sent to Financiers for bidding. The cost of financing is borne by the buyer. The Buyer then chooses the most suitable bid. The Seller receives funds from the Financier within 48 hours.

Based on the acceptance of the invoices by the buyer, the seller receives immediate payment from the financier. On the due date of payment, the Buyer pays the outstanding amount to the Financier. The set facility is without recourse to the MSME.

Savita Shankar, Independent Researcher and Lecturer, School of Social Policy and Practice, University of Pennsylvania

Reverse factoring needs to be encouraged by allowing exclusive TReDS platforms to be set up for large public and private sector enterprises for financing their MSME vendors through non-recourse factoring. The convenience of an exclusive platform in which only MSME vendors approved by them participate may act as an incentive for large companies to participate in factoring. This is similar to the highly successful initiative of Nafin in Mexico which has enabled many SMEs to benefit from factoring (<https://openknowledge.worldbank.org/bitstream/handle/10986/8939/wps3593.pdf>).

Participation in an exclusive TReDs platform could help a large enterprise develop better ties with its vendors and also enhance its image as it would be seen to be assisting MSMEs.

Setting up sub-target for TReDS within PSL limit, enhancing borrowing limits for corporate buyers and reviewing capital adequacy norms for new-to-bank customers

The TReDS platform enhances the efficiency of the bill discounting system. It may, therefore, be given prominence by banks, financial institutions and regulatory

bodies in meeting the working capital requirements of MSMEs.

Sundeep Mohindru, Chief Executive Officer, M1xchange

Banks should be given a sub-target to achieve a minimum TReDS outstanding within their PSL targets.

Many banks carve out a small TReDS exposure limit from the limits already sanctioned to corporate buyers. This is unacceptable to many buyers; hence they prefer not to discount MSME invoices on TReDS. Banks may be advised to set up reasonable limits for TReDS in addition to the existing limits.

At present, finance against receivables for bank's own existing customers is not treated as an unsecured exposure. Since TReDS envisages without-recourse factoring to the MSME, the capital adequacy norms should be reviewed so that the TReDS portfolio of a new-to-bank customer is also treated at par with the receivable financing of their own existing customers.

Creation of a secondary market to enhance liquidity of TReDS transactions

A secondary market for trading TReDS-factored bills receivable will enhance the liquidity of the transactions

and increase the uptake of the platform.

Sundeep Mohindru, Chief Executive Officer, M1xchange

Secondary market transactions on Individual Factoring units on TReDS:

As already envisaged in TReDS guidelines - Secondary market transactions on TReDS would enable the financiers to off-load / trade their TReDS portfolio with other financiers who wish to purchase them at a certain cost premium. It will help to bring liquidity in the market since the limits of the portfolio selling financier would get freed to the extent of the portfolio offloaded / traded by them with the other purchasing financier.

Trading of PSL portfolio through TReDS platform:

Trading of PSL TReDS portfolio should be permitted for financiers, which would result in release of limits of a financier and thereby increase participation and volumes on TReDS.

Integration of TReDS platform with GSTN e-invoicing portal / TReDS ‘Second Window’

A TReDS ‘Second Window’ offers a facility for MSME vendors registered on the platform, to avail finance on their bills receivable, based on their cash flows and GST

payments, without waiting for the buyers’ acceptance of the bills.

Kailashkumar Varodia, Chief Financial Officer, Receivables Exchange of India Ltd

TReDS integration with GST will lead to automatic uploading of all GST invoices onto TReDS. All the invoices of an MSME would be now accessible to TReDS subject to their consent and will foster an environment of greater transparency.

With the TReDS Second Window, MSMEs can receive financing for the invoices based on the cash flow and GSTN data provided, bringing additional liquidity to MSMEs. Moreover, they don’t need to wait for the buyer to accept their invoices. The financier will take an exposure on financing the seller invoices based on the available data. However, it is purely on recourse to the seller, while without recourse financing to the MSMEs is a significant aspect of the TReDS platform.

Double Factoring

Under this concept, e-commerce companies can set up their own financing units and offer bill discounting

solutions to the vendors listed with them, while subsequently selling the same to larger financiers.

