

FINANCIAL INCLUSION: THE ROLE OF MSMEs IN INDIA

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ABSTRACT:

MSMEs are great part and play a significant role in the growth in India. The globalization will bring many advantages for enterprises however MSMEs will face severe competition at the local, national and international level. In order to maintain and promote the significant role of MSMEs in the context of increased competition, MSMEs have to change and adopt new technologies. Micro, Small and Medium Enterprises (MSMEs) play a vital role for the growth of Indian economy. MSMEs including khadi and village/rural enterprises. MSMEs are the engine of growth in many Economies around the world. India is expected to become one of the World's Largest Economies in the coming decades. The Micro, Small and Medium Enterprises (MSMEs) are expected to play an Important role in the rise of the Indian Economy. The Enactment of the Micro, Small and Medium Enterprises Development (MSMED) act, 2006 is a turning point for the development of the Indian Industry.

MSME sector which has large employment potential of 59.7 million persons over 26.1 million enterprises, is considered as an engine for economic growth and promoting financial inclusion in rural Areas. MSMEs primarily depend on bank credit for their operations. By Providing essential financial services to underserved segments of the MSME Sector, NBFCs play a vital role in promoting Financial Inclusion. This, in turn, stimulates economic growth, as more MSMEs are able to invest in their businesses, create jobs, and contribute to the overall economy.

KEY WORDS: MSMEs, Financial Inclusion, Globalization, Economic growth.

INTRODUCTION:

MSME Sector is expected to play an important role in the rise of the Indian economy. The development of this sector is critical to meeting the country's needs for financial inclusion and significant job creation across the country. Moreover, it can encourage and support the Development of new-age Enterprises who have the potential to create globally competitive businesses from India. MSME sector in India was largely unorganized and controlled by the Ministry of Small Scale Industries and the Ministry of Agriculture and Rural Industries. Although this sector contributed significantly in terms of number of units, employment generation and exports before the 1980s, in the post-liberalization and globalization stage, increased competition as a sector from a protective environment to a competitive environment has contributed to the growth of this sector. Business performance declined. Recognizing the need to legalize the policy framework in this area, the Micro, Small and Medium Enterprises Development Act (MSMED) was notified and subsequently came into force from October 2, 2006.

DEFINITION OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs): The definition is provided Micro, Small and Medium Enterprises Development Act, 2006 and was notified in September, 2006. The new Classification has come into effect from 1st July, 2020. The Act Provides for Classification of Enterprises based on their Investment size and the Nature of the activity undertaken by that Enterprise. As per MSMED Act, 2006 Enterprises are classified into two categories – Manufacturing Enterprises and Service Enterprises.

| MANUFACTURING SECTOR ENTERPRISES | | INVESTMENT IN PLANT & MACHINERY |
|----------------------------------|---------------------------|---------------------------------|
| 1. | Micro Enterprises | < or = Rs 25 lakh |
| 2. | Small Enterprises | > Rs 25 lakh < Rs 5 crore |
| 3. | Medium Enterprises | > Rs 5 crore < Rs 10 crore |
| SERVICE SECTOR ENTERPRISES | | INVESTMENT IN PLANT & MACHINERY |
| 1. | Micro Enterprises | < or = Rs 10 lakh |
| 2. | Small Enterprises | > Rs 10 lakh < Rs 2 crore |
| 3. | Medium Enterprises | > Rs 2 crore < Rs 5 crore |

*Source: MSME Annual Reports

NEW DEFINITION OF MSMEs: The Union Budget **2025-26** revised the definition of Micro, Small, and Medium Enterprises (MSMEs) by increasing investment and turnover limits. The new definition aims to help MSMEs scale up and adopt better technology. Finance Minister Nirmala Sitharaman announced a major update to the New MSME classification, increasing the investment limit by 2.5 times and doubling the turnover limits. This is aimed at fostering growth, encouraging innovation, and creating a more enabling ecosystem for MSMEs to flourish.

| MANUFACTURING AND SERVICE SECTOR ENTERPRISES | INVESTMENT IN PLANT & MACHINERY/ ANNUAL TURNOVER |
|--|--|
| Micro Enterprises | Investment < Rs. 2.5 crore and turnover < Rs. 10 crore |
| Small Enterprises | Investment < Rs. 25 crore and Turnover < Rs. 100 crore |
| Medium Enterprises | Investment < Rs.125 crore and Turnover < Rs.500crore |

*Source: MSME Annual Reports

FINANCIAL INCLUSION:

Financial Inclusion is the availability and equality of opportunities to access financial services. It refers to processes by which individuals and businesses can access appropriate, affordable, and timely financial products and service, which include banking, loan, equity, and insurance products. It provides paths to enhance inclusiveness in economic growth by enabling the unbanked population to access the means for savings, investment, and insurance towards improving household income and reducing income inequality.

