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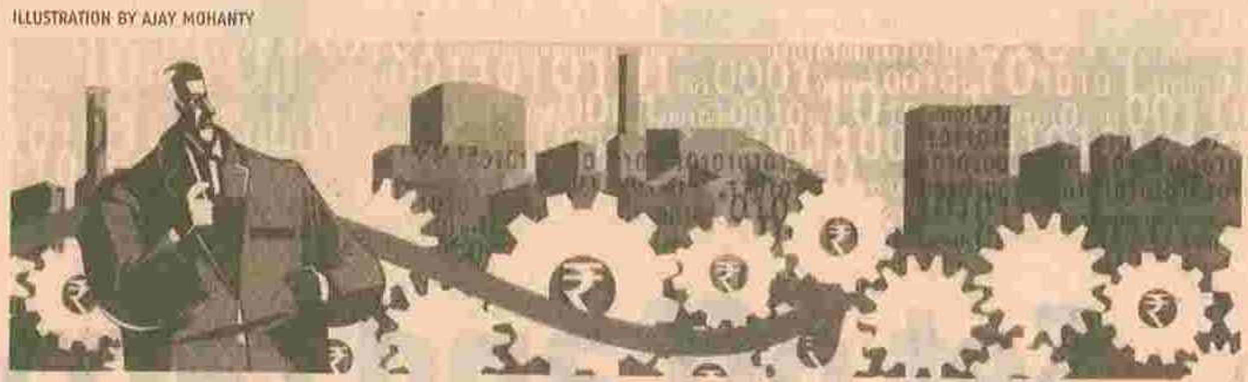

India's next growth engine

A digital revolution in MSMEs' access to credit might accelerate growth and prosperity — if policymakers focus on simplicity, access, and human capital

Where will India's next growth boom come from? This question may be central to thinking about our medium-term prospects, but isn't easy to answer at all. Not just because predicting sectoral growth is never easy, but also because India's structural problems at the moment seem so deep and so unresolvable that a sense of gloom has set in even though the official GDP numbers suggest a recovery.

In some sense the basic problem is that the lending and investment pipeline continues to be clogged. The non-performing asset (NPA) crisis at public sector banks (PSBs) is nowhere close to being resolved. The Insolvency and Bankruptcy Code (IBC) is indeed an important reform — perhaps the only major advance introduced by the Narendra Modi-led government. But it is PSBs that have dominated lending to industry, and most of us worry that until they feel confident enough to lend, there is no chance of a real private sector-led recovery, let alone a boom. Perhaps this concern is partly responsible for the renewed push towards a "bad bank", currently being considered by a committee of secretaries. This was and is still a bad idea, in my opinion — at some point somebody needs to take responsibility for haircuts as a consequence of bad decisions taken in the past, and we can't pass the buck indefinitely.

POLICY RULES

MIHIR S SHARMA

As things stand, one has to assume that the "standard" Indian investment pipeline is not likely to reach full efficiency anytime soon. Given that, one cannot be certain that sectors that depend on big-ticket lending will take off fast. Excessive state borrowing by states and the Union means the debt market is also overburdened.

And yet, I would suggest that one engine of medium-term growth might well be sputtering to life. And that is micro, small and medium enterprises (MSMEs).

This might come as a surprise at one level. After all, we are emerging from a few years in which MSMEs have been hardest hit by government policy. Demonetisation, which is universally understood now to have had almost no positive effects and multiple strong negative consequences, hit micro-enterprises that depended on cash for operations and working capital hardest. Subsequently, the goods and services tax's (GST's) overly complex structure, and the built-in fixed-cost requirements for compliance, further decimated the MSME sector. Over the calendar year to date, the BSE small-cap and mid-cap indices are both down by over 10 per cent, although the Sensex has increased in value marginally. (This follows a 2017 in which both indices demonstrated stellar growth.)

Yet there have been some other indicators that suggest growing health in this sector. By early June, over 250 companies had listed on the BSE SME platform, and have raised over ₹20 billion from the markets; the SME IPO pipeline looks robust, and has easily outperformed the broader market. More importantly, most lenders believe that SMEs will demonstrate an appetite for credit, and are making the shifts in their business strategies that match this belief. Rashesh Shah of Edelweiss has been quoted as projecting growth in SME and retail credit at 18-20 per cent per annum for the next decade and more.

I would argue that there are important changes to the economy's plumbing that have been put into place that could help energise MSMEs. If one is solidly optimistic, one could argue that the government's infrastructure spending over the past few years would help connect MSMEs physically to the global market. I am unconvinced that this transformation has indeed occurred at the scale required, or even that infrastructure would make a difference to MSME integration without an easing of regulatory hurdles. The GST also has to be simplified. This would require a shift in government attitudes: The GST should not be seen as a tool to increase compliance, but to ease taxpayer burden. That will automatically reduce evasion and increase revenues.

However, where the Indian state has been successful in recent years has been in its introduction of soft or digital architecture. Let us, for a moment, set aside Aadhaar's legal and political problems. Let us also ignore the government's ignoble emphasis on exclusion and pseudo-"savings" in welfare schemes.

When these are ignored, what is left is an extraordinary expansion of the digital arm of the state, and the creation of digital public goods. What does this mean for MSMEs in particular? Well, I'm thinking of the revolutionising of credit that increased ease of access to activity data might provide.

In spite of an increase in lending and listing, in spite of the MUDRA programme, which essentially rebrands existing lending, smaller Indian enterprises remain essentially credit-constrained. A recent CIBIL report argued that more than 150 million possible borrowers — a number which includes both individuals and MSMEs — are credit-worthy but nevertheless do not have access to credit. Quietly, however, this access problem is being rendered insignificant. It is now possible for loan-seekers to make their GST and bill payment records available to financial institutions, including NBFCs. This allows banks to screen much more quickly, sometimes within minutes, for credit-worthiness. As opposed to three years' audited returns, it is also more accurate — given the somewhat dubious reputation of some of the fly-by-night auditors in the MSME sector. You can speed up loan-giving with no compromise on the essential principles of prudence. A consent architecture is being built on top of the payments architecture that enables this process of diligence. Even those who might be currently considered credit-worthy will discover that they can access capital infinitely more quickly — reducing the cost of capital, and increasing the number of orders, projects and investments they can undertake.

This is not to say there are no dangers to SME lending. MUDRA loans may well prove to be the next stress point for banks. Even those lenders that have scaled up MSME and individual lending against property certificates might well find themselves in trouble with the inevitable revelation that Indian property prices have been over-inflated. In this case, elementary principles of risk have been ignored. Digital technology does not change those principles, or allow you to ignore them — it merely permits their more efficient application.

If we want to take full advantage of this possibility for super-sized MSME growth — with all the consequences for broad-based prosperity it implies — then, however, this additional plumbing is not in fact enough. We will also need to scale up financial and digital literacy. In all of the government's planning for Digital India, this has largely been ignored. It is unclear what form a programme to fill this gap would take — perhaps state-run digital boot-camps are not the best way to do it. One advisor to the sector instead suggests "NIITs for digital finance". Either way, some growth pressures from MSMEs are likely — but if skills are matched to the new digital infrastructure, growth will be even higher, and benefits far more widely spread.

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