

Voices of India's MSMEs: Insights notes from The Diaries

Edition 1

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About Omidyar Network India

Omidyar Network India invests in bold entrepreneurs who help create a meaningful life for every Indian, especially the hundreds of millions of Indians in low-income and lower-middle-income populations, ranging from the poorest among us to the existing middle class. To drive empowerment and social impact at scale, we work with entrepreneurs in the private, non-profit, and public sectors who are tackling India's hardest and most chronic problems. We make equity investments in early-stage enterprises and provide grants to non-profits in the areas of Digital Identity, Education, Emerging Tech, Financial Inclusion, Governance & Citizen Engagement, and Property Rights. Omidyar Network India is part of The Omidyar Group, a diverse collection of companies, organizations, and initiatives, supported by philanthropists Pam and Pierre Omidyar, founder of eBay. <https://www.omidyarnetwork.in/>

About MSC

MicroSave Consulting (MSC) is a boutique consulting firm that has, for 20 years, pushed the world towards meaningful financial, social, and economic inclusion. With 11 offices around the globe, about 180 staff of different nationalities, and varied expertise, we are proud to be working in over 65 developing countries. We partner with participants in financial services ecosystems to achieve sustainable performance improvements and unlock enduring value. Our clients include governments, donors, private sector corporations, and local businesses. We can help you seize the digital opportunity, address the mass market, and future-proof your operations. <https://www.microsave.net/>



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Foreword

MSMEs are the backbone of the Indian economy. India has close to 63 million unincorporated, non-farm MSMEs engaged in different economic activities. They contribute almost 30% of India's GDP (2018-19). Most MSMEs are unregistered and operate as Informal Enterprises (IEs). Estimates indicate that the informal workforce in India comprises 75-90% of all workers (2021). However, the sector lacks a high-quality data system to track and report the financial and operational health of IEs and the challenges they face. Efforts are needed to channel data into key feedback loops for necessary industry action and policy interventions.

Commissioned by Omidyar Network India and in partnership with the World Bank, MSC will make a pioneering effort to bridge the data gap in India's IEs sector. We have named this effort the 'Voices of India's MSMEs' as it endeavors to capture the unheard voices of India's MSMEs through data insights. The research initiative includes the following key components:

- i. A first-ever, independent large survey with a sample size of ~10,000 IEs to draw authentic, accurate, and actionable data-driven insights at the macro level; conducted by the World Bank, and analyzed by MSC,
- ii. Financial Diaries-based research on 50 microenterprises¹ spread across 10 different locations across India to develop a nuanced understanding of the financial and non-financial lives of IEs in India,
- iii. Insights on MSMEs from the World Bank's Enterprise survey and Microenterprise surveys, which cover a wider gamut of enterprises.

A vital component of this effort is the Financial Diaries-based research. Originating from the 'Portfolios of the Poor', this research methodology has revolutionized the way we understand how the poor manage their money. This method (which involves continuously tracking a small sample of IEs over a long period) can generate deep insights that one-time large-sample surveys often miss. Despite a small sample size, this approach can give us the temporal view and the change over time, along with the current state/stock situation of IEs in a way that no other kind of research can.

We believe that together, this package of insights - ranging from a large sample survey to identify significant trends, to diaries that help us understand the nuances - will provide a first-ever comprehensive data bank on the lived realities of India's MSMEs, especially IEs.

This insights note is named "Voices of India's MSMEs: Insights notes from the IEs sector." It is the first of a series of four notes that we shall publish over the next year. The series presents voices of the IEs from the ground. In this edition, we have shared our observations and critical insights on the business finances of the IEs in the section: "What does the data tell us." We have also presented our assessment of a critical aspect (digital adoption) relevant to the IEs in each edition under the "Thematic focus of the edition."

¹ Out of the 50 enterprises, 49 are informal and 1 is formal

Foreword

Please see the Annex for an overview of the sources of data and the Diaries research methods. At the beginning of the note, we have summarized the key insights and the key takeaways for policymakers and financial & digital service providers.

In the forthcoming editions of the Insights notes, we intend to cover in detail our learnings on the following aspects that are essential to the growth and evolution of the IEs' sector—

- Access to finance, and savings practices
- Supply chain management,
- Access to government-supported schemes and social transfer programs,
- Skill-building,
- Formalization,
- Gender dynamics that impact business performance and practices

We plan to explore all these topics in the future editions of this Insights series. Until then, we hope you find this 1st edition interesting and resourceful. Keep watching www.voicesofindiasmsmes.com for more insights notes and updates. For any questions or suggestions, please write to abhishek@microsave.net. Happy reading!

We hope this project will further the important national conversation on what it would take to advance the journey of India's MSMEs towards greater productivity, competitiveness, and livelihood generation.

Varad Pande

Partner, Omidyar Network India

Manoj Sharma

Managing Director, MSC

Executive summary

Data insights on how IEs manage their finances and how external factors affect them:



1 Owners of informal businesses continuously adapt, innovate, and strategize to maximize their revenues. To address business opportunities and mitigate threats, they take quick decisions. They are open to taking significant risks such as investing their savings to start completely new business lines which might earn good profits in the short term.

“We did not have any other option; the situation was getting worse by the day. We needed to do something and we started the grocery business along with my tailoring business. Thank God the gamble paid off. Things are much better now.”

- Devika, tailoring, and grocery business owner, Bhopal



2 IEs face volatile business income; many times they struggle to manage their sales and outflows to achieve a positive cash flow balance. Seasonality further compounds it.

“In some of the months, I earn more. In others, my income is minimal. Sometimes my net earning is low because I have to order stock in bulk and not enough sales take place. This is all part of the game.”

- Subir, grocery shop owner, Kolkata



3 External shocks like COVID-19 and medical emergencies can devastate small businesses. The drop in net income can be as high as 90%. Many affected businesses are prone to suffer from long periods of closure. Most businesses lack a plan or a financial cushion to fall back on.

“These days I hardly get time to run the business after fulfilling all my household duties. Taking care of my sick brother-in-law takes a lot of my time. But there is no way out; these are responsibilities of the women of the household. It has been days since I ran my shop for the whole day. I think I will ask my son to put in the time to run the business.”

- Babli, grocery shop owner, Panipat



What opportunities are there on sight for financial service providers (FSPs)?²

Though very agile to adapt to the dynamic environment, informal business owners lack financial planning. Most enterprises find themselves in a financial crisis if their business strategies fail or exigencies emerge. Once in that situation, most informal businesses struggle to resume normal business volumes as they lack access to finance. The following are some opportunities for policymakers to focus on and for FSPs to adopt based on the insights from our research:

- **Savings products to build a financial cushion against shocks:** Low-cost savings and investment products tailored to small businesses can help them build financial discipline and create an emergency fund. These financial cushions can help the IEs survive the shocks and to resume their businesses once the crisis is over.
- **Credit products for urgent needs of funds:** Collateral-free, small-ticket loans, and returnable grants, processed quickly, can effectively address the need for urgent funds for business, be it to address an opportunity or to tide over an emergency. In the absence of such sources of funds, IEs often have to avail credit from informal sources at exorbitant costs. A public-private partnership to mobilize funds, coupled with the use of technology platforms can effectively lower the cost on borrowers while reducing the effective TAT for loan disbursement.
- **Insurance products for medical emergencies and business discontinuity:** Low-cost risk cover instruments, especially health insurance and hospital cash insurance that covers all family members, are crucial to secure the financial health of the business and the household in case of a medical emergency. Also, the fear of losing investments and the looming uncertainty of external shocks that lead to the closure of a business discourage many entrepreneurs from starting a business or committing more capital to scale up their business. Long periods of closure force the owners of informal and microenterprises to spend most of their savings on sustenance while having no income from the business, thereby leaving little in reserve to invest in the business. They also lose their creditworthiness among suppliers and informal sources and hence many are rendered incapable of re-opening their businesses. While there are insurance products (such as shopkeeper's insurance and disability insurance for business owners) that address the risk of damage to business stock & assets and disability of the owner that renders him/her unable to work, the risk of total closure of business due to external shocks remains unaddressed. An affordable insurance cover for business discontinuity tailored for IEs can provide much-needed confidence to these small entrepreneurs. Alternate channels, such as banking agents or digital platforms like payment apps with increasing market penetration, can be effective platforms for sales and services for such products.

