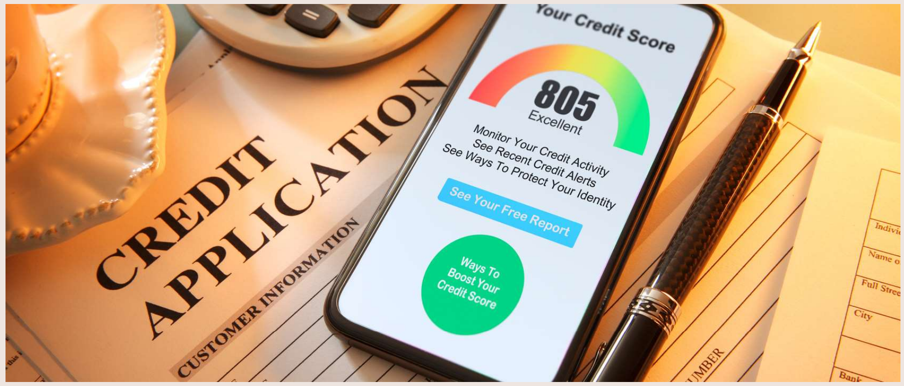
MSMES BEHIND THE CREDIT WALL: TIME TO RETHINK CREDIT ASSESSMENT

India's micro, small, and medium enterprises are evolving fast, but the frameworks used to assess their financial health haven't quite kept pace. Access to formal credit remains a persistent hurdle for many SMEs, not necessarily due to poor performance, but because the current credit rating systems do not reflect the full picture. The rating models, often inherited from large corporate standards, overlook the operational patterns and cash flow rhythms unique to smaller enterprises.

The existing long-term rating scale used by credit agencies ranges from AAA to D. For large corporates, fine distinctions are made within the investment-grade spectrum, from AAA to BBB. However, below this range classified as non-investment grade—most SMEs are clustered into a broad BB to C band, with little granularity. This results in a scenario where vastly different businesses, in terms of financial discipline and repayment ability, are viewed as equally risky by lenders.



This simplification does a disservice to many small businesses. A firm with consistent cash flows, solid customer relationships, and a clean repayment history may still be rated at the same level as a business with irregular revenueand weak compliance. Without the abilityto distinguish betweenthe two, lenders tend to erron the side of caution, eitheroffering loans at high interest rates or avoiding the segment altogether. For the SME, this means restricted access to capital,often forcing relianceon costlier options outside the banking/FIs system.

There is a growing consensus that the solution lies in broadening the rating lens. Instead of treating the non-investment grade zone as a homogenous space, further refinement can provide a more calibrated risk view. This would promptcredit agencies to evaluate businesses in greater detail,going beyond traditional financial ratios.

What also deserves greater focus is the type of data used to evaluate SME creditworthiness. While balance sheets may not always capture the full story, patterns in tax compliance, frequency of digital payments, and stability in customer orders can reveal a business's financial discipline. These behavioral signals often speak louder than static financials. Including such operational indicators in credit modelswould allow lendersto identify resilience that may not be obviousfrom legacy metrics.

Consider a few examples. A solar panel installation firm operating in tier-2 citiesmight generate most ofits income aroundpeak summer months.While revenue appearslumpy, the businessis stable and supported by repeat contracts. An edtech contentprovider working with vocational traininginstitutes may receive milestone-based payments spread across academic cycles, yet maintains a consistent delivery track record and cash discipline. Or take a food processing unit exporting specialty ingredients —its working capital is stretched due to long shipping and payment timelines, but it has a robust export pipeline and low customerchurn. Traditional ratingmodels often flag these businesses for uneven earnings or elongated receivables, missing the deeper signals of sustainability and reliability.

Even with a growing digital footprint, many banks remain hesitant to underwrite MSMEs. The resistance stems not from lack of data, but from a deeperdiscomfort with the perceived reliability and interpretability of that data. Credit officers are more accustomed to assessing audited financials and tax returns than parsing real-time transaction histories or alternate data trails. As a result, even well-run MSMEs with digital discipline often struggle to convert their digital visibility into bankable credit.

