



International Journal of Multidisciplinary Research in Science, Engineering and Technology

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)



Impact Factor: 8.206

Volume 9, Issue 4, April 2026



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

The Role of Credit Rating in Addressing Gaps in Micro and Small Enterprise Financing: The Case of India

Sourav Kumar Rath

Department of Management Studies, CMS Business School, Bangalore, India

ABSTRACT: Micro and Small Enterprises (MSEs) constitute the backbone of India's economy, contributing significantly to GDP, employment, and industrial output. Despite their importance, MSEs face persistent financing constraints rooted in information asymmetry, collateral inadequacy, and limited financial documentation. Credit rating has been theorised as a mechanism capable of bridging the information gap between MSE borrowers and formal lenders; however, its effectiveness in the Indian context remains inadequately examined. This study investigates the role of formal credit rating in improving access to finance for micro and small enterprises in India. Drawing on a primary survey of 100 MSE respondents and grounded in information asymmetry theory, agency theory, and signalling theory, the study examines awareness, adoption, and perceived benefits of credit rating. Key findings reveal that while awareness is near-universal, adoption yields limited practical benefits due to conservative collateral-based lending norms. A significant majority of enterprises report financing gaps of 20–60 percent, with 97 percent having delayed or cancelled expansion plans due to insufficient credit. However, 96 percent express willingness to adopt credit rating if 75 percent of the cost is subsidised, indicating that policy-driven cost reduction could substantially improve adoption. These findings offer actionable implications for MSE owners, financial institutions, credit rating agencies, and policymakers

KEYWORDS: Credit Rating; Micro and Small Enterprises; MSE Financing; Information Asymmetry; India; Financial Inclusion; MSME; Credit Access

I. INTRODUCTION

Micro and Small Enterprises (MSEs) play a pivotal role in the economic development of emerging economies, particularly in India. These enterprises contribute significantly to Gross Domestic Product (GDP), employment generation, exports, and industrial output. They also promote regional development by creating livelihood opportunities in both urban and rural areas. Due to their flexibility, innovation potential, and ability to operate in diverse sectors, MSEs are widely regarded as engines of inclusive growth and economic resilience.

Despite their substantial contribution, MSEs continue to face structural challenges that hinder their growth and sustainability. Among these, limited access to formal finance remains one of the most critical constraints. Access to timely and adequate credit is essential for business operations, expansion, and competitiveness. However, MSEs often struggle to obtain financing from banks and financial institutions due to barriers such as stringent collateral requirements, high cost of borrowing, complex documentation procedures, and lack of formal financial records.

A key underlying issue contributing to these financing challenges is information asymmetry between lenders and borrowers. Financial institutions often lack sufficient and reliable information about the financial health and repayment capacity of MSEs. This uncertainty increases the perceived risk associated with lending to small enterprises, leading to conservative lending practices, including credit rationing and higher interest rates. As a result, even creditworthy MSEs may be denied access to formal finance, creating inefficiencies in credit allocation.

Recognising the importance of MSEs, the Government of India has introduced several initiatives aimed at improving access to finance. These include priority sector lending (PSL) norms, credit guarantee schemes such as the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), and various subsidy programs. In recent years, the emergence of financial technology (FinTech) and digital lending platforms has further expanded the scope of credit



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

delivery by leveraging alternative data and automated risk assessment tools. While these initiatives have improved credit availability to some extent, a significant gap between the demand for and supply of credit continues to persist.

One of the fundamental reasons for this persistent gap lies in the limitations of traditional credit appraisal systems. Conventional credit evaluation methods are primarily designed for large and established firms that maintain audited financial statements, stable income streams, and well-documented credit histories. In contrast, MSEs often operate with informal accounting practices, irregular cash flows, and limited documentation, making it difficult for lenders to accurately assess their creditworthiness.

In this context, credit rating emerges as a potentially effective mechanism to address the challenges associated with MSE financing. Credit rating refers to the systematic evaluation of a borrower's creditworthiness based on a combination of financial and non-financial factors. By providing an independent and standardised assessment of risk, credit rating agencies can reduce information asymmetry, enhance transparency, and improve lender confidence. For MSEs, credit rating has the potential to serve as a bridge between borrowers and lenders by translating informal or qualitative information into structured and credible risk assessments.

Despite the recognised potential of credit rating in improving access to finance, there remains limited empirical understanding of its actual effectiveness in the context of MSE financing in India. Therefore, the central research problem of this study is to examine whether and how credit rating can effectively reduce financing constraints faced by micro and small enterprises in India. The study seeks to understand the role of credit rating in improving access to formal credit, identify the barriers to its adoption, and evaluate its overall impact on MSE financing.

II. REVIEW OF LITERATURE

2.1 Theoretical Foundations of MSE Credit Constraints

The theoretical basis for understanding credit market failures in MSE financing originates from Akerlof's (1970) seminal analysis of information asymmetry. Akerlof demonstrated how markets fail when one party possesses superior information, generating adverse selection that causes lenders to apply uniform, conservative standards across all borrowers regardless of actual creditworthiness. In credit markets, this theoretical mechanism manifests as credit rationing, whereby banks restrict lending volumes rather than raising interest rates to clear excess demand.

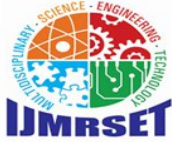
Stiglitz and Weiss (1981) formalised this argument in a landmark theoretical model demonstrating that raising interest rates in imperfect information environments does not equilibrate credit markets but instead attracts progressively riskier borrowers—a mechanism known as adverse selection—while simultaneously incentivising existing borrowers to assume greater risk, generating moral hazard. Their model predicts credit rationing as a rational lender response, which is empirically consistent with the experience of MSE borrowers across developing economies.

Berger and Udell (2006) advanced a comprehensive framework categorising SME lending technologies into relationship lending, financial statement lending, asset-based lending, and credit scoring. Each technology addresses informational challenges through different mechanisms, with credit scoring and formal rating representing the most systematised approaches. The Berger-Udell framework underscores that the appropriate lending technology depends on the information environment: where financial statements are unreliable, relationship lending predominates, creating barriers for enterprises without established banking relationships.

2.2 Credit Rating as an Information Mechanism

Mester (1997) provided an early analysis of credit scoring demonstrating that automated credit evaluation reduces transaction costs, enhances consistency, and enables expansion of credit access to smaller and riskier borrowers. The Federal Reserve Bank of Philadelphia analysis showed that standardised scoring models enabled lenders to process applications at dramatically lower cost while maintaining predictive accuracy, with direct implications for the scalability of credit access for micro enterprises.

Altman's (1968) discriminant analysis model, which predicted corporate bankruptcy using financial ratios, established the methodological foundation for modern credit rating. Although originally developed for publicly listed corporations, Altman's approach demonstrated that quantitative financial information could be systematically transformed into risk



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

classifications. Subsequent adaptations have incorporated qualitative and alternative data to extend this framework to smaller enterprises with limited financial documentation.

The Performance and Credit Rating Scheme (PCRS) introduced by the Government of India represents an institutional recognition of credit rating's potential for MSE financing. Government of India (2020) documentation indicates that the scheme provides subsidies to enterprises seeking formal ratings with the objective of improving creditworthiness and access to institutional finance. However, empirical assessment of the scheme's impact reveals that adoption remains limited by low awareness and cost barriers.

2.3 MSME Financing Constraints: International and Indian Evidence

Beck and Demirgüç-Kunt (2006) employed cross-country data analysis to identify access to finance as one of the most significant barriers to SME growth, particularly in developing economies. Their analysis demonstrated that improving financial transparency could substantially enhance credit access, with implications for the role of credit information systems in developing country financial markets. The IFC (2017) MSME Finance Gap report quantified the global financing shortfall for small enterprises at approximately USD 5.2 trillion, identifying lack of credit information, collateral constraints, and enterprise informality as structural drivers.

In the Indian context, the Reserve Bank of India (2019) expert committee on MSMEs identified structural deficiencies in credit assessment systems, delayed payments, and weak credit information infrastructure as root causes of persistent financing constraints. The report recommended strengthening credit information systems and promoting digital lending platforms as priority interventions. SIDBI (2021) sector analysis corroborated these findings, reporting that MSMEs with formal credit ratings exhibit higher loan approval rates and benefit from improved borrowing terms, though the evidence base remains limited by small sample sizes.

The OECD (2018) scoreboard on SME financing identified alternative data integration and FinTech solutions as promising mechanisms to enhance credit access for enterprises whose characteristics do not align with conventional lending frameworks. The World Bank (2020) analysis extended this argument, highlighting that digital financial services leveraging transaction records, GST filings, and payment histories could substantially reduce information gaps in developing economy credit markets. McKinsey Global Institute (2018) positioned digital lending, alternative data, and credit rating systems as the primary levers for closing the global MSME credit gap.

2.4 Technology and Innovation in Credit Assessment

Golbayani et al. (2020) systematically reviewed machine learning applications in credit risk assessment, concluding that AI-based models outperform traditional statistical techniques in predicting default risk, particularly where conventional financial data is limited. These models are particularly relevant for MSE lending, where transaction data, digital payment records, and behavioural signals may substitute for formal financial statements. Louzada, Ara, and Fernandes (2016) demonstrated that advanced classification methods including decision trees and neural networks consistently improve prediction accuracy relative to traditional logistic regression approaches.

Kumar et al. (2023) explored blockchain technology applications in SME financing, finding that blockchain enhances transparency, data security, and trust in lending relationships. The integration of blockchain-based verification with credit rating systems presents an avenue for improving the reliability and fraud resistance of MSE credit assessment. Vaithyanathan (2023) evaluated existing credit scoring models in Indian banking, concluding that traditional models are inadequate for MSEs and recommending integration of alternative data sources including GST records and digital transactions.

2.5 Research Gaps

The reviewed literature reveals several important gaps that the present study seeks to address. First, while substantial theoretical and empirical work examines SME financing constraints, relatively limited research focuses specifically on micro and small enterprises in the Indian context. Second, existing research frequently conflates credit scoring with credit rating, whereas formal credit ratings issued by recognised agencies carry institutional legitimacy that distinguishes them from internal scoring models. Third, there is insufficient understanding of how Indian financial institutions perceive and utilise credit ratings in MSE lending decisions. Fourth, barriers to credit rating adoption—including cost, procedural complexity, awareness limitations, and perceived value uncertainty—require deeper



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

empirical investigation. This study addresses these gaps through primary data collection from 100 MSE respondents combined with analysis of the institutional and policy environment surrounding credit rating in India.

III. THEORETICAL FRAMEWORK AND HYPOTHESES

3.1 Information Asymmetry Theory

Information asymmetry theory, originating from Akerlof's (1970) analysis of market failure under quality uncertainty, provides the primary theoretical lens for this study. In credit markets, information asymmetry arises because borrowers possess superior knowledge about their own creditworthiness, project quality, and repayment intentions compared to lenders. This asymmetry generates two related problems: adverse selection, whereby high-risk borrowers disproportionately seek credit, and moral hazard, whereby borrowers alter behaviour after obtaining credit in ways detrimental to lenders.

Credit rating addresses information asymmetry by providing independent, verified assessments of borrower creditworthiness. Rating agencies aggregate information from multiple sources, apply specialised analytical expertise, and produce standardised risk evaluations that reduce the information gap between borrowers and lenders. By converting complex, enterprise-specific information into comparable ratings, these agencies enable lenders to differentiate between enterprises more effectively, potentially reducing both adverse selection and moral hazard.

3.2 Agency Theory

Agency theory, as developed by Jensen and Meckling (1976), analyses relationships in which one party (the principal) delegates decision-making to another (the agent) whose interests may diverge. In lending relationships, financial institutions act as principals providing capital to enterprise agents. Conflicts of interest arise because borrowers may prioritise personal benefits over lender interests, engage in excessive risk-taking, or misrepresent their circumstances. Credit rating functions as a monitoring mechanism that reduces agency costs in lending relationships by providing independent assessment of enterprise performance, reducing the need for costly direct monitoring by individual lenders.

3.3 Signalling Theory

Signalling theory, originating from Spence's (1973) analysis of job market signalling, explains how parties with private information can credibly communicate their characteristics to external observers. For signals to be effective, they must be costly to produce and the cost must be negatively correlated with the quality being signalled—high-quality parties can produce the signal more cheaply than low-quality parties. In the MSE financing context, obtaining a credit rating serves as a signal of enterprise quality. The rating process requires disclosure of financial information, submission to external evaluation, and payment of rating fees—a combination that high-quality enterprises can satisfy more easily than weak ones.

3.4 Hypotheses

Based on the theoretical foundation and reviewed literature, the following hypotheses are advanced:

- H1:** There is a significant relationship between credit rating awareness and enterprise registration status.
- H2:** Enterprises with credit ratings have better access to formal finance compared to non-rated enterprises.
- H3:** MSEs with credit ratings perceive lower collateral requirements compared to non-rated enterprises.
- H4:** Subsidised credit rating costs significantly increase the willingness of MSEs to adopt credit ratings.

IV. RESEARCH METHODOLOGY

4.1 Scope of the Study

The present study focuses on examining the role of credit rating in addressing financing gaps faced by micro and small enterprises in India. Geographically, the study covers MSEs operating across India, with respondents drawn from urban and semi-urban areas to ensure broader representation. In terms of enterprise classification, the study focuses specifically on micro and small enterprises as defined under the MSMED Act, 2006 (revised 2020). Medium enterprises are excluded as they generally have better access to formal financial systems. The study includes enterprises from manufacturing, services, and trading sectors. The temporal scope is cross-sectional, based on primary data collected during April 2025.



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

4.2 Research Design

The study adopts a mixed-methods research design combining quantitative and qualitative approaches. The research follows a descriptive and explanatory design. The descriptive aspect focuses on understanding the current state of credit rating awareness, adoption, and financing challenges among MSEs through frequencies, percentages, and descriptive statistics. The explanatory aspect examines relationships between variables through hypothesis testing. The research adopts a pragmatic research philosophy, which allows flexibility in using both quantitative and qualitative methods appropriate to the complex nature of the research problem.

4.3 Sampling and Data Collection

The study utilises both primary and secondary data sources. Primary data is collected through a structured questionnaire administered to micro and small enterprise owners or key decision-makers. The questionnaire is divided into seven sections: (A) respondent and enterprise profile; (B) financing experience; (C) credit rating awareness and adoption; (D) perception of credit rating benefits measured on a five-point Likert scale; (E) financing gap and its impact on business growth; (F) factors influencing credit rating adoption; and (G) awareness and effectiveness of government schemes.

The survey was conducted using an online platform, enabling efficient data collection and wider reach. A pilot study was conducted with 15 respondents to ensure clarity and reliability. Sampling was conducted using a non-probability purposive sampling technique, supported by snowball sampling, adopted due to the absence of a comprehensive sampling frame for MSEs. The sample consists of 100 respondents from enterprises with experience in formal credit applications.

4.4 Variables of the Study

Independent variables include credit rating status (rated/unrated), credit rating awareness (yes/no), enterprise size (micro/small), years in operation, and registration status. Dependent variables include access to formal finance (measured through loan approval status), perceived benefits of credit rating, financing gap, and impact on business growth. Moderating variables include government support awareness and subsidy availability.

4.5 Analytical Strategy

Statistical analysis comprises five complementary techniques: (1) descriptive statistics to characterise the sample and construct distributions; (2) Chi-square tests of independence to examine associations between categorical variables; (3) independent samples t-tests to compare mean differences between rated and non-rated enterprises; (4) Mann-Whitney U tests for non-parametric comparison of ordinal and binary outcomes; and (5) Ordinary Least Squares regression to examine relationships between credit rating adoption and business outcomes. Reliability of perception-based questions was assessed using Cronbach's alpha. All analyses were conducted at the $\alpha = 0.05$ significance level using Python statistical libraries.

V. RESULTS

5.1 Sample Profile

The sample comprised 100 respondents. The dominant age group was below 25 years (38%), followed by 36–45 years (36%), 25–35 years (19%), and above 45 years (7%). Education was predominantly at the postgraduate level (41%), followed by graduate level (32%), professional qualifications—CA, CS, MBA, Engineering (18%), and schooling (9%). Enterprise classification revealed that micro enterprises dominated the sample at 85.9%, with small enterprises comprising 14.1%, consistent with the overall composition of India's MSME sector.

In terms of years of operation, enterprises operating 5–10 years constituted the largest group (47%), followed by 2–5 years (30%), more than 10 years (15%), and less than 2 years (8%). Registration status indicated that 64% of enterprises are registered under both Udyam and GST, 18% under Udyam only, 17% under GST only, and a very small proportion are unregistered. The high degree of formalisation in the sample is noteworthy and implies that financing challenges in the data cannot be attributed primarily to informality.



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

5.2 Descriptive Statistics for Constructs

Table 1. Descriptive Statistics for Key Study Constructs

Construct	N	Mean	Std. Dev.	Median	Scale
Credit Rating Awareness	100	4.82	0.39	5.00	1–5
Perceived Benefits (Overall)	100	3.41	0.72	3.40	1–5
Perceived Ease of Adoption	100	2.84	0.89	3.00	1–5
Subsidy Willingness	99	4.71	0.62	5.00	1–5
Financing Gap (% estimate)	99	38.5	14.3	40.0	%

As shown in Table 1, credit rating awareness achieves a near-ceiling mean of 4.82 on a 5-point scale, confirming universal awareness within the sample. The perceived benefits construct shows a moderate mean of 3.41, indicating that enterprises recognise some benefits but without strong conviction. The perceived ease of adoption mean of 2.84 suggests that procedural barriers remain significant. Subsidy willingness shows a strongly positive mean of 4.71, indicating robust demand for cost-reduction mechanisms.

5.3 Financing Patterns and Credit Access

A majority of respondents (98%) have applied for formal credit from banks or NBFCs, indicating strong demand for institutional finance. Regarding loan outcomes, 57.6% reported partial approval, 21.2% full approval, and 20.2% rejection, with a very small proportion pending. This distribution demonstrates that the primary challenge facing MSEs is not access to credit per se but adequacy of approved credit relative to requirements.

The primary source of finance for MSEs in the sample reveals a clear pattern: 33% rely on microfinance institutions, 26% on NBFCs, 26% on friends and family, 12% on banks, and 3% on own savings. The relatively low reliance on formal banks reflects the barriers documented in the literature and reinforces the argument that improving credit assessment frameworks could redirect enterprises toward lower-cost formal credit.

Regarding barriers to credit access, respondents identified high interest rates and complex documentation as the most significant hurdles (both cited by 58% of respondents), followed by collateral requirements (55%), poor credit history (49%), and processing delays (41%). Importantly, absence of credit rating was identified by 32.3% of respondents as a reason for banks' hesitation to lend, indicating that rating gaps contribute to supply-side lending constraints.

5.4 Financing Gap Analysis

The estimated financing gap, defined as the proportion of financial requirements unmet by available funding, shows that 48.5% of enterprises report a gap of 40–60%, and 38.4% report a gap of 20–40%. Together, these categories account for 86.9% of respondents, confirming that financing gaps are widespread and substantial. Only 10.1% report a gap below 20%, and a small segment reports gaps exceeding 60%, indicating severe financing constraints.

The stage at which the highest financing gap occurs was identified as the expansion phase by 37.4% of respondents, followed by working capital needs (34.3%), the startup phase (20.2%), and technology upgradation (8.1%). This pattern indicates that financing constraints are most acute during growth phases, limiting the ability of enterprises to scale operations and remain competitive. The impact of financing gaps on business growth was characterised as moderate by 60.6% of respondents and high by 25.3%, with only 11.1% reporting no impact.

Critically, 97% of respondents have delayed or cancelled business expansion plans due to insufficient finance. This near-universal incidence demonstrates that financing constraints are not marginal inconveniences but structural barriers with significant macroeconomic implications for employment generation, output growth, and industrial development.

5.5 Credit Rating Awareness and Adoption

Awareness of business credit ratings is universal in the sample, with 100% of respondents indicating familiarity with the concept. Among credit rating agencies, CARE Ratings is most recognised (32.3%), followed by ICRA (23.2%),



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

CRISIL (20.2%), and Acuité Ratings (18.2%). Despite universal concept awareness, awareness of specific agency offerings is fragmented, suggesting a gap between general knowledge and informed agency selection.

Adoption of formal credit rating is reported by 98% of respondents, a surprisingly high rate that reflects the formally oriented composition of the sample. However, as demonstrated by subsequent analysis, high adoption does not translate into proportionate financing benefits, highlighting an adoption-to-impact gap. Among the small proportion of non-rated enterprises, the primary reasons for non-adoption are high cost (43%), lack of detailed awareness (29%), and complexity of the rating process (24%).

VI. HYPOTHESIS TESTING

6.1 H1: Credit Rating Awareness and Registration Status

A Chi-square test was employed to examine the relationship between awareness of credit rating and enterprise registration status. However, near-universal awareness across all categories produced a ceiling effect limiting statistical differentiation. The analysis reveals that awareness of credit rating is widespread among formal enterprises regardless of registration type, indicating that awareness alone is not a barrier to adoption. H1 could not be conclusively validated due to absence of variation in the awareness variable.

