TransUnion CIBIL

MSME PULSE

MARCH 2023

sidbi

Mr. Sivasubramanian Ramann

Chairman & MD, SIDBI

The progressive reforms introduced by the government for MSME sector resurgence have borne fruit as reflected in the vigorous business activity and improved credit uptake by enterprises across all the segments. We would encourage the credit industry to duly support this increasing demand by providing timely access to credit opportunities for MSMEs, thereby contributing to the sustained growth of the sector and the economy in order to meet the government's USD 5 trillion economy objective.

Mr. Rajesh Kumar

MD & CEO, TransUnion CIBIL Ltd.

Demand for credit from the MSME sector is at an all-time high and supply by the credit industry remains stable while delinquencies have declined. These findings prove that the credit industry has been able to wield the power of insights and data analytics to identify deserving MSMEs and drive access to credit opportunities astutely across business sectors and geographies. The rapid pace of innovations driven by the government, regulator, and the lending ecosystem has significantly fortified the MSME sector to continue its high growth trajectory. These innovations have provided capabilities for triangulating the power of financial, income and trade information so that credit institutions can get a unified view of the business entity, enabling improved risk differentiation for underwriting MSME loans.

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EXECUTIVE SUMMARY

The micro, small and medium enterprises (MSME) sector is dynamic and fast-expanding, contributing ~30% to India's GDP and employing ~111 million people. Hence, it's crucial to improve MSMEs' access to finance and explore innovative solutions to unlock sources of capital.

This edition of MSME Pulse analyses accelerated growth across the sector which has primarily been achieved by providing timely credit to resilient MSME borrowers. The first chapter highlights key characteristics of MSME credit, and assesses the demand, flow and performance of the sector.

The following chapter evaluates the potential next wave of growth in the micro segment. And finally, we explore consequent detection of early warning signals of risk in the sector.

CREDIT DEMAND, SUPPLY AND CREDIT GROWTH

Demand for MSME loans (measured in terms of number of commercial credit inquiries) has accelerated and has grown to about 1.7 times the demand of two years ago. NBFC saw credit demand crossing 2x for the same period. This can be attributed to the efforts on the part of government and financial sector to develop and implement mutiple support mechanisms, and an evolving digital public infrastructure for the MSME sector.

Disbursements by amount in FY23-Q2 have grown by 24% YoY. The micro segment in FY23-Q2 saw 54% growth in disbursements compared to same period last year (FY22-Q2). Significant growth in micro reaffirms the increased inclusivity focus in the market. MSME disbursements by amount in FY23-Q2 for PSB, PVT and NBFC grew by 21%, 25% and 34%, respectively compared to FY22-Q2.

PORTFOLIO PERFORMANCE

Total MSME credit expsoure (excluding default cases ~ ₹ 1.2 Lakh Cr in doubtful category and ~ ₹ 1.3 Lakh Cr beyond 720 DPD/Loss category) was at ₹ 22.9 Lakh Cr as of Sep'22(FY23-Q2), reflecting a YOY growth rate of 10.6%.

Overall, MSME NPA rates(90+DPD) was 12.5% as on Sep'22 (FY23-Q2), down from 13.9% same time last year (FY22-Q2). With this edition of Pulse, the new definition for Delinquency rates(90+ DPD) is being introduced and excludes legacy accounts with DPD beyond 720 days or reported as loss/doubtful. Delinquency Rate was 3.0% for Sep '22 (FY23-Q2), down from 4.4% same time last year (FY22-Q2). Delinquency rates dropped YoY across all the three lender categories (PSBs, PVT and NBFCs); the highest drop in PVT Segment (i.e., from 2.8% in FY 22-Q2 to 1.5% in FY 23-Q2).

NEXT WAVE OF GROWTH – MICRO SEGMENT

Credit to the 'micro' (with aggregate credit exposure not exceeding ₹ 1 Cr) segment by balance grew by 13% YoY as of Sep '22 vs 10.6% YoY growth for overall MSME. Very small (with aggregate credit exposure not exceeding ₹ 10 Lakh), Micro1 (with aggregate credit exposure between ₹ 10-50 Lakh) and Micro2 (with aggregate credit exposure between ₹ 50 Lakh to 1 Cr) experienced balance growth of 20%, 15% and 11% YoY respectively showing sudden spurt in Micro lending, which is not just a post-pandemic bounce back.

High growth in the micro segment reaffirms the confidence lenders have in this segment. 93% of MSME entities are in the micro segment which contributes 25% to the MSME portfolio. Due to formalization of MSMEs and their adoption of platform-based banking services, it has enabled lenders to capture more data. This makes credit processing and loan delivery seamless, and makes underwriting and debt collection more granular, boosting confidence of financial institutions. Most large banks are capitalizing on this trend and are tying up with Fintechs to augment such capabilities. This combination of scale and digital prowess can drive an exponential growth in Micro credit.

Interestingly, more than 50% of new originations came through new-to-credit (NTC) borrowers for the segment – which emphasizes the importance of alternate data sources for effective underwriting.

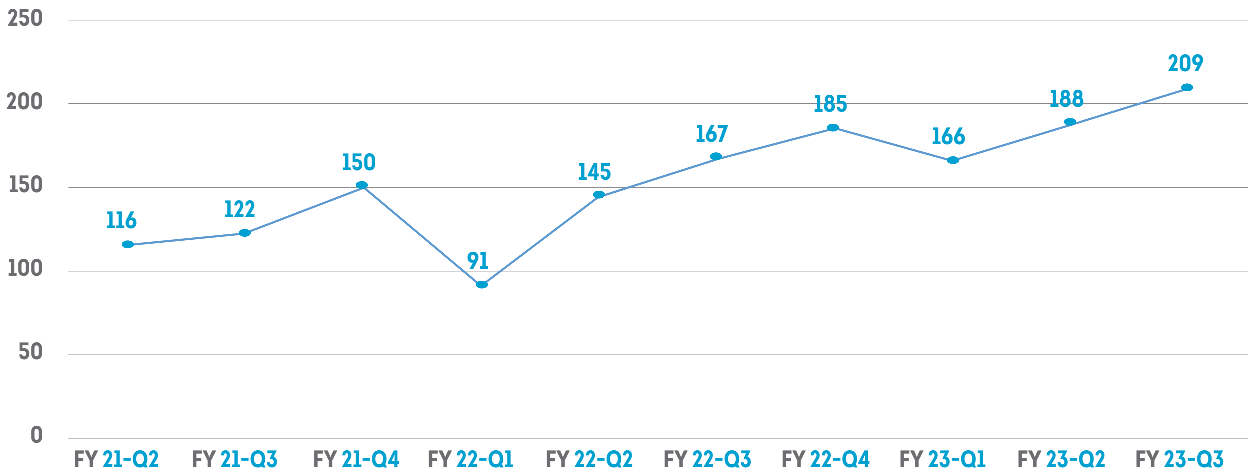
EARLY WARNING SIGNALS (EWS) OF RISK

With MSME lending moving towards being granular and replicating platform based consumer lending landscape, innovative solutions are required to track the performance of an underwritten entity. Reacting to an account currently in DPD bucket may be a delayed reaction as there are other indicators which could signal potential default in the near future. Therefore, EWS becomes an inseparable part of credit risk management plan and allows lenders to take preventative actions. Adoption of such innovative solutions can assist lenders mitigate risk on timely action.

CREDIT DEMAND

Recovery in economic and business activities have led to increased credit demand for commercial lending. The Purchasing Managers Index (PMI) has been on the rise; consistently at over 50 for last 6 months, indicating expansion in the manufacturing/service sector. The same is reflected in credit demand (measured in terms of credit inquiry volumes), which is on an increasing trend with Sep'22 numbers close to 1.7x times of the demand two years ago.

Indexed Commercial Credit Inquiry Volumes

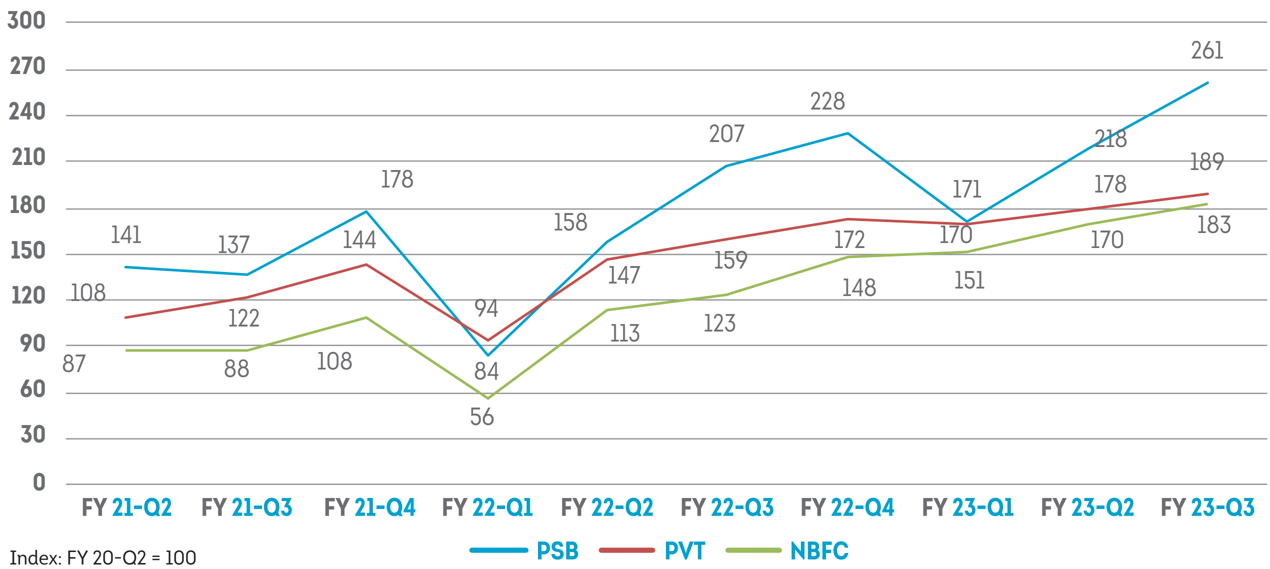


Index: FY 20-Q2 = 100

CREDIT DEMAND BY LENDER TYPE

Credit demand stands at 1.9x and 1.6x as on Sep'22 over 2 years for PSBs and PVT Banks, respectively. For NBFCs, the demand grew by more than 2x for the same period. This can be attributed to the efforts on the part of the government and financial sector to develop and implement mutiple support mechansisms for the MSME sector. A push toward digital transactions from both government, as well as the private sector, further redressed the credit requirement.

