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Examining the impact of FinTechs in extending capital access to MSMEs

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Abstract

The advancement in technology in the finance sector has given birth to FinTech. South Asia will be witnessing the highest FinTech growth rate in the next five years. Indian MSMEs have been seen to be riding this tide, and FinTechs are well aware of that. This study aims to examine the role of Fintech-based microfinancing in the growth and sustainability of MSMEs. We have followed qualitative methodology to understand the impact of FinTech services on the MSMEs' overall development. Insights from interviews revealed many problems, especially credit-related, faced by MSMEs. The participants accepted that FinTechs have helped them overcome the problems by offering quick and customized short-term loans. The study establishes that the support from FinTech has made the MSMEs more financially stable, resulting in their growth. This study will be the first to investigate this relationship between Fintech and MSMEs. The evidence found in our work points towards the overarching effect of such ecosystems on the nation's economy.

Keywords: FinTech, MSME, entrepreneurship, microfinancing

1. Introduction

Globally, the landscape of the financial sector is changing in this digital era (Mention, 2019). The reason behind the change is the advancement in cyberspace that is giving birth to several innovations. With the changes in the financial sector due to advancements in technology, financial services have become more affordable (Leong et al., 2017). The innovation also helps in the financial inclusion of the people living in a remote geographical area. The role of technology in managing the resources efficiently and effectively is increasing day by day, which is also beneficial for the community (Goldstein et al., 2019). The advancements in technology and its use in the financial sector have led to the emergence of Financial Technology or FinTech, in short, a new way of doing finance through artificial intelligence-powered algorithms. A number of the start-up involved in financial services have tried to offer financial services to the community. Technological innovation in the financial sector has brought new ways of doing things and can be seen as a clear departure from the traditional setup (Nakashima, 2018).

In the future, with the help of quantum computing, FinTech will grow exponentially. FinTech has already grown beyond the Internet of Things (IoT). On the one hand, IoT has created an ecosystem interrelating business. It has become such a phenomenon that those not directly involved can also experience the disruption (Nakashima 2018; Schulte and Liu 2017). On the other, FinTech led to creating (Nakashima, 2018; Schulte & Liu, 2017). On the other, FinTech led to creating innovative asset classes and technologies that will create a revolution in contemporary business customs. According to Mordor Intelligence (2020) report, FinTech in South East Asia will have the highest growth rate in the next five years (Figure-1). According to Mordor Intelligence (2020) report, FinTech in South East Asia will have the highest growth

rate in the next five years (Figure-1). FinTech has propelled rapid growth in numerous sectors globally, starting from payment start-ups, crowdfunding, lending, personal finance, financial research, retail investment, remittances, etc. The payment business and loans are the top two contributors in the FinTech business, followed by aggregation and crowdfunding (Deloitte Touche Tohmatsu Limited, 2019).

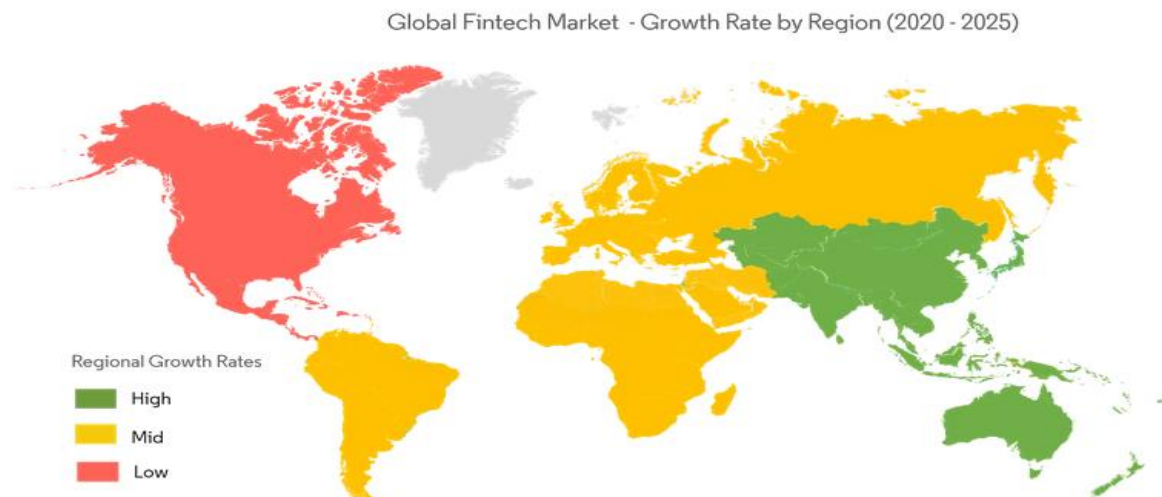


Figure 1: Global FinTech Landscape (Source: Mordor Intelligence)

Micro, Small, and Medium Enterprises (MSMEs) are considered as the growth engine of the nation in India (Singh, 2015). The Government of India have laid down the following criteria for the categorization of an organization as MSMEs (*What's MSME | Ministry of Micro, Small & Medium Enterprises*, 2020):

"

- a micro-enterprise, where the investment in Plant and Machinery or Equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;
- a small enterprise, where the investment in Plant and Machinery or Equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees;
- a medium enterprise, where the investment in Plant and Machinery or Equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees."

It employs almost 124 million people in the country, second to the agricultural sector. At present, nearly 56 million MSMEs are engaging in various industries across India. Out of which nearly 14% of enterprises are owned, controlled, and managed by women entrepreneurs, and almost 60% are grounded in rural areas. MSME contributes 45% of merchandise exports and contributes 8% in overall Gross Domestic Products (GDP) (Ministry of Micro, 2021; Vasal, 2020). Moreover, the disbursement of business credit and debtors is witnessing sustained growth post-liberalization era. According to the Reserve Bank of India (RBI), the public sector bank lending has stood at Rs 8.20 lakh crore, Rs 8.28 lakh crore, and Rs 8.64 lakh crore in FY16, FY17, FY19, respectively (RBI, 2015). In 2019, it was recorded that public sectors made the Rs 8.81 lakh crore loan disbursement to MSMEs. Afterward, the target in 2020 will be to cross Rs. 9 lakh crores, but the Covid-19 pandemic may impact the disbursement of the business credits. As shown in Figure 2, the annual gross loan portfolio is expected to reach INR 3,627 Bn, whereas the clientele will reach 64 Mn by FY 2022 (KPMG International Cooperative, 2019).

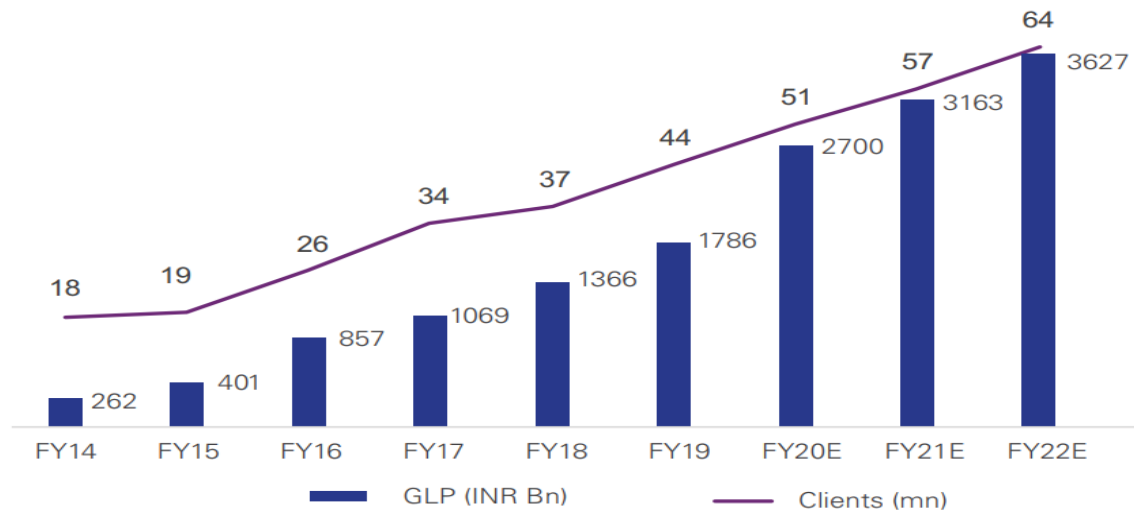


Figure 2: Microfinance growth in portfolio size/number of client (Source: MFIN Micrometer report FY 14-19)