² Our recommendations based on the data insights and inferences drawn from them.

Data insights on digital adoption:

1

Many IEs have become adopters of digital payments, driven by customer demand and behavioral changes induced by COVID-19. A typical business that accepts digital payments receives a varied range of daily payments digitally—in a metro, it can be as high as 90%. In tier 2 or 3 cities, it is approximately 30%.

“I started to accept digital payment after COVID-19, both PhonePe and Google Pay.”

- Hemant Dubey, Owner of a unit that manufactures and produces home decoration items, Delhi NCR



2

The IEs that do not use digital payments still perceive digital payments as a misfit for their personal and business profiles. Some believe that digital payments are better suited to young and tech-savvy users. Many businesses consider digital transactions as more time-consuming and unreliable, compared to their traditional means of dealing in cash.

“Digital payment is not for us. It is for the next generation”.

- Bikram Singh, Grocery shop owner, Hanumangarh



3

IEs do not see any value addition from using digital solutions for business management (eg. Khatabook, Pagarbook, Vyapar, Udaan). They believe that for their small scale of business operations, their manual systems of book-keeping are adequate. The perceived benefits of using digital solutions are grossly inadequate to motivate them to make efforts for learning the usage of digital solutions. They also regard e-commerce platforms in a similar light, mostly owing to their ultra-local nature of business and the small scale of their operations. Moreover, IEs are excluded by default from e-commerce platforms that require GST registrations.

“I have heard of the Udaan app from one of my friends. I have compared the prices that I can get from the app with what I get from the regular supplier. And there is hardly any difference. I have also heard that these apps need a shop license which I do not have. So, my manual method works just fine”.

- Surjo, Grocery shop owner, Kolkata



4

Many IEs have adopted ingenious methods to address the demand for the usage of digital payments. Many small businesses have informal arrangements with nearby, larger shops (that regularly accept digital payments) with whom they partner to address the demand from customers who insist to pay digitally. They ask such customers to pay to the partner shop's/its owner's digital account which in turn returns the equivalent amount in cash to the small shop owner at the daily close of business³. Thus, the small business owners manage not to lose any customers while still having access to cash that they need to pay off their suppliers and manage their businesses expenses. (see page 16 for more details)

“I accept digital payment from my customers in my digital wallet, transfer that amount to the wallet of my friend, and get cash from him.”

- Arun, vegetable shop owner, Hyderabad



³ In our sample of respondents, none have reported incurring a cost for such arrangements

What opportunities are there on sight for policymakers and service providers?⁴

IEs do not see a strong value proposition for digital solutions, especially business management and e-commerce platforms. They lack adequate knowledge of these solutions and hence struggle to assess the benefits they can derive from them. Convenience is the driver for some, as incentives are for others. Providers need to identify and establish specific, strong value propositions with their products for informal and small businesses. We could also infer from our interactions with the IEs that a business needs to be of a minimum scale, below which the benefits of using digital solutions (especially business management solutions and e-commerce) are not commensurate to the effort needed to start using such solutions. Hence, the targeting from the providers also has to be appropriate.

The ecosystem needs fundamental changes to increase the penetration of digital payments. In most cases, the scale of adoption of and motivation to use digital payments at the level of IEs is driven by the acceptance of digital payments among the other players in the business value chain- especially suppliers as they directly transact with the IEs. In most cases, the IEs have reported that suppliers accept only cash. Thus to make the ecosystem truly cash-light, service providers have to address the requirements of not just the end-users (IEs) but also assess how those of the entire ecosystem can be addressed.

Following are some opportunities for financial service providers based on the insights:

- **Highlight convenience of using digital payments for more uptake:** To motivate more IEs to start adopting digital payments, providers should be more specific in highlighting the convenience aspect of their solutions, through communication campaigns or advertisements.
- **Focus on addressing the safety concerns of digital payments to increase usage:** To motivate early adopters of digital payments to increase usage of digital payments, service providers need to inform such IEs about the safety features of their solutions. Features that drive a sense of comfort and safety in the usage of digital payments include safety features that prevent fraud, the processes for addressing a digital transaction failure, and channels of communication customers can use to register grievances and queries. Communication through recorded voice messages, advertisements in regional languages in the local media, and messaging via outreach agents can generate awareness and onboard new businesses.
- **Establish and highlight the use of digital payments data for increased creditworthiness:** The regular usage of digital payments and solutions will lead to useful data that can indicate a business's overall health and growth. Such data can find use as proxies to underwrite loans for these IEs. Digital service providers and financial institutions can collaborate to incentivize/ motivate IEs to increase the uptake and usage of digital solutions. The chance to avail a credit line via payments history can motivate IEs to increase the usage of digital payments.

⁴ Our recommendations based on the data insights and inferences drawn from it.

- **Improving UI/UX and partnership with e-commerce companies to increase the value proposition of digital solutions:** : More than expecting users to adopt new-age technology, the technology solutions should match the capacity and understanding of the users. Particular focus should be laid by the providers on the user interface (UI) and user experience (UX) to make the technology solutions easy to use. Voice-based technology interfaces can encourage early-stage and first-time technology users and encourage more IEs to adopt technology solutions. Partnerships between digital platforms, such as business management or e-commerce companies, and digital payment players alongside cross-selling can also increase the value proposition of the products.

And here are some opportunities for policymakers:

- **Review decision on making GSTIN mandatory for IEs to use e-commerce platforms:** New-age social-commerce platforms like Facebook marketplace, Facebook Live, Instagram Shopping do not need GSTIN unless the business crosses the applicable turnover limit. Policymakers can review the decision to mandate GSTIN for e-commerce platforms, as it significantly hinders the onboarding of more IEs.
- **Encourage suppliers to accept digital payments from traders:** The customer demand is already pushing the adoption of digital payment by traders. However, it cannot move beyond a certain point unless the other players of the supply chain, especially suppliers start accepting digital payments from IEs. More research is needed to assess how acceptance of digital payments can be improved among the supplier's segment and others. Reduction in tax rates on payments through digital channels could be possible motivators for the suppliers to accept payments digitally.



What does the data tell us: Observations on the business finances of IEs and how external factors affect them.

In this section, we present three key observations from the data.

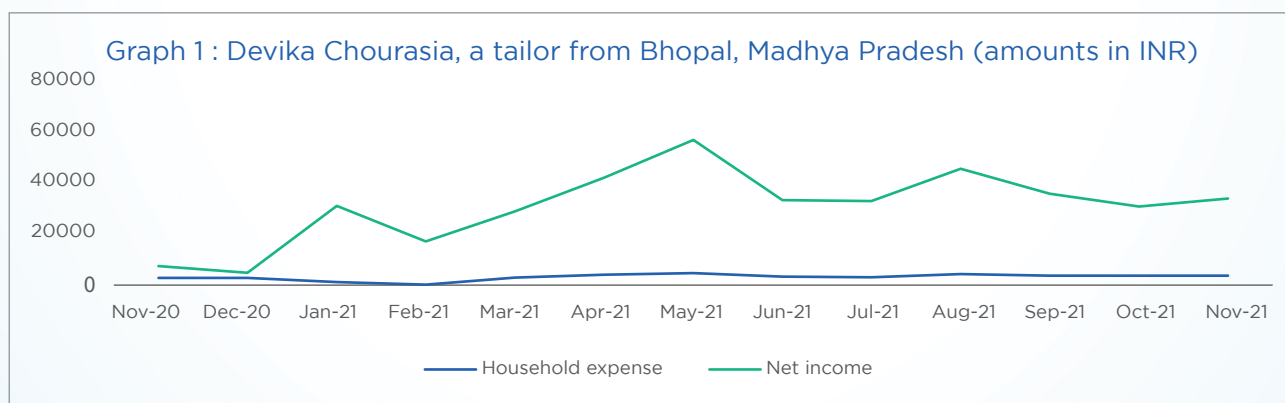
1

Informal businesses owners continuously adapt, innovate, and strategize to maximize their revenues, and are open to take risks.



IEs adopt innovative ways to maximize their income, including adding new product lines in particular seasons.

Instance 1: Devika started her tailoring business around three years back using a subsidized loan of INR 1,50,000 from the Bank of India. However, the business was not picking up as expected owing to tough competition in the area.



Devika and her husband decided to diversify the business and set up a grocery shop alongside the tailoring business during Diwali 2020. The grocery shop had limited stock owing to a lack of working capital, which restricted its growth. It remained ancillary to the tailoring business. The situation worsened in the coming months. At one point, they were not in a position to pay the loan installments for consecutive months. Devika and her husband were in a make-or-break situation, and they decided to take a gamble. They had faith that the grocery business had the potential to grow. They borrowed money from informal sources, such as friends and relatives, exhausted their savings, and substantially increased inventory in the grocery business. The gamble paid off, and the grocery business started to grow. After a few months, the income from that business surpassed the income from the tailoring business, and it improved the household's financial condition substantially.



We did not have any other option; the situation was getting worse by the day. We needed to do something and we started the grocery business along with my tailoring business. Thank God the gamble paid off. Things are much better now.

- Devika, tailoring and grocery business owner, Bhopal

Now Devika's husband has stopped doing odd jobs and works full time in the grocery business. They decided to give their all to the business, diversified their offerings, did not give up—and it paid off⁵.

Instance 2: Anup added mustard oil to the list of other grocery items in his shop. The price of mustard oil in India has spiked since February 2021. The price increase from INR 100-110 per liter in November, 2020 to INR 150-170 per liter in March-April, 2021 contributed to a substantial increase in income.

Instance 3: Rakesh increased his income in March 2021 by selling colors and gift items during the Holi festival. Fortunately, wedding events in his neighborhood helped him sell more gift items, which helped him make a windfall gain.

Instance 4: Vikram set up an additional product line of cakes and confectionaries during winters; the Christmas season caused a spike in income. Yet another diarist, Shruti, expanded her stock of cosmetic items; she included bridal makeup to take advantage of the wedding season. That investment paid off by increasing her income during December-January.



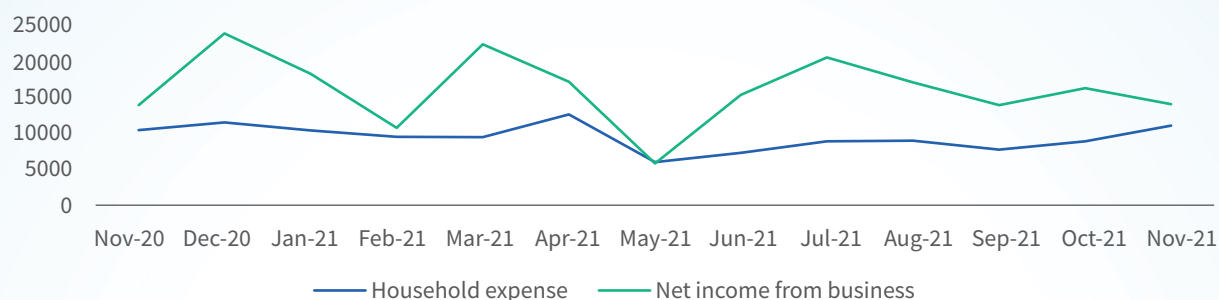
⁵ In Diaries, we capture the household expenses incurred by the diarist alone, not the other household members. In the case of Devika, her husband also manages some of the household expenses. Hence, the numbers are on lower side in some months.

2

Informal businesses face volatility in their business finances; seasonality is a major contributing factor.



Graph 2: Aggregated data on mean income and expenses of nine grocery shops (INR)



As is evident from Graph 2⁶, the net incomes⁷ of the grocery shops have been volatile over the past 13 months. Only in three months (December 2020, March, 2021, and July, 2021) out of the past 13 months have shops enjoyed a considerable positive gap between net income and household expenses. The gap was moderate in five months (January, 2021, June, 2021, August, 2021, September, 2021, and October, 2021). The gap was minimal in the remaining five months, and the corner shops barely managed to stay afloat. Yet notably, these businesses are viable and the expenses have not surpassed income, even during the second wave of COVID. This again reinstates our first insight on the innovations and resilience of the informal businesses to stay afloat.

The spikes in income are the result of standalone initiatives by the entrepreneurs. The dips mostly reflect the typical ups and downs of a business. In yet other cases, the dips are due to the entrepreneurs being forced to close down shops for a considerable duration due to illnesses in the family or personal work.

The sales figures often depend on various external factors—including, most dominantly, seasonality. Some items, such as cigarettes, which carry a higher profit margin, see higher sales during winter. The COVID-19 pandemic and the lockdowns induced have devastated the incomes of these businesses. During the pandemic, several factors contributed to a drop in income for all types of informal businesses, including a reduction in customer footfall, reduction in per-customer sales, higher cost of items, and the inability of suppliers to provide items on credit. Initially, the reduction in customer footfall was the biggest challenge. However, lower spending by customers and lack of credit from suppliers gradually became greater problems for shop owners.

⁶ We have used statistical imputation techniques to manage few missing data points

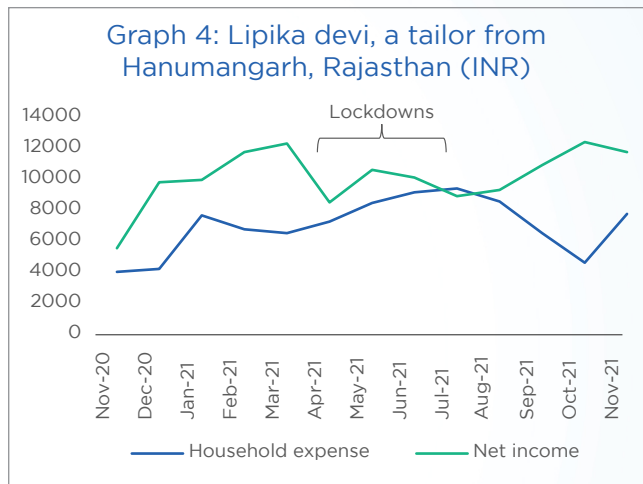
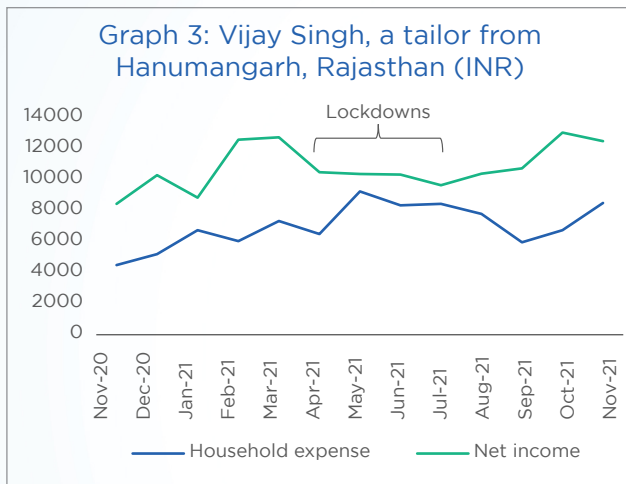
⁷ Net income is calculated as (revenue from business) - (businesses related expenses)

For example, grocery shops enjoyed higher sales in the initial days of lockdowns as customers tended to stock up on necessary items. However, in the subsequent months, the businesses bought higher stock volume but saw lower per-customer purchases and lower net income.



In some of the months, I earn more. In others, my income is minimal. Sometimes my net earning is low because I have to order stock in bulk and not enough sales take place. This is all part of the game. But the COVID lockdowns hit my business like never before. I am still struggling to recover from it.

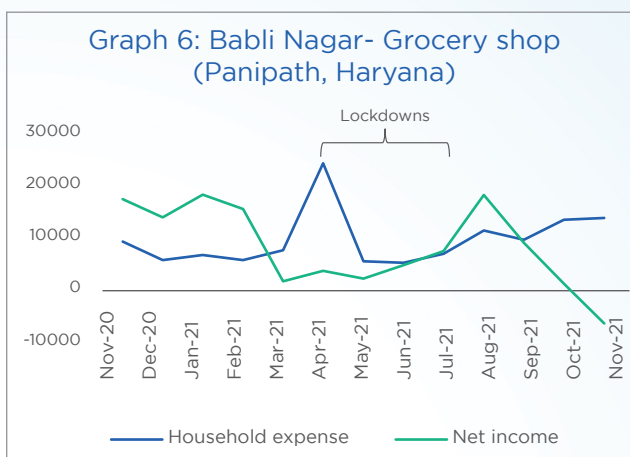
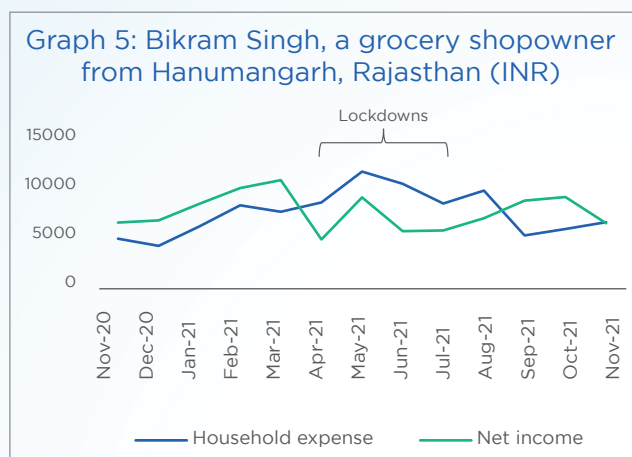
- Subir, grocery shop owner, Kolkata



The trends hold for service businesses too. Graphs 3 and 4 depict the trends in income and expenses of two tailors from our sample. They reinforce that income for IEs is volatile—though the degree is different—and external factors like seasonality affect income. The income spikes observed during February-March were mainly attributed to two reasons. First, these two months is the wedding season, which led to an increase in orders. Second, these two months is the post-harvest season when people in the area have more money in their hands. We see another spike during October-November, which can be attributed to the festive seasons of Navratri-Durga Puja-Diwali.

3 External shocks like COVID-19 and health emergencies can disrupt the business. The drop in net income can be as high as ~90%. Most of the businesses lack a plan to fall back on.

Seasonality affects different businesses differently. For some businesses, such as grocery shops, tailors, and pharmacies, the effect of seasonality is limited to increased income in certain months. However, certain informal businesses depend solely on certain seasons to balance the low or moderate-income on other months. For example, handicraft businesses in tourist spots depend primarily on the tourist seasons to maximize their income; the revenue is little or moderate at best for the rest of the year.



As seen in graphs 5 and 6, Babli's business was doing much better than Bikram's in November, 2020. Yet, a sudden case of medical exigency with her brother-in-law falling sick in March, 2021 hurt her income. Babli's business faced a considerable drop in profit in March 2021, and it has not fully recovered yet. The medical expenses increased her household's overall expenses. Yet, a more significant blow to Babli was when she was forced to close her shop for an extended time to provide caregiving support to her ailing brother-in-law.

The shop remained closed for quite some time, and Babli still has not started to attend to her shop fully. This occasional absence has led to a significant drop in income from the business. The maximum drop we observed for Babli's income (from February, 2021 to March, 2021) is ~90%. The sudden out-of-pocket expenses from the health emergency also affected the business cash flows. Babli's husband, who works as a laborer in a factory, is now the only earning member in the household with a stable income. Babli's son attends to her shop whenever possible. Yet, the business is open only in small intervals and intermittently at best. The shop was open in August, 2021, which led to a spike in income for that month. During October-November, we again see a massive drop in net income. This fall is due mainly to two reasons. First, because of a wedding in the family, Babli could operate her business for a limited time. Second, she ordered a good amount of merchandise with the hope of selling it during the Diwali festive season but failed to do so, leading to a drop in net income. The family wedding and paintwork at home increased the household expenses during these two months. As most of the regular customers of her shop are from the same locality, they tend to come back whenever her shop reopens; but she is not very sure if that will continue for long.

The situation could have been different if Babli's brother-in-law had health insurance coverage. Babli's family lacks awareness of government health insurance schemes. They also never felt the need to get one from a private organization. Both factors underline the abject lack of awareness of financial solutions focused on risk mitigation. Babli could have also benefitted from a risk cover plan for business discontinuity. It could have provided critical financial support and instilled confidence in Babli to continue with her business plans.

The **gender dynamics** at play are also evident in this case. Babli's business suffered as her role as a caregiver took priority over her business. She ended up spending a considerable amount of time in her caregiving role (taking care of her brother-in-law, preparing for the wedding at home) at the expense of her business. With competing priorities at home and the household responsibilities increasing, she plans to involve her son more to manage the business. Babli's case re-emphasizes that gender roles are a significant impediment for women entrepreneurs—as domestic duties can risk taking precedence over their income-generating role.

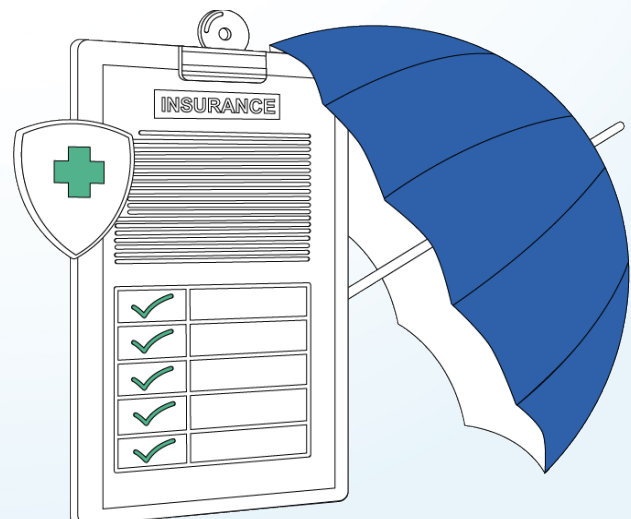


These days I hardly get time to run the business after fulfilling all my household duties. Taking care of my sick brother-in-law takes a lot of my time. But there is no way out; these are responsibilities of the women of the household. It has been days since I ran my shop for the whole day. I think I will ask my son to put in time to run the business.

- Babli, grocery shop owner, Panipat

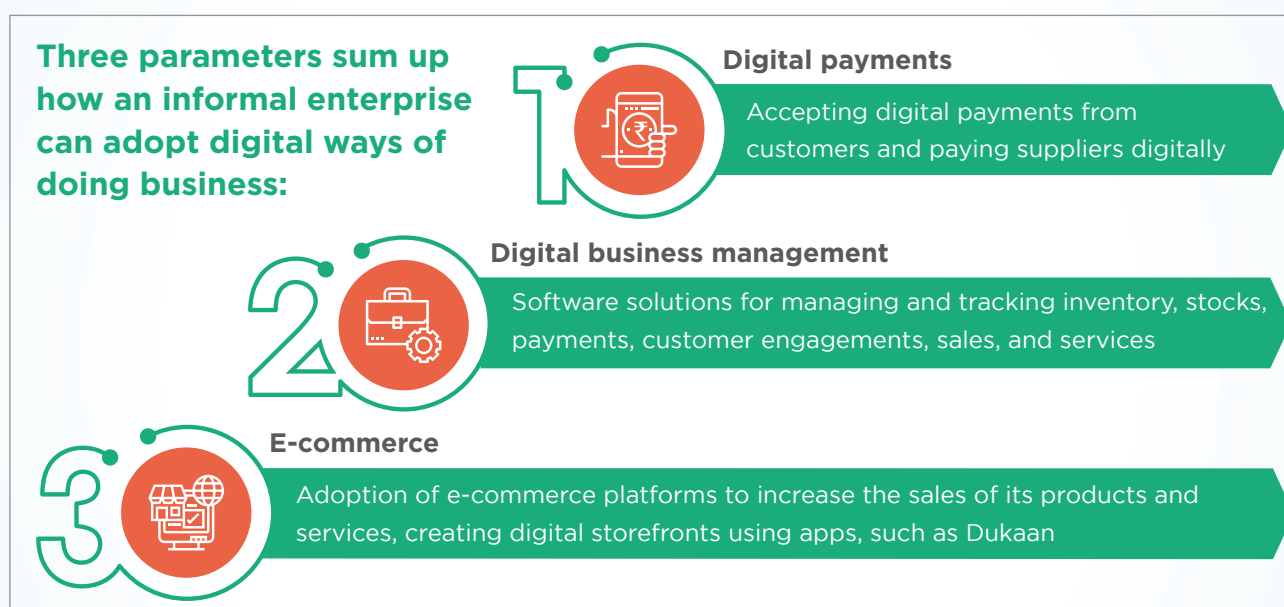
Like Babli, Bikram also does not have an alternate plan to save his business from shock events. However, he and his family were fortunate not to suffer from a medical emergency. He also has a support system in the form of three brothers employed in agriculture to manage financial shocks temporarily. In the forthcoming Insights notes, we will further examine the role of savings and insurance products in managing such crises.

These shock events can devastate the financial health of entrepreneurs in this segment, especially in businesses like grocery shops that generally derive a meager 5-10% margin on their products.



Thematic focus of the edition: Digital adoption

Digitization is often touted as the silver bullet for multiple challenges IEs face—and rightly so. Digitization drives growth in revenues and profit margins. Yet, the sector still does not seem eager to join the digital bandwagon. Nearly 35% of India's offline⁸ small and medium businesses (SMBs) believe that digitization will not add much value to their business. The lack of understanding of where to start to “go digital” is also a common barrier many faces. Where exactly do the IEs fall in the journey of digitization? To what extent have they adopted the digital ways of doing business? What are the challenges and the opportunities? In this section, we will attempt to answer these questions. But first, let us define digital adoption.



With the high penetration of smartphones and internet data facilitated by reducing costs, the digital life of Indians has taken a new pace in the past few years. Using messenger apps like WhatsApp, social media platforms like Facebook, and video-streaming platforms like YouTube have become a way of life. This is true for informal business owners as well. However, not all those who have an active digital life and use messenger apps, social media, or video entertainment apps use digital methods for business.

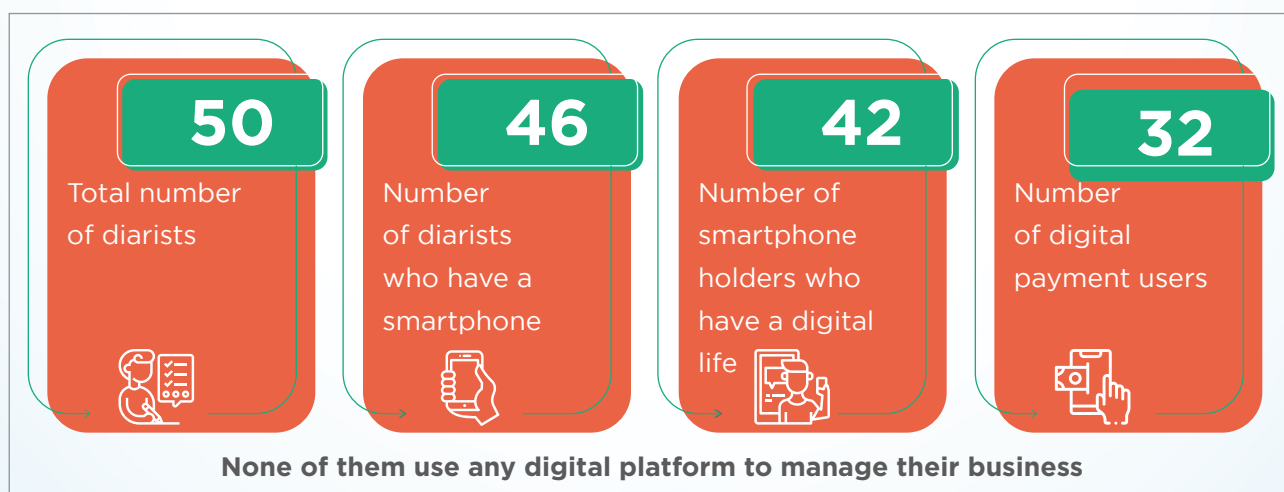
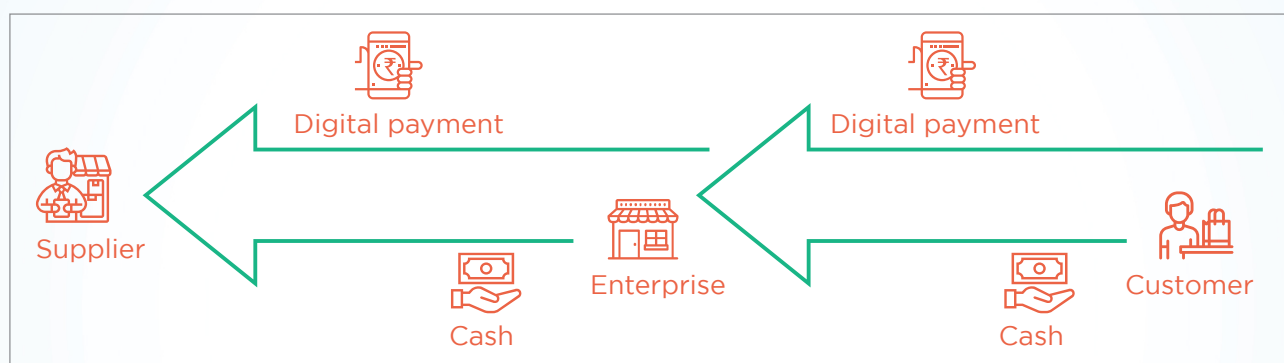
1. Digital payments:

In most cases, digital payments are the first step of digital adoption by IEs. Three players occupy a significant share of the market- PhonePe, Google Pay, and Paytm. The introduction of the Bharat QR code made interoperability possible, thus making the system more convenient.

⁸ SMBs with no internet connectivity, may or may not have a personal computer, do not use social media for business purposes

The following infographic sums up the digital life of our 50 Diarists and their exposure to digital payments. Out of 50 diarists, 46 have a smartphone, while 42 also have an active digital life. They use WhatsApp⁹, Facebook, or YouTube. Out of those 42, 35 use digital payments. Among those who use digital payments, not more than 30-40% of their transactions are digital. All of the 35 use UPI as the mode of accepting digital payments from the customers; only six of them also use digital wallet along with UPI. A significant portion of the clientele of these businesses belongs to the low- and middle-income segment, who transact primarily in cash. The case is the same with the suppliers from whom these IEs procure their stock—they demand cash payments. Hence, a lack of a conducive ecosystem for digital payments across the demand and supply chain inhibits them from increasing the share of digital payments in their overall transactions.

We are yet to see any enterprise that has gone entirely digital in its business transactions. Enterprises are either completely cash-based, as seen in 18 of our 50 diarists, that is, 36%, who deal entirely in cash. Else, they base their business on a mix of cash and digital payments—both while paying suppliers and receiving payments from customers.



The 7 respondents who, despite having a digital life, do not use digital payments indicate an untapped and almost-ready segment of IEs. They can be motivated to start using digital payments. The non-users are averse to starting using digital payments. They perceive the onboarding processes to be lengthy and arduous. They also feel that digital payments are designed and best suited only to those familiar with technology and eager to try new solutions.

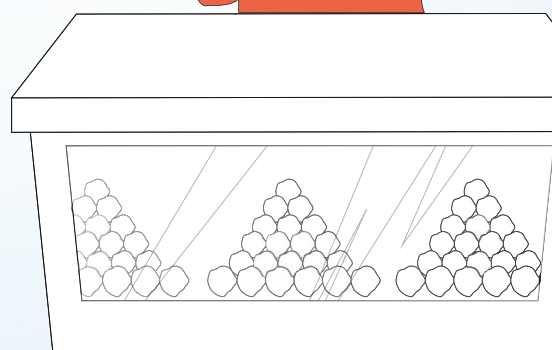
⁹ WhatsApp is the most commonly used app by our diarists

Business owners do not understand the advantages of digital payments for their businesses. Moreover, they also perceive these solutions to be risky and prone to fraud and hence do not trust digital payments with their business transactions. The lack of trust stems mainly from anecdotal instances of fraud, missing money, and failed transactions, which they get to know from various sources. Lack of clarity about who will bear the liability in case fraud/transaction failure happens also makes the enterprises skeptical about adopting digital payments. Most IEs believe that there is little to no recourse in terms of sharing such risks if they were to be victims of such frauds. Service providers also need to increase awareness among IEs on the benefit of enhancing their creditworthiness by increasing their digital footprint in payments and transactions.

Observation 1: Digital payments are catching up in a still cash-dominant business environment



- For many businesses, depending on location and size—be it in the busy markets of northern Kolkata or in a village in Panipat—cash is king. Both customers and suppliers prefer to deal mostly in cash.
- Digital payments are slowly catching up, mostly in the metros. COVID-19 has partially acted as a catalyst for some enterprises to start/increase accepting digital payments. Yet, an addressable gap persists. Despite having smartphones, many entrepreneurs do not use digital payments. Non-users mostly perceive digital payment as something that suits the younger, tech-savvy generation.
- For many, customer demand drives the adoption of digital payments. Businesses that have mostly middle-aged or older customers did not see any demand for digital payment. Peer influence and perceived convenience also play critical roles.
- Suppliers are also gradually starting to accept digital payments but most still prefer to deal in cash, both due to the perceived ease of dealing in cash and in a bid to avoid taxes.



Observation 2: IEs make informal arrangements with other enterprises to manage digital payments



- Some enterprises that lack the facility to accept digital payments have made an informal arrangement with other bigger shops near them to accept digital payments. If the customer is unable to pay in cash, they can pay using the digital payment facility of a nearby shop and the shop later gives cash to the informal enterprise. In many cases, there is some quid pro quo between the two businesses; the larger shops get some kind of service from the smaller shops in return to helping with this. For example, one of our diarist who is a cobbler gets to set up his shop in front of a large pharmacy and gets to use the digital payment facilities from that pharmacy. In return he has to clean the premises of that pharmacy every day.
- Such informal arrangements are also common for trading digital money with cash. While some businesses accept digital payment, they transfer their digital payment to a friend's wallet or bank account digitally and get cash in return. The need to convert digital money to cash is an imperative for these IEs, as most of their business and personal dealings are in cash.

2. Digital business management:

The second aspect of digital adoption is using digital platforms for business management. According to a [Tech Mahindra report](#), the operating cost of running SMEs reduces by ~20-30% if they adopt digital technologies. Several digital platforms have emerged to help IEs manage their businesses better.

Platforms like [PagarBook](#) help enterprises manage their payroll and staff attendance. [Khatabook](#) is a platform that can help to digitally record the credit that the businesses extend to their customers and digitalize bookkeeping. Inventory management platforms like [Vyapar](#) have also emerged in recent times. New-age B2B e-commerce apps like [Udaan](#), [Jumbotail](#), [Teikei](#), and [ShopX](#), among others, are disrupting the traditional supply chain by giving better deals and doorstep delivery. Apps like [Dukaan](#) are enabling businesses to set up their digital storefronts.

However, none of our diarists uses any digital platform to manage their businesses. The Diaries exercise was the first attempt that most diarists made on formal bookkeeping. The primary reason for not using digital platforms for business management is the complete absence of a perceived need. The entrepreneurs firmly believe their manual methods work just fine. The small size of these businesses makes it possible for the owners to manage most operational tasks manually.

Several factors add to the reluctance to adopt digital pathways, including their lack of digital capacity in terms of know-how and access to smartphone or internet connection, lack of trust in digital methods—especially digital payments, and the general inertia to break the status quo. Moreover, entry-level barriers like the requirement of business registration and trade license to use some of these apps prove significant hindrances.

Observation 3: IEs do not find good value in digital business management solutions



IEs perceive the current manual systems of business management to be adequate. The fact that these businesses are quite small and rarely have additional staff to manage adds to their belief that they do not need digital solutions. The B2B apps as a supplier option also do not attract small businesses because of the mandatory requirement of trade license.

In addition, the status quo bias does not let the businesses shift to these digital options from their old brick-and-mortar system. One of our diarists mentioned that the price difference between his suppliers and the apps like Udaan is not much. Hence, they do not feel a need to shift. While some of our diarists have heard of Khatabook, none use it—“a pen and paper is better than a mobile phone to keep records and do calculations.”

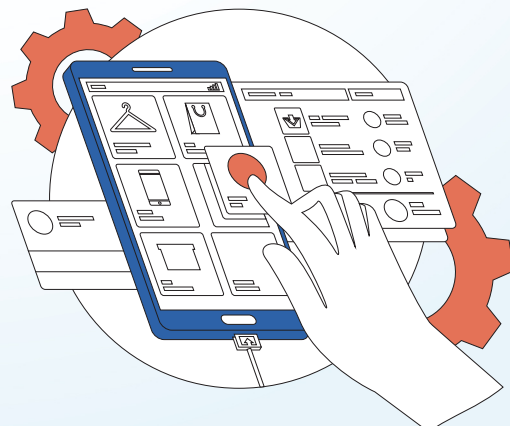


I have heard of the Udaan app from one of my friends. I have compared the prices that I can get from the app with what I get from the regular supplier. And there is hardly any difference. I have also heard that these apps need shop license which I do not have. So, my manual method works just fine.

- Surjo, Grocery shop owner, Kolkata

3. E-commerce: 

In India, MSMEs that adopted e-commerce reported 27% higher revenue growth than their offline counterparts. The increase in revenue comes from offering competitive prices, offering superior goods and services, serving more customers, or a combination of all three. Digital adoption makes this scenario a reality. Many e-commerce platforms have started to foster digitization and offer support to MSMEs. Some notable initiatives are SAMARTH by Flipkart, MSME Accelerate by Amazon, Atmanirbhar by ShopClues.



However, e-commerce is a difficult option for informal enterprises due to several reasons:

The presence of e-commerce in smaller cities is limited:



1

For many types of businesses, such as salons, roadside eateries, laundry shops, tailors, garages, and vegetable vendors, e-commerce is not a suitable solution. While one can find roadside eateries enlisted with Zomato or Swiggy in metro cities like Mumbai, this is not a norm for the rest of India. More than 65% of food vendors in India are in the unorganized sector.

Awareness of business owners regarding e-commerce is low:



2

Although most business owners know of these platforms, many do not know about the processes, services, and features. They, therefore, miss the full range of benefits from e-commerce and fail to see a strong value proposition for their businesses.

Digital capability is restricted:



3

Their limited digital capacity or its lack in terms of how to use various digital platforms and lack of ease in using a software or app solution, among other factors, further impede the usage of such solutions.

Informality is a challenge:



4

Online platforms like Flipkart, Amazon, Zomato, and Meesho, among others, mandate most enterprises to provide GSTIN to register their businesses. The only exceptions are enterprises that sell books, maps, plastic bangles, and certain notified handicraft goods. This requirement proves to be a deterrent for IEs to use these platforms.

Local focus:



6

e-commerce is generally of use if a business is looking for geographical expansion and reach out to clientele from outside their neighborhood. However, the IEs generally operate in ultra-local mode and they hardly look for customers from other geographies. Hence, e-commerce is not of much use for many of them.

However, there are exceptions. New-age social commerce platforms, such as Facebook marketplace, Facebook Live, or Instagram Shopping, do not need any GSTIN to operate unless the business crosses a specified turnover limit¹⁰.

Observation 4: E-commerce is still not a lucrative value proposition (and not needed to be at the moment)



Most small businesses do not see value in adoption of e-commerce; the need for formalization is also a constraint. Some of the small business owners use WhatsApp to get orders from customers but joining any aggregator or platform is extremely rare. This informal arrangement of ordering supplies, doing marketing activities and getting orders using social media/chat messenger services is the first step of the journey. For most IEs, this is sufficient for their need.

We will end this section with three case studies to understand the factors that motivate the use of digital payments and the associated nuances. The case studies will span the manufacturing, trading, and services sectors.

Rita Rani (25 yrs.)

Delhi NCR, runs a tailoring business and has a savings bank account

Rita, a graduate, runs a tailoring shop in Delhi NCR. She knew of the digital payment methods but did not use them until her brother motivated her to do so. Initially, she started using digital payments for her personal needs. Later, she started to accept digital payments for her business. Her brother took care of the application and installation of the QR code in her shop. She uses both Bharat QR codes for UPI transactions and mobile wallet (Paytm) using the phone number.

Rita has been using this digital payment method even before the COVID-19 outbreak. She estimates that nearly 30-35% of her customers prefer using digital payment methods. She says it is easier, safer, and convenient; she has not faced any difficulty using digital transfer methods so far. Rita is willing to accept all her receipts in digital money as some (not all) of her suppliers also accept digital payment and she does not need much cash to run her business. Network issues are rare in her locality and she is quite happy with digital payments.

01



¹⁰ A business whose aggregate turnover in a financial year exceeds Rs.20 lakhs (or Rs.40 lakh for a supplier of goods) has to mandatorily register under Goods and Services Tax. This limit is set at Rs.10 lakhs for North Eastern and hilly states flagged as special category states.

02

Hemant Dubey (22 yrs.)

Delhi NCR, runs a shop that manufactures and sells home decoration items and has a savings bank account

Hemant is from Delhi NCR and he runs a business of manufacturing and selling home decoration items. He does not have a retail front; he takes orders from the customers directly and operates from home. He is a young entrepreneur who has recently completed his graduation. He has been using digital payment methods for personal use even before COVID-19. He started to accept digital payments for his business after COVID-19, using PhonePe and Google Pay, both through UPI-enabled phone numbers.

Many of his friends who themselves had started using digital payments inspired Hemant to follow suit. The steady increase in usage and acceptance of digital payments among vendors and customers was another catalyst to his embrace of digital. Most of his suppliers accept digital payments as well. Hemant claims that currently, up to 90% of his customers have switched to digital payments, as it is a safer, faster, and involves no physical contact. He is willing to accept 100% of his payments digitally as he does not need much cash to run his business. He has not faced any issue with digital payments, except for occasional network and server downtime.



03

Arun Srivastava (18 yrs.)

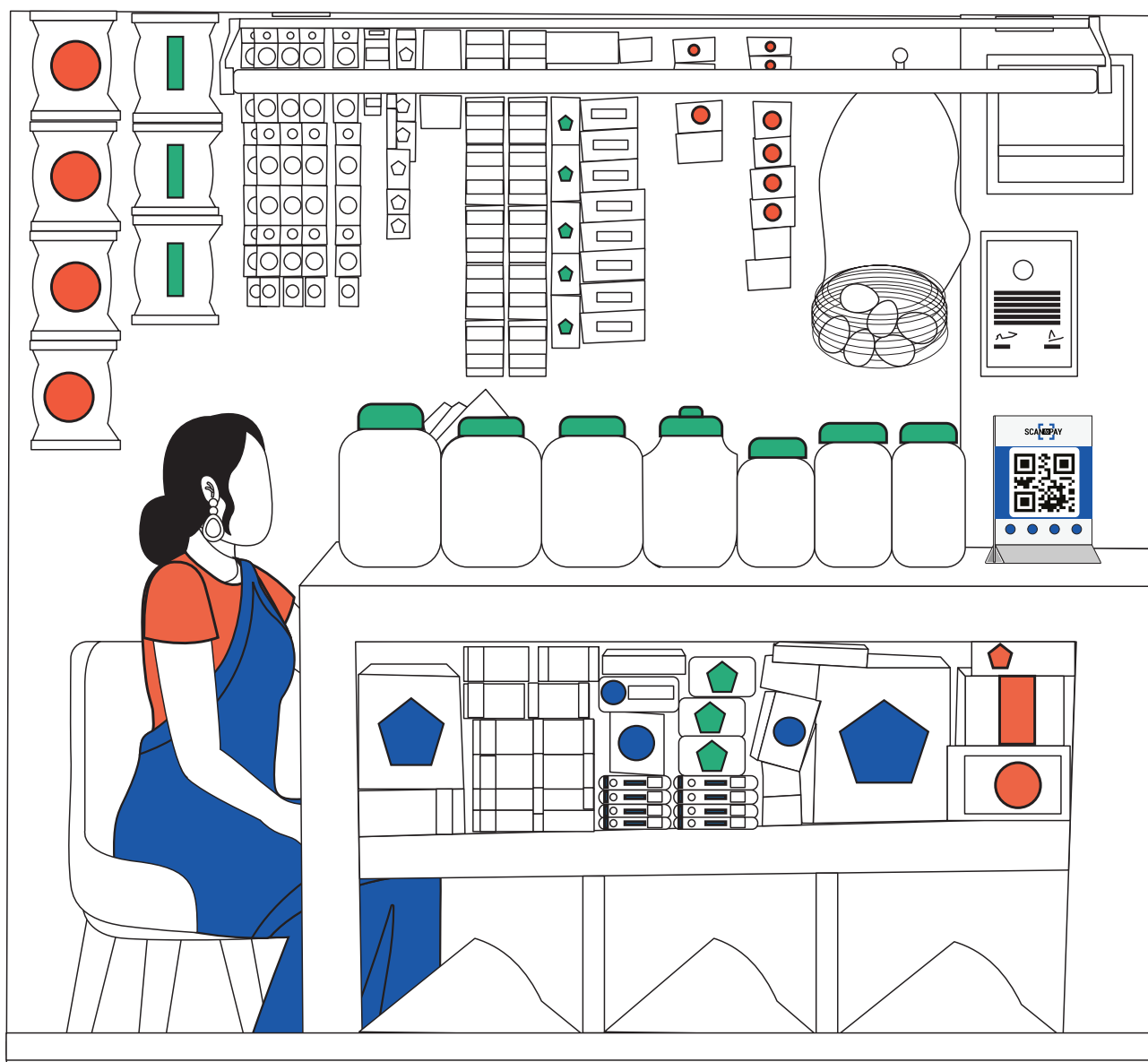
Hyderabad, runs a vegetable shop, saves money at home, does not have a bank account

