

The Role of Government and Policy in Encouraging Digital Payment Adoption Among MSMEs in India

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Abstract - The significant role of government policies and initiatives in accelerating digital payment adoption among Micro, Small, and Medium Enterprises (MSMEs) in India transformative journey of India's MSME sector towards digital payment integration, driven by government initiatives under the Digital India program, such as the DIGIDHAN Mission and the Unified Payments Interface (UPI) is the key areas which this paper examines. The surge in digital payment transactions and the pivotal role of platforms like UPI in this growth are underscored. Additionally, the study discusses the Reserve Bank of India's Digital Payment Index, indicating a deepening reliance on digital transactions across India, supported by increased internet and mobile phone penetration and government initiatives.

The research also explores challenges, including digital literacy and access, security concerns, and the barriers to digital financial inclusion. Government policies and initiatives aimed at enhancing market access, technological empowerment, and financial inclusion for MSMEs, such as the Procurement and Marketing Support Scheme and the MSME Champions Scheme, are critically analyzed.

Keywords: Digital Payment Adoption, MSMEs, Government Policy, Digital India, Financial Inclusion.

Introduction - The transformative journey of digital payment adoption in India's Micro, Small, and Medium Enterprises (MSMEs) sector is a compelling narrative of technological integration and policy-driven empowerment. As a critical pillar of the Indian economy, MSMEs have witnessed a significant digital leap, particularly in the domain of digital payments, catalyzed by robust government initiatives and evolving financial technologies.

The Government of India, recognizing the critical role of digital payments in economic transformation, has launched several initiatives under the Digital India programme to promote the digital payment ecosystem. The DIGIDHAN Mission, established by the Ministry of Electronics & IT (MeitY) and later transferred to the Department of Financial Services (DFS), has been a cornerstone in this endeavor. Since its inception, there has been a remarkable increase in digital payment transactions, growing from 2,071 crore in FY2017-18 to 13,462 crore in FY 2022-23. This surge underscores the growing acceptance and integration of digital payments across the country, bolstered by the availability of diverse payment modes like BHIM-UPI, debit/credit cards, and IMPS, among others. (PIB, 2023)

This surge in UPI transactions illustrates the platform's pivotal role in the digital payment landscape, driven by continuous innovation and user-centric features such as

AutoPay and P2M Global transactions. (PIB, 2023)

The Reserve Bank of India's Digital Payment Index (DPI) provides a quantitative measure of the adoption and penetration of digital payments, showing a significant increase to 304.06 in September 2021 from 217.74 in the same period the previous year. This growth indicates a deepening reliance on digital transactions across the Indian populace, supported by factors such as increased internet and mobile phone penetration, and government initiatives like the Jan Dhan-Aadhaar-Mobile (JAM) trinity. (SIRU, 2022)

The government's focus extends beyond just transactional support, The Procurement and Marketing Support (PMS) Scheme, for example, aims at enhancing the marketability of MSME products and services through adoption of e-commerce platforms and participation in trade fairs. (MSME, 2022)

Hypothesis and Objectives:

H1: Digital financial inclusion initiatives reduce the transaction costs and barriers associated with accessing credit for rural MSMEs.

H2: The utilization of digital financial services leads to an improvement in the financial literacy and management capabilities of MSMEs.

H3: Infrastructure and regulatory frameworks significantly influence the effectiveness of digital financial inclusion

initiatives in rural areas.

Objectives:

Primary Objective: To evaluate the impact of digital financial inclusion initiatives on enhancing sustainable credit access for rural MSMEs in India.

Secondary Objectives:

1. To analyze the influence of infrastructure and regulatory policies on the success of digital financial inclusion initiatives in rural India.
2. To identify best practices and provide recommendations for enhancing the effectiveness of digital financial inclusion initiatives in promoting sustainable credit access for rural MSMEs.