Savita Shankar, Independent Researcher and Lecturer, School of Social Policy and Practice, University of Pennsylvania

E-commerce companies can be permitted to set up NBFCs which can participate in factoring. MSME companies whose products are sold on the e-commerce site will then be able to access factoring services as they can conveniently sell their receivables to these NBFCs. These NBFCs can in turn sell their receivables to larger and better capitalized banks and NBFCs. This is the concept of “double factoring” that has been adopted widely in China, one of the leading factoring markets in Asia (<https://asiatimes.com/2018/02/chinas-e-commerce-firms-unlocking-sme-potential>).

The new-age digital financing solutions for MSMEs can have a multiplier effect on factoring volumes as they would directly help MSMEs access factoring. This is preferable to other measures such as earmarking a percentage of factoring fund corpus for MSMEs as in the latter case the problem of connecting the MSME with the factor in a convenient manner remains. Enhancing MSMEs’ access to factoring services is a relatively easy way to channel finance to these entities in a sustainable manner thereby boosting their viability and growth.

BIG TECH CREDIT



Big Tech Credit

Apart from fintech credit, which is largely extended by start-up enterprises, there is another growing segment, which is called 'big tech' credit, where credit to small scale firms is extended by large technology-based companies such as Amazon, Alibaba, Google and Apple, to name a few. Large companies in communication technologies, e-commerce, smartphone and social media platforms are experimenting innovative credit products to serve small scale entrepreneurs. For instance, large e-commerce

companies such as Flipkart and Amazon offer credit to the merchants selling goods on their platforms. Such credit services, which are defined as 'big tech' credit, are championed by global firms such as Alibaba, Airtel, Vodafone, Samsung, Baidu, Tencent and Microsoft, to name a few. Volume of big tech credit is estimated to have grown from USD 10.6 billion in 2013 to USD 572 billion by 2019, according to BIS.

The New Digital Paradigm

A major challenge faced by MSMEs is access to timely cash-flow based financing. Despite the presence of bill discounting platforms such as the Trade Receivables Discounting System (TReDS), SMEs find it difficult to avail uncollateralized cash flow-based loans. Delay in receipt of outstanding dues affects their working capital cycle and can severely stress the cash flows of MSMEs owing to fall in revenues due to low demand emanating from the Covid-19 crisis.

With increased digitization, many MSMEs are actively using e-commerce platforms and e-marketplaces. These online aggregators have a digital financial footprint left behind by the MSMEs registered on their platforms. Thus, these online intermediaries can synthesize lenders' credit products as part of their core offerings, using the

Open Credit Enablement Network (OCEN) and Account Aggregator (AA) framework, and offer working capital finance to MSMEs.

The new digital paradigm based on OCEN and AA frameworks allows easy sharing of data, thereby reducing the time and cost involved in sourcing leads, underwriting loans and performing RBI compliant KYC. The Government eMarketplace (GeM) SAHAY initiative is the first reference implementation. Post GeM SAHAY a second reference implementation - GST SAHAY - for invoice financing will be launched. Finally, there are a host of e-commerce companies eager to use these frameworks in the avatar of a Loan Service Provider in order to provide different credit products to MSMEs.

Key Developments aiding Digital Modes of Finance

The advent of the digital finance revolution is set to improve access to various forms of working capital finance such as receivable finance and purchase order finance for MSMEs. The following developments in the economy support newer forms of digital financing:

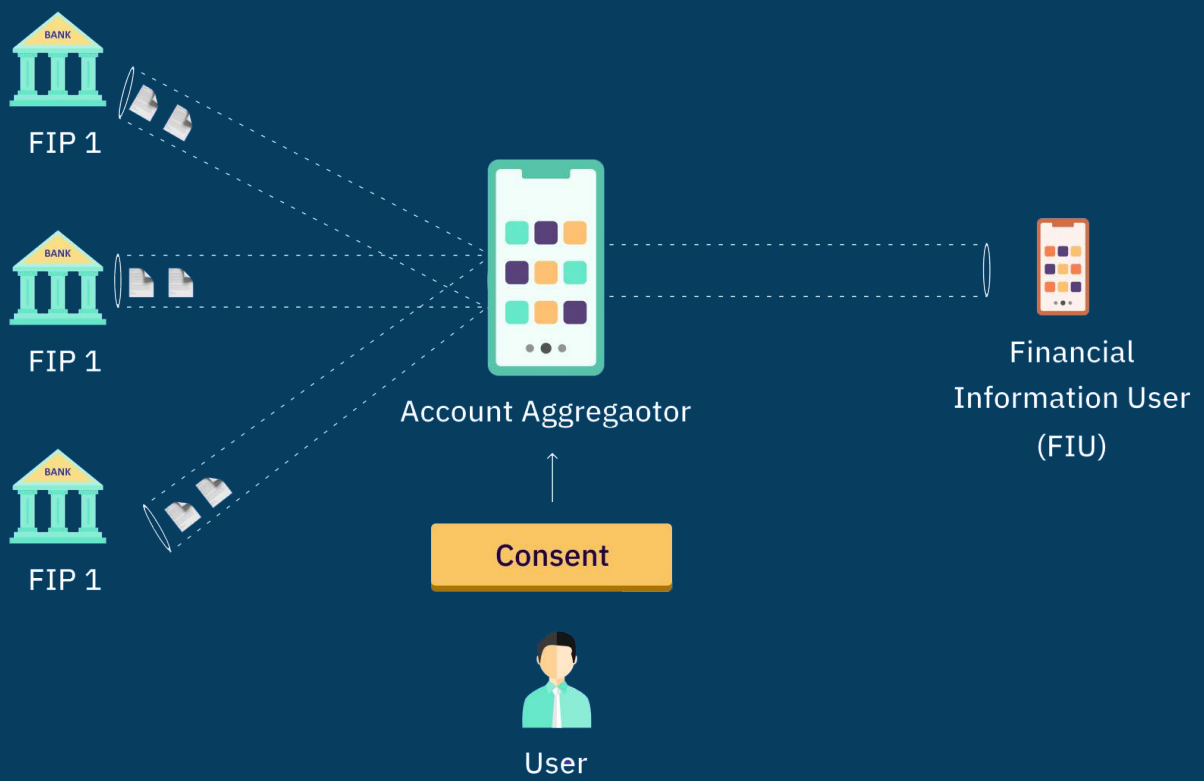
Advent of digital mode of payments such as UPI, QR Code, net banking and pre-paid payment instruments or wallets have made available digital data on cash flows and payment history of the borrower. This enables credit risk assessment and devising appropriate working credit products to suit the cash flow structure of the borrower.

With the introduction of GSTN, there is one more potential data repository on invoices and tax payment history of the MSMEs, which can be useful source of information for taking credit decisions.

The popularity of e-market platforms such as IndiaMart, Flipkart, Amazon and aggregation platforms such as cab hailing apps, food delivery apps, grocery shopping apps etc. have helped lenders identify their potential borrowers from these platforms. For instance, a conventional bank can reduce its cost of customer acquisition and distribution of loan products, if it gets the list of sellers on these e-market platforms, their daily sales volume and their contact details.

The introduction of digital signature, e-NACH and e-mandate will help do away with the paper-work, time and cost involved in loan disbursement under the conventional system.

ACCOUNT AGGREGATORS (AA)



Account Aggregators (AA)

As the world economy enters the digital age, data has assumed the role of 'public good'. In this age of digital technologies, a customer's financial data such as her bank deposits, investment in other financial assets, loan outstanding, insurance status etc. are the critical inputs for determining her credit eligibility or credit worthiness. Insufficient access to a borrower's financial data can hinder her access to the formal credit market. At the same time, inadequate access to such data acts as a significant handicap for financial institutions to map the risk profile of their borrowers and consequently lead to mispricing of loan products and even lead to flow of credit to high risk borrowers. Such inadequate access to data can lead to poor credit decision and increases the odds of large scale defaults with destabilizing consequences for the entire financial system.