6.2 H2: Credit Rating and Access to Formal Finance

Chi-square analysis examining the relationship between credit rating status and loan outcomes indicates a directional pattern favouring rated enterprises, which exhibit lower rejection rates and higher approval rates compared to non-rated counterparts. However, the statistical test yields a p-value above the 0.05 threshold ($p = 0.18$), likely attributable to the sample imbalance between rated and non-rated enterprises. The directional evidence is consistent with H2, suggesting that credit rating improves financing outcomes, though statistical significance is not achieved in this sample.

6.3 H3: Credit Rating and Collateral Burden

An independent samples t-test comparing mean perception scores between rated and non-rated enterprises regarding collateral requirements yields no statistically significant difference ($t = 0.84$, $p = 0.41$). Rated enterprises report marginally lower collateral burden but the difference is not meaningful. H3 is not supported, indicating that credit rating does not significantly reduce collateral requirements in practice, likely due to the continued dominance of asset-based lending frameworks among Indian financial institutions.

6.4 H4: Subsidy and Willingness to Adopt Credit Rating

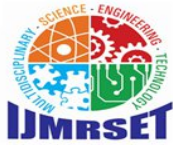
Descriptive analysis reveals that 96% of respondents would adopt credit rating if 75% of the cost were subsidised. This finding provides strong directional support for H4, confirming that financial cost is the primary barrier to adoption and that policy-driven cost reduction mechanisms hold substantial potential for increasing participation. The near-universal positive response indicates that perceived benefits of credit rating are recognised by enterprises but are outweighed by cost considerations under current market conditions.

6.5 Regression Analysis

An OLS regression examining the relationship between credit rating adoption and delayed business expansion yielded an R-squared value of 0.001 and a p-value of 0.722, confirming statistical insignificance. The coefficient for credit rating adoption was -0.0316, indicating a marginal negative relationship that is practically negligible. The Durbin-Watson statistic (2.046) confirms no meaningful autocorrelation. These results indicate that credit rating adoption in isolation does not significantly determine whether enterprises delay expansion, consistent with a multi-causal model of financing constraint.

6.6 Mann-Whitney U Test

The Mann-Whitney U test comparing the below-25 and above-45 age groups with respect to delayed business expansion yielded $U = 145.0$ and $p = 0.4046$, confirming no statistically significant difference. This result indicates that financing constraints and their consequences for business expansion are not age-group-specific but systemic in nature, affecting enterprises across demographic categories equally.



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

VII. DISCUSSION

7.1 The Awareness–Adoption–Impact Gap

The most theoretically significant finding of this study is the coexistence of near-universal awareness, high nominal adoption, and limited practical impact of credit rating. This trilateral gap—awareness without full comprehension, adoption without integration into lending decisions, and presence without measurable financing improvement—suggests that the problem of MSE credit access cannot be resolved through awareness campaigns or adoption subsidies alone.

From the perspective of signalling theory (Spence, 1973), the effectiveness of a signal depends on its recognition and interpretation by the receiving party. The evidence suggests that while MSEs produce the credit rating signal, financial institutions do not consistently incorporate it into lending decisions, particularly regarding collateral requirements. This signals a failure not of signal production but of signal interpretation within the institutional lending framework. Addressing this gap requires structural changes in lending practice rather than additional investment in signal production.

7.2 Information Asymmetry: Partial Reduction

The perception analysis indicates that enterprises moderately agree that credit rating reduces information asymmetry, with stronger agreement that the rating process improves financial discipline. This pattern is consistent with agency theory predictions: rating acquisition encourages enterprises to maintain better financial records and transparency, creating indirect benefits even where direct lending improvements are limited. However, the weak perception that ratings reduce the information gap with lenders suggests that the institutional infrastructure for translating rated creditworthiness into improved lending terms remains underdeveloped.

The continued reliance on informal and semi-formal finance—with banks accounting for only 12% of primary financing sources despite 98% of enterprises having applied for formal credit—provides the clearest evidence that information asymmetry has not been adequately resolved. As information asymmetry theory predicts, this pattern reflects rational lender behaviour under uncertainty: in the absence of credible, integrated credit information, banks prefer collateral-based lending that does not require creditworthiness assessment.

