INTERNATIONAL JOURNAL OF NOVEL RESEARCH AND DEVELOPMENT (IJNRD)
© 2026 IJNRD | Volume 11, Issue 7, July 2026 | ISSN: 2456-4184 | IJNRD.ORG

ASSESSING THE FLOW OF COMMERCIAL BANK CREDIT TO MSMES IN INDIA: AN ANALYSIS

Dr. Kavitha Vani SD*
*Associate Professor
L.B.S. Government First Grade College
R.T. Nagar, Bengaluru 560032

Abstract

Financial support to micro and small enterprises has peen a part of social banking priorities since 1960 and it has been identified as a priority sector lending by National Credit Council. Despite continuous policy support and various government initiatives, the existing literature consistently highlights that MSMEs continue to face significant challenges in accessing timely and adequate bank credit. Consequently, a persistent credit gap has existed over the years, limiting the growth and competitiveness of the sector and underscoring the need for more effective financial inclusion measures. In this context, the study aims to analyze the trends and growth of commercial bank credit to MSMEs, and assess the impact of MSME credit on NPA.
The study is based on secondary data to examine the flow of commercial bank credit to the MSME sector and to analyze the relationship between MSME credit and Non-Performing Assets (NPAs). Data were analyzed using Microsoft Excel, employing percentage analysis, correlation analysis, and tests of statistical significance. Graphs and tables were used for effective presentation and interpretation of the data. The findings provide insights into the trend of commercial bank credit, the level of NPAs, and the impact of bank credit on the MSME sector.

Keywords: Commercial Banks, MSME, NPA, Finance Gap, Large enterprises

Introduction

The Micro, Small, and Medium Enterprises sector remains a cornerstone of India's economic growth plying a vital role in fostering innovation, employment generation, and exports. Often referred to as the backbone of the Nation's manufacturing and industrial eco-system. The share of MSMEs in the country's Gross Value Added increasing from 27.3% in financial year 2020-21 to 29.6% in financial year 2021-22 and 30.1 in financial year 2022-23 highlights its growing role in national economy. Exports from MSMEs have seen substantial growth, raising from ₹ 3.95 lakh crore in financial year 2020-21 to ₹ 12.39 lakh in the financial year 2024-25 (SIDBI). MSMEs in India contribute 30% to business value added and 62% to employment and play a significant role in manufacturing and trade (McKinsey). Recognizing their vital role in fostering inclusive and sustainable economic growth, ensuring an adequate and uninterrupted flow of institutional credit to the MSME sector has become a key priority for the government and financial institutions. Commercial banks, in particular, serve as the primary source of external finance for MSMEs, enabling them to meet their working capital requirements, invest in technology, expand production capacity, and enhance their competitiveness.

Despite several policy initiatives and priority sector lending provisions introduced by the Government and regulatory authorities, access to timely and adequate bank credit continues to remain a major challenge for MSMEs. Many enterprises encounter difficulties in obtaining formal finance due to factors such as inadequate collateral, limited credit history, information asymmetry, high transaction costs, weak financial records, and stringent lending procedures adopted by banks. These constraints are more pronounced for micro and small enterprises, which often lack the financial strength and documentation required to satisfy conventional lending norms.

As a result, a persistent credit gap exists between the financing needs of MSMEs and the amount of credit actually made available by formal financial institutions. Deloitte reports an estimated credit gap at around ₹

25 lakh crore as of March 2025. Deloitte added that unmet credit requirement could potentially be much larger. This financing gap restricts the growth potential of MSMEs, limits their ability to adopt new technologies, reduces productivity, and adversely affects their contribution to employment and economic development. Therefore, assessing the flow of commercial bank credit to MSMEs and identifying the extent of the credit gap are essential for evaluating the effectiveness of existing financial policies and for formulating strategies to improve credit accessibility and strengthen the MSME sector in India.

Review of literature

Access to finance is widely recognized as a critical factor in promoting entrepreneurship development and economic growth. For Micro, Small, and Medium Enterprises (MSMEs), timely and adequate access to finance is essential for survival, expansion, and long-term sustainability. Rajamani et al. (2022) observed that firm-specific characteristics, sources of finance, and the life-cycle stage of an MSME significantly influence its access to finance. Their study further revealed that financial obstacles adversely affect enterprise growth and, consequently, economic development. Despite the substantial contribution of MSMEs to employment generation, manufacturing output, and exports, the growth of institutional finance to the sector remains inadequate. Yadav (2012) argued that the low share of bank credit to MSMEs hampers inclusive economic growth and restricts banks from fulfilling their social responsibility toward financial inclusion. The exclusion of a large proportion of MSME units from formal finance continues to be a major concern, highlighting the need for greater banking sector focus on this segment. The challenge of accessing finance is not confined to India alone. Ayyagari et al. (2017), based on evidence from 135 countries, found that access to finance remains a severe obstacle for small firms, particularly in developing economies. Their findings indicate a significant credit gap, with small firms utilizing substantially less formal credit compared to larger enterprises. This suggests that financing constraints continue to be a universal challenge for MSMEs.

In the Indian context, MSMEs continue to face financial difficulties despite numerous policy initiatives introduced by the Government and the Reserve Bank of India. Mund (2020) noted that obtaining timely and adequate finance remains one of the major challenges confronting the sector. The study emphasized the importance of financial inclusion initiatives and financial management support services in enhancing the financial capability and sustainability of MSMEs. Nair and Das (2019) highlighted concerns regarding the ability of large universal banks to effectively channel financial resources to small enterprises. Drawing lessons from countries such as China, Malaysia, and members of the European Union, they warned that inadequate access to finance and rising operational costs could weaken the competitive position of MSMEs. Their findings underscore the importance of developing financing mechanisms tailored to the needs of small enterprises.

Awareness and utilization of credit enhancement schemes among MSMEs also remain limited. Tiwari (2024) reported a significant gap in understanding these schemes, coupled with stringent eligibility requirements such as turnover thresholds, profitability records, and documentation requirements. The study further noted that private sector banks are increasingly emerging as alternative sources of short-term finance, while MSME financing continues to be affected by both credit supply and demand-side constraints.

The significance of MSMEs extends beyond India. Yoshino et al. (2018) observed that SMEs account for over 96 percent of businesses across Asia and generate a substantial share of private-sector employment. However, access to affordable finance remains a major challenge. Since most Asian economies are bank-dominated, capital market financing is often inaccessible to MSMEs. Banks tend to prefer lending to larger firms due to lower perceived risks, thereby limiting credit availability to smaller enterprises.

Recent developments in the financial sector have introduced alternative financing channels. McGeown (2025) found that the contraction in bank lending following the global financial crisis created opportunities for non-bank lenders. Non-bank finance has emerged as an important source of funding for firms that are rejected, discouraged, or underserved by traditional banks, particularly young enterprises. The study suggests that partnerships between banks and non-bank lenders could provide complementary financing solutions throughout the business life cycle. The issue of access to finance also exhibits demographic and geographical variations. Mallick et al. (2026) observed that rural female entrepreneurs often enjoy better access to finance than their urban counterparts due to government support, self-help groups, and non-institutional lending arrangements. Their findings indicate that access to finance is shaped by the interaction between formal and informal financial institutions and varies across regions. Information asymmetry remains another significant barrier to MSME financing. Swaminathan (2024) pointed out that inadequate financial records, weak credit histories, and limited availability of reliable information contribute to a substantial gap between credit demand and formal credit supply. These challenges continue to impede MSMEs from securing timely and adequate institutional finance.

Similarly, Mittal (2025) emphasized that access to timely and sufficient credit remains one of the most pressing challenges for MSMEs despite extensive policy interventions. The study found that reliance on informal borrowing sources among SME enterprises is relatively low, suggesting a preference for formal financing channels. However, the persistence of financing constraints indicates the need for more targeted and sector-specific policy measures to address the diverse financial requirements of MSMEs.