Therefore, financial data is a public good and Reserve Bank of India has identified a new category of companies, known as 'Account Aggregators' (AAs). These account aggregators offer the valuable service of retrieving / collecting and sharing critical financial information about borrowers to banks and other financial users for a fee. AAs retrieve data from financial information providers such as banks and mutual funds, who possess the financial profile of the customer, with her consent, and pass the same to the users of this information who may be fintech companies, banks or other financial institutions assessing the credit-worthiness of the customer. Even though account aggregators are engaged in collecting and disseminating financial data, they cannot read the same as the data is encrypted by the sender of the data and it can only be decrypted by the ultimate user of the information. The data that is passed on by the AA is end-to-end encrypted, digitally signed and tamper proof.

Since 2016, Reserve Bank of India has been regulating account aggregators, by stipulating norms for their registration, roles and responsibilities, consent mechanism to collect and share financial data, rights of the customers (whose data is retrieved and shared by the AAs), customer grievance etc. RBI's guidelines also stipulate norms for charging fees for the service of AAs, having a sound information technology to ensure data security and prevent unauthorized access to customer data.

The AA framework is expected to improve ease of access to secure and trusted financial information such as bank account statements of potential borrowers; and hence it reduces the time and costs involved in risk evaluation while sanctioning loans by financial institutions. In September 2021, the AA network was formed in India with eight large banks participating in this network. As more and more banks and other financial institutions join this network, the entire financial system can benefit from seamless access to secure financial data of their potential borrowers.

A borrower, who wishes to avail loan from a different financial institution, than the one where she already has a bank account, has to register herself on the mobile app of any one of the licensed AAs. So far, RBI has given license to four AAs, viz. Finvu, OneMoney, CAMS Finserv, and NADL, besides providing in-principle approval to three others. Also, both the financial service provider and the financial service user, should be registered with the AA network, so that the AA can serve as an intermediary for collecting and transferring the necessary financial information among them.

OPEN CREDIT ENABLEMENT NETWORK (OCEN)



Open Credit Enablement Network (OCEN)

Open Credit Enablement Network (OCEN), which has the potential to unleash a new wave of digital lending in India, was developed by Indian Software Product Industry RoundTable (iSPIRT), a think-tank of the software industry and it was first announced in July 2020.

The objective of OCEN is to democratize the lending business by enabling any business entity, on which millions of people transact, to become a loan service provider (LSP). The LSP integrates multiple lenders to provide completely digital loans. In order to facilitate this, technology service providers (TSPs) can help onboard LSPs and lenders on OCEN an AA. Just as the common payment infrastructure Unified Payment Service (UPI) enabled companies such as Google and Amazon to become payment service providers (PSPs) by launching their mobile apps on the UPI platform, the OCEN platform will allow businesses that wish to help source credit for an MSME, to become a LSP.

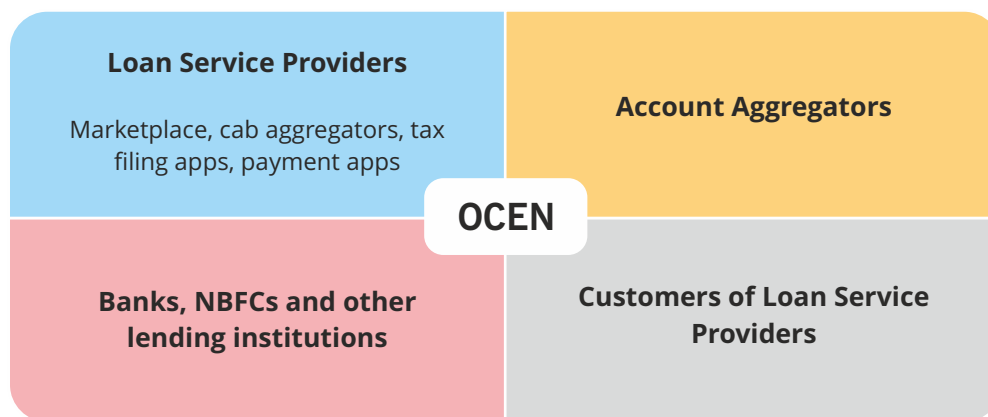
OCEN is a set of standard Application Programming Interfaces (APIs), which any LSP can integrate, whether it is an e-commerce company such as Flipkart or a cab hailing firm like Ola or a mobile payments app Google Pay, in its mobile app. Thus, if Ola plugs in the OCEN API in its app, all its drivers can avail loans from lenders who

wish to onboard on the Ola mobile app. Similarly, the network of Account Aggregators (AAs) can also be onboarded on the Ola app through OCEN. Thus, OCEN is a set of common APIs that integrates lenders, LSPs (in this case Ola) and AAs.