Financial inclusion efforts typically target those who are unbanked or under banked, and then direct sustainable financial services to them. Providing financial inclusion entails going beyond merely opening a bank account. Banked individuals can be excluded from other financial services. Having more-inclusive financial systems has been linked to stronger and more sustainable economic growth and development, thus achieving financial inclusion has become a priority for many countries across the globe.

Since financial inclusion was established as a priority for the GOI and RBI, progress has been made. Mangalam, Puducherry became the first village in India where all households were provided banking facilities. States or union territories such as Puducherry, Himachal Pradesh and Kerala announced 100% financial inclusion in all their districts. The Indian Reserve Bank vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on IT. However, illiteracy, low-income savings, and lack of bank branches in rural areas remain a roadblock to financial inclusion in many states, and there is inadequate legal and financial structure.

In India, MSMEs account for 30% of India's Gross Domestic Product (GDP) and over 45% of the exports. These businesses, ranging from micro business entities to mid-sized manufacturers and export-oriented entities MSMEs are at the core of the value chain of Indian economy.

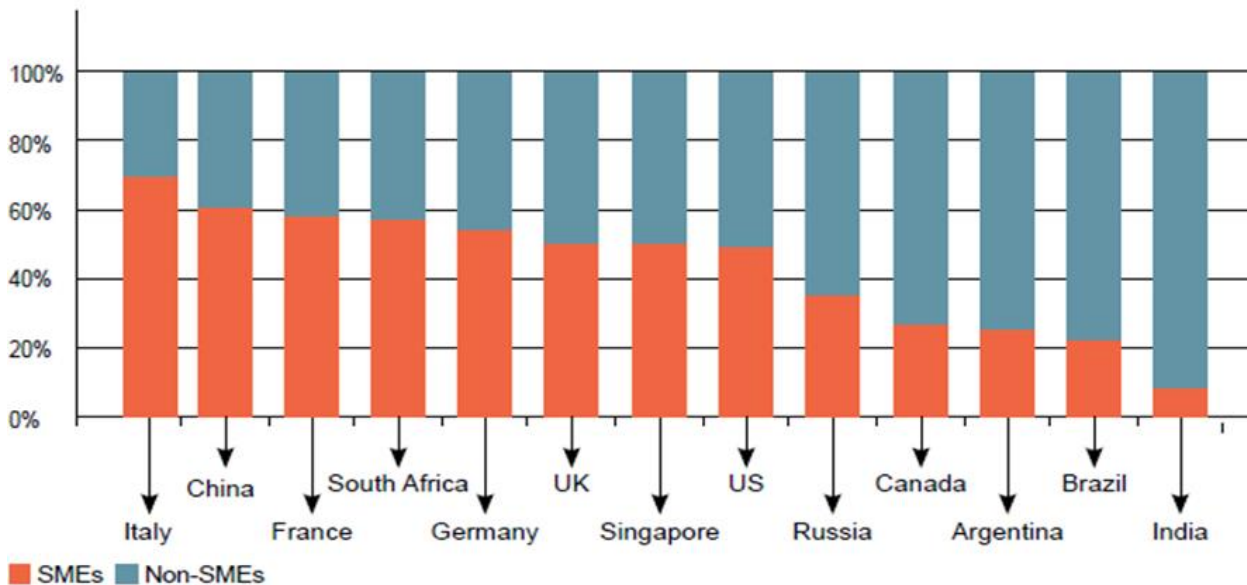
GROWTH AND DEVELOPMENT OF MSMEs IN INDIA