Overall, the literature consistently highlights that while MSMEs play a vital role in economic development, employment generation, and industrial growth, access to adequate finance remains a persistent challenge. Existing studies identify credit gaps, information asymmetry, institutional barriers, and policy implementation issues as key obstacles to MSME financing. These findings underscore the importance of examining the flow of commercial bank credit to MSMEs and assessing whether the banking sector has been successful in meeting the financing requirements of this strategically important sector.

Research Gap

The existing literature extensively highlights the importance of access to finance for MSME growth and economic development. Several studies have examined factors influencing MSME financing, such as firm characteristics, financial obstacles, information asymmetry, credit enhancement schemes, financial inclusion initiatives, and the role of formal and informal sources of finance. While these studies have identified persistent challenges in MSME credit accessibility, a significant financing gap continues to exist despite numerous policy interventions by the Government of India and the Reserve Bank of India.

Most of the previous studies have focused on determinants of access to finance, financing constraints, financial inclusion, and alternative financing sources. However, there is limited empirical evidence assessing the actual flow and growth trend of commercial bank credit to MSMEs over a sustained period and whether such credit flow has improved in proportion to the sector's contribution to GDP, employment, exports, and industrial output. Furthermore, few studies have comprehensively examined the relationship between commercial bank credit to MSMEs and key banking indicators such as Non-Performing Assets (NPAs), sectoral credit distribution, and the effectiveness of policy measures in bridging the credit gap**.**

Statement of the problem

The Micro, Small and Medium Enterprise plays a crucial role in Indian economy by contributing significantly to employment generation, industrial production, exports and
overall economic growth. Despite of their importance, lack of adequate and timely access to finance continues to remain the biggest challenge for the sector and has constrained its growth (IFC). The persistence of this issue raises an important question whether the disbursement of credit by commercial banks has improved over the time and whether the MSME sectors growing financial needs are being adequately met. In this context, the study aims to analyze the trends and growth of commercial bank credit to MSMEs, and assess the impact of MSME credit on NPA**.**

Need for the study

The Micro, Small, and Medium Enterprises sector remains a cornerstone of Indian Economic growth, playing a vital role in fostering innovation, employment generation, and exports (SIDBI). It is often referred to as the backbone of the nation's manufacturing and industrial ecosystem. An adequate and timely finance is essential for the establishment, expansion, and competitiveness of MSMEs, and commercial banks are the primary source of institutional credit. However, the sector continues to face a persistent credit gap despite numerous policy interventions. An estimate of World Bank shows approximately 70% of MSMEs in the emerging markets lack access to credit and a study on bank credit the micro and small enterprises find a downward movement throughout the study period from 2007 to 2017, In view of continuing finance gap identified by the several studies conducted over the years, there is need to examine the flow of commercial bank credit to this sector. The study is necessary to understand whether the credit flow has improved overtime and evaluate the growth and trends in commercial bank credit to MSME sector.

Hypothesis

H0: There no significant relationship between MSME credit and NPA

H1: There is a significant relationship between MSME credit and NPA

Objectives

- To understand the evolving landscape of MSME financing in India.
- To analyze the credit flow from commercial banks to MSMEs.
- To analyze the trend and percentage of NPA in Commercial bank credit extended to MSMEs and Large industries.
- To examine the relationship between MSME credit and Non-Performing Assets

Research Methodology

The present study adopts a descriptive and analytical research design to examine and assess the flow of commercial bank credit to Micro, Small, and Medium Enterprises (MSMEs) in India. The descriptive approach is employed to analyze the trends and patterns of credit flow, while the analytical approach facilitates an evaluation of the adequacy, growth, and significance of bank credit in supporting the MSME sector.