Indexed Commercial Credit Inquiries by Lender Type



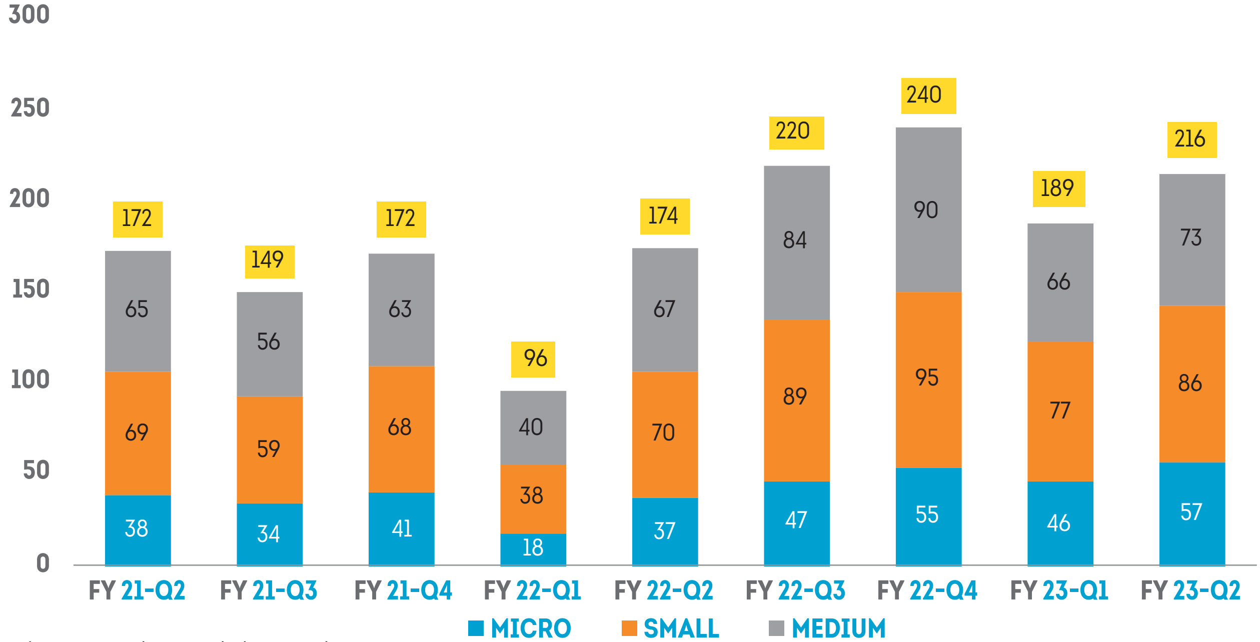
Index: FY 20-Q2 = 100

CREDIT SUPPLY

Disbursements in FY23-Q2 grew by 24% YoY. Micro, small and medium segments saw a growth of 54%, 23% and 9% in disbursements, respectively.

Significant growth in the micro segment establishes that there's increased inclusivity focus in the market.

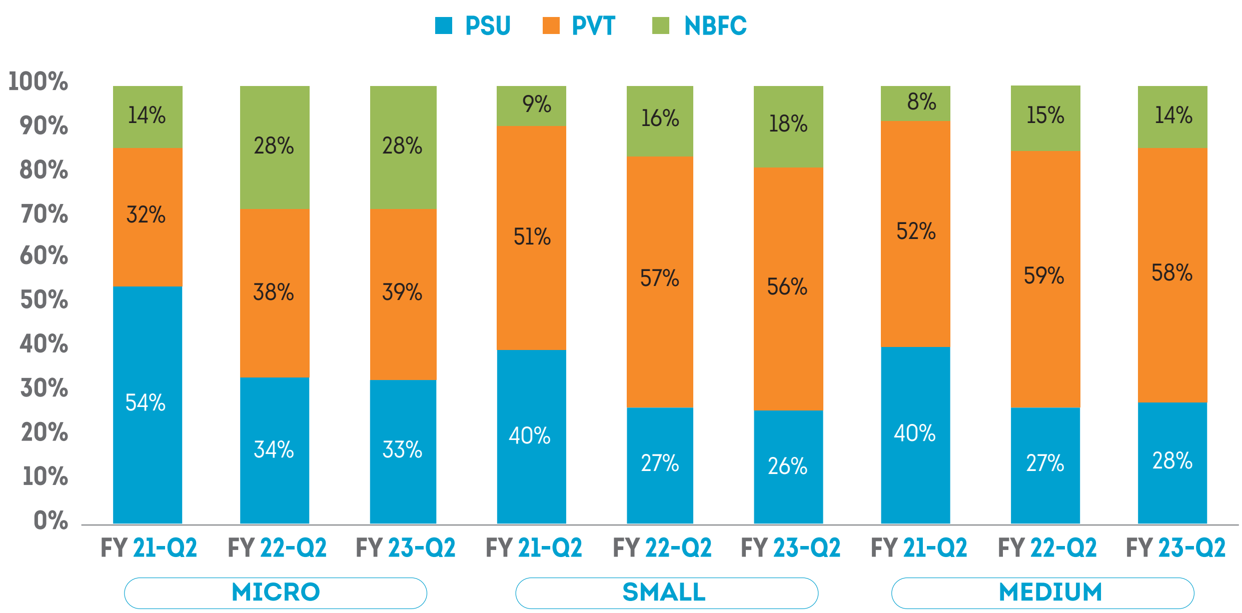
MSME Disbursement Amounts (In ₹ Thousand Cr)



Disbursements do not include renewals

Share of origination amount across lenders remained broadly similar to that of last year, and private players maintained the highest market share across all segments in FY23 Q2. Disbursements in PSBs, PVT and NBFCs grew at 21%, 25% and 34%, respectively. In Micro segment, origination share has moved from PSBs to PVT and NBFCs over 2 years.

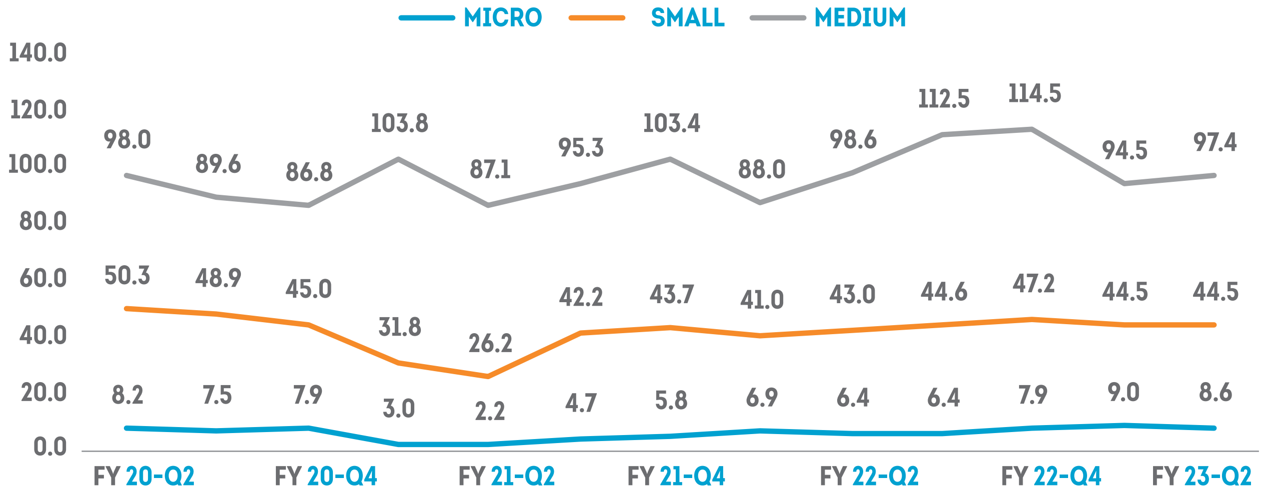
Share of Origination Amount across Lenders