Literature Review:

The integration of digital payments within the Micro, Small, and Medium Enterprises (MSME) sector is pivotal for economic progress, particularly in emerging economies like India. The transition from traditional financial transactions to digital platforms is influenced significantly by government initiatives, policy interventions, and the inherent characteristics of MSMEs. This literature review systematically explores these facets, drawing from various sources, including research papers, government reports, and empirical studies.

Challenges and Barriers to Adoption-

Digital Literacy and Access: A significant challenge remains in the form of digital literacy and access to digital infrastructure, especially in rural and semi-urban areas. Addressing these challenges is critical for the widespread adoption of digital payments among MSMEs (Widayani, 2022)

Security Concerns: Security concerns associated with digital transactions can also deter MSMEs from adopting digital payment methods. Policies aimed at enhancing cybersecurity measures and educating MSME owners about secure digital practices are essential in mitigating these concerns (Widayani, 2022)

(Widayani, 2022) highlight functional barriers such as the perceived complexity and risk associated with digital payment systems. Additionally, psychological barriers stemming from traditional business practices and resistance to change also play a significant role.

Barriers and Transaction Costs: Despite the progress, challenges remain in fully realising the potential of DFI. A study highlighted the barriers to financial inclusion, such as financial literacy, high service costs, and regional inequalities, which hinder the widespread adoption of digital financial services among rural populations (Gaurav Agrawal, 2019). Addressing these barriers is essential for ensuring that DFI initiatives reach and effectively serve rural MSMEs.

Barriers and Challenges for MSMEs: Despite these advancements, MSMEs face obstacles, including digital literacy, access to technology, and regulatory complexities. For instance, the literature suggests that only 6% of enterprises have adopted digitization, primarily due to low

digital awareness and high adoption costs (Kakkar, 2021)

Governmental Initiatives and Digital Infrastructure:

Impact of Digital Financial Inclusion on Rural MSMEs:

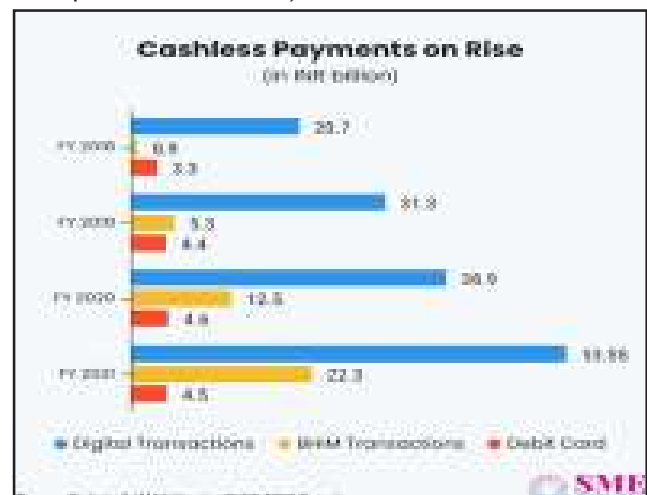
The advent of the India Stack, including Aadhaar and the Unified Payments Interface (UPI), has revolutionised access to financial services, significantly impacting rural MSMEs. The Aadhaar system provided a digital enabling the government's direct benefit transfer schemes. Similarly, UPI has democratised payment services, allowing small traders and vendors to participate in the digital economy (BY YAN CARRIÈRE-SWALLOW IMF, 2021).

Government Initiatives and Policy Framework: The Indian government has launched several programs aimed at digital financial inclusion and literacy. One prominent initiative is the Digital India campaign, which seeks to transform India into a digitally empowered society and knowledge economy, (Digital Report MeitY, 2020). Within this framework, specific schemes like the Pradhan Mantri Jan-Dhan Yojana (PMJDY) have been instrumental in increasing access to financial services through digital means.

Digital Saksham, a partnership between CII, Mastercard, and the government, aims to train around 3 lakh MSMEs in digital tools, underscoring the concerted efforts towards digitization. (Kakkar, 2021)

The government's efