

# ROLE OF NBFCs ON MSME FINANCING: A SPECIAL REFERENCE OF CREDIT ACCESSIBILITY AND ECONOMIC GROWTH

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**Abstract** *The role of Non-Banking Financial Companies (NBFCs) in financing Micro, Small, and Medium Enterprises (MSMEs) has become increasingly pivotal in the context of India's economic growth. However, despite their potential, access to formal credit remains a significant challenge for many MSMEs due to stringent lending norms and collateral requirements imposed by traditional banks. This study explores the impact of NBFCs in addressing these challenges and facilitating better credit accessibility for MSMEs. Through a comprehensive analysis of existing literature, case studies, and secondary data from MSME annual reports and NBFCs data, the study examines the role of NBFCs in bridging the credit gap, their lending practices, and their influence on MSME growth. It evaluates how NBFCs, with their more flexible and innovative financial products, have contributed to enhancing financial inclusion for MSMEs, especially in underserved sectors and regions. Additionally, the study investigates the economic implications of this financing, including the potential for job creation, increased productivity, and overall contribution to national economic growth. The findings suggest that NBFCs have significantly improved credit access for MSMEs, particularly in rural and semi-urban areas, where traditional banking institutions are often underrepresented. By providing customised financial products and services that cater to the unique needs of MSMEs, NBFCs not only support their growth but also promote economic dynamism. However, challenges such as high interest rates, regulatory constraints, and limited risk appetite among some NBFCs are identified as areas requiring attention for sustainable growth.*

**Keywords** *Non-Banking Financial Companies, Financial Inclusion, Credit Gap, Debt Financing, Micro Small Medium Enterprises*

## INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) are acknowledged as the backbone of the Indian economy. These industries are important in driving innovation, employment generation and economic development in the country. According to the Ministry of Micro, Small and Medium Enterprises, these enterprises contribute to around 30% of India's GDP, create over 110 million jobs and are a significant source of foreign exchange. Despite their importance, one of the major obstacles to the development of MSMEs is their limited access to finance. Lack of access to adequate financial resources often limits expansion, innovation and sustainability in competitive markets. However, SMEs often faced difficulties in getting loans from these banks due to eligibility criteria, product requirements and lack of financial documentation, especially for small or new businesses. This financial constraint renders a large section of the MSME sector unprofitable and vulnerable, hindering its growth and contribution to the economy. The landscape is evolving to fill the gap between traditional banks. Offering a wide range of financial products such as loans, mortgages and property management, NBFCs are encouraged by the specific needs

of SMEs, such as easier lending, faster turnaround times and increased flexibility. Unlike banks, NBFCs tend to have less stringent credit standards and tend to lend to risky borrowers, especially those who do not have the necessary collateral or credit history.

The aim is to explore the role of non-banking financial institutions in improving access to finance for MSMEs with an understanding of their unique lending practices and products. Business finance addresses these important needs. This study will also analyse the impact of the overall market for NBFC financing on the growth of MSMEs, including employment generation, increase in productivity and capitalisation of these businesses, with the aim of helping boost the national economy. The panel reported that MSMEs, the engine of India's growth, are facing a huge gap of Rs. 20-250 billion. Credit gap refers to the difference between credit demand and credit supply. In fact, the ACC CA report states that this credit gap has worsened in the last five years. Moreover, more than 80% of MSMEs do not have access to finance.

Non-banking Financial Companies (NBFCs) have tried to bridge this gap by increasing lending to the MSME sector.

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With faster verification processes and better lending products that help MSMEs, they have become the preferred lenders for MSMEs in India (Table 1).

This paper examines the impact of nonbanking financial institutions on MSME financing and aims to provide an understanding of their effectiveness. This study offers valuable insights into financial support, business development and growth in the MSME sector. Additionally, this study will highlight the challenges faced by NBFCs in this process and provide policy recommendations to enhance the role of NBFCs in supporting the growth of MSMEs and the development of the economy.

## LITERATURE REVIEW

Richa Gupta studied the role of RBI-Registered. NBFCs in Financial Inclusion. Based on an analysis of primary and secondary data, the success of NBFCs in meeting demands and financial needs was evaluated. The empirical evidence revealed that the NBFCs might significantly increase financial inclusion with lending products and delivery channels. However, issues such as regulatory, risk and competition factors persist.

Nandini M and Shubha B N focuses on the situation of MSMEs. They identified the factors causing the finance gap and the satisfaction level of the borrowers towards bank finance in India. Using the convenience sampling method, a structured sample questionnaire was taken from 97 MSME borrowers from different sectors. The study's findings indicate that the finance gap is larger in small enterprises. The sample size in this study was very low, which might affect the generalisability of the findings.

Haareca Chintala studied a total of 24 NBFCs for the purpose of regression analysis of the problems faced in terms of borrowings, data for the years 2013–2019 has been taken. The purpose of the research was to analyse the problem faced by NBFCs both in terms of implementing co-origination of loans as a scheme.

Rashi Khanna conducted a detailed study on MSMEs in India, and concluded that MSMEs emerged as a vibrant dynamic sector of the economy in terms of manufacturing output, employment generation and exports, according to the study MSMEs have smaller markets, lower investment and leads to effective mobilisation of resources and equitable distribution of national income (Table 2).

The Reserve Bank of India Bulletin points out that the non-banking financial sector in India has grown significantly in recent years, unlike the public finance companies operating

in other countries of the world (Table 3). The report shows that the financial performance of India's non-banking financial institutions is improving steadily, becoming a main source of credit for the financial sector and Small and Medium-sized Enterprises (SMEs).

## OBJECTIVES OF THE STUDY

- To investigate how NBFCs contribute to the financial inclusion of MSMEs.
- To analyse how the financial support provided by NBFCs influences the growth, sustainability, and competitive capacity of MSMEs.
- To understand the economic impact of MSME financing by NBFCs.

## RESEARCH METHODOLOGY

This study uses secondary data and a descriptive research design to understand how NBFCs impact MSMEs. Data was gathered from various reputable publications, organisations, government reports and newspapers. The data is analysed to identify the trends, issues and gaps in MSME financing.

## RESULTS AND DISCUSSIONS

The MSME sector has emerged as a growth engine, maintaining and sustaining the competitiveness of the economy through employment which is crucial for all aspects of economic development.

39 million of micro enterprises are registered on the Udyam Registration Portal of the Government of India which constituting over 97% of the MSME sector.

The total employment in MSMEs is Rs.20.51 crore as on 22nd July 2024 as reported on the Udyam Registration Portal and Udyam Powered Platform.

*GDP and MSMEs:* Contribution of over 29% to the GDP.  
*MSMEs and Exports:* 50% of the country's total exports.

**Table 1: NBFCs vs. Bank Lending**

Parameter	Banks	NBFCs
Loan Processing Time	15-30 days	3-7 days
Collateral Requirement	High	Moderate-Low
Digital Access	Limited	Extensive
Credit Score Dependency	High	Moderate-Low

**Table 2: Market Share of Banks and Financial Institutions in MSME Lending**

Type of Bank	Number of Branches	Share (%)
Public Banks	91,445	65.8%
Private Banks	24,661	17.8%
Small Banks	22,482	15.1%
Foreign Banks	288	0.2%
Total	128,835	100%

Source: RBI, NABARD Annual Report 2016-17.

**Table 3: MSMEs Source of Finance**

Sr. No.	Source	In INR Trillion
1	Formal	10.9
2	Informal	58.4

**Table 4: Sectoral Distribution of NBFCs Lending**

Sector	% of Total NBFC Lending to MSMEs
Trading	42%
Manufacturing	31%
Service	24%
Others	3%

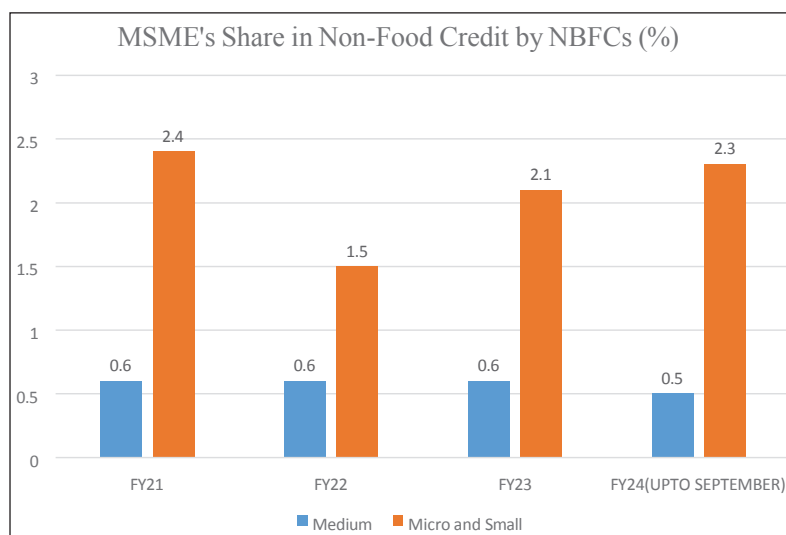
The NBFCs' lending to MSMEs is estimated at INR 1.5 trillion, which accounts for 14% of the total debt across the 119 MSME sectors. Over the past few years, NBFCs have increasingly turned to MSMEs as a growth opportunity, as profit margins in this business are higher and these enterprises are not receiving the best support from traditional banking sources (Table 4). Banks typically have a spread of 4% to 5%, but NBFCs can charge higher interest rates

on loans, allowing the spread to be as high as 8%. MSMEs are willing to pay higher interest rates to NBFCs because they can disburse loans faster and more efficiently, provide long-term loans directly to MSMEs, and operate in closer proximity to businesses than banks. This study suggests that NBFCs will become dominant players in the MSME space because they have a flexible structure and can adapt to niche markets better than banks. However, in the last few years, non-banking financial institutions have increased the amount of money for products. For example, the amount of credit provided by non-banking financial institutions to MSMEs has tripled from INR 0.2 trillion (US\$ 3 billion) to INR 0.6 trillion (US\$ 3 billion) in 2010 to 2015. Of these, 87% are providing services and are in key roles.

*The growth and distribution of non-food credit to micro and small enterprises by SCBs and NBFCs has improved from FY19 to FY24.*

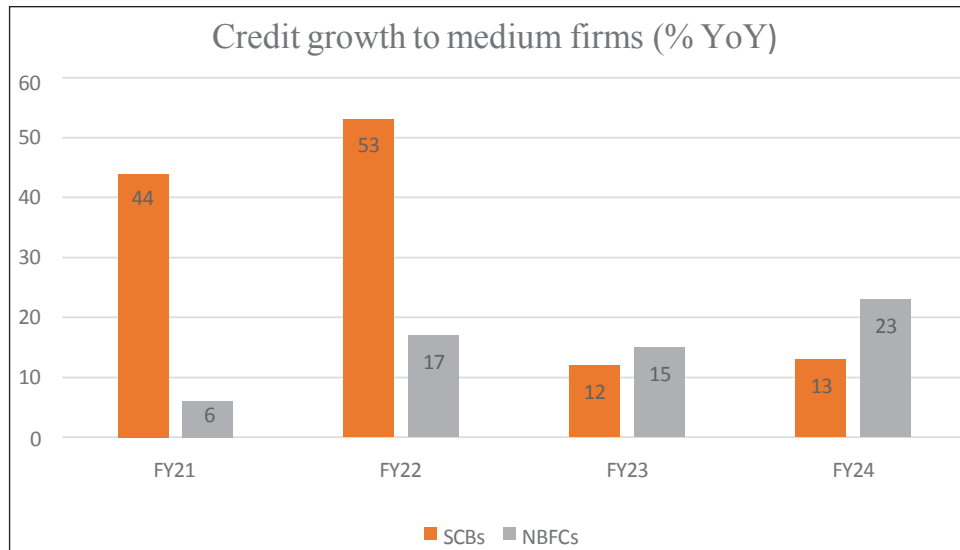
However, the share of MSMEs in business credit (exclude food credit) remains low at 6.3% in FY24. This has improved since FY2019 (4.9%). The distribution of non-food credit to micro and small enterprises has increased by 60 basic points for SCBs and NBFCs from FY 2019 to FY 2024 (Fig. 1). Compared to the total non-food credit growth of around 20% in FY24, Standard Chartered's credit growth to micro and small enterprises is 14.7% and average is 13.3%, but this is higher than the market size of 6.5% (Fig. 2).

The decline in default rates indicates that MSMEs are managing their repayments, which is boosting their prospects. The default portfolio rate for NBFCs is 1.5%. Compared to the second quarter of 2019, there was a decrease of 290 basis points for Standard Chartered, 80 basis points for private sector banks and 70 basis points for non-banking financial institutions (Fig. 3).



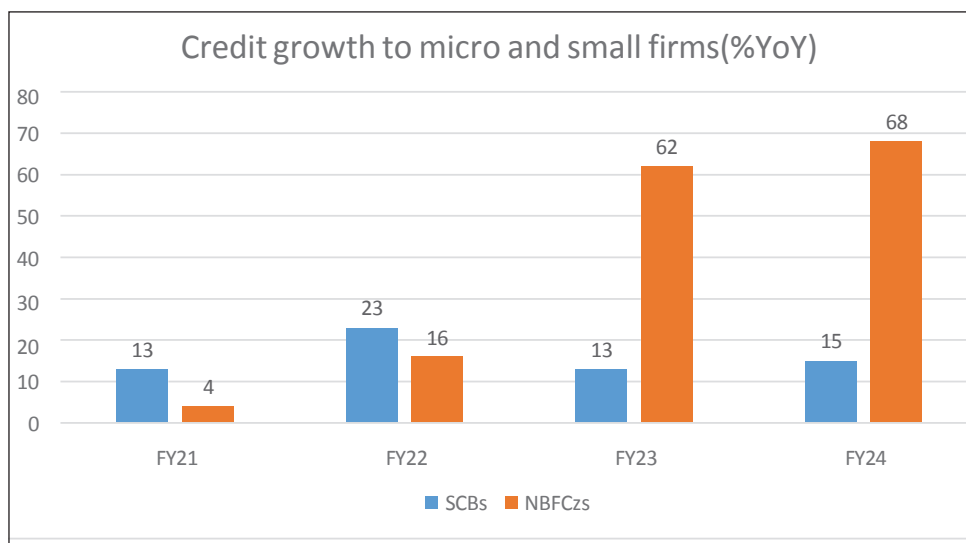
Source: Reserve Bank of India (RBI).

**Fig. 1: MSME's Share in No-Food Credit by NBFCs (%)**



Note: For NBFCs data for FY24 is up to September Source: Reserve Bank of India (RBI).

**Fig. 2: Credit Growth to Medium Firms (% YoY)**



Note: For NBFCs data for FY24 is up to September Source: Reserve Bank of India (RBI).

**Fig. 3: Credit Growth to Micro and Small Firms (%YoY)**

### Analysis of Credit Gap by Type of Enterprise

The manufacturing sector faces a significant finance gap, estimated at INR 12.8 trillion (USD 200 billion). This gap is largely due to current lending practices that prioritise immovable collateral when approving loans. Similarly, in the services sector, many potential borrowers are unable to access credit because they cannot provide acceptable collateral to secure loans. This has led to a growing number of Fintech companies seizing the opportunity by partnering

with e-commerce platforms to provide financing to the suppliers on these platforms.

### Key Policy Measures to Support MSME Development

Over the years, the government has implemented various policies aimed at supporting the growth and development of MSMEs. These government initiatives have played a crucial role in helping the sector maintain its resilience and recover from the slowdown caused by the pandemic (Table 5).

**Table 5: Key Policy Measures to Support MSME Development**

Finance and Credit Related Schemes	Impact
Credit Guarantee Fund Scheme (CGTMSE): 2000 to October 2023	Cumulatively 11 mn proposals have been accorded guarantee approvals for ₹ 4.244 trn.
Credit Lined Capital Subsidy Scheme (CLCSS): FY17 to FY22	Total no. of Units benefited- 47100. Total subsidy disbursed ₹ 32.5 bn
Pradhan Mantri MUDRA Yojana: 2015 to July 2024	484.2 mn loans amounting to ₹ 29.5 trn sanctioned.
Micro Credit Scheme (PMSvaNidhi): 2015 to July 2024	Number of beneficiaries - 6,455,429 sanctioned amount- ₹ 122.433 bn.
59 minute loan: (2018 to May 2024)	0.229 mn loans, involving ₹ 698.23 bn have been disbursed.

As India prepares to realise its 'Viksit Bharat' vision of becoming a developed nation by 2047, the pivotal role of Micro, Small and Medium Enterprises (MSMEs) in this process cannot be ignored. MSMEs are the engine of innovation, employment generation and entrepreneurship; they contribute significantly to India's GDP and drive economic growth. India's economic growth in FY24 has exceeded everyone's expectations; GDP grew at an annual rate of 8.2%. Looking ahead, FY25 is expected to support this period, with annual growth forecast at around 7%. Reflecting this strong economic outlook, S&P Global Ratings has upgraded India's economic outlook to positive, citing strong growth and improved government spending. The role of Viksit Bharat's in this vision is significant and is based on the business principles in India's ancient scriptures, which advocate a balanced business where public capital and private sector work hand in hand. The government's focus on innovation, technology development and financial support to MSMEs reflects the ongoing trend and ensures that MSMEs remain important to India's economy and development.

## Findings of the Study

NBFCs are likely to make financing more accessible to MSMEs, particularly those that face barriers with traditional banks. This can be attributed to more flexible loan terms (such as smaller loan sizes and lower collateral requirements), faster loan processing times, innovative credit assessment models (e.g., alternative credit scoring using transaction data). MSMEs financed by NBFCs shows, higher growth rates in sales, revenue, and employment, increased investment in technology, infrastructure, or human resources, improved business sustainability, with many MSMEs having better access to working capital.

NBFC-financed MSMEs can lead to job creation, especially in rural or underserved areas where job opportunities are limited, regional economic development due to the dispersion of economic activities and businesses beyond urban centres, and increased local tax revenue, as more businesses grow and become economically viable.

NBFCs contribute significantly to financial inclusion, particularly in areas where traditional banking services are limited. This includes the expansion of services to rural and semi-urban areas and the inclusion of informal or unorganised sectors, which are typically excluded from mainstream banking.

## CONCLUSION

The study found that NBFCs have increasingly filled the credit gap left by traditional banks, particularly for MSMEs that may face challenges in accessing formal financing due to stringent credit requirements or a lack of collateral. By offering flexible lending terms, customised financial products, and quicker disbursement of loans, NBFCs have emerged as an essential alternative source of financing for MSMEs.

NBFCs are playing a crucial role in bridging the financing gap for MSMEs, thereby contributing to economic growth. While challenges remain, the continued support for and development of the NBFC sector could significantly strengthen the MSME ecosystem and drive sustainable economic progress. Further research and policy interventions are needed to ensure that the role of NBFCs in MSME financing remains robust, inclusive, and resilient in the face of changing economic dynamics.

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