The lack of capital, channelizing of goods, licensing, and administrative tasks like bookkeeping are common difficulties that entrepreneurs and MSMEs face in managing their business activities (Kumar et al., 2009). Apart from these, managing other functions like marketing, product development, product pricing, human resources, and their promotional task adds to the woes of the entrepreneurs. Several studies present that (Ghouse, 2017; Hamid, 2017; Harvie, 2019; Kumar et al., 2009). The collateral is one important obligation that has to be fulfilled by the MSMEs for applying for the loan from banks and such institutional setups. Lack of collateral is the major hurdle to raise business capital faced by MSMEs. These problems must be assessed while forming the policies for the MSMEs so that it becomes painless for them to access loan assistance. One way to deal with these problems is to streamline the process, remove unnecessary compliances caused by existing policies and institutional setup (Guild, 2017).

It is expected that an artificial intelligence-driven financial model will help overcome the problem of business capital in the days to come, in the way helping MSMEs with their operation. The spectrum of services provided by FinTech will play a pivotal role in the development of MSMEs. Therefore, this study aims to examine the role of FinTech based microfinancing in the sustainability of MSMEs in India.

The key objectives of this paper are:

- To analyze the key problem faced by MSMEs.
- To examine whether FinTechs have improved the availability of capital to the MSMEs.

The rest of the paper is organized as follows. Section 2 presents the methodology, Section 3 presents the findings, and Section 4 summarizes the conclusions.

2. Methodology

In our study, we have followed qualitative research methodology. We have conducted a few pilot interviews to develop a better understanding of the phenomenon. Based on the findings of the interviews, we will proceed with the survey. We interviewed the clients of FinTech dealing in microfinance; the interview focus was broadly around the problems they were facing earlier and how FinTech helped them get around them. We also enquired about how FinTech helped them increase overall efficiency, and they were financially beneficial. During the pilot study, we opted for purposive sampling. Due to COVID-19, the interviews were conducted over the telephone or via zoom meeting. The interviews were semi-structured. The average duration of the interviews was around 45 to 50 minutes and was conducted once per respondent. The educational level of all the respondents was graduate or above, and the average age was 30 years. During our qualitative study, we adhered to guidelines laid down by Klein and Myers (1999) specifically, and we remained cautious about the interaction between interviewer and respondent to avoid any possible biases. We started with some basic questions about the respondents, their educational background, and their work to set the context. So far, we have conducted 10 interviews and will continue conducting more interviews until theoretical saturation is achieved.

Once the interviews were conducted, they were transcribed manually. Since India is a non-English speaking nation, some interviews were conducted in the local language as the respondents were not well versed in English. Those interviews were translated to English for analysis. Both the authors performed the translation separately and the help of an English language scholar to review those translations to arrive at a final version. The interviews were examined using the narrative analysis technique. The narrative analysis is suitable when the information collected via interviews is functional and purposive (Figgou & Pavlopoulos, 2015). We used the dialogic/ performance analysis as it is concerned with who, what, and why (Riessman, 2008).

Findings

From our qualitative study, we were able to gain considerable insights. The study suggests FinTechs have been instrumental in meeting the short-term capital requirements of the borrowers.

When asked about the minimum amount of loan they have taken, participant 3 mentioned, "The loans were available for as low as Rs 2000/- for a period as short as 30 days".

When enquired about their problems and factors affecting their growth, participants 4 and 7 highlighted several problems. They mentioned, "the regulatory requirements were proving difficult to meet sometimes, and terms and conditions were unfavorable especially interest rates, borrowing period, repayment schedule, minimum amount, etc."