AVERAGE LOAN SIZE

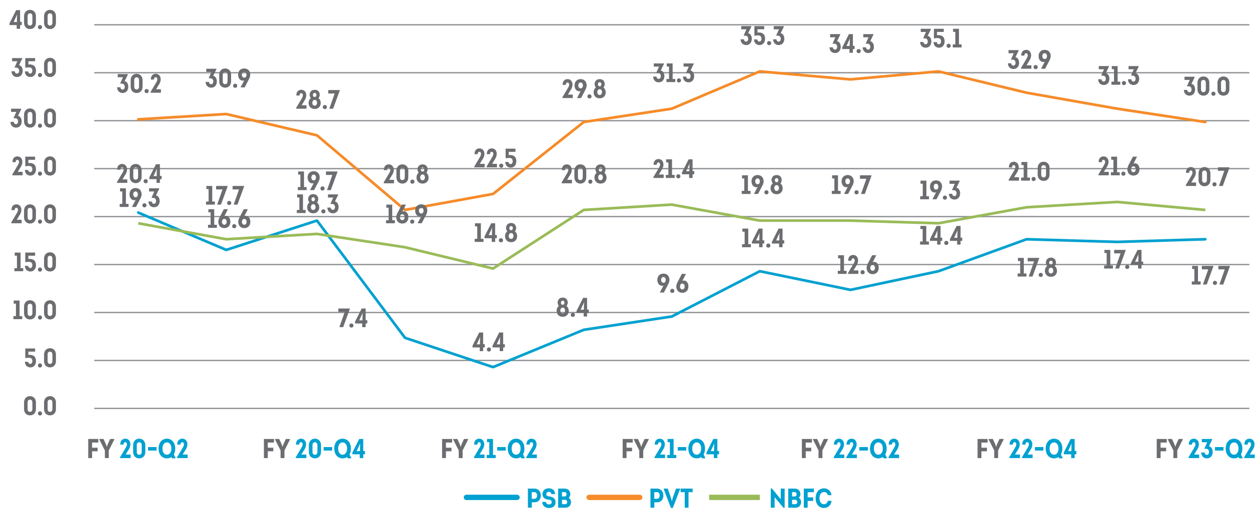
Average loan size for micro and small segments increased YoY by 34% and 4%, respectively, and decreased YoY by 1% in medium segments in FY23 Q2. Average loan size for micro and small segments that witnessed a decline post-COVID due to increased focus on ECLGS loans is now trending back to pre-COVID levels.

Average Loan Size (in Lakh) by MSME Segment



For private players, increased focus on issuing loans to the micro segment resulted in a YoY decrease in average loan size by 13%. At the same time, average loan size increased YoY by 40% and 5% for PSBs and NBFCs, respectively. Average Loan size for PSBs, which saw highest ECLGS loans, are back to pre-pandemic levels.

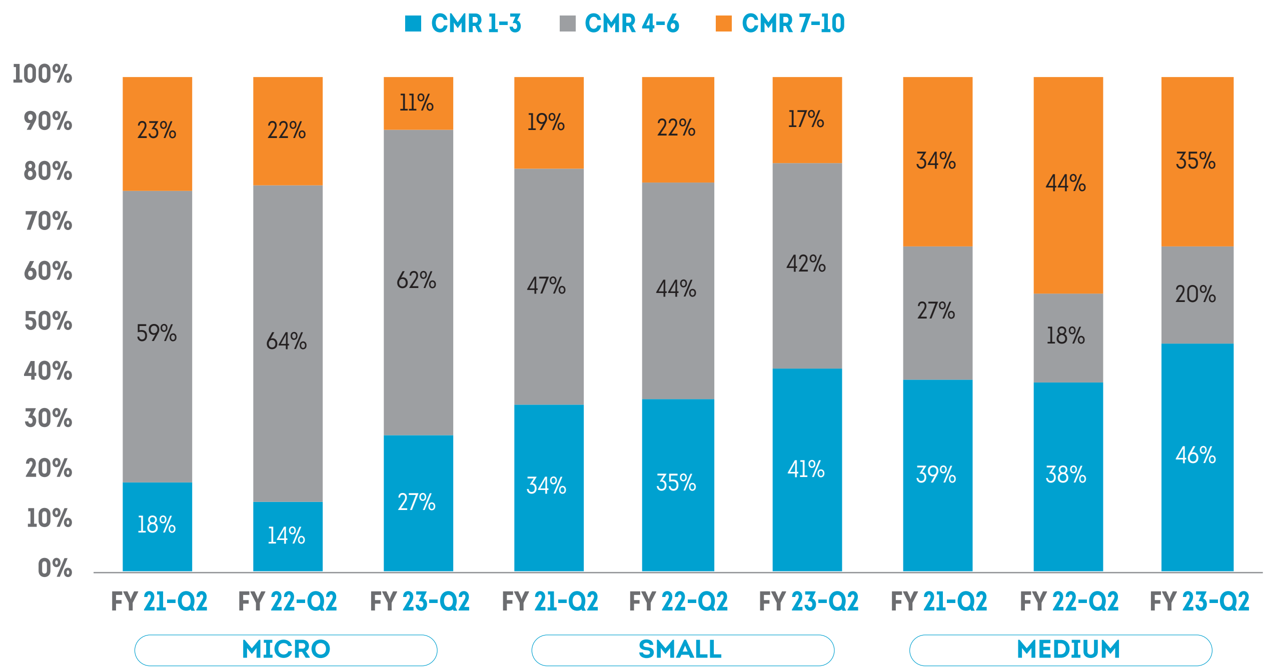
Average Loan Size (in Lakh) by Lender Type



ORIGINATIONS DISTRIBUTION OF MSMEs BY CMR

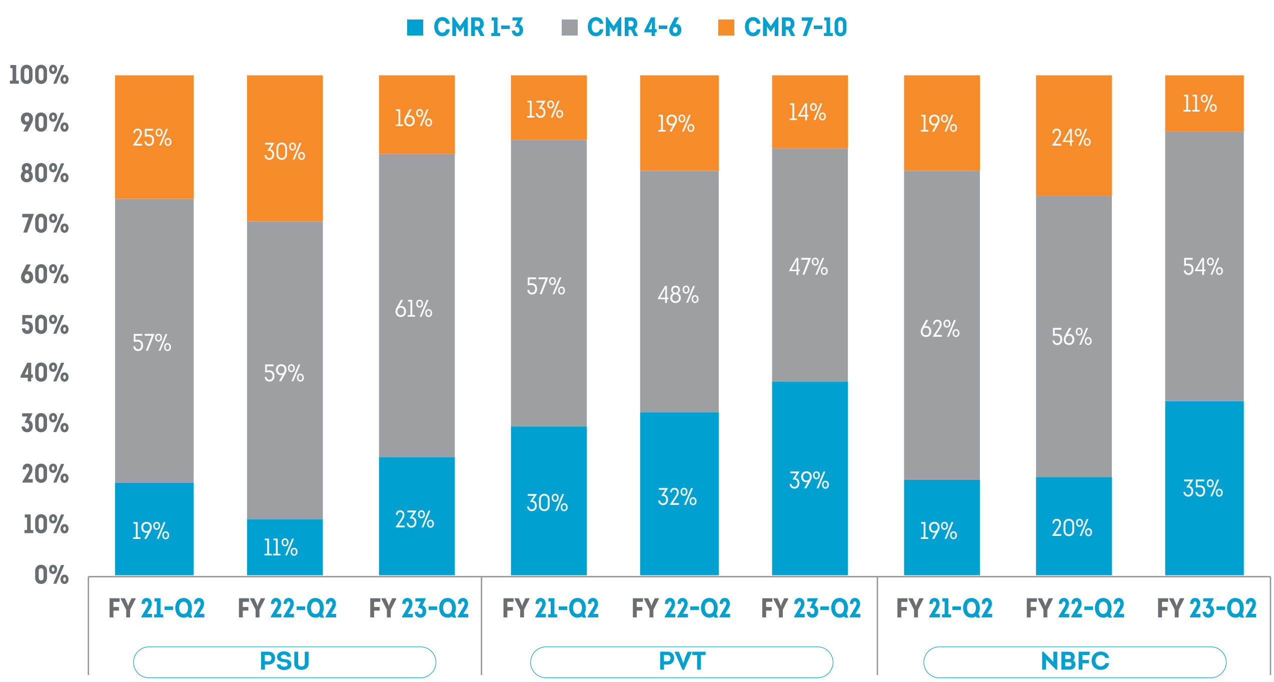
For the entire MSME segment, the share of originations from low-risk tiers (CMR 1-3) increased from 22% to 31% YoY (highest shift seen in Micro segment). It also showed a significant decrease in high-risk tiers (CMR 7-10) from 24% to 13% YoY for entire MSME segment.

Share of #Origination Trades by CMR – By MSME Segment



Originations for PSBs and NBFCs in the high-risk tier (CMR 7-10) decreased significantly – primarily driven by a reduction in share of high-risk originations coming from the micro segment.

Share of #Origination Trades by CMR – By Lender Type

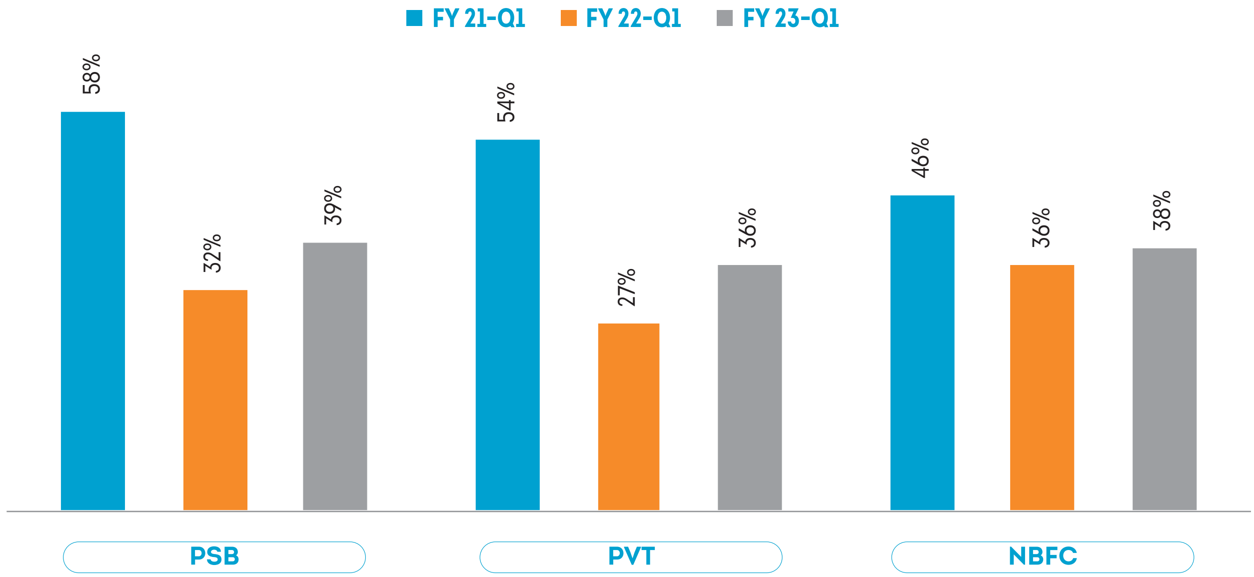


APPROVAL RATE

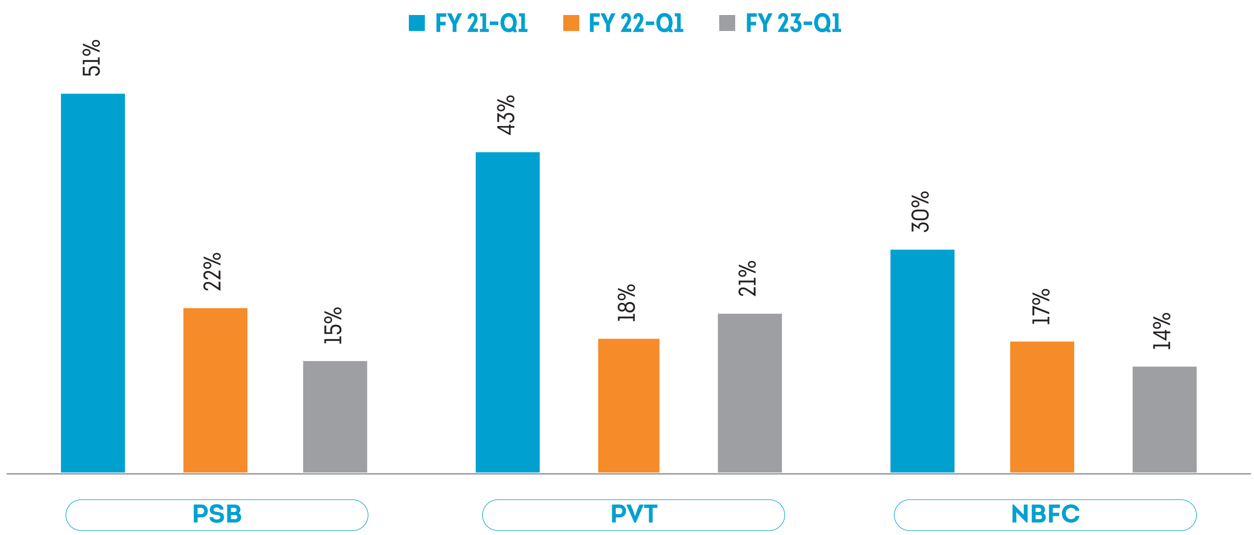
In order to understand the risk appetite of lenders, we looked at approval rates. For computing approval rates, we looked at inquiries and their corresponding originations in the next 90 days.

Approval rates for the low-risk tier (CMR 1-3) remained stable at 22% for PSB, 39% for PVT & 32% for NBFC compared to last year. Approval rates for the medium-risk tier (CMR 4-6) improved; however, for the high-risk tier (CMR 7-10), there was a slight decline compared to last year for PSB and NBFC. In spite of the increasing credit demand, NBFCs have a lower risk appetite and are very cautious in their selection.

Medium Risk Tier (CMR4-6) Approval Rate across Lender Type



High Risk Tier (CMR7-10) Approval Rate across Lender Type



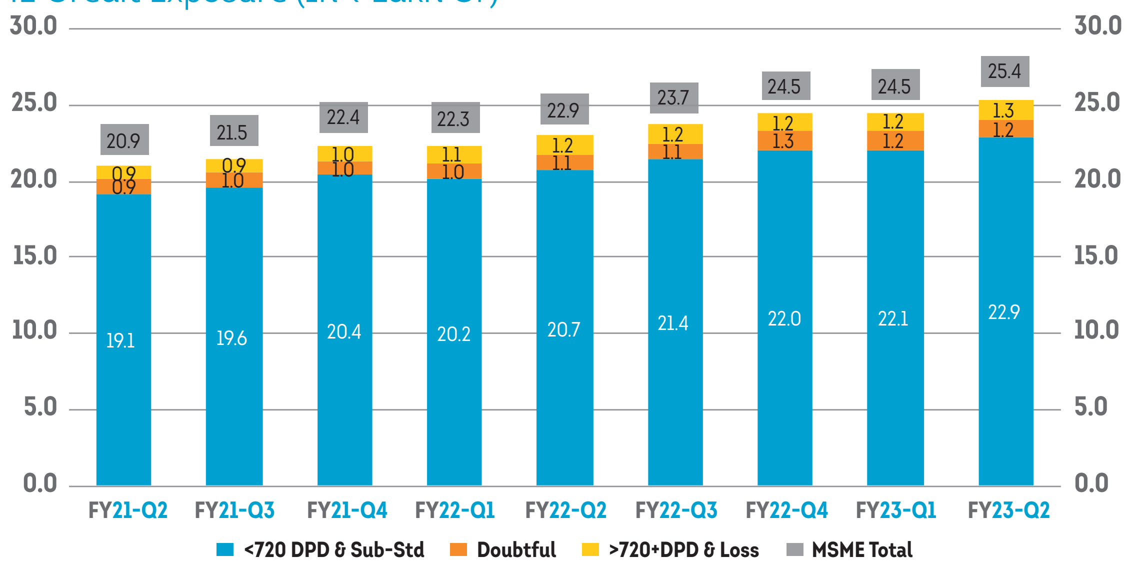
CREDIT GROWTH AND PERFORMANCE

We've been tracking the exposure in MSME segment based on entire outstanding balance till date. But, a portion of this book (~10%) is from legacy accounts with DPD beyond 720 days or reported as loss/doubtful. Thus, the book that will be considered going forward for MSME Pulse stands at ₹ 22.9 Lakh Cr (excluding 1.3 Lakh Cr against 720+ DPD/ Doubtful & 1.2 Lakh Cr against loss) as of FY23-Q2 with YoY growth rate of 10.6%. Including Doubtful/Loss Accounts /Accounts beyond 720 DPD, the value is ₹ 25.3 Lakh Cr.

Total Doubtful/Loss Accounts/Accounts beyond 720 DPD outstanding balance stand at ₹ 2.46 Lakh Cr in FY22. Out of this current total, ₹ 1.79 Lakh Cr (73% of total) was 90+DPD in FY19 also. Thus, these are legacy default cases which do not truly reflect the current outstanding value for the MSME segment.

The book of ₹ 22.9 Lakh Cr is made of ₹ 7.9 Lakh Cr from PSBs, ₹ 10.1 Lakh Cr from PVT, and ₹ 3.1 Lakh Cr from NBFCs, remaining fall under Others. The small segment has the highest proportion in the MSME book at ₹ 9.5 Lakh Cr, and micro and medium at ₹ 5.8 Lakh Cr and ₹ 7.6 Lakh Cr, respectively.
This credit growth is observed across all sub-segments of MSME lending: Balances for micro grew at 13% YoY, whereas the small and medium segments' books grew at 10% and 8%, respectively. Outstanding balances increased YoY by 6%, 18% and 3% for PSBs, PVT Banks and NBFCs, respectively.

MSME Credit Exposure (In ₹ Lakh Cr)

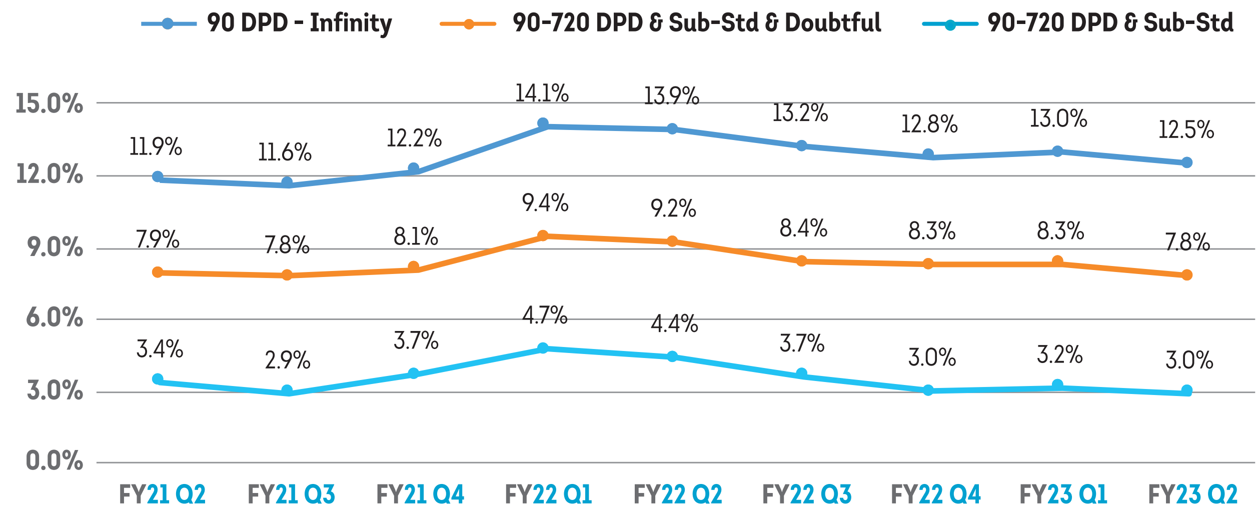


DELINQUENCY RATES

Historically, we've seen NPA rates (90+DPD) of 12.5%, which is very high given the legacy DPD accounts that continue to show MSME as a high-risk business. Considering the book, as per new definition (i.e., excluding Doubtful, Loss and 720+ DPD accounts), the delinquency rates are as low as 3.0% for FY23 Q2.

The delinquency rates were 4.4% same time last year, showing a constant decline thereon.

Delinquency Rates

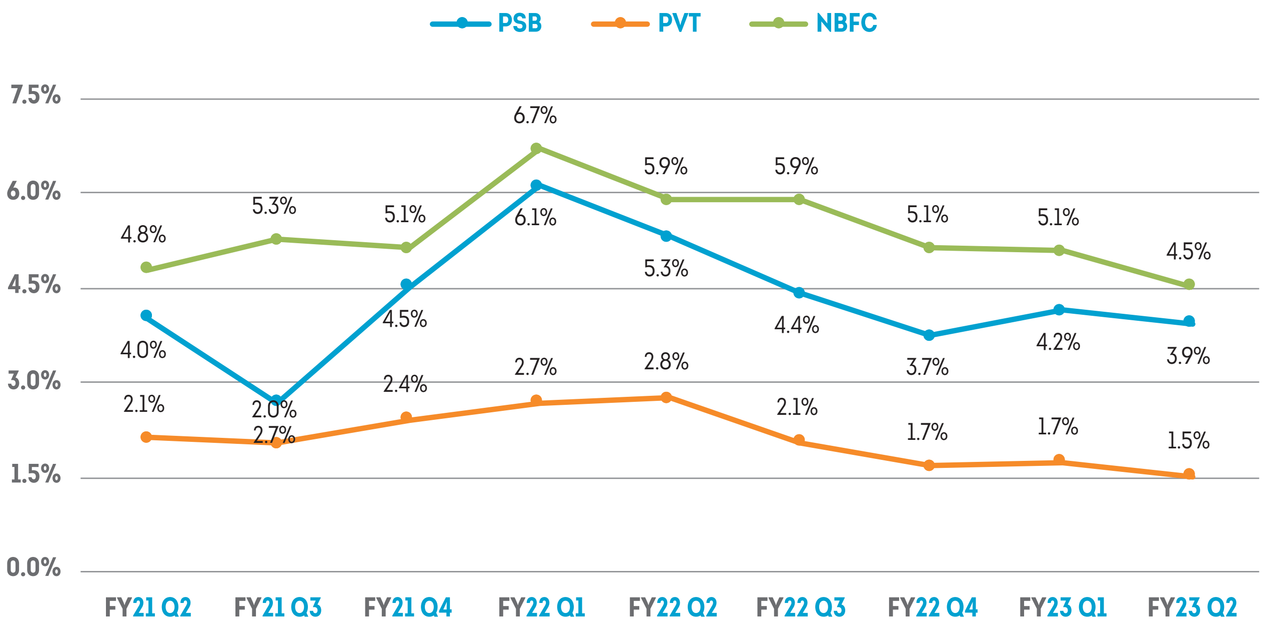


Loss has been excluded from all calculations

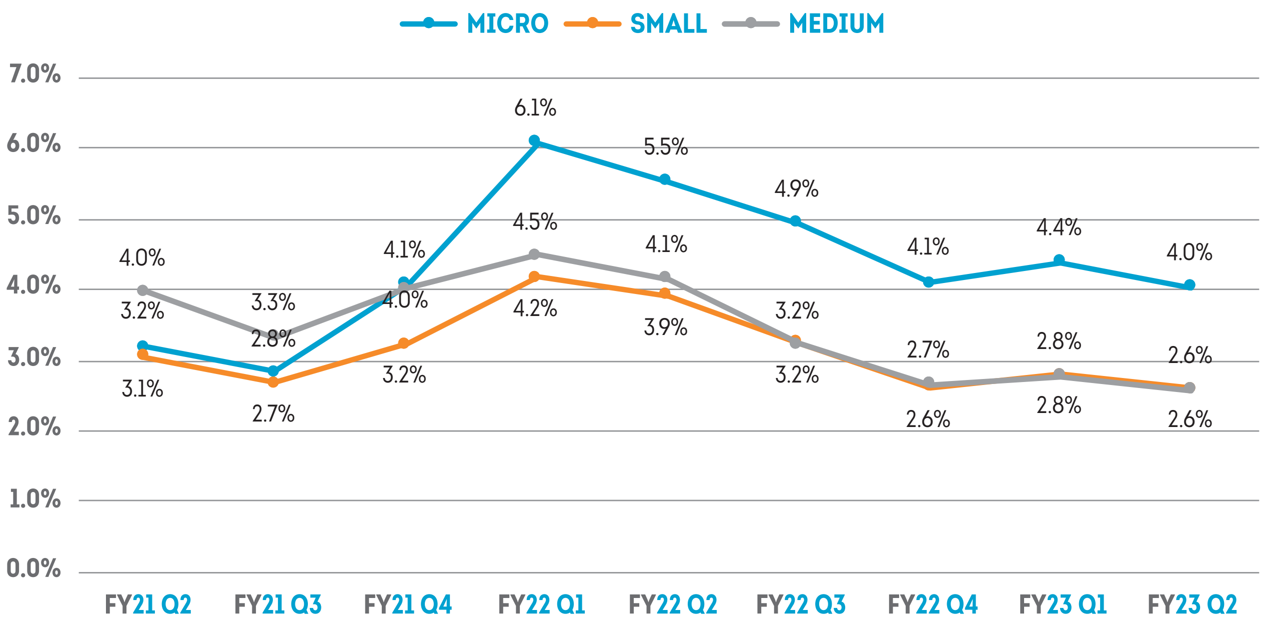
DELINQUENCY RATES BY LENDER-TYPE: 90+ DPD

YoY comparison, the delinquency rates dropped across all the three lender categories – with the maximum drop in PVT segment from 2.8% in FY 22-Q2 to 1.5% in FY 23-Q2.

Delinquency Rate by Lender Type



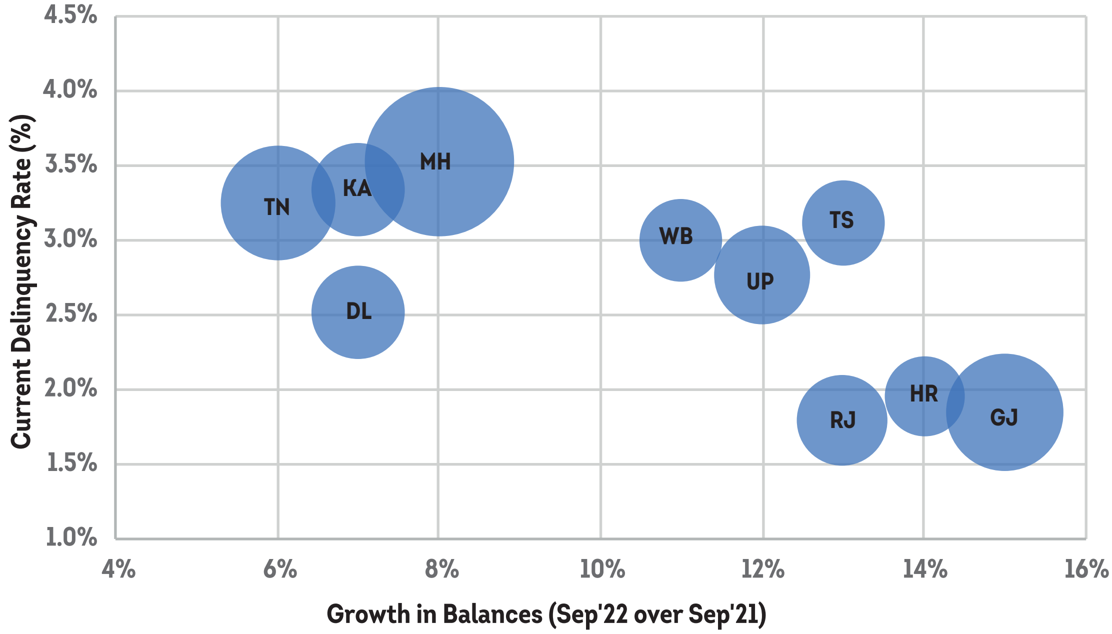
Delinquency Rate by MSME Segment



PORTFOLIO V/S DELINQUENCY COMPARISON

The top 10 states as per current outstanding as of Sep'22 constituted 72% of the MSME book. Out of these, Gujarat saw maximum growth (15%) & Rajasthan lowest current delinquency rate.

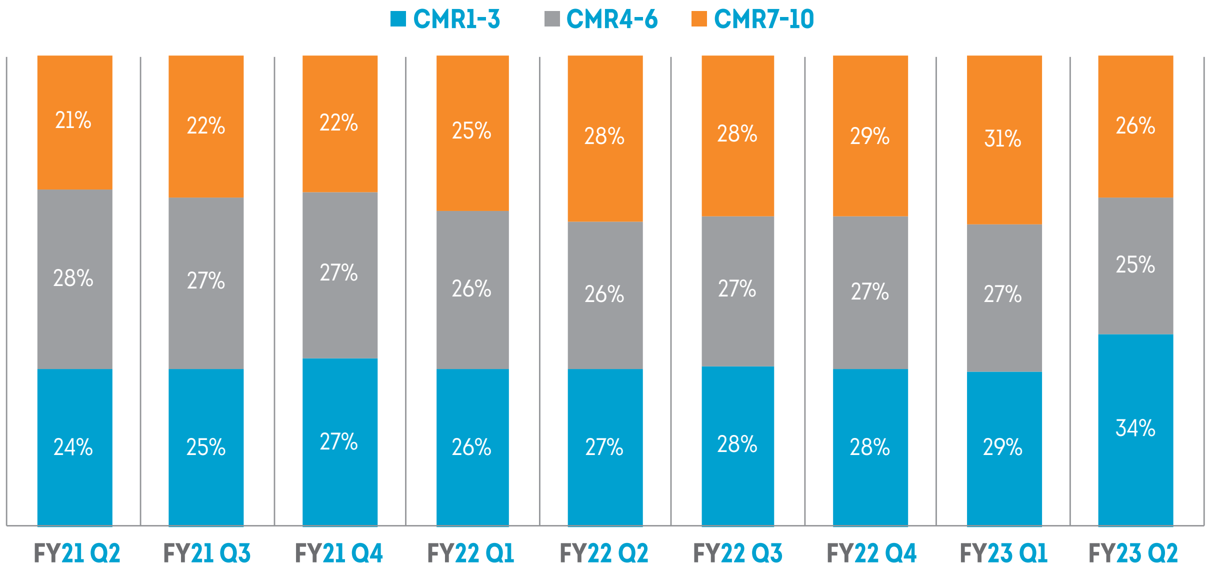
Growth in Portfolio V/S Current Delinquency Rate



DISTRIBUTION OF BORROWERS

Consequently, the proportion of high-risk entities by amount, which was 28% of total live entities as of Sep'21 (FY22-Q2), shrank to 26% in Sep'22, in-turn increasing the proportion of low-risk entities from 27% to 34% for the same time frame.

Borrower Distribution by Portfolio Outstanding



RISK PROFILE

CIBIL MSME rank transition was monitored for borrowers over a one-year period starting Sep-21 to Sep-22, and transition was monitored for rank buckets of low risk: CMR 1-3; medium risk: CMR 4-6; and high risk: CMR 7-10.

It was observed 31% of total borrowers who were in CMR 1-3 in Sep'21 downgraded to lower rank buckets by Sep'22, and 14% of total borrowers who were CMR 4-6 in Sep'21 upgraded to higher rank buckets by Sep'22.

Transition Matrix of CMR from Sep-21 to Sep-22

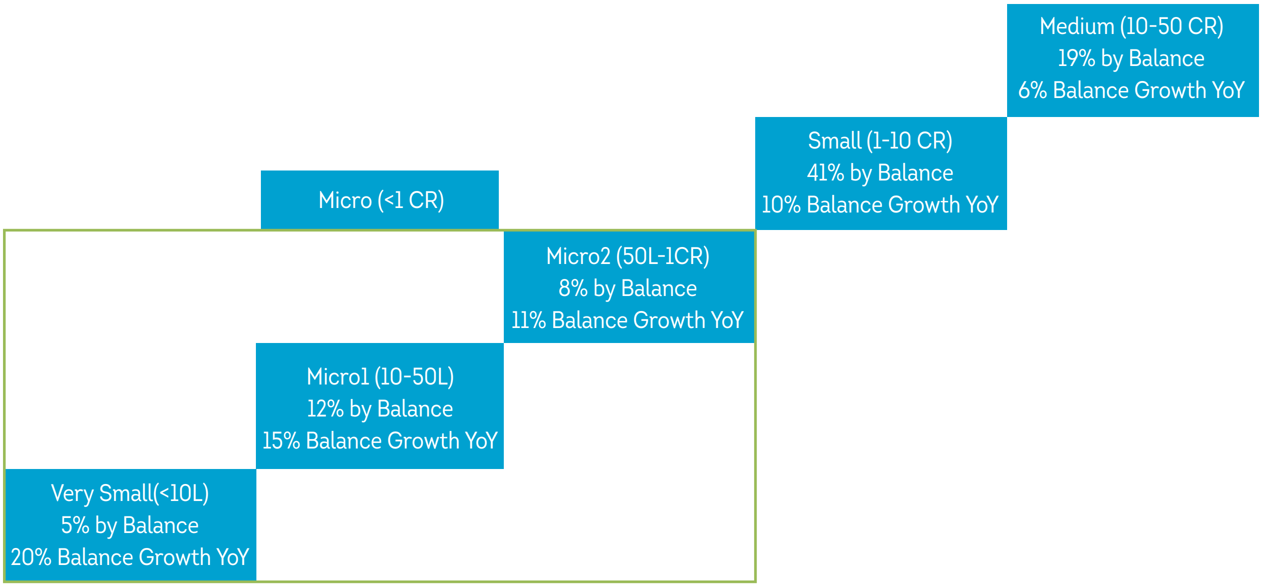
		CMR as of Sep'22			Downgrades	Upgrades	Same
		CMR1-3	CMR4-6	CMR7-10			
CMR as of Sep'21	CMR1-3	69%	25%	6%	31%	0%	69%
	CMR4-6	14%	67%	19%	19%	14%	67%
	CMR7-10	2%	11%	87%	0%	13%	87%

Similar movement was tracked for the portfolio same time last year. The percent of downgrades from Sep-20 to Sep-21 were higher vis-à-vis downgrades from Sep-21 to Sep-22. In CMR 1-3 band, 37% downgrades were seen, and in CMR 4-6 band, 30% downgrades were seen from Sep-20 to Sep-21.

NEXT WAVE OF GROWTH – MICRO SEGMENT

93% of entities are in the micro (Sub ₹ 1 Cr) segment, contributing to 25% of the MSME portfolio with 13% YoY growth rate as of FY23 Q2.

Segment-Wise YoY Growth and Balance Contribution



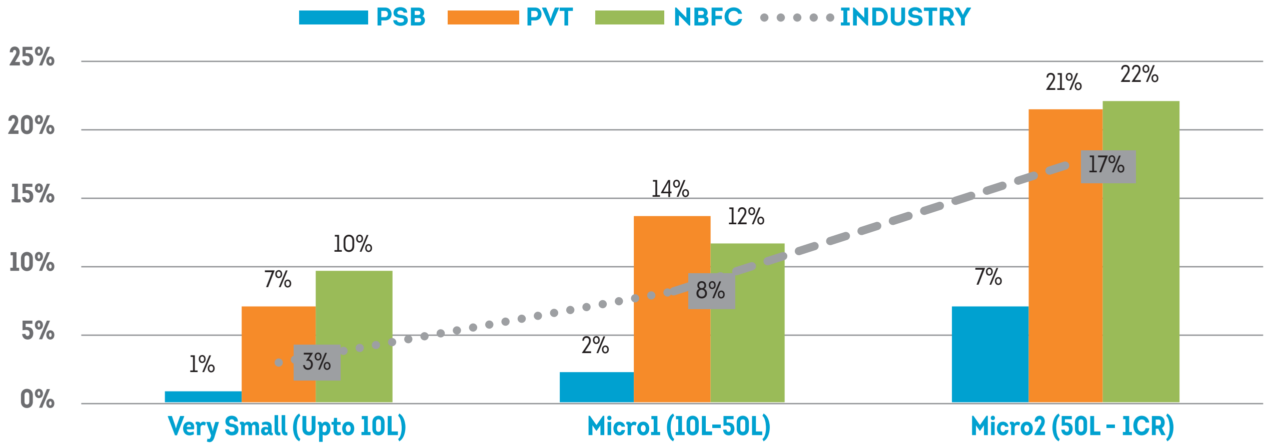
Commercial loans classified on the basis of credit exposure aggregated at entity level,
Micro: exposure up to ₹ 1 Cr Very Small: < ₹ 10 Lakh;
Micro1: Exposure between ₹ 10 Lakh and ₹ 50 Lakh;
Micro2: Exposure between ₹ 50 Lakh and ₹ 1 Cr

Very small, Micro1 and Micro2 experienced balance growth of 20%, 15% and 11% YoY respectively showing sudden spurt in Micro lending, which is not just a post-pandemic bounce back but more due to stronger digital infrastructure.

7% of the originations in the Very small segment for private banks experienced migration to Micro1 & 14% of originations in Micro1 segment migrated to Micro2 segment & 21% of originations in Micro2 migrated to Small segment, within 12 months of origination.

Private banks and NBFCs showed a higher number of entities with growth in balance, which resulted in more entities upgrading to a higher segment after 12 months of origination (e.g., movement from the very small segment to the Micro1 segment over a period of 12 months). This re-affirms the strength of the micro segment – once it gains access to formal credit.

Micro Segment: Upgrades by Lender Category

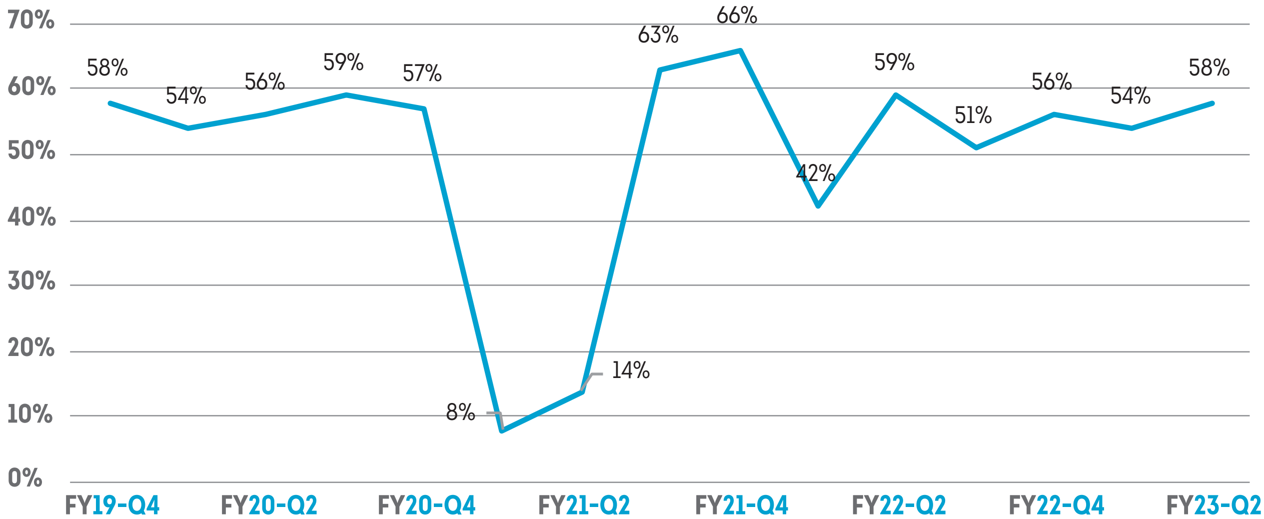


Period : 2021 (Apr-Sep) Originations and growth in balance after 12 months

Upgrade: Moving into next higher segment eg: Very Small to Micro1, Micro1 to Micro2 as so on in 12 months

Looking at the new-to-credit (NTC) segment in the MSME space, NTC as a percentage of new originations across entire MSME stands at 44% in FY23-Q2. For the micro segment, more than 50% of new originations came from NTC borrowers. NTC's percentage bounced back to pre-pandemic levels for micro and is consistently high. While it's evident the credit demand for the micro segment is high, lenders are equally aggressive in onboarding them.

NTC as a Percentage of New Originations in Micro

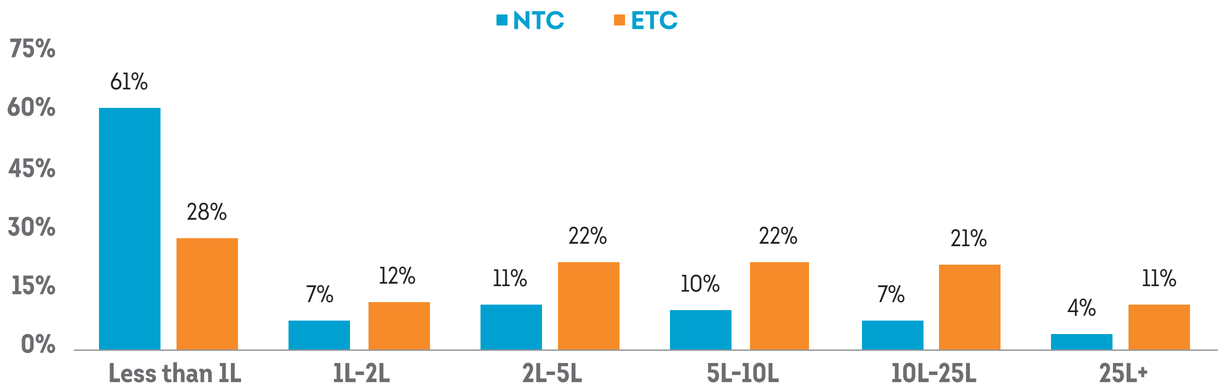


MICRO SEGMENT: NTC V/S ETC

We took a deep-dive on various characteristics of NTC/ETC segments. ETC segment comprises borrowers with established credit history. For this exercise, originations between Oct'20 and Mar'21 were considered. For ETC, only those borrowers with previous history of at least two years have been taken, and has been sampled as per CMR rank and sub-segment within micro for like-to-like comparison with NTC.

The NTC segment has a higher proportion of lower-ticket size borrowers compared to ETC; 61% NTC borrowers have initial ticket size of < ₹ 1L.

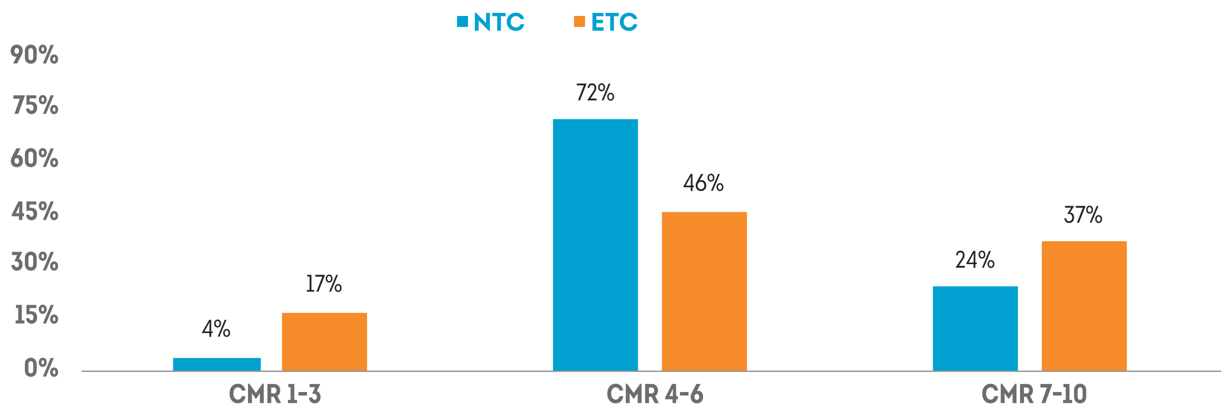
NTC v/s ETC Distribution as per Ticket Size



Originations considered between Oct'20 - Mar'21
ETC Borrowers with minimum two years history as of Mar'21 have been considered

ETC and NTC have different risk profiles. The first CMR generated for NTC is in the medium risk range (CMR 4-6) for most borrowers (~72%), whereas 46% of borrowers with established histories are in the medium range.

NTC v/s ETC Distribution as per CMR

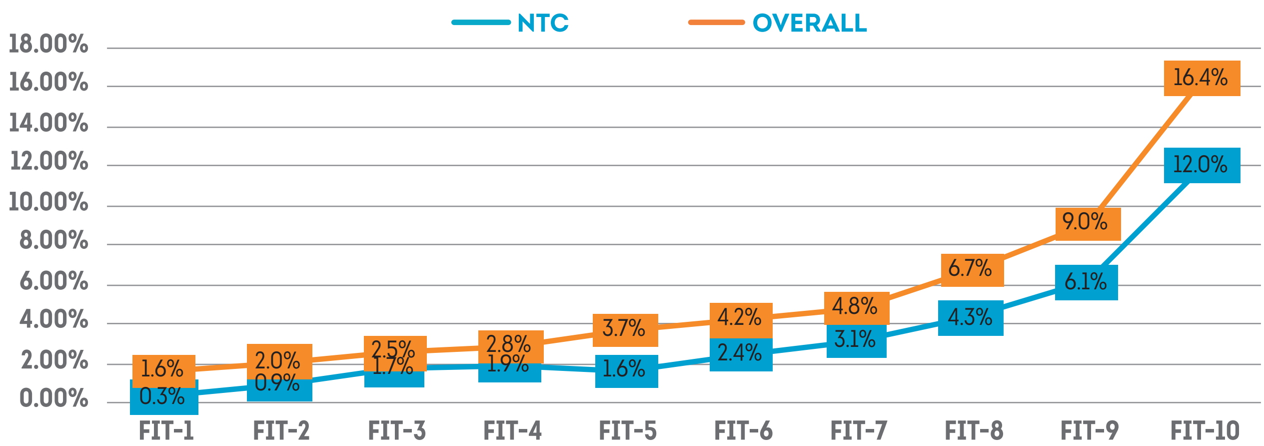


Given the differences in profiles of NTC and ETC customers, there's a growing need for alternative data sources to be considered for effective underwriting NTC in this space. Micro inclusion in formal credit is critical for economic growth and onboarding new entities helps them build long term credit history.

FIT RANK is a credit default predictor model which leverages the power of goods and services tax (GST), bank statements and income tax returns (ITR); information that provides a ranking model for MSME lending. The ranking model uses machine learning algorithms to predict the probability of an MSME becoming a non-performing asset (NPA) in the next 12 months. Fit Rank scores range between 1 and 10: 1 being the least risky segment.

FIT RANK triangulates information from multiple sources to provide a unified view of financial, income and trade data for an MSME, enabling improved risk differentiation and sharpened credit underwriting for MSME loans. Thus, this can prove to be a great tool to consider enriched information for the NTC segment – adding to its growth and inclusivity.

FIT Rank – Probability of Default



Performance of CMR v/s Fit Rank showed risk-split even better, these capabilities are further explored. Bad rates for CMR 1-3 stand at 2.2%, but even within that population, we saw pockets with bad rates as low as 1.1% (FIT 1-3) and as high as 6.3% (FIT9-10).

FIT Rank – Cross Tab with CMR

Bad Rates		CIBIL MSME Rank				
		Low (CMR 1-3)	Medium (CMR 4-6)	High (CMR 7-10)	New to Credit	Overall
FIT Rank	Low (FIT 1-3)	1.1%	1.7%	12.1%	1.5%	2.1%
	Medium (FIT 4-8)	2.1%	3.8%	16.4%	3.2%	4.4%
	High (FIT 9-10)	6.3%	9.3%	27.8%	11.1%	12.7%
	Overall	2.2%	4.7%	19.8%	4.0%	5.4%

EARLY WARNING SIGNALS OF RISK

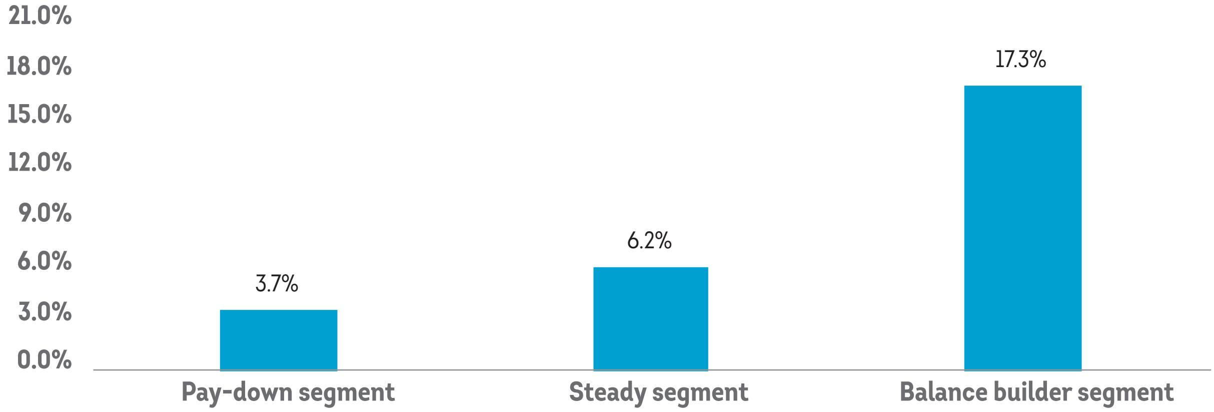
With MSME lending moving towards being granular and replicating platform based consumer lending landscape, innovative solutions are required to track the performance of an underwritten entity. Reacting to an account currently in the DPD bucket may be a delayed reaction as there are other indicators that could signal potential default in the near future. Therefore, early warning signals (EWS) become an inseparable part of a credit risk management plan, allowing lenders to take preventative actions.

CreditVision® trended algorithms and attributes can be used to identify 'early warning signs' of an entity and hence mitigate risk if timely action is taken. Defaults in recent past and continuous build-up of credit in a short period of time are also significant indicators of default in the near future.

The MSME portfolio as of Sep'21 (0 DPD) was considered for analysis, with performance in the next 12 months (Ever 90 DPD) measured across CreditVision trended algorithms.

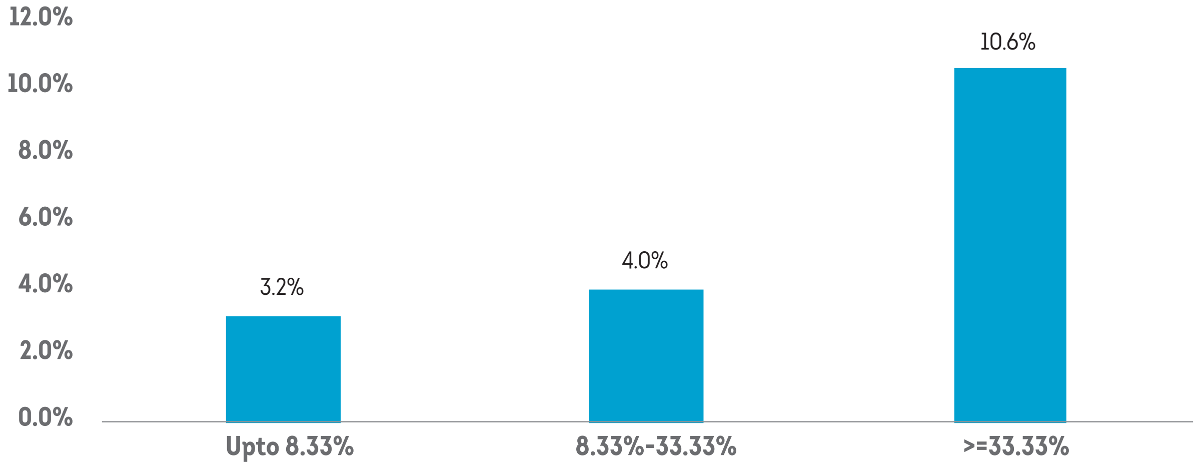
Borrowers who have been consistently building up credit in the last 24 months exhibited the highest bad rates, signifying this category of balance builders can be potential defaulters in the next 12 months.

12M Ever 90: Balance build-up (Last 24 months)



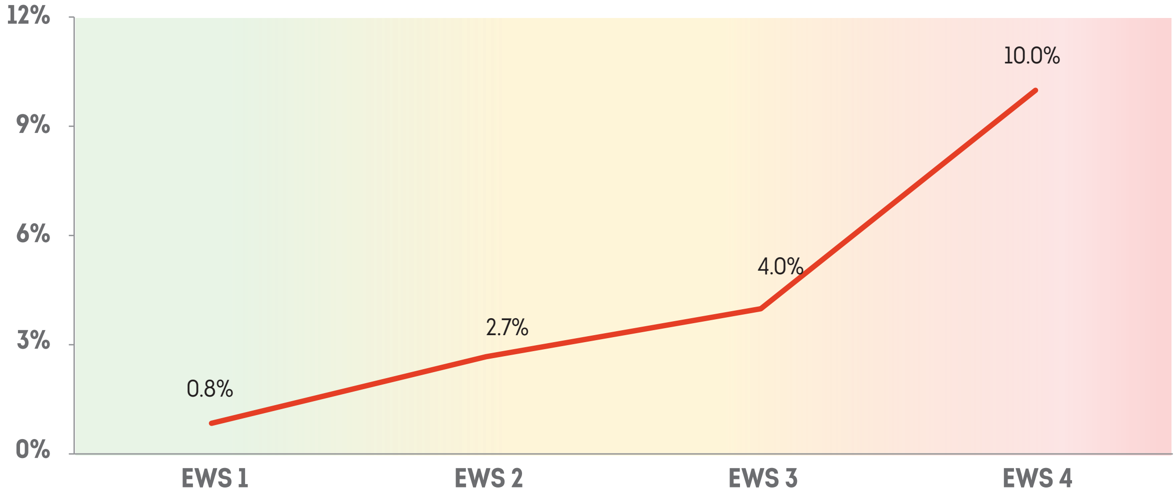
Even with current delinquency (month of analysis) being 0 DPD, a higher number of missed payments in the last 12 months showed higher default rates.

12M Ever 90: Missed Payment Ratio (Last 12 months)



We looked at the combination of the above and additional indicators that help identify possible NPA cases even before they actually start defaulting. The below segmentation is an example of how some of these metrics can be combined and used to predict risk. Early warning signal buckets have been created to categorize potential cases of default ranging from one to four (lower bands indicate lower risk).
Of the base under EWS4, 10% went 90+ in 12 months since Sep'21.

Ever 90 in the next 12 months as per EWS Bucket



Borrower Base: MSME Book with CMR1-6 and 0 DPD as of Sep'21(T0) Performance: 90+ in 12 months from T0

Performance of CMR v/s EWS showed even within the risk-splitting, capabilities are further explored. Bad rates for CMR 1-3 stand at 2.1%, but even within that population, we saw pockets with bad rates as low as 0.8% (EWS1) and as high as 4.0% (EWS4).

Additional Risk Differentiation over CIBIL MSME Rank

Population Distribution		CMR Score Band			Performance (Ever 90 in next 12 months)		CMR Score Band		
		CMR1-3	CMR4-6	Overall			CMR1-3	CMR4-6	Overall
EWS TIERS	EWS1	4.2%	4%	8.3%	EWS TIERS	EWS1	0.8%	0.9%	0.8%
	EWS2	10.4%	16.7%	27.2%		EWS2	1.8%	3.3%	2.7%
	EWS3	7.0%	24.2%	31.2%		EWS3	2.4%	4.5%	4.0%
	EWS4	4.0%	29.4%	33.3%		EWS4	4.0%	10.9%	10.0%
	Overall	25.6%	74.4%	100.0%		Overall	2.1%	6.5%	5.4%

TransUnion CIBIL

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