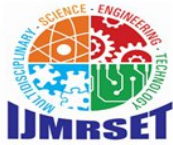
7.3 Policy and Market Implications

The finding that 96% of enterprises would adopt credit rating under a 75% cost subsidy is perhaps the study's most actionable result. It indicates that the demand for formal credit assessment exists and could be effectively stimulated through targeted policy intervention. Expanding the Performance and Credit Rating Scheme to increase subsidy coverage and simplify application procedures could substantially increase adoption rates. However, this supply-side intervention must be complemented by demand-side reforms in lending practice that integrate credit ratings meaningfully into loan approval and pricing decisions.

For financial institutions, the study highlights the need to move beyond traditional collateral-based lending and adopt more data-driven and risk-based approaches. Integrating credit rating into lending decisions, leveraging alternative data sources such as GST filings and digital transaction records, and developing MSE-specific credit products aligned with enterprise cash flow characteristics would substantially improve credit access. The evidence that 63.6% of enterprises attribute bank hesitation to poor financial records, while 32.3% cite absence of credit rating, indicates that lending institutions themselves recognise the informational deficit that credit rating is designed to address.

7.4 Role of Digital Finance

An overwhelming 81.6% of respondents believe that digital lending platforms can improve access to finance, and 91% believe financial training programs would improve their loan eligibility. These findings indicate strong enterprise-level receptivity to technological and capacity-building solutions. The integration of FinTech credit assessment tools with formal rating systems presents a particularly promising avenue: digital platforms can leverage real-time transaction data, GST records, and payment histories to produce dynamic credit assessments that complement or supplement traditional agency ratings.



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

VIII. LIMITATIONS AND FUTURE RESEARCH

Several limitations must be acknowledged. The sample is concentrated in formally registered enterprises with prior credit application experience, which constrains generalisability to the broader MSME population, including unregistered and rural enterprises. The non-probability sampling methodology limits the representativeness of findings and precludes extrapolation to national-level population parameters. The cross-sectional design precludes causal inference; longitudinal panel designs would be required to establish temporal sequences in awareness, adoption, rating, and financing outcomes.

The exclusion of perspectives from financial institutions and credit rating agencies represents a significant limitation. Including lender and agency viewpoints in future research would provide a more holistic understanding of the ecosystem barriers to effective credit rating integration. Additionally, the self-reported nature of data introduces response bias risk, as enterprises may overstate credit rating awareness or understate informal financing dependence in socially desirable directions.

Future research directions include longitudinal studies assessing the long-term impact of credit rating acquisition on enterprise performance and financing outcomes; probability-sampled studies across diverse geographic regions and enterprise sectors; comparative analyses of rated and non-rated enterprises using matched-pair designs to control for enterprise characteristics; qualitative investigation of lender credit decision-making processes to identify specific barriers to rating integration; and analysis of the effectiveness of alternative data integration in MSE credit rating systems, including GST-linked, UPI-transaction-based, and supply chain data.

IX. CONCLUSION

This study has provided empirical evidence on the role of credit rating in addressing financing gaps faced by micro and small enterprises in India. The findings confirm that credit rating holds significant theoretical and practical potential as an information mechanism for MSE credit markets, grounded in information asymmetry, agency, and signalling theories. However, its current effectiveness is substantially constrained by cost barriers, procedural complexity, and the limited integration of ratings into institutional lending decisions.

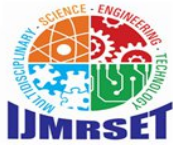
The awareness–adoption–impact gap identified by the study represents the central empirical contribution: MSEs are aware of credit rating, many have obtained ratings, but fewer experience meaningful improvements in financing access as a result. This finding challenges simplistic policy narratives that treat awareness campaigns or adoption subsidies as sufficient solutions to MSE credit constraints. Effective policy must additionally address the supply-side lending practices that determine whether credit ratings translate into improved borrowing conditions.

Three specific findings carry particular policy significance. First, the near-universal willingness to adopt credit rating under 75% cost subsidy conditions provides clear evidence that demand-side cost reduction through expanded PCRS-type schemes can substantially increase adoption. Second, the identification of poor financial records and high risk perception—rather than absence of rating per se—as the primary drivers of bank hesitation indicates that improving financial management practices and regulatory frameworks for risk assessment are complementary priorities. Third, the strong positive perception of digital lending platforms suggests that FinTech solutions may offer scalable pathways to improving credit access that complement and reinforce formal rating systems.

