

Case Study on innovations in SME financing beyond credit

Framework of the Study

The Micro, Small and Medium enterprises (MSMEs) portray a significant role in the overall industrial economy of India. MSMEs constitute more than 80% of the total number of industrial enterprises and support industrial development. MSMEs contribute nearly 45% to manufacturing and about 40% to the Indian export sector. Their contribution to the Indian GDP is 8% and the sector has registered growth rate of 10.8%. Indian MSMEs have moved up from the manufacture of traditional goods including leather, gems and jewelry, agricultural goods to much more value addition in the manufacturing sector to its entry in the value-added services as well.

But, like other entities, SMEs also witnessed numerous challenges amid the ever-changing market situations. While the need to innovate and adapt to change is imperative for any firm, the SMEs were faced with a new set of challenges during the global pandemic that accelerated the need for reinvigorating the way they carried out business operations.

Small and medium-sized businesses play a significant part in the country's economic growth and competitiveness. According to the World Bank, SMEs in developing countries are responsible for creating numerous job opportunities, which remain key to gradual economic development. And the situation in India is no different. As mentioned above, it is clear that supporting MSME's financial requirements is critical to country's overall growth. SME's form a loyal customer segment to Banks as well. It is imperative that Bank's should focus on SME lending, which are critical to nation's economic well-being.

Challenges faced by Banks in automating the SME Lending Journey

Banks now a days are leveraging their digital capabilities to originate SME loans. They have been using innovative technology to simplify the SME lending process, improve customer experience and so on. Around 85% of the MSME's remain underserved in terms of credit and only one-fifth of their financing needs were fulfilled by formal credit. The contributing factors to this issue are cost, access and conventional underwriting process. Traditional lenders require MSME borrowers to furnish their credit history, formal records, business vintage etc., which may exclude many small businesses from the formal lending space. Some of the common challenges SME's face while availing business loans in the country is furnished below

- Entrepreneurs to turn financially literate – A number of studies indicate that the business owners in India are still not financially literate. They do not track and understand the latest updates in financial technologies. Likewise, many small business owners still do not consider banking and online lending options to be safe and secure. Besides, they hesitate in applying for an SME loan online as they fear their information would be mistreated. It is important for the new-age lending institutions in India to make the entrepreneurs financially literate and inform them about the ongoing financial market trends. There is a need for lenders to invest in advanced financial technologies and promote technology-driven loan products without the small business owners.
- Emphasis on Credit Score - While processing business loan applications, most loan lending institutes consider the business owner's personal and business credit score (consumer & commercial bureau scores). But today's most significant percentage of online lending institutions offer business loans to MSMEs who have excellent personal credit history and score. But many business owners lack the skills to improve the bureau score and build a positive credit history. The SME owner must work on improving his/her bureau score and building credit history and the lenders should properly guide them in this aspect.
- Cumbersome Disbursement Process - The traditional lending option requires the business owners to meet their strict eligibility criteria including high CIBIL/Experian scores and submit numerous documents. Besides, traditional lenders also take time in processing the loan application and credit funds into the borrower's account. Hence, it becomes comparatively difficult to avail a loan for business from traditional lenders to meet urgent working capital needs and manage cash flow. Therefore, it makes sense to avail credit services from alternative lending institutions, such as NBFCs to efficiently reduce the loan disbursement time.
- Non-standardized Project Appraisal - The lending institutions evaluate the risk in lending based on a number of factors. This is why the eligibility criteria for different loan products differ. Many of the lenders give over importance to the financial documents, business plans and the projects submitted by the borrower to assess the overall credibility of the borrower. However, there are no predefined rules or standards for project appraisal.
- Collateral Requirements - Often SMEs find it easier to get access to funds to expand their business. However, small business owners find it challenging to avail themselves of business loans that require hypothecating collateral to back the loan amount. They do not have business property to hypothecate to avail a business loan. Many small business owners in India avail business loan from NBFCs which is offered without collateral. Thus, they are able to meet their requirements without pledging any asset. In the end, the latest financial technology has changed the way, through which the financial institutions in India operate. Now, the loan lenders are able to address the challenges faced by SMEs in India. Thus, they are helping them to avail SME financing without much hassle and delay. In the near future, lenders will be able to resolve the issues faced by SMEs and have also become a helping hand in the growth of the SMEs.

Digital Transformation: A complete solution

Digital transformation includes adapting to tools and technology for various business operations to meet desired goals and customer expectations. The primary need for digital transformation was to support business continuity disrupted during the pandemic. Therefore, following in the footsteps of industry giants, SMEs underwent a complete digital transformation that gave them better access to their business operations, generated better leads and helped in brand recognition sans any lags and interruptions. The World Economic Forum predicts that the societal and industrial digital transformation market will reach 100 trillion USD by 2025. The statistics indicate that this transformation is not only a phase but a crucial business strategy for every SME to incorporate.

With digital transformation, companies can improve their management by having better access to information, appropriate communication with vendors and faster networking. With digitalization comes automation that can be combined with several operations to do menial and repetitive tasks, saving time and costs for the organizations. Similarly, procuring financial support and human resources can be more streamlined and expedited on the back of a digital presence. With the digital approach at the forefront, training the workforce can become seamless and more effective. Moreover, SMEs can track and log their employees' progress while preparing in advance to tackle future challenges on the back of valuable insights.

To reach their customers significantly, SMEs can opt to go digital with the help of web development for brand introduction and establishment. Also, with a growing dependency on smartphones and other mobile devices, SMEs can rope in software firms to create applications with interacting user interfaces (UI) for better customer engagement and customer experience (CX). As physical documents tend to get damaged, SMEs can also opt for cloud services for better data management, security and interoperability.

Future of SMEs is Digital

While large companies continue to run away with the limelight, the SMEs are working silently to revolutionize development by being a vital cog in the country's economic wheel. Regardless of the size, modern-day businesses have embraced digital transformation to procure long-term benefits. When it comes to SMEs, owing to their small size, they can undergo the transformation process more readily than large-cap enterprises.

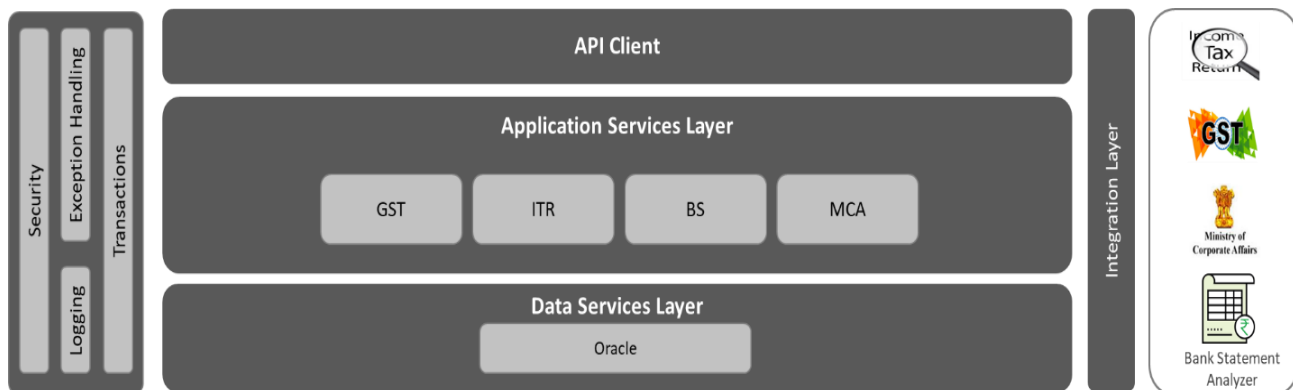
On the other hand, SMEs can also rope in a credible partner to help them set up their IT infrastructure, among other requirements needed to fulfil their digital transformation. And with the rise of entrepreneurs in India, the digital process will not only get streamlined but also become more manageable. Newer technologies have always paved the way for industries to solve issues that traditional methods could not. It is precisely for this reason that, in the coming years, digital transformation will be integrated into all aspects of a company to meet the needs of industry and consumers.

Problem Statement

The SME underwriting process in Federal Bank was manual, wherein branches/relationship managers collect the loan application form, related loan documents, run the bureau checks and login the case in the loan origination system manually, which in turn increased the TAT for sanctioning an SME loan to a prospective customer.

Solution - How 'Federal Insta Loans' Platform digitized SME lending Process in Federal Bank

We implemented the 'Federal Insta loans platform' in June 2021, which revolutionized the SME lending process both from the customer experience as well as from the loan processing angle. This digital platform enables SME clients to avail digital in-principle loan sanction up to Rs. 2 crores in less than 30 minutes, after assessing the eligibility of the borrower based on the business rules integrated in the platform. The platform uses sophisticated algorithms to read and analyze data points from various sources such as IT returns, GST data, bank statements, MCA, bureau in less than 30 minutes while capturing the borrower's basic details using smart analytics. It also analyses Balance sheet/Financial statements from the income tax returns (ITRs) uploaded by the borrower and provides detailed financial analysis required for sanctioning the loan. Borrowers will receive an online in-principle sanction letter after completion of the process. Borrowers can visit their respective Federal Bank branch selected during the journey along with the in-principle sanction letter and complete the remaining loan sanction formalities.