Data Source

The present study relies exclusively on secondary data. The required information has been gathered from authentic sources such as reports and publications of the Reserve Bank of India (RBI), commercial banks, the Ministry of Micro, Small and Medium Enterprises (MSME), the Small Industries Development Bank of India (SIDBI), the International Finance Corporation (IFC), Economic Surveys, McKinsey reports, and peer-reviewed journals. These sources have been utilized to examine and assess the flow of commercial bank credit to MSMEs in India.

Data Analysis

The study covers data from the period 2018 to 2025 to examine the trends, and pattern of credit flow from commercial banks to the MSME sector. Various statistical tools such as percentage analysis, growth rate analysis, trend analysis, ration analysis and correlation analysis are employed to evaluate the flow of MSME credit and its relationship with variables such as GDP and non-performing assets.

Limitations of the study

- The analysis is based entirely on secondary data collected from published reports, official publications, and other documented sources. Consequently, the findings and conclusions are dependent on the accuracy and reliability of the available secondary data.
- The study covers a limited period from 2017–18 to 2024–25, and therefore may not capture long-term trends in MSME financing beyond this timeframe.
- The scope of the study is confined to credit extended by commercial banks to the MSME sector in India. Credit provided by other financial institutions, such as cooperative banks, regional rural banks, non-banking financial companies (NBFCs), fintech lenders, and other alternative financing sources, has not been considered.

Evolving landscape of MSME financing in India

The provision of financial support to Micro and Small Enterprises (MSEs) has been an integral component of India's social banking framework since the 1960s. Recognizing the significant role of small-scale industries in economic development and employment generation, the National Credit Council identified Small-Scale Industries (SSIs) as a priority sector for bank lending, alongside agriculture. However, with the advent of economic liberalization in the early 1990s, banking sector priorities were redefined to align with the objectives of creating a more efficient, competitive, and profit-oriented financial system (Nair and Das, 2019).

The MSMED Act, 2006 was enacted to provide enabling policy environment for promotion and development of the sector by way of defining MSMEs putting in place a framework for developing and enhancing competitiveness of the MSME ensuring flow of credit to the sector.

MSMEs often face difficulties in obtaining institutional credit due to information asymmetry, inadequate collateral, lack of financial records, and higher perceived risk. As a result, many enterprises continue to relay on informal source of finance, which are often expensive and insufficient for business operations. Recognizing the critical role of MSMEs in economic development, the Government of India and the banking system have introduced several policy measures over years to improve credit accessibility and bridge the finance gap.

Initiatives to address the finance gap

Credit Guarantee Schemes

- **CGTMSE:** Credit Guarantee Fund Trust for Micro and Small Enterprises is introduced to address collateral constraints faced by micro and small enterprises. This scheme provides collateral free loan up to 10 crores for eligible micro and small enterprises. The trust has approved a cumulative guarantee coverage of ₹ 9.34 lakh crore as on 31-03-2025 to eligible MSEs.
- **MCGS-**MSME: Mutual Credit Guarantee Scheme for MSMEs provides for 60% guarantee coverage by National Credit Guarantee Trustee Company Limited to member lending institutions for collateral free term loan assistance up to ₹ 100 crore to eligible MSMEs for purchase of machinery/equipment.
- **PMMY**: Pradhan Mantri Mudra Yojana provides loan up to ₹ 20 lakh backing of a credit guarantee provided by Credit Guarantee Fund for Micro Units.
- **CGSS**: Credit Guarantee Scheme for Start-ups provides for guarantee against the credit instruments extended by Member Institutions. During the Union Budget 2025-26, the guarantee covered under CGSS increased from ₹ 10 crore to ₹ 20 crore.
- **SUPI:** Stand Up India scheme facilitates bank credit to women in SC/ST entrepreneurs in setting up greenfield enterprises. The total outstanding amount outstanding in the scheme as at the end of December 2024 was ₹ 57466 crore.
- **PMEG:** Prime Minister Employment Generation Programme provides credit linked subsidy for setting up micro enterprises, and has supported 89,118 enterprises by disbursing ₹ 3093.87 crore during 2023-24

Standup India: The scheme facilitates bank credit to women and SC/ST entrepreneurs in setting up green field enterprises, the total loan outstanding in the scheme was ₹ 57,466 crore.