Since OCEN enables any LSP, whether it is an e-commerce company, or mobile advertising service provider, or a tax filing app or an insurance policy app, to connect its customers to lenders and AAs, lenders such as banks and NBFCs can benefit by onboarding on the apps of these LSPs and offer innovative credit products to suit the needs of the customers of these LSPs. For instance, by onboarding on the Amazon Pay app, banks and NBFCs can offer unique credit products to suit the capital needs of all the merchants using the payment solution of Amazon Pay. With OCEN, these LSPs can also plug in AAs in their apps, so that lenders can verify the financial data of the customers before sanctioning loans to them.

The first app to be launched through the OCEN framework is GeM SAHAY, under which vendors can apply for working capital loans against purchase orders from government departments. GST SAHAY, which will enable traders to access to financing against their invoices will be launched in the first half of 2022.

OCEN: Integrating multiple stakeholders in the lending ecosystem



**Savita Shankar, Independent Researcher and Lecturer, School of Social Policy and Practice,
University of Pennsylvania**

The OCEN (Open Credit Enablement Network) and Account Aggregator framework can be used to expand access to factoring. Banks and NBFCs can use GSTN data to verify invoices and conduct a credit risk appraisal based on bank account data and information from credit bureaus. While factoring currently provided through TReDS platforms is non-recourse (implying that once MSME receivables are sold, the financier has no recourse to the MSME even if the buyer defaults), through this mechanism even full recourse factoring can be offered to MSMEs. Full recourse factoring could be useful when buyers' credit worthiness is hard to establish but MSME's bank account data and credit history indicate that the transaction is bankable. To reduce risks, e-liens can be set up through the framework to trap cash flows for repayment. This model for providing full recourse factoring is preferable to full recourse factoring based on credit rating of MSMEs as the latter would require MSMEs to pay rating fees to the credit rating agency. MSMEs are likely to find it unaffordable to pay rating fees and would require Government subsidies.

Hrushikesh Mehta, Chief Evangelist – CredAll, Volunteer - iSPIRT

While large businesses and salaried individuals are able to access credit relatively easily, access to credit has always been a massive challenge for MSMEs. This has been for 3 major reasons:

1. Lack of high provenance data: The availability of credit bureau data and the ability to identify counterparty risk (the ability to assess the consistency of a borrower's income) led the market to build highly automated models for the salaried class which drove an explosion of credit for this segment. The challenge with lending to MSMEs is that credit bureau data is not enough. Being able to analyze their ability to generate business (e.g. via GSTN data) and translate that business into cash (bank statements) in a machine driven environment will help identify seasonality, counterparty risk and length of payment cycles in order to build effective lending models. Moreover, bank statements or tax returns currently submitted by borrowers (as opposed to retrieved from a reliable third party) are susceptible to fraud. This means additional layers of checks and even more manual intervention which further drives up costs.

2. Manual processes involved in servicing loans: Lenders typically need to employ armies of people to collect, assess and store documentation which does nothing but increase turnaround times and drive up costs. In addition, the loan documentation required for companies (given the challenges in identifying the appropriate signing authority) is even more cumbersome than that required for individuals.

3. High cost of fund transfer: For small ticket sachet loans, high costs of fund transfer make the loans unviable for the borrower. While there are digital modes of transfer available, they often charge upto 1 per cent for each transfer. For someone who takes a Rs. 500 loan at 9 am and returns the loan at 5 pm the cost of the money transfer is more than the interest cost on the loan!