Arun, just 18 years old, runs a vegetable shop in Hyderabad with his brother's help. He uses all types of digital payments. His father, who works as a security guard, has a bank account that the whole family uses. Arun is curious and likes to learn new things. He has been using digital payments for two years now. He learned about this from one of the digital payment platform's aggregators. Currently, he accepts payment exclusively through mobile numbers—the same mobile number is linked with Paytm, PhonePe, and Google Pay; he does not use QR code. The money goes to his mobile wallet, which he then encashes daily from a shop run by a friend. He transfers the amount to that shop owner's mobile wallet and the shop owner, in turn, gives him cash. He does not pay any charge for this conversion; this is an informal arrangement between Arun and that shop owner. This arrangement benefits Arun as he gets the necessary cash to buy his stock every morning, and the shop owner benefits by not having to manage a lot of physical cash; the fact that they are close friends also benefits the arrangement. Arun estimates that digital transactions have risen since the pandemic begun, and currently ~30-40 % of his customers prefer to pay digitally. These customers first confirm the availability of the provision of paying digitally before buying vegetables. He has not faced any trouble receiving or sending payments through the digital medium so far and he is happy using it as it is simple, safe, and promotes no-touch payments.



Conclusion

Financial products that can help build a disciplined habit of regular savings, along with collateral-free small ticket-size loans, can be essential tools to tide over sudden business shocks and economic shocks. Low-cost savings and insurance products to hedge against medical emergencies and business discontinuity can also help significantly. Building trust among the IEs on using digital platforms is another crucial need. Strong use cases, transparent information, robust grievance resolution processes, and a focused communication approach by the providers are the need of the hour. Partnerships between digital payment players and providers of digital business management services can offer more suitable solutions for IEs. They can catalyze the increased adoption of overall digital solutions not just in the hinterlands of India but beyond.



Annex: Sources of data

We use three distinct data sources for this insights series:

- i. Microenterprises Diaries (ME Diaries):** One-time surveys can provide a snapshot of the situation of microenterprises at one point in time. Though quite useful to frame an initial understanding, they fail to provide the required nuanced understanding of the complex life of microenterprise owners. Moreover, aspects like income, expenses, savings, and credit for microenterprise change frequently over time. Hence, an alternate approach is required to capture the volatile financial situation of microenterprise and understand how external factors affect them over time. These factors include new regulations and changes in the local sociopolitical situation, coupled with others like seasonality.

MSC has been conducting research based on Financial Diaries to bridge this evidence gap. Diaries is the approach pioneered by [Stuart Rutherford](#), [David Hulme](#), [Jonathan Morduch](#), and [Daryl Collins](#). It captures a nuanced understanding of the lives of microenterprises, especially informal ones. This research, named IE diaries, is a part of the “Voices of India's MSMEs” research that receives support from Omidyar Network India.

In this method, we track daily financial transactions of the microenterprises, especially the informal ones, whom we refer to as “diarists” in this note. We collect the following data daily:

- income from the business as well as from other income sources,
- business expenses (raw material, rent, electricity bill, internet bill, staff salary, business asset-buying, etc.),
- different types of personal expenses (grocery, vegetables, fish/egg/meat, milk and dairy products, education, health, household asset, religious expenses, etc.),
- savings deposited in various avenues (bank account, SHG, ROSCA, etc.),
- savings withdrawn from various sources,
- loans are taken (from a financial institution, moneylender, SHG, etc.),
- loans repaid, etc.

In-depth qualitative discussions with the diarists complement the daily diaries data. These help build a better understanding of the reasons behind various spikes and dips in income and expenses and the reasons behind various financial decisions diarists take. We will conduct monthly micro-surveys to gather insights into different thematic areas. The diaries data collection started in late July, 2021 and will continue until July, 2022.

We chose 25 microenterprises for this research from five locations; 24 of these were informal microenterprises. Of the 25 selected diarists, five each were selected from each of the locations—Delhi NCR, Surat (Gujarat), Lucknow (Uttar Pradesh), Patna (Bihar), and Hyderabad (Telengana). The composition of these 25 diarists in terms of business types is as follows:

Type of business	Sample size
Tea stall	2
Video production business	1
Book shop	1
Mobile repair shop	1
Manufacturing units (clay pot/home decoration items/bracelets/flex, hoardings and banners/packaged snacks items)	5
Tailor/boutique	4
Paan shop	1
Eating joints	3
Cobbler	1
Electric appliances repair shop	1
Bike repair shop	1
Laundry	1
Fish shop	1

- ii. **Corner Shop Diaries:** this is part of the global Corner Shop Diaries research effort—a collaborative effort by L-IFT and MSC. In this research, we track corner shops, small neighborhood shops selling items and services of daily needs, using the Financial Diaries method. We started tracking 25 corner shops from late October, 2020, and tracked them until the end of 2021. See this for more details.

We chose 25 corner shops for this research from five locations—Prayagraj (Uttar Pradesh), Bhopal (Madhya Pradesh), Hanumangarh (Rajasthan), Kolkata (West Bengal), and Panipat (Haryana). Each location has five diarists. Among these 25 diarists, we have the following businesses:

Type of business	Sample size
Grocery shops	9
CICO agents (bank/Fintech)	3
Tailor	3
Pharmacy	1
Tea/snacks stall	1
Mobile shop	1
Digital services (photocopy/print/cyber café/mobile accessories)	3
Cosmetics shop	1
Beauty parlor	1
Men's salon	1
Laundry/ironing of clothes	1

- iii. **Secondary data** from various research reports/statistics published by government departments/think tanks/universities/financial organizations, newspaper articles published by leading dailies/news portals (Times Of India, The Hindu, Indian Express, Financial Express, Economic Times, Livemint, etc.) and credible websites (ClearTax, RBI, the Ministry of MSMEs, etc.)



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