The borrower journey in the platform for obtaining in-principle loan approval is completely digitized and does not involve any manual intervention. The platform offers in-principle sanctions for business loans up to Rs 2,00,00,000/- (Rupees two crore) to eligible micro, small & medium enterprises (MSME) through this platform. The platform aims to reduce the overall TAT involved in sanctioning business loans to a greater extent.

Benefits

The implementation of the platform brought down the TAT involved in sanctioning a business loan significantly, as it automated data points such as online GST returns validation, auto generation of financial and bank statement analysis. With the introduction of this digital lending platform, we could sanction a business loan in 5-8 working days, moving away from the traditional lending process which would take 15-30 days in an getting an SME loan sanctioned.

The final loan sanction process for the branches/credit team is also hassle free, as majority of the data points filled during the online journey will be auto fetched to the LOS, which will in turn eliminate the data entry to be done at their level. The branch/credit team is also relieved from the manual preparation of credit appraisal memo (CAM) and other financial ratios, as the Insta loans platform will auto generate a comprehensive CAM covering all the details/analysis, ratios, and assessment.

Now, the customers also find it easy and convenient to avail an in-principle SME loan sanction through the platform, as the application runs through our business rules configured in the platform providing a GONOGO decision and all of this happening in less than 30 minutes.

Conclusion

To sum it up, the implementation of Federal Insta loans platform played a major role in automating the SME loan underwriting process from the conventional lending model. This platform has become an enabler for our branches/relationship managers to source more quality business proposals and increase the SME loan portfolio in Federal Bank.

Now, with the system in place, we are working towards further reducing the TAT involved in SME loan sanction by implementing a straight through process (STP), which will provide end to end loan sanction digitally, eliminating the need for the borrower to visit our branch for completing the documentation formalities.

Note- Sample screens depicting the borrower journey in the Federal Insta Loans platform is provided in Annexure 1

Screen 1: Signup/Login

The screenshot shows the top navigation bar of the Federal Bank website with links for Home, FAQs, Business Loan, Home Loan, Personal Loan, Auto Loan, and Mudra Loan. On the right side of the navigation bar are links for Login and Register. Below the navigation bar is the Federal Bank logo. The main content area features a 'Sign Up' form with the following fields and elements:

- Full Name:** A text input field with the placeholder text 'Enter Your Full Name'.
- Email Address:** A text input field with the placeholder text 'Enter Your Email Id'.
- Mobile Number:** A text input field with the placeholder text 'Enter 10 Digits Mobile No' and a 'Send OTP' button to its right.
- OTP:** A text input field with the placeholder text 'Enter 6 Digits OTP'. Above this field is the text 'Didn't get OTP? Resend OTP'.
- Agreement:** A checkbox followed by the text 'I agree to [Privacy policy](#), [Terms & conditions](#) and [Disclaimers](#)'.
- Proceed:** A large blue button at the bottom of the form.
- Already Registered? Login:** A link centered below the 'Proceed' button.

Screen 2: Entry and validation of PAN

The screenshot shows the 'Create new profile' page on the Federal Bank website. On the left is a dark blue sidebar with navigation links: PROFILE, LOANS, MONITORING, and BUREAU REPORT. The main content area has a header with a notification: 'To complete sign up process, request to verify your E mail account "grawadh.shrimal@onlinepo10ans.com" Change E mail'. A green success message in the top right corner says 'Profile created successfully'. The main form is titled 'Create new profile' and contains:

- Name Your Profile:** A section with the label 'Trade Name' and the text 'ABC LTD'.
- Enter Your Business PAN:** A section with the label 'PAN' and an empty input field.
- Validation Text:** Below the PAN field, there is explanatory text: 'We will use your PAN to verify company details. We have found following GSTIN Registered with your PAN.' followed by a 'Submit' button.
- Navigation:** 'Back' and 'Proceed' buttons at the bottom of the form.

The footer of the page includes the contact number 075-41055599, social media icons for Facebook, Twitter, and YouTube, and links for Privacy Policy, Terms And Conditions, and Stakeholder.

Screen 3: GSTIN Fetch and validation of turnover.