This is not a conducive environment to provide working capital to cash-starved MSMEs in a timely fashion. As a result, people who want smaller loans have been excluded from the credit ecosystem.

Impact of the New Paradigm

- Financing will be based on continuous cash flows rather than on income and assets.
- As more and more number of MSMEs register themselves on e-commerce and other online aggregating platforms, and avail loans based on their cash flows and past payment records, the credit crunch faced by these MSMEs will be mitigated, and their business growth will be achieved.
- Increase in the digital mode of transacting due to the Covid-led disruptions enhance the possibilities of the evolution of a dynamic MSME financing ecosystem in India by utilising bigtech solutions.

Hrushikesh Mehta, Chief Evangelist – CredAll, Volunteer - iSPIRT

The solution to the problem of providing working capital to cash-starved MSMEs in a timely fashion:

Cutting edge technology infrastructure: The recent launch of the Account Aggregator (AA) network – with 8 banks that cover over 300 million bank accounts - will help provide high provenance data to help assess creditworthiness of borrowers. In addition, the beta version of the first mobile application built on the Open Credit Enablement Network (OCEN) - GeM SAHAY - has been launched. The application facilitates the disbursal of funds in 10 minutes. These have been landmark moments in India's digital journey where underwriting, disbursal and collections all happen in a paperless, presence-less and completely automated fashion. What's more, the smallest loan disbursed of Rs. 160 was done in a profitable manner. Given that KYC and assessment costs could be as high as Rs. 3,000, this was impossible to do previously.

Challenges with the New Paradigm

Digital frameworks such as OCEN and AA enable easy cash-flow-based lending, and also expedite the process of credit disbursement, while bringing down costs. However, the system is fraught with challenges such as difficulty in doing digital KYC for partnerships, private limited and public limited companies, limits on the maximum permissible amount of UPI eMandate and

eKYC for loan approvals etc, which restrict the utility of the OCEN and AA frameworks, and limit the uptake of cash-flow based lending. Further, there is a compulsion to have a GSTIN to avail GeM SAHAY loans, which makes it difficult for many micro organizations to avail non-collateralized loans.

SUGGESTIONS TO ENHANCE UPTAKE OF OCEN AND AA-BASED LOANS



Suggestions to enhance uptake of OCEN and AA-based loans

- Banks and NBFCs have traditionally given collateralized loans. Given the availability of GST and Bank Statement data (high provenance data, directly from the source and in machine-readable format), lenders should discover credit models for the previously underserved MSME segment based on informational collateral. This can be achieved using OCEN and AA.
- PSU / private corporate buyers should be encouraged to pay their outstanding dues in time so that MSME sellers do not incur interest payments towards loan repayment due to the lax behavior of buyers.
- Considering that we have a Central KYC registry in place which makes document verification easy for lenders, the eKYC limit for loan approval should be raised.

Hrushikesh Mehta, Chief Evangelist – CredAll, Volunteer - iSPIRT

While the technology to facilitate the flow of credit now exists, there are a number of constraining factors that are throttling the flow of credit. These are:

- **Address Aadhar eKYC Limits:** eKYC helps facilitate presenceless and paperless verification of an individual. Currently RBI guidelines limit disbursements made on the basis of Aadhar eKYC to Rs. 60,000 annually. This limit should be removed to help drive the flow of credit.
- **Introduce Foundational KYC:** The process of conducting KYC for a business entity is based on physical documents today. Foundational KYC allows a new lender to rely on another scheduled commercial bank's KYC to disburse a loan to the existing KYC-compliant account. For instance, if a disbursement is made into a bank account for which account data has been received via the AA ecosystem (which in turn has been verified by the user with credentials issued by that bank) then there should be no need to conduct additional KYC checks. Relying on existing infrastructure to create a seamless user experience but maintaining anti-money laundering standards and other checks will help ease the flow of credit to MSMEs.
- **Encourage Account Aggregator Adoption:** While India's largest banks are participating in the ecosystem, it is important to have guidelines issued that direct all regulated entities to participate. The wider the availability of data, the more likely lenders will be able to disburse credit. Account Aggregator enables data sharing only with the explicit consent of the individual or MSME.
- **Digital Agreements:** One of the major challenges with lending to non-individuals is ascertaining who is authorized to sign a loan agreement. As a result, for partnerships, all partners have to sign the agreement. Moreover, for private limited and public limited companies a board resolution is required to be attached to the loan agreement. A more prudent way to solve for this would be to create the position of a "nodal officer" in companies. The nodal officer is authorized by the company to digitally sign loan agreements in a non-repudiable fashion. Limits on this authority can be specified by company and verifiable by the counterparty.
- **Address UPI eMandate Limit:** The current upper limit on the value per transaction is Rs. 2,000. The upper cap should be removed to enable collections for small ticket loans.

