Policy Brief

July – September 2017

Vol 1 – Issue 1

Policy Recommendations For Small and Medium Enterprises

Gunja Kapoor

YES BANK, India's fifth largest private sector Bank, is the outcome of the professional & entrepreneurial commitment of its Founder Rana Kapoor and his top management team, to establish a high quality, customer centric, service driven, private Indian Bank catering to the Future Businesses of India. YES BANK has adopted international best practices, the highest standards of service quality and operational excellence, and offers comprehensive banking and financial solutions to all its valued customers.

For further information
Alisha Prakash
alisha.prakash@yesbank.in

Pahle India Foundation (PIF) is a not for profit, financial, economic and political research think tank, dedicated to the task of making India first by putting India first. Over the years, we have learnt that there is no universally accepted development model. Each country has to take into account its people, its resources and its socio economic and cultural legacy for effective policy formulation and implementation. At PIF, we work towards this objective of creating the necessary paradigm shift in development thinking and practices in India to achieve this aspirational goal. PIF currently has an analytically strong team of dedicated researchers who are self motivated. PIF's highly qualified team specialises in analyzing India's political economy and its engagement with the global flows in finance, trade and technology.

For further information
Gunja Kapoor
gunja.kapoor@pahleindia.org

Policy Brief

Driving Entrepreneurship through SMEs..7

SMEs are most likely to play a decisive role if India is to achieve its stated objective of ramping up manufacturing sector's share in GDP to 25% and generate an additional 100 million jobs in this sector. However, issues faced by SME entrepreneurs are manifold including credit availability, affordable technology, and lack of access to markets.

Impact of GST on SMEs 13

Goods and Services Tax (GST) will make it easier for them to start businesses, improve SME market expansion, lower logistical overheads, aid in dealing in sales and services and lead to a unified market. On the other hand there are concerns such as infrastructure and training. Like every reform, this one too will have its share of hurdles. While GST is expected to boost the GDP growth and reduce the fiscal deficit, the extent of such an impact will depend on a favourable consensus on GST rates for all business segments and integrated implementation of the same.

FinTech - Enabler for SME Business 20

It is expected that FinTech and SMEs will prove to be a successful alliance in India. These FinTech companies are not only filling the void on account of access to finance, they are also equipping SMEs with software and technology platforms. The government and RBI have extended support to FinTech companies too, since their role towards ease of doing business, financial inclusion and catering to the enterprise segment untapped by banks cannot be ignored.

Foreword

SMEs contribute around 8 per cent to India's GDP, 40 per cent to exports, and 45 per cent to the total manufacturing output. The segment provides employment to around 80 million people, through a basket of more than 6,000 products. Role of SMEs assumes significance with its inherent capabilities to generate employment, contribute to exports, galvanize financial inclusion, and nurture entrepreneurs. India's future growth is also likely to be fuelled by the small and medium enterprises (SMEs), which are expected to contribute to 15 per cent of GDP in 20201, and provide employment to 50 per cent2 of the workforce over the next ten years during which India's GDP is expected to grow up to $ 5 trillion as compared to $2.1 trillion in 2015-16.

However, despite this exceptionally large domestic base, SMEs in India have so far largely been unable to participate in global and regional production and value chains. This has prevented them from unshackling themselves from their domestic buyers, many of whom are larger companies which procure components or intermediate inputs from SMEs for further processing and value addition. This inability to break into external value chain circuits can be explained by the preponderance of SMEs in the informal sector in India. As a consequence of being largely confined to the informal sector of the Indian economy, while SMEs are pivotal to the India economic progress and employment generation, this segment has been plagued with certain innate challenges.

Access to formal credit is limited as the risk associated with extending credit to SMEs is high, mainly on account of inadequate book keeping, that makes their track record look unattractive; lack of unencumbered collateral; high business uncertainty, and weak management competence. Lack of funds prevents SMEs from harnessing their full potential. With rising consumerism that ensures expanding demand, seamless access to formal credit would implicitly translate into expansion in capacity, domestic production and employment.

With increase in FDI inflows, thrust on indigenisation, and the "Make in India" attracting domestic and international interest, vast opportunity has opened up for the SME sector. The "Digital India" revolution also opens the exponentially expanding sectors of

IT and Communication for participation by SMEs. in sectors related to technology and communication.SMEs would not only generate employment and contribute to nation building, they would create vocational opportunities for women and marginalised sections alike. Both, economic and social fabric of the nation is sensitive to MSME segment, making it critical for achieving national objectives.

We envisage a future India that is globally competitive driven by inclusive growth, equitable distribution of wealth, and reduced regional imbalances. The MSME segment will be an integral part of this road to growth.Given the various developments and the challenges in the MSME sector, it is felt that a discussion forum is required to get together associations and stake holders on a single platform to put forth their views / ideas / suggestions in the overall interest of SMEs.As India pursues its goal of employment intensive growth, we need to unearth the true potential of SMEs. Their role can be augmented from their present state, by seizing the available opportunities on the back of a bespoke SME business policy framework.

Pahle India Foundation (PIF) and Yes Global Institute (YGI) a practicing think tank of YES Bank have conceived a monthly series of seminars on issues and opportunities for the MSME segment. This discussion series proposes to bring together sector experts, practitioners, economists, lawyers and policymakers to discuss certain areas of concern within the MSME space in greater detail.We hope to actively advocate selected policy recommendations that emerge from this seminar series.

Thank you.

Nirupama Soundararajan

Driving Entrepreneurship through SMEs

Driving Entrepreneurship through SMEs

SMEs provide springboard opportunities for entrepreneurs to test their ideas, technology, and processes in a real-time business environment.Moreover, with their potential to create job creators, SME sector becomes a critical piece in the schema of job creation and poverty alleviation. In this backdrop, the debate on implementing policies and programs oriented towards fostering entrepreneurship and enterprise management is pertinent and imminent.

As per the OECD Growth Project (The New Economy: Beyond the Hype, OECD, Paris, 2001), there is a need for micro-policy reforms in SME, especially in knowledge based economies and one of the four micro drivers of growth of SMEs was identified as entrepreneurship.

Modern economies, that appreciate contribution of entrepreneurs should provide for creation of new enterprises, sustenance and contraction/exit of inefficient units. Since new enterprises consume resources, create new skill requirements, and eventually provide new revenue streams and jobs to the economy, it is important to provide a business environment, which will allow young firms to grow rapidly across industries, and also, permit exit of such firms that could not achieve their operational or monetary objectives.

Creating such entrepreneur-friendly economies require mutually reinforcing and supportive monetary, fiscal and structural policies to be embedded in their economic framework. These policies comprise of labour markets, tax structure, financial access, bankruptcy code, competition, resource allocation etc, which are critical in deciding the penetration and success of entrepreneurs.

In this context, Pahle India Foundation and Yes Global Institute, a practicing think tank of Yes Bank have identified the following concerns and propose recommendations for the same.

Recovery of Receivables for SMEs

SMEs are critically dependent on their trade receivables for the purpose of business continuity. However, delays in receipt of outstanding payments is a chronic problem. On most occasions, promoters infuse funds to meet working capital requirements, which is a poor entrepreneurial practice.

The MSMED Act, 2006 Chapter V articulates the liability of the buyer to make payment to the supplier on or before the agreed date, extending up to 45 days. The Act also mentions about the interest payable, in case of delayed payments.

Unfortunately, the law is yet to assuage the receivable woes of the sector. To make matters worse, as per the CRISIL report, "SMEs with large corporate customers have receivables of 90 to 120 days of sales on their balance sheets, as against 45 days stipulated by the Micro, Small, and Medium Enterprises Development (MSMED) Act". Clearly, large size customers brazenly use their bargaining power to delay receivables. Average working capital cycle of SMEs is around 66 days, compared to 42days in US and 40 days in Europe and Asia.

Recommendation

- There needs to be concerted effort from the policy makers, bankers and rating agencies on large corporates to ensure payment of dues to SME customers is done well within the stipulated time.
  - The credit rating framework currently does not deep dive into the vendor list to identify the timeliness of payments to SME vendors.
- Public Sector Enterprises and Units (PSUs) which avail services or purchase goods from SMEs should lead by example. SMEs need to be assured of payment of dues, for them to continue to contribute to the economy.
- Incidental payments from the State/Central, related to support for particulars including export exhibitions, trade fairs need to be cleared in a time bound manner. This promptness will not only boost the confidence of SMEs in the administrative machinery, it will relieve the entrepreneurs of the inertia that has prevented them from testing their own limits.

Compliance

According to a study by World Bank[1], regulatory, administrative and legal burdens impinge growth of entrepreneurs. Compliance burdens on entrepreneurs should be minimized and those applicable should have greater benefits than associated costs.

Recommendation

- One of the approaches to adopt a minimal yet effective compliance regime is to continuously assess the compliance and regulatory framework applicable for entrepreneurs for its relevance and impact.
- Administrative, regulatory and legal burden may be reduced by setting up information kiosks, single window transactions and promoting e governance.
- Multiple orbits of compliance may be explored for SMEs operating within certain bands of asset size or leverage. The compliance ecosystem shouldn't deter entrepreneurs from growing beyond a particular size or consume their decisive operational resources including management bandwidth.
    - The SME ecosystem shouldn't incentivize firms to remain small, or resort to partial disclosures for the sake of avoiding compliance burdens.

      For example, rebate as low as 1 percent for all MSMEs which have reported a turnover of more than INR 50 crore, and complied with certain socially relevant regulations (labor, environment, CSR) could be explored.

Seamless Exit for Entrepreneurs

Exit is an inevitable reality for any enterprise, and as a nation committed to providing an ecosystem that would synthesize economic growth and ease of doing business, it is a matter of concern that there is absence of a systematic roadmap for proprietorships and partnerships to wind business.10-15% SMEs exit every year.Only 2.4 percent of SMEs are private limited companies. The remaining SMEs are left wanting, if they were to wind up their businesses.

---

1 World Bank, Doing Business in 2004: Understanding Regulation, Washington, DC, 2003

Recommendation

- Entrepreneurs who are exploring exit as their next step should be provided the required regulatory and administrative support.
- SMEs need to be encouraged to shut shop, than merely cease operations of the enterprise. Ghost firms/companies have done more damage to the economy than failed enterprises.
- Failed entrepreneurships should be duly issued all No Objection Certificates and clearances within a stipulated time, thereby facilitate the entrepreneur into future endeavors without any legacy baggage.

Credit Rating of Debutant Entrepreneurs

Among the three dimensions used for credit rating of MSMEs, Management is critical to determining the rating of the firm/company. As a matter of fact, the management score is directly proportional to the number of years of experience and alignment of the key management personnel's family to entrepreneurship. This works against the first-time entrepreneurs whom the current establishment intends to support by way of Stand-Up India and Start-Up India.

Recommendations

- Credit rating agencies need to incorporate assessment of business plan as a key dimension in rating of debutant entrepreneurs.
- Green field projects need to be assessed for continuity of cash flow projection, than compared to the existing framework which focusses heavily on tangible securities such as unencumbered land, gold and earmarked fixed deposits.
- Endorsements from customers, who have expressed interest in the business venture, letter of interest from suppliers and such incidental collaterals need to be given space in the overall rating exercise of debutant entrepreneurs.
- Relative rating of SMEs needs to be meshed with dimensionless analysis of the proposed entrepreneurship for succinct ratings that are catalyzing in nature.

Level Playing Field for SMEs

The input cost of quality raw material is high, however the products are sold at a lower cost due to cut throat competition in the sector. Moreover, the big players form a cartel, thereby controlling the prices and restricting competition. To assume global leadership, it is pivotal to ensure a level playing field for SMEs in India.

Recommendations

- Involve SMEs in smart city projects for designing and manufacturing of new age public transportation vehicle that are much faster, safer and smarter. This would give them a local market to flourish and expand.

Revisiting the Definition of MSMEs

The role of Micro Small and Medium Enterprises (MSMEs) in developing countries is often argued in terms of their well-known contributions, such as employment and balanced regional development. However, the need forensuring sustainability demands that definition berevised to ensure actual policy implementation is in sync with the requirements of the SMEs. Today the MSMEs are defined/ classified by the investment in Plant& Machinery and this definition is governed by MSMED Act - 2006. This is a dated criteria, as since 2006, there has been rapid development and investment in technology and other allied infrastructure.

Recommendations

The threshold limits of investment in Plant & Machinery to be classified as Micro, Small & Medium should be revisited. There is a demand from various MSME quarters to revise the investments thresholds for micro, small and medium enterprises in line with inflation to encourage them to invest and expand. The small and medium enterprises are often reluctant to breach the prescribed threshold investment limits and expand as they would lose the various benefits reserved for them

Impact of GST on SMEs

Introduction

Goods and Services Tax (GST) was introduced in India on July 1, 2017. GST is an indirect, destination based tax, applicable throughout India, and has replaced all the cascading taxes that were levied by the Centre and States. In the pre GST era, multiple points of tax arbitrage existed. This resulted in firms optimizing tax, instead of optimising production; adversely impacting capacity utilization and economic growth. With the advent of GST, it is expected that production levels will be optimised, and an efficient tax monitoring system will be established.

A note by Federal Reserve System's series of International Financial Discussion Papers (IFDP), suggests GST could improve GDP by more than 2 percent, similar to the estimate forecasted by NCAER. One of the highlights of GST structure in India, is that it enforces compliance, by ensuring all parties, down the value chain, pay tax.

Impact of GST on the SME sector include (not limited to):

a. Compliance cost:

One of the immediate consequences of GST is the increase in compliance cost for SMEs. All SMEs in India do not have technical expertise to deal with online systems. Significant number of these SMEs may eventually hire intermediaries to obtain registration for them, furtheradding to the cost of compliance.

b. Transparency

On multiple occasions SMEs understate their profits or operate in a one business, multiple firm model to ensure the tax threshold is not breached. It is observed that SMEs often encourage cash transactions to ensure the turnover is less than INR 1.5 crore (save excise duty). SME industry has often justified these practices as its only resort to operate at sustainable margins and offer competitive pricing. With the dawn of GST, SMEs will be forced to operate in a certain manner, which may eventually impact their business sustainability and growth.

c. Organize the Unorganized

Manufacturers of non-Original Equipment Manufacturer (OEMs), primarily catering to replacements of parts will be forced to come in the tax net, as any missing link in the entire supply chain will devoid all the members ahead, of the input tax credit.

d. Working Capital Requirement

Under the GST regime, there is tax levied on stock transfer. This will result in higher working capital requirement for SMEs, which have longer credit cycles to customers or are in the business of stock transfer itself. Increase in working capital requirements will increase interest costs, and eventually this may be passed on to the price of finished goods.

e. Access to Markets

Prior to the GST roll-out, companies optimised supply chains by procuring goods from SMEs in their vicinity. This caused SMEs to have a limited customer base, within the periphery of their state of operations. As tax boundaries fade away with GST, SMEs can now expand their realms to other states, as tax credit will be transferred irrespective of the location of the buyer and seller.

f. GST is uniform for Goods and Services

Keeping with the global standards, GST does not differentiate between Goods and Services. This will simplify processes for SMEs operate on sale and services model.

g. Low logistical overheads

Since GST is a state-neutral tax, it will ensure time consuming inter-state queues and tolls will be done away with. Reduction in logistic expenses of SMEs is expected to materially impact the operating profits of SMEs.

h. Support for Capital Goods

In the context of capital goods, only 50 per cent of input tax credit is available in the year in which goods are purchased. However, under GST, complete amount eligible for input tax credit can be availed in the same year. This is expected to bolster SMEs engaged in manufacturing activities in India, and also benefit the flagship project, “Make In India”.

i. Online Support

All procedures related to GST compliance are available online. There is little or no human intervention required in the entire lifecycle of tax payment (Registration, Payments, Refunds and Returns). This will not only save the SMEs from spending resources consumed during interaction, it will also help alleviate corruption.

SME Industry concerns include (not limited to):

a. SMEs face high levels of uncertainty related to the process of claiming of Input Tax Credit

b. SMEs need to undergo multiple registrations which would increase cost, and consume promoter's bandwidth among other resources, which may adversely impact operational efficiencies. Every registered SME needs to file at least thirty-seven returns during a financial year!

c. Transfer of liability in the event a particular supplier fails to comply with GST norms; customers of such a supplier shall not be able to avail input tax credit, blocking the working capital of customers and other value chain members in question

d. SMEs expect liquidity crunch, in addition the above mentioned concern related to working capital requirement as GST requires maintenance of funds in the form of electronic credit ledger with the tax department.

e. Tax exemption on excise for SMEs with turnover between INR 20 lakh to INR 1.50 crore is no more valid under the GST regime

In a seminar titled "Impact of GST on Small and Medium Enterprises" following solutions to key issues raised by the sector were discussed.