The screenshot shows a web application interface for GSTIN verification. On the left is a dark blue sidebar with menu items: PROFILE, LOANS, MONITORING, and BUREAU REPORT. The main content area has a header with a notification: "To complete sign up process, request to verify your E-mail account 'prakash.shrivast@onlinepibans.com' Change Email" with a "Verify Email" button. Below this is a heading "Please complete your GSTIN details". A light blue box contains a tip: "You will get an OTP on your registered mobile no. with GST". The main form is titled "Complete GSTIN Verification" and includes a "GSTIN" input field with a "13" character count, a "+ Add Another GSTIN" button, and a "Verify Selected GSTIN" section with fields for "GSTIN Number" and "GSTIN Username", and a "Get OTP" button. A bottom tip states: "Ensure you have enabled the API access in your GST Account", with "Read Instructions" and "Watch Video" buttons. At the bottom are "Back" and "Proceed ->" buttons.

Screen 4: ITR upload/Fetch

The screenshot shows a web application interface for ITR upload. On the left is a dark blue sidebar with menu items: PROFILE, LOANS, MONITORING, and BUREAU REPORT. The main content area has a header with a notification: "Manually Fill financial details" with the text "You can Self Declare your Financial Data if Income Tax Return is Not Applicable to You". Below this is a tip: "ITR of Financial Year 2018-2019 is mandatory". A question asks: "Would you like to upload ITR for Financial Year 2019-20?" with radio buttons for "Yes" and "No" (selected). The main form is titled "Upload ITR (ITR 3/5/6 XML or ITR 4e PDF Format)" and includes a table for uploading ITR files for FY 2018-19*, FY 2017-18, and FY 2016-17. The table shows file names like "2019-09-05-15-12-47-441_282189000_.xml" and "FY 2017-2018.xml". A tip states: "Ensure you have uploaded 2019-19 ITR". A bottom tip says: "How To Download ITR in XML Or PDF Format", with "Read Instructions" and "Watch Video" buttons. At the bottom are "Cancel" and "Proceed ->" buttons.

Screen 5: Bank Statement upload

To complete sign-up process, request to verify your E-mail account "prakash.sharma@onlinepsbloans.com" [Change E-mail](#) [Verify Now](#)

Please complete your Bank details

Upload Bank Statement
By selecting this you have an option to upload latest 4 Months Bank Statements in PDF format.

Manually Add Bank Account
By selecting this you have an option to verify your bank account manually.

You Can Add Up To 3 Bank Account

Upload Bank Statement [Get One-Time Password](#)

Bank Details found for A/C no. 36039824439

Branch on Jan 5, 2021	Account Holder Name	Value of Transactions credited ₹ 20,18,20,018	Account Location 4 Years Worth
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Please Make Sure That You Have Uploaded The Bank Statement At Least For The Months From May/20 To October/20

[Cancel](#) [Proceed](#)

Screen 6: Loan details entry

To complete sign up process, request to verify your E-mail account "prakash.sharma@onlinepsbloans.com" [Change E-mail](#) [Verify Now](#)

And here we go, just a step away!

Business Details

Industry * Sector * Sub-sector * MSME Registration Number

Product/Service Description * Udyog Aadhar Memorandum No.

Do you have Collateral Security? * Yes No

Loan Details

Loan Amount Required * Promoter Contribution * Purpose of Loan *

Is your Company/Firm ISO certified? * Yes No

Factory Premise * Know How * Competition *

Screen 7: Product Match and selection

The screenshot displays a web interface for loan selection. At the top, a navigation bar includes a profile icon and the name 'prakash'. A message banner reads: "To complete sign up process, request to verify your E-mail account 'prakash.sharma@onlinepbloans.com' [Change E-mail](#) [Verify Now](#)". Below this, there is an "Apply Filter" button and a "Sort by your preference" dropdown menu.

Congratulation! We have found 3 bank products for you

Bank & Product Info	Max tenure	ROI	Processing Fee	Total EMI (Excluding + add-on)	Action
Your Existing Bank					
Federal Bank Working Capital Business LAF - CC - BCD	7 Years	13.25%	1%	₹ 17,45,000 (₹ + 17,45,000)	Proceed →
Federal Bank Working Capital BCD check	7 Years	12.41%	1%	₹ 13,09,000 (₹ + 13,09,000)	Proceed →
Federal Bank Working Capital BCD 24	7 Years	13.25%	1%	₹ 5,41,000 (₹ + 5,41,068.64)	Proceed →

Note -> Loan proposal covered under CGTMSE scheme may have additional cost to be paid by the borrower. The same is not included in the above cost.

At the bottom left, there is a "Safe Lock SECURE" logo. At the bottom right, there is a contact number "0179-4100999" and social media icons for Facebook, Twitter, and YouTube, along with links for "Privacy Policy", "Terms And Conditions", and "Disclaimer".