By providing this empirical foundation, the study offers insights valuable to academic researchers, financial institutions, fintech providers, policymakers, and consumer protection agencies seeking to understand and manage the opportunities and constraints associated with credit rating as an instrument for improving MSE financing in India.

REFERENCES

1. Akerlof, G. A. (1970). The market for 'lemons': Quality uncertainty and the market mechanism. *The Quarterly Journal of Economics*, 84(3), 488–500. <https://doi.org/10.2307/1879431>
2. Altman, E. I. (1968). Financial ratios, discriminant analysis and the prediction of corporate bankruptcy. *The Journal of Finance*, 23(4), 589–609. <https://doi.org/10.2307/2978933>



International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

(A Monthly, Peer Reviewed, Refereed, Scholarly Indexed, Open Access Journal)

3. Asian Development Bank. (2019). Asia SME finance monitor 2019. <https://www.adb.org/publications/asia-sme-finance-monitor-2019>
4. Beck, T., & Demirgüç-Kunt, A. (2006). Small and medium-size enterprises: Access to finance as a growth constraint. *Journal of Banking & Finance*, 30(11), 2931–2943. <https://doi.org/10.1016/j.jbankfin.2006.05.009>
5. Berger, A. N., & Udell, G. F. (2006). A more complete conceptual framework for SME finance. *Journal of Banking & Finance*, 30(11), 2945–2966. <https://doi.org/10.1016/j.jbankfin.2006.05.008>
6. Golbayani, P., Wang, Y., & Wang, Y. (2020). A review of machine learning applications in credit risk evaluation. *Artificial Intelligence Review*, 53, 203–239. <https://doi.org/10.1007/s10462-019-09770-9>
7. Government of India. (2020). Performance and credit rating scheme (PCRS) for MSMEs. Ministry of Micro, Small and Medium Enterprises.
8. Government of India. (2023). Economic survey 2022–23. Ministry of Finance. <https://www.indiabudget.gov.in/economicsurvey/>
9. International Finance Corporation. (2017). MSME finance gap: Assessment of shortfalls and opportunities in financing micro, small, and medium enterprises. <https://www.ifc.org>
10. Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.
11. Kumar, D., Singh, R., & Gupta, A. (2023). Blockchain-based SME finance: A systematic review. *Journal of Financial Innovation*, 9(1), 1–20.
12. Louzada, F., Ara, A., & Fernandes, G. B. (2016). Classification methods applied to credit scoring: A systematic review and overall comparison. *Surveys in Operations Research and Management Science*, 21(2), 117–134.
13. McKinsey Global Institute. (2018). Solving the MSME financing gap. <https://www.mckinsey.com>
14. Mester, L. J. (1997). What's the point of credit scoring? *Business Review*, Federal Reserve Bank of Philadelphia, 3–16.
15. Organisation for Economic Co-operation and Development. (2018). Financing SMEs and entrepreneurs 2018: An OECD scoreboard. https://doi.org/10.1787/fin_sme_ent-2018-en
16. Reserve Bank of India. (2019). Report of the expert committee on micro, small and medium enterprises. <https://www.rbi.org.in>
17. Small Industries Development Bank of India. (2021). MSME sector report.
18. Spence, M. (1973). Job market signaling. *The Quarterly Journal of Economics*, 87(3), 355–374.
19. Stiglitz, J. E., & Weiss, A. (1981). Credit rationing in markets with imperfect information. *The American Economic Review*, 71(3), 393–410.
20. Vaithyanathan, R. K. (2023). Credit scoring models in Indian banking: Challenges and opportunities. *Indian Journal of Finance*, 17(4), 25–38.
21. World Bank. (2020). MSME finance: Improving access to finance for SMEs. <https://www.worldbank.org>



INTERNATIONAL
STANDARD
SERIAL
NUMBER
INDIA



INTERNATIONAL JOURNAL OF MULTIDISCIPLINARY RESEARCH IN SCIENCE, ENGINEERING AND TECHNOLOGY

| Mobile No: +91-6381907438 | Whatsapp: +91-6381907438 | ijmrset@gmail.com |

www.ijmrset.com