Reduce Three Tax Filings to One

GST requires three subsequent monthly returns on the 10th, 15th, and 20th of every month. This is essentially a three step process, where:

1. GSTR1: Details of outward supplies of taxable goods and/or services effected are filed

2. GSTR2: Details of inward supplies of taxable goods and/or services effected claiming input tax credit are filed
3. GSTR3: Monthly return on the basis of finalization of details of outward supplies and inward supplies along with the payment of amount of tax

These three frequent filings, mandated on a month-on-month basis, require dedicated resources, which the SME sector may not be ready to dedicate or afford.

Recommendation

- These three steps should be subsumed into one through a centralized monitoring and invoice matching algorithm.
- This is possible by launching a common software for all Business To Business (B2B) transactions. This will facilitate real-time invoice matching and since the Government will have complete access to this software, invoice matching will be fulfilled real-time.
- Moreover, all claims of input credit will be facilitated as and when filed, or in batches of a set frequency, as opposed to the existing system, where the filings need to be decoded for line by line invoice matching within a specified window.

Longer Filing Period for SMEs

Under the GST regime, there is tax levied on stock transfer. This will result in higher working capital requirement for SMEs, which have longer credit cycles to customers or are in the business of stock transfer itself. Increase in working capital requirements will increase interest costs, and eventually this may be passed on to the price of finished goods.

Recommendation

- As per the GST structure, the input tax credit can be claimed only once the SME has paid the amount to the supplier.
- To solve for the working capital gap created on account of filing GST returns, the filing period forSME sector be made longer than that for large enterprises.
- This step, does not impact the revenue to the Government.

GST on Free Samples

Under the existing GST structure, input tax credit shall not be available in respect of "goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples".

Recommendation

- Keeping with international standards and business requirements, free samples should be exempted from GST.
- Free samples are distributed to customers for the purpose of promotion and advertisement. These schemes are usually a part of the overall strategy of the market participant to increase market share and survive amidst competition.
- Also, the input cost incurred towards manufacturing of these free samples is included in the cost of rest of the articles.
- Thus, the Government does not lose any revenue by exempting GST on free samples.

GST Kiosks

GST is technology driven tax structure, which aims to eliminate human interface from all possible points of intervention during the course of tax filing. It is estimated that more than 50 percent of the trading community in the MSME sector does not have access to technology. This could be counterproductive and serve as a means of exclusion of informal sector, as opposed to one of the objectives of GST i.e. maximising participation of tax payers.

Recommendation

- Set up free of costGST kiosks at strategic locations in both rural and urban areas. Places such as bank branches, mandis, utility payment centres can be used to set up such facilities.
- Appoint local volunteers or onboard NGOs which can operate these kiosks and assist the local business community in filing of returns.

Other Recommendations

- Do away with the tallying of corresponding credit and debit notes with individual invoices
- Limit the HSN code to 4 digits and have no more variation within that code, based on price, end-use, or any other relevant variable
- Time-based refund policy, with zero tolerance for delays
- Centralized registration, as against the existing requirement of 36 registrations for those operating in all states and union territories. Such excessive compliance could deter market players from spreading their geographical footprint.
- Reduce the tax rates on mass consumption products to maximise the tax payer base and contain rent seeking. On most occasions, tax payers pay rent to avoid paying high taxes.

GST is expected to bring about ground breaking changes in SMEs, both operational and behavioural. It is expected to reengineer the business ecosystem and it is only in the self-interest of SMEs that they leverage on this opportunity to bring about structural changes in the sector, which have been overdue for a long time.

FinTech - Enabler for SME Business

Introduction

Micro, Small and Medium Enterprises (MSMEs) play a critical role towards India's economic growth. However, insufficient access to credit has time and again, threatened the growth of these enterprises. They have been denied access to financial services on account of multiple factors including insufficient documentation, absence of unencumbered collaterals, credit history. Moreover, the small ticket size instantly makes these customers unattractive for large formal financial institutions. Growth in the e-commerce sector has been a recent driver in the growth of MSME market in India. There are 51 million MSMEs in India, of which only 32 percent are digitally engaged. This provides a huge unaddressed market for FinTech players to explore.

This gap was immediately identified by Financial Technology (FinTech) companies. These companies have taken the role of not just lenders, but business solution providers, through innovative products and solutions. Alternate credit scoring methodology and advanced data analytics have supplanted the tedious documentation requirements, solicited by banks in the same regard. This also helps FinTech companies provide services to their customers in a turnaround time to the tune of as less as 48 hours, making credit, "timely" available.

While Fintech firms are definitely filling the credit gap, they are not limited to this service alone.

- Invoice discounting is an unexplored area in India, and it could prove to be a game changer in the MSME growth trajectory. This allows enterprises to convert the invoices into assets, and use them for fund raising purposes.
- FinTech companies are collaborating with SMEs, to provide them with book keeping assistance, sales tools and applications that will simplify complex business processes.
- StoreKey makes PoS systems for stores to modernize their operations and better aggregate their collective demand resulting in better pricing for their goods.
- Credit providers like CapitatFloat and LendingKart address the market through a diversified bouquet of products such as invoice financing, bill discounting, loan against property, cash-flow based financing.

As banks undergo restructuring of balance sheets, SMEs have been receptive to borrowing from FinTech firms and being a part of the digital universe. However, FinTech is not the only reason why SMEs have stepped into the digital space. Rapid migration of customers to digital platforms has also acquiesced SMEs to adopt digital ways of doing business. It must be noted that only 2 percent of SMEs are actively engaged in selling/promoting their business.

Digital Engagement

The KPMG Report on Impact of Internet and Digitization on SMBs in India[1] classified SMEs into four tiers based on sophistication and investment by SMEs to engage with specific technologies.

- **Offline:** SMEs with no connectivity, may or may not have a personal computer, do not use social media for business purposes.
- **Enabled:** SMEs that have their own website or use social media for their businesses or maintain a corporate email ID to engage and understand their customer base
- **Connected:** SMBs that use the internet for general information gathering and communication but do not use the internet for business purposes, such as social media, online listing, e-commerce etc.
- **Engaged:** SMEs using digital technology actively to enable business online by either selling on e-commerce websites or advertising online or listing on 3rd party portals.

The report states that digital engagement will increase revenue growth for SMEs at a much rapid pace. These technologies help SMEs increase their reach and engage better with the customers. As digital SMEs increase in size, they are also able to achieve higher efficiencies of fixed costs.

1 https://assets.kpmg.com/content/dam/kpmg/in/pdf/2017/01/Impact-of-internet-and-digitisation.pdf

Employment

In 2015, SMEs employed around 14 percent of the working age population. The sector is expected to absorb around 280 million people by 2050. This establishes the importance of SMEs to generate employment. Connected SMEs employ around 1.5 times more people, compared to those offline.

Challenges for SMEs in India

- **Lack of awareness:** Widespread inertia due to limited awareness and benefit of digital technology
- **Talent:** Lack of knowledge and skill impedes adoption of FinTech. Availability of talent is polarized, impairing growth of Fintech
- **Infrastructure:** High hardware costs and recurring connection expenses keep SMEs from participating in FinTech revolution
- **Regulatory Support:** It is expected that issues around Merchant Discount Rate, enterprise risk, uniform KYC and participation of the Government in the market-place will be discussed and a policy on FinTech will be released in the near future

FinTech is expected to continue to bring about changes in the way businesses work. While it has proved its abilities to bring about tectonic shifts in business processes, much remains wanting. Financial inclusion of SMEs is a natural road ahead, as we continue to jettison old for the new, both on the consumer and financial services front.

In a seminar titled "FinTech - Enabler for SME Business" following solutions to key issues raised by the sector were discussed.

Empowering Feature Phones

Today over 85 percent of the urban Indian population owns a mobile phone. While smartphones get most of the attention, 56 percent of this user base actually uses feature phones. Since one of the prime requirements of FinTech is internet infrastructure, we need to explore ways to empower the existing feature phone users, than wait for them to migrate to smart phones, and then eventually participate in the FinTech revolution.

Recommendation

- To include this 56 percent of potential customer base, option of an add-on device similar to a sleeve needs to be explored. This will be similar to a dongle which can be connected to a feature phone (physical or wireless, depending on the feature phone).
- The feature phone user is onboarded on the internet of things, and is a part of the smart phone user community. This add-on device will be cost-effective, interoperable (device and networks), and shared.
    - Yes Bank has launched a similar product called SIMsePAY, which empowers feature phones to be become smart phones, which expects to reach 500,000 users by the end of 2017.

Udyog Dhan Yojna for SMEs

Lessons from the astounding success of Pradhan Mantri Jan Dhan Yojna (PMJDY) should be applied to the MSME sector. As per PMJDY website, there are 295.2 million or account holders, with a total bank balance in their accounts of INR 658.45 billion. As per Bank Accounts For The Unbanked: Evidence From A Big Bang Experiment (Chopra, 2017), three notable trends were observed in PMJDY. One, around 70 percent of PMJDY accounts moved out of dormancy, level of activity of PMJDY accounts was significantly higher than others n similar socio-economic conditions, PMJDY accounts witnessed increase in account balance.

Recommendations

- Frame a Udyog Dhan Yojna (UDY) for SMEs, and link it to Udyog Aadhaar
- UDY should be used as the main account for carrying all firm/enterprise transactions
- Use the trail in UDY for credit assessment/due diligence and monitoring purposes
- Transfer any direct benefits to the firm to this UDY.

Permit NBFCs to Issue Digital Products

We observe that while both banks and Payment Protection Insurance (PPIs) are able to issue digital payments products, NBFCs are not allowed to issue the same.

- We envisage NBFCs to play a critical role towards increasing credit penetration to SMEs.
- NBFCs' have the ability to be as agile as FinTech firms and assess credit risk using their long-drawn experience.

Recommendation

Permit NBFCs to issue digital payments products in priority sectors and MSMEs. This will be in line with the overarching objective of organizing the unorganized and increasing digital penetration in economy.

Strengthen the FinTech Ecosystem Infrastructure

Recommendation

- **Connectivity:** Despite a vibrant telecom sector, India has not yet developed a capable digital infrastructure. Broadband and mobile network availability is erratic in most parts of the country while internet speeds are among the slowest in the world. Absence of affordable 3G and 4G coverage and bandwidth continues to impede FinTech growth in the country. Due to sluggish speed and erratic connectivity, payments are vulnerable to security attacks and stand low chance to see successful completion.
- **Distribution:** Increasing POS penetration is the foremost challenge. High distribution costs and poor connectivity deters vendors from providing connectivity in remote areas.
- **Financial Literacy:** Banks and financial institutions need to introduce customers to digital products. Due to the high reach enjoyed by banks, they are in a position to influence customer habits. Banks could lead from the front, by educating their respective staff members and their family members to adopt digital ways of transacting. This will have a significant multiplier effect, considering banks have their presence across rural India and undeveloped digital markets.

- **Consumer Protection:** Report from Committee on Digital Payments (2016)[2], highlights the importance of consumer protection in the FinTech ecosystem, and the positive externalities, these measures are capable of. Digital players should share transaction details, on a set frequency, free of charge. Also, with optimum use of technology, veracity of the transaction needs to be identified. Consumers need to feel protected against identity theft or system failure. FinTech players need to assure their consumers, that their personal data, including sensitive details such as Aadhaar are well protected, by both, the company and regulation.

India is at the threshold of a Digital Revolution. With multiple structural measures, right from the demonetisation to the GST, it is evident that there is a concerted effort to include the informal into the formal, by osmosis. It is imminent that eventually, MSMEs will have to become formalised. Technology friendly demographics, along with strong political push for digitization and good governance, are necessary variables that will enable Fintech to accelerate growth of MSMEs in India.

---

2 http://mof.gov.in/reports/watal_report271216.pdf

PAHLE INDIA FOUNDATION
FACILITATING POLICY CHANGE

facebook.com/pahleIndia @pahleindia
Tel: +91 11 41551498, 26519889
www.pahleindia.org