New Scoring Model: New Credit Assessment Model for micro and small enterprises announced in Union Budget, July 2024. The credit assessment will be based on the digital footprints and verifiable data available in the eco system to appraise the MSME loan application.

Union Budget 2025-26: In order to foster the sectors growth, key announcements such as revised classification of criteria to benefit larger MSMEs, credit card for micro enterprises, enhanced credit guarantee, schemes for first time enterprises, Deep Tec Fund to Funds, Private R&D investment and more to address the credit gap, promote entrepreneurship and enhance the overall performance MSMEs.

Result and Discussions

Credit Flow from Commercial Banks to MSMEs

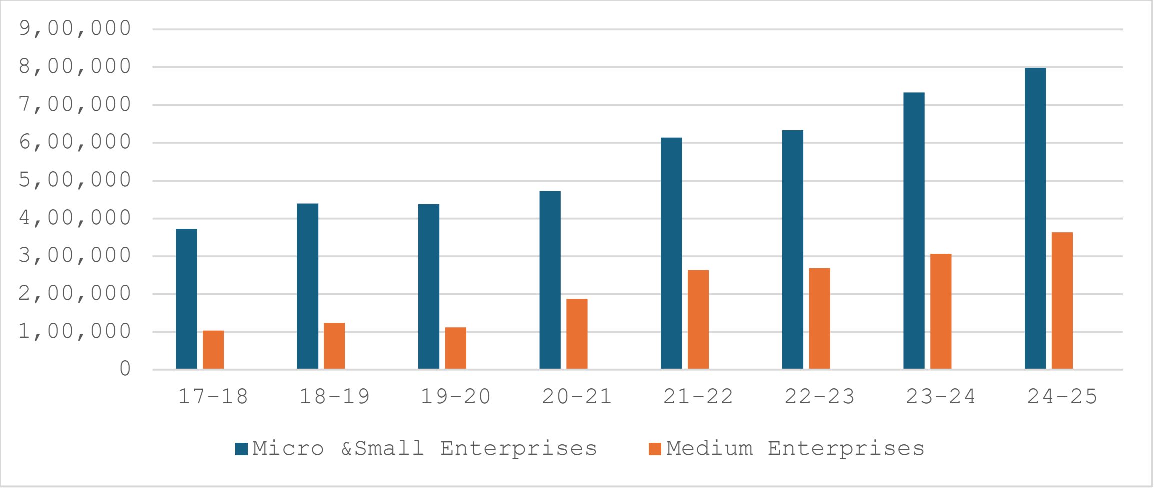
Table 1: Table showing flow of credit to Micro, Small and Medium Enterprises

(₹ in crore)

Year	Micro &Small Enterprises	Medium Enterprises
17-18	3,73,000	1,03,700
18-19	4,39,811	1,23,843
19-20	4,37,658	1,12,367
20-21	4,72,529	1,87,599
21-22	6,14,037	2,63,959
22-23	6,33,289	2,68,286
23-24	7,33,123	3,06,425
24-25	7,98,473	3,63,245

Source: www.rbi.org.in

Chart 1: Chart showing flow of credit to Micro, Small and Medium Enterprises



Source: Table 1

The flow of credit to Micro & Small, and medium industries in the above table and chart indicates a steady increase in credit disbursed by commercial banks during the study period. Credit to MSEs increased from ₹ 3,73,000 crore to ₹ 7,98,743 crore, while credit to medium enterprises rose from ₹ 1,03,700 crore to ₹ 3,63,245.

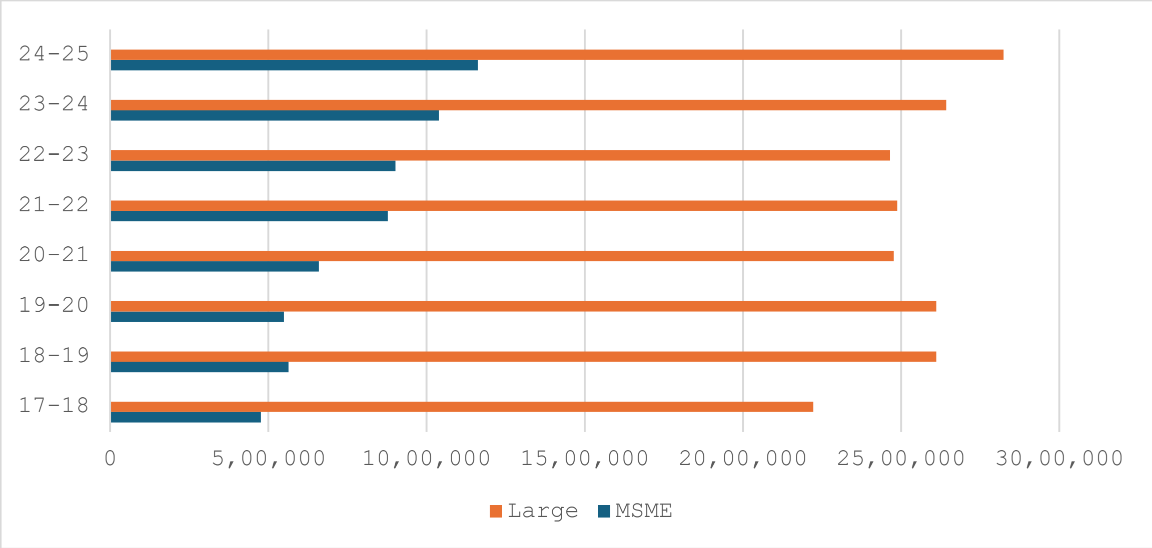
Table 2: Table showing the flow of commercial bank credit to MSMEs and Large Industries

(₹ in crore)

Year	MSME	Large
17-18	4,76,700	22,22,600
18-19	5,63,654	26,11,567
19-20	5,50,025	26,11,377
20-21	6,60,128	24,76,702
21-22	8,77,996	24,88,228
22-23	9,01,575	24,64,831
23-24	10,39,548	26,42,844
24-25	11,61,718	28,23,942

Source: rbi.org.in

Chart 2: Chart showing the flow of commercial bank credit to MSMEs and Large Enterprises



Source: Table 2

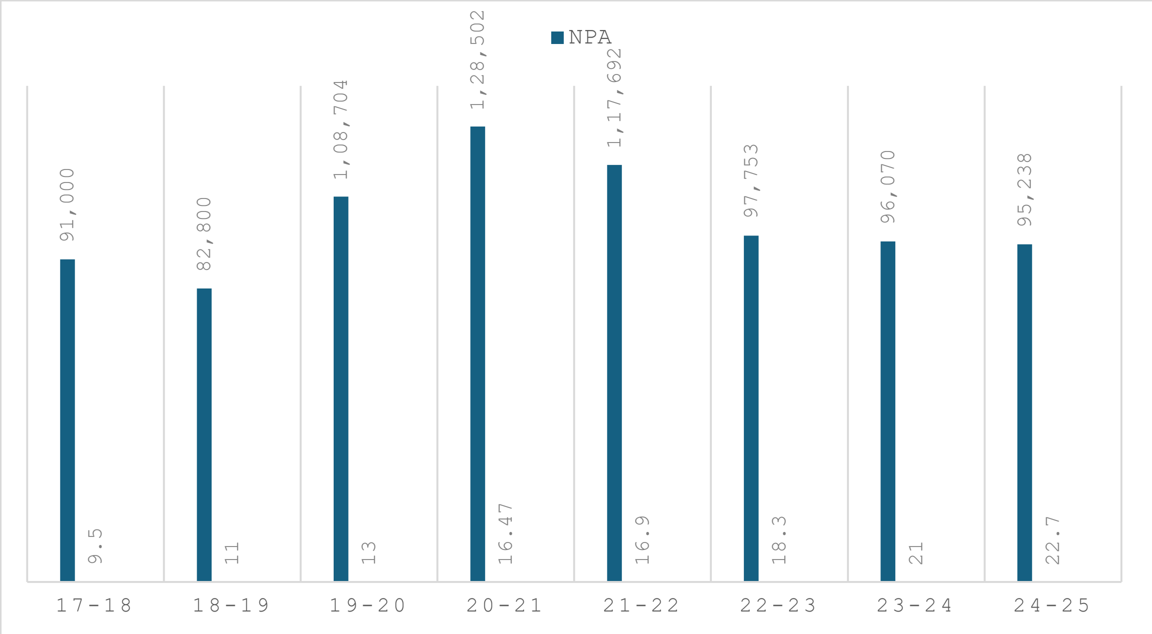
A comparative analysis of credit flow to MSMEs and Large enterprises indicates that commercial bank credit to MSMEs has grown consistently over the assessment period increasing from ₹ 4,76,700 crore in 2017-18 to ₹ 11,61,718 crore in 2024-25 representing an overall growth of approximately 144%. The credit to large enterprises remained relatively stable throughout the assessment period.