These policy interventions will help create credit infrastructure which is more conducive to lending to MSMEs while maintaining robust ecosystem controls.

Conclusion

Advancement in digital technologies has improved access to various goods and services used in our day-to-day activities. However, technology democratisation is successful if it reaches the last-mile user, in an easy and convenient manner. Further, it should bring down the cost of transacting.

New-age digital financing solutions such as TReDS, OCEN and AA have the potential of easing MSME financing by offering collateral-free loans, while ensuring that these loans are serviced in a timely and cost-effective manner. Moreover, credit is offered at the fingertips using mobile applications, and is used to meet the immediate working capital requirements, thereby mitigating disruptions in the supply chain cycle.

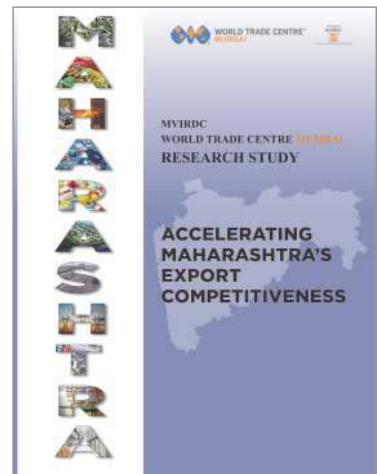
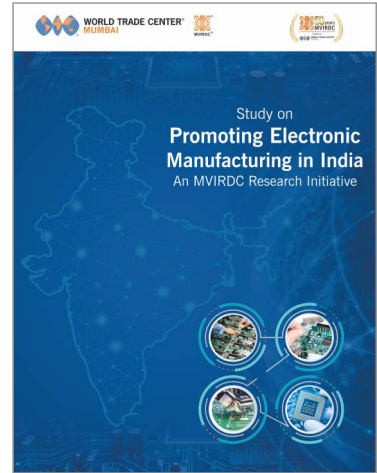
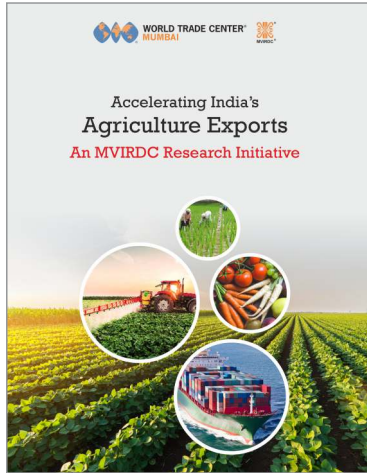
These timely innovations enable bringing together financiers, sellers and buyers on one platform, and competition among financiers leads to lowering of the cost of borrowing. However, in order to ensure the

success of these platforms, several nitty-gritties need to be addressed.

These include creation of a unified payments platform for all MSME vendor payments by a PSU, Reverse Factoring, setting a sub-target for TReDS within Priority Sector Lending limit, creation of a secondary market to enhance liquidity of TReDS transactions, integration of TReDS with GSTN e-invoicing portal, Double Factoring, addressing Aadhar eKYC limits, introducing foundational KYC, encouraging AA adoption, and addressing UPI eMandate limit, among others.

At a time when the Covid-19 pandemic has disrupted commercial activities of several MSMEs, technological interventions in the financial sector can bring them the much-needed respite to survive and grow in the years ahead. Policy-makers should, therefore, ensure speedy implementation of the reforms needed to bolster the sector.

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