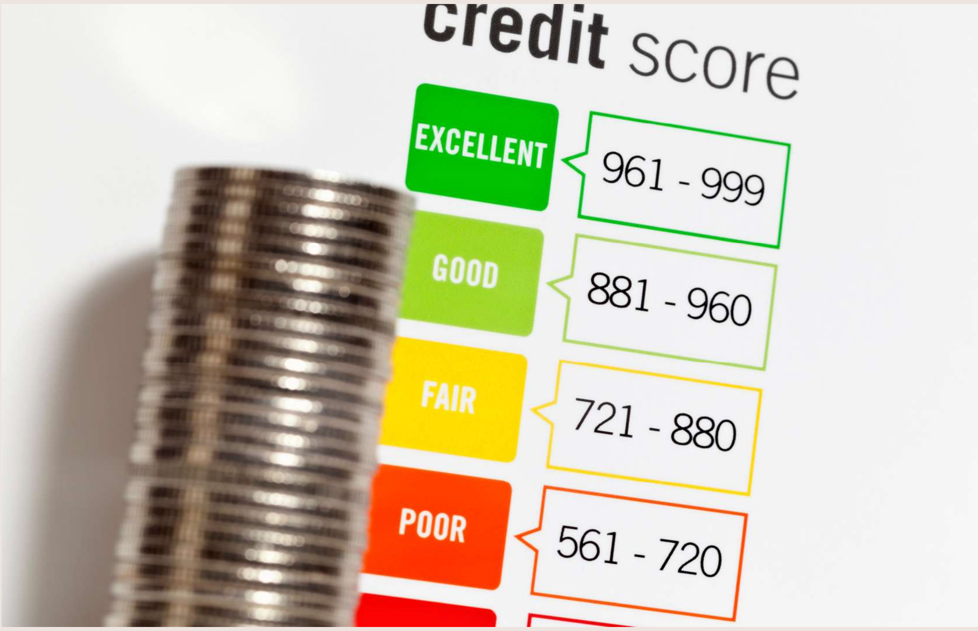
Part of the problem lies in the uneven qualityof the data itself. Digitalpayments may not be reconciled to revenue and many MSMEs still rely on informal practicesthat don't leavea clean digital trail. While fintechs have adapted by building context-aware models that adjust for sector, seasonality, or billing cycles, banks have been slower to integrate such contextualisation into their risk frameworks. In effect, MSMEs are penalized not because they lack activity, but because that activity doesn't fit the reporting structures banks are comfortable with.

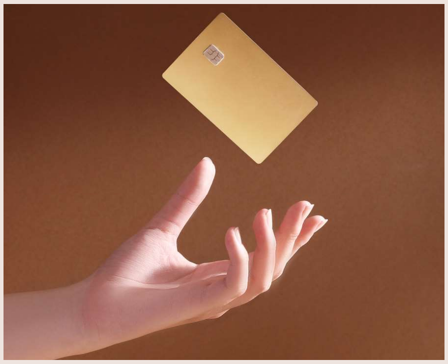
This disconnect is further exacerbated by a conservative credit culture that equates formality with safety. For many lenders, the absence of audited financials or pledged assets becomes an automatic red flag—regardless of whether the MSME has maintained consistent cash flows or low default risk through digital means.

Bridging this gap requires more than regulatory nudges; it demands active skilling and mindset shifts within the credit machinery of banks. Credit officers need training in interpreting behavioral and transactional data, supportedby tools that translate digitalsignals into actionable lending parameters.

A better ratingsystem would not only offer fairer assessments but also unlocknew financial avenues. When SME risk is more accurately priced, it becomes easier for institutions beyond traditional banks to participate, whether through capital markets, debt funds, or new-age fintech platforms. But broader participation depends on trust, and trust depends on credible, differentiated ratings.

There is also a role for regulators in facilitating this shift. The Reserve Bank of India, which recently made efforts to inject liquidity into the system through rate cuts and CRR adjustments, can support the credit ecosystem by linking regulatory incentives to improved rating frameworks. If risk weights on SME loans are adjusted based on more granular, behavior-based ratings, it would give banks a reason to expand their portfolios without stretching their capital buffers disproportionately.





The push toward more inclusive and transparent credit models is already underway. Platforms like Account Aggregators and the Open Credit Enablement Network (OCEN) are designed to make financial data more accessible and credit delivery more efficient. But these tools will deliver their true value only if rating systems are updated to absorb and process richer data streams. Without that upgrade, the ecosystem risks building new pipes for an outdated product Importantly, betterratings don't just benefit lenders.They also encourageSMEs to formalize, digitize, and build stronger financial records—actions that contribute to broader financial inclusion. A well-rated business can negotiate better loan terms, attract new partners, and scale sustainably.

Jyoti Prakash Gadia

Managing Director
Resurgent India
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