Table 3: Table showing the amount and percentage of NPA

Year	NPA (₹ in crore)	%
17-18	91,000	9.5
18-19	82,800	11
19-20	1,08,704	13
20-21	1,28,502	16.47
21-22	1,17,692	16.9
22-23	97,753	18.3
23-24	96,070	21.0
24-25	95,238	22.7

Source: rbi.org.in

Chart 3: Chart showing the amount and percentage of NPA



Source: Table 3

The data reveal the amount of MSME NPAs fluctuated over the assessment period, where the amount of NPA declined from ₹ 91,000 crore in 2017-2018 to -82,800 crore in 2018-19. However, NPAs increased sharply in 2020-21 and gradually declined falling to ₹95,238 crore by 2024-25. The percentage of NPA exhibited a continuous upward trend from 9.5% in 2017-18 to 22.7%.

Table 4: Table showing the amount of MSME credit and NPA

Years	credit to MSME	NPA
18-19	5,63,654	82,800
19-20	5,50,025	1,08,704
20-21	6,60,128	1,28,502
21-22	8,77,996	1,17,692
22-23	9,01,575	97,753
23-24	10,39,548	96,070
24-25	11,61,718	95,238

Source: rbi.org.in

Correlation

	Credit to MSME	NPA
Credit to MSME	1	
NPA	-0.190233591	1

Source: Excel output

The Pearson correlation coefficient -0.190233591 indicates a weak negative relationship between commercial bank credit to MSMEs and NPAs. This suggests that flow of commercial bank credit to MSMEs is not associated with NPAs.

r = -0.190233591

$$t=\frac{r\sqrt{n-2}}{\sqrt{1-r^2}}$$

$$t=\frac{-000.190233591\sqrt{7}-2}{\sqrt{1}-(-0.19023359)^2}$$

t = ≈ -.434

Degrees of freedom df = n-2 =5

The corresponding two tailed p-value is p ≈ 0.683

The p-value 0.683 is greater than the significance level at 5% ($p>0.05$), indicating that the correlation is not statistically significant. There is insufficient evidence to conclude that commercial bank credit to MSMEs has significant relationship with NPAs during the assessment period.

Findings

- The Government of India has introduced several policy initiatives and financial support measures over the years, recognizing the critical role of MSMEs in promoting economic growth, employment generation, exports, and inclusive development.
- Commercial bank credit to the MSME sector has shown a steady upward trend during the study period, indicating increased institutional financial support to the sector.
- The comparative analysis reveals that credit disbursement to MSMEs by commercial banks has consistently increased throughout the assessment period, reflecting greater emphasis on financing the sector.
- The amount of Non-Performing Assets (NPAs) in the MSME sector has fluctuated over the study period. Although the absolute value of NPAs has declined in the later years, the NPA percentage has increased, indicating a deterioration in asset quality relative to outstanding credit.
- The correlation analysis shows a very weak negative relationship between commercial bank credit to MSMEs and MSME NPAs, suggesting that changes in credit disbursement are not associated with corresponding changes in NPAs.
- The statistical analysis yielded a p-value of 0.683, which is greater than the 5% significance level (0.05). Therefore, the relationship between commercial bank credit to MSMEs and NPAs is statistically insignificant, and the null hypothesis of no significant relationship is accepted.