Participants 5 and 8 mentioned "how the limited working hours during COVID, weekends, and public holidays made it difficult for them to obtain a loan quickly."

These and other problems got aggravated during the COVID-19 lockdown.

When speaking about how FinTech-based solutions have helped them with the problems, they mentioned, "With FinTech operating 24x7, not only were they able to apply for the loan at any time of the days through app or website but were also able to get a quick response from the

company. With flexible terms and conditions and lenient approach, the respondents were able to procure the loan, bypassing most of the paperwork required with conventional Microfinance Institutions (MFIs)."

The respondents also reported that they could get the required capital directly from the investors with a peer-to-peer lending platform. The respondents also revealed that their cost of funds had declined significantly because they provide a customized loan in terms of payment schedule compared to the stringent payment schedule of banks and other financial institutions.

From the insight obtained from the qualitative study, it can be said that FinTechs are indeed helping MSME in their growth. The gamut of solutions provided by Fintech companies is helping MSMEs in navigating through the complex institutional structure of regulations. We believe it won't be too early to say that if fully realized, Fintech-based innovation will become a catalyst for the growth of the MSME sector that will, in turn, propel India to become an economic superpower.

Conclusion

Fintech is an intervening improvement between user and saver of the fund in the economy through an expanded money-related transaction. In the era of the digital revolution, where technology is changing rapidly, the overall community should practice this ongoing innovation as a fashion (Darma et al., 2020). Financial services became more affordable and assessable because of the innovation done by FinTech in their product portfolio. The prospects of Indian MSMEs are enormous. However, the inadequate financial resources availability and low penetration of financial inclusion hamper their growth. FinTech based microfinancing can help MSMEs to raise business capital quickly, enhancing which in turn enhances customer experience, promoting customer engagement, helps in sharing of information, providing provides payment schemes, collaboratively providing systems provides system like identity verification, and quickening quicken money- related administrations. The advancement in technology in the financial sector also shields systems and shoppers from highly hazardous conduct and possible interruptions.

MSMEs are at the core of ATMANIRBHAR BHARAT. MSME revolution is a must for the resurgence of the Indian economy. Fintech-based innovation can be seen as the potential solution for the long-standing problems ailing the growth of MSMEs. Only by maneuvering through these issues will we be able to realize the growth of the country as a whole. This type of growth will generate large-scale employment and put India in the global spotlight as the go-to destination in the manufacturing and assembling sector.

The key findings of this paper are:

- The MSMEs are facing a myriad of problems, especially during the COVID pandemic. All our participants have mentioned the difficulty in gaining access to capital as their single most ailing pain point. Except these, the paper works, and excess documentation has also been mentioned by most of our participants as a problem.
- From the narrative analysis conducted over the interviews, one common theme emerged: FinTechs have been phenomenal in extending capital access to the MSMEs. From quick credit assessment of the application to all-day availability to customized terms and conditions have been the constant underlying theme identified from the interviews.

Research Limitations

Gaining our respondents' trust proved to be the single most challenging task apart from lack of financial knowledge and proper financial records. When we talk about a firm's performance or unit generally, we talk about its financial performance, for which there are standard measures such as return on investment, return on asset, and other similar measures. But lack of financial knowledge in our respondents forced us to limit our finding on qualitative evidence only that mostly revolves around perceived business performance. Existing financial reporting regulations don't help us as they exempt MSMEs from maintaining books of financial records. Another major limitation was the coronavirus pandemic, due to which we had to limit our data collection method to phone and video calling. The advantage of these techniques is that you can reach anybody anywhere, but the absence of face-to-face interaction that could have helped us establish rapport severely constrained our interactions with the respondents. In addition to that, the technical communication medium proved to be a major inconvenience to our respondents and us. So far, our findings are based on qualitative study only. However, we will have to complement them through quantitative study to make them more robust and generalizable. We shall further strengthen our findings with a quantitative study.

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