| SNo. | Year | SMEs (lakhs) | Production (Price in Crores) | Employment (lakh persons) | Exports (Rs. In Crores) |
|------|-----------|--------------|------------------------------|---------------------------|-------------------------|
| 1. | 2013-2014 | 3.36 | 1,57,525 | 220.55 | 48,979 |
| 2. | 2014-2015 | 7.15 | 1,70,379 | 229.10 | 54,200 |
| 3. | 2015-2016 | 10.10 | 1,84,401 | 238.73 | 69,297 |
| 4. | 2016-2017 | 15.21 | 1,95,613 | 249.33 | 71,244 |
| 5. | 2017-2018 | 19.49 | 2,10,636 | 260.21 | 86,019 |
| 6. | 2018-2019 | 23.95 | 2,28,730 | 271.42 | 97,644 |
| 7. | 2019-2020 | 28.59 | 2,51,511 | 282.57 | 1,14,417 |
| 8. | 2020-2021 | 33.42 | 2,75,581 | 299.85 | 1,50,242 |
| 9. | 2021-2022 | 38.44 | N.A | 312.52 | N.A |
| 10 | 2022-2023 | 43.68 | N.A | 322.28 | N.A |

*Source: MSME Annual Reports 2022-23

SMEs contribution to GDP: India vs. some major global economies

Thanks to the dominance of unregistered and unorganised players, India lags far behind its global peers when it comes to GDP contribution from SMEs



Source: Country specific SME reports and TDB Intelligence Unit; non-SME sector includes unorganized and unregistered enterprises

OBJECTIVES OF STUDY:

- ❖ To Study the Importance of Financial Inclusion.
- ❖ To Know the Financial Inclusion and Technology.
- ❖ To Study the Financial Inclusion for MSMEs.
- ❖ To Measures to Improve Financial Inclusion for MSMEs.
- ❖ To Study Empowering through Financial Inclusion for MSMEs.

REVIEW OF LITERATURE:

The Application of Entrepreneurial behavioural methodologies in comprehending entrepreneurial behaviour in emerging markets is often limited. It provides the comprehensive and argumentative review of existing literature on Financial Inclusion for MSMEs in India.

(Zhou & de Wit, 2009) Micro, small, and medium enterprises (MSMEs) are an important generator of jobs. Hence, insights into the determinants of enterprise growth are important from a policy perspective. There is a growing literature that assesses the effects of the set of factors, policies, and institutions that affect enterprise growth. Generally, the determinants of enterprise growth are characterized as either being external or internal to the firm. Most studies summarize and classify the determinants of enterprise growth into three broad dimensions: individual, organizational, and investment climate factors.

(Legas, 2015) At the individual level, entrepreneurship has gained momentum as a key vehicle leading to higher jobs and sustainable economic growth. However, entrepreneurs face many challenges among them lack of financial inclusion, the tightest laws and regulations, and the poorest infrastructure.

(Dugassa, 2012) Lack of a comprehensive entrepreneurial training and small market size also emerged as a critical challenge that entrepreneurs in the region face.

The World Bank (2014) To track the impact of financial inclusion on firm growth in India, a clear and unified definition of the concept of financial inclusion is needed to identify policy gaps, understand both served and underserved firms, and define priorities for action.

IMPORTANCE OF FINANCIAL INCLUSION

There are very broad and general reasons why financial inclusion is important. Some of the key reasons include:

- **Financial inclusion reduces poverty and inequality:** Financial inclusion provides opportunities for marginalized and low-income individuals to access formal financial services, such as savings, credit, and insurance. By empowering them with the tools to manage their finances and invest in income-generating activities, financial inclusion can help lift people out of poverty and reduce economic disparities.
- **Financial inclusion promotes economic growth:** A general argument is that when more people have access to financial services, they can participate actively in the economy. Increased financial inclusion leads to higher levels of savings, investment, and entrepreneurship, fostering economic growth and stability in both local communities and national economies.

- **Financial inclusion promotes small businesses:** Small businesses often face challenges in accessing credit from traditional banking sources. Financial inclusion through innovative lending models and online platforms can provide much-needed funding for entrepreneurs to grow their businesses.
- **Financial inclusion empowers otherwise marginalized demographics:** For example, financial inclusion initiatives targeted at women can promote gender equality and women's economic empowerment. By providing access to financial services, women gain more control over their finances, which can lead to improved educational opportunities, better health outcomes, and increased decision-making power within households.
- **Financial inclusion promotes innovation:** Financial inclusion drives innovation in the financial sector, leading to the development of new technologies and fintech solutions that cater to the needs of underserved populations. These innovations can benefit the broader financial ecosystem and lead to advancements in financial services.
- **Financial inclusion may foster digital inclusion:** As technology plays a significant role in financial inclusion, promoting access to digital financial services also contributes to digital inclusion, ensuring that more people can participate in the digital economy.

FINANCIAL INCLUSION AND TECHNOLOGY

There are countless ways technology can and is playing a major role in enhancing financial inclusion. Here are some ways we can use modern innovations to better serve the world with financial services.

1.Mobile Banking:

Mobile banking applications offer a wide range of services, including checking account balances, transferring funds, paying bills, and even applying for loans. These apps are user-friendly and accessible 24/7, enabling individuals to conduct financial transactions conveniently from their smartphones, without the need to visit physical bank branches.

2.Digital Payments:

In 2021, the FDIC found 46.4% of all U.S. households were using nonbank online payment services. Online payment systems provide various options for making cashless transactions. Mobile wallets allow users to store funds digitally and make payments using their mobile phones, while contactless payment methods such as Near Field Communication (NFCs) and QR codes enable swift and secure payments in physical retail settings. Both solutions reduce the risk of theft or loss associated with carrying cash.

3.Agent Banking:

Agent banking models use technology to equip banking agents with mobile devices and software. Agents act as intermediaries, representing financial institutions in remote areas where brick-and-mortar branches are impractical. They offer services such as account opening, deposits, withdrawals, and fund transfers to individuals who may not have easy access to traditional banks.

4.Online Lending Platforms

Fintech lending platforms connect borrowers and lenders directly through online platforms. Borrowers can apply for loans, and lenders can assess their creditworthiness based on data analytics and alternative credit scoring. This streamlines the lending process and extends credit access to individuals and businesses underserved by traditional banks or those who would have otherwise been excluded from securing traditional credit. For example, LendingClub boasts that more than 4.8 million members have used their services to achieve their financial goals.

5.Blockchain and Cryptocurrency

Blockchain technology provides a decentralized and immutable ledger for secure financial transactions. Cryptocurrencies enable individuals without traditional bank accounts to participate in the digital economy, offering potential alternatives to traditional banking systems. Consider developing country implementations of these solutions to promote transaction speed, counter weak national currencies, and promote financial system accessibility.

6.Financial Education Apps

Financial education apps and online platforms offer interactive and engaging content to improve financial literacy. Users can access educational modules, budgeting tools, and investment insights to enhance their understanding of financial concepts and make better financial decisions.

7.Crowd funding

Similar to peer-to-peer lending, crowd funding allows geographically-separated individuals to still commune and support a single cause through donation or equity contributions. Crowd funding platforms allow individuals, startups, and social impact projects to raise funds from a diverse pool of investors. This democratized fundraising approach expands access to capital for underserved entrepreneurs and impactful initiatives. As of July 2023, GoFundMe has helped raise over \$9 billion.

MEASURES TO IMPROVE FINANCIAL INCLUSION FOR MSMEs:

The role of government intervention is vital in expanding MSME finance spaces. This is especially relevant in developing countries as they usually have less efficient financial markets than their more developed counterparts. However, it is equally important to minimize the potential distortions brought along by improper actions. Governments should keep in mind that government intervention aims to achieve an efficient market rather than address market imperfections and failures. Identifying the market failure and setting intervention boundaries is the critical prerequisite to designing an appropriate strategy. In all cases, government intervention should be appropriately designed to avoid any disincentive for private sector providers of financial services to serve the MSME segment. Following are the policy recommendations to enhance MSME financing:

- Developing country-specific diagnostics and strategies, creating a supportive legal and regulatory framework, strengthening the economic infrastructure, designing effective government support mechanisms, building consistent and reliable data sources on MSME finance, and building the capacity of the financial institutions.
- Leveraging state-owned financial institutions, including state-owned banks, DFIs, and specific MSME banks, to serve MSMEs. The state-owned financial institutions have more incentives and willingness to suit particular market segments. Compared to their private counterparts, some state-owned financial institutions have less-developed MSME lending technologies, lower levels of profitability and higher costs. In addition, many state banks' failure can also be explained by political interference, excessive risk exposure due to irrational development goals, and internal operational inefficiencies. Therefore, it is essential to impose independent corporate governance, efficient operation and proper MSME lending and risk management technologies to improve access to MSME financing.
- Implementing direct lending and programmes in collaboration with other financial institutions in the form of soft loans, lines of credit, co-financing and equity funds. Such programmes should also be carefully designed to minimize the subsidy component, political interference and crowding-out effects on the private sector. A good financing programme requires precisely defined performance targets, an independent governance structure, clear selection criteria for beneficiaries and collaborating institutions, and a very high-quality management team. The operation of the programme needs to be market-oriented, and a commercial interest rate should be applied. The mission and products of the programme should be flexible and adapted according to market maturity.
- Creating an overall enabling environment that offers incentives for financial providers to fill the MSME finance space. This requires a proper regulatory and supervisory framework that balances the risk and benefits of providing innovative MSME financial products while narrowing the existing financial gaps.
- Building reliable and comprehensive financial infrastructure, such as accounting and auditing standards and credit information systems, reduces the information asymmetries and legal uncertainties in MSME

financing. In addition, governments and MSME agencies may facilitate MSME capacity and creditworthiness by providing localized training and consultation services in collaboration with local financial service providers to meet the specific needs of both the supply and demand sides.

- Increasing government procurement from MSMEs is another effective measure to enhance MSME creditworthiness and viability by avoiding receivable payments and improving cash flow, how sound policy can assist MSMEs in accessing finance in India.

EMPOWERING MSMEs THROUGH FINANCIAL INCLUSION:

Micro, Small and Medium Enterprises (MSMEs) are strategic assets for economic development and employment generation, but remain too small and informal to make an impact. Over 95% of Indian enterprises are classified as micro, leading to the curious ‘missing middle’ syndrome. One of the key factors inhibiting the scaling up of MSMEs is a lack of affordable finance. MSMEs face a credit gap of ₹69.3 trillion out of which only ₹36.7 trillion is addressable by formal financing.

DEMAND AND SUPPLY FINANCING CONSTRAINTS:

Both demand and supply constraints result in lack of financial inclusion of MSMEs. Demand-level constraints in the MSME ecosystem include delayed payments from buyers, inadequate formal records, and information asymmetry among MSMEs. Limited supply of formal financing by banks due to outdated underwriting process, unsuitable loan products and high transaction cost prohibit MSMEs from accessing credit at affordable rates.

STAKEHOLDER INTERVENTIONS

Multiple stakeholders are providing a range of financing options to MSMEs. Banks, non-banking financial companies (NBFCs) and microfinance institutions remain the main institutional credit providers. Digital lending through financial technology companies, or fintechs, is solving unique and sector-specific challenges. Through their platforms such as TReDS, government and regulatory bodies.

INCLUSIVE CREDIT SCORING

Traditional credit scoring metrics may alienate or discriminate against those with limited credit history. Financial inclusion strives to explore alternative credit scoring methods that consider non-traditional data sources can extend credit access to those with limited credit history.

FINANCIAL EDUCATION AND LITERACY

Financial education and financial literacy refers to providing financial education and programs that equip individuals with essential financial knowledge and skills. This empowers them to make informed decisions, budget effectively, and understand the benefits of using formal financial services instead of relying on potentially exploitative alternatives.

CONCLUSION:

The policy implication on size, efficiency, and dynamism of the business sector in Uganda is that lack of finance displaces activity from MSMEs firms in benefit of large ones. Given that MSMEs have more employment and growth effects, there is a need to increase financial inclusion of MSMEs. There is also a need to improve the business environment, particularly formalization of micro firms. This will go a long way in increasing the capacity of the state in collecting taxes and paying for fundamental inputs for private sector development such as innovation, transport, and electricity infrastructure, capital needs of MSMEs.

Measures of regulatory environment and infrastructure suggest that MSMEs benefit from informality, less regulation, and less infrastructure development, which may help divert some economic activity to MSMEs. However, MSMEs are more susceptible to giving bribes to sustain the informal and the invisible status.

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