The findings indicate that the growth in commercial bank credit to MSMEs has not significantly influenced the level of NPAs during the study period, implying that other economic, operational, and sector-specific factors may have contributed to changes in MSME NPAs.

Conclusion

Recognizing the contribution of MSMEs to Indian economy, the Government has initiated various policy measures to increase the access to finance and primarily through commercial banks since 1960. The study reveals that commercial bank credit to MSMEs has shown a consistent upward trend during the study period, reflecting the growing emphasis on financing this sector. The correlation analysis indicates a weak negative and statistically insignificant relationship between commercial bank credit and NPAs, suggesting that the expansion of MSME credit has not resulted in a significant increase in non-performing assets during the study period. This finding implies that concerns regarding rising NPAs should not discourage banks from extending credit to viable MSMEs. Strengthening credit appraisal mechanisms, promoting digital lending, expanding credit guarantee schemes, and enhancing financial literacy among MSMEs can further improve access to formal finance while maintaining the quality of bank assets.

Scope for Future Research

The present study is based on secondary data and primarily examines the flow of commercial bank credit to MSMEs and its relationship with non-performing assets (NPAs) and economic growth. Future research can be extended by incorporating primary data collected from MSME entrepreneurs, bankers, and policymakers to gain deeper insights into the challenges of accessing institutional finance.

.

References

- Abhinanda Mallick, Renjith Ramachandran (2026), Gender, Geography and Access to Finance: Rethinking the Urban Advantage for Women Entrepreneurs in India, International Journal of Sociology and Social Policy, 2nd Jan 2026.
- Chandrashekar Mund (2020), Problems of MSME Finance in India and Role of Credit Guarantee Fund Trust for MSEs, IOSR Journal of Economics and Finance, Vol II, Issue 4, Ser III, pp1-06.
- Daithri Tiwari (2024), A Sub-urban Perspective on MSME Loans in India: Bridging the Gap in Lending with Private Sector Banks, Artha Sept. 2024.
- Eimear Mc Geown, Bernadetta Power and Edward Shinnkle (2025), International Journal of Entrepreneurial Behaviour and Research, Vol 31, No. 11, 2025, pp-172-193.
- Meghana Ayyagari, Asli Demirgic-Kunt, Vojislav Makismovic (2017), Policy Working Research Paper 8241, World Bank Group.
- Rajamani, N., Jan, A., Subramani, A. K., & Raj, A. N. (2022). Challenges faced by micro, small and medium enterprises in India. Engineering Economics, 33(1), 73–85.
- Ram Jass Yadav, Issues in SME Financing, Bank of Baroda.
- SIDBI (2025), Understanding Indian MSME Sector: Progress and Challenges, Economic Research and Data Analysis Vertical, May 2025.
- Sri. Swaminathan J (2024), MSMEs- Bridging the Credit Gap through Improving Confidence in Lending, www.rbi.org.in.
- Tara Nair, Keshab Das, (2019), Financing the Micro and Small Enterprises in India- Antecedents and Challenges, Economic and Political Weekly, Vol LIV, No. 3.
- Yoshino, Naoyuki, Taghiza deh-Hesary, Farhad (2018), The Role if SMEs in Asia and their difficulties in Accessing Finance, ECONSTOR, ADBI Working Paper 911, Dec 2018.

Websites

- www.rbi.org.in
- www.sidbi.in
- www.nabard.org
- www.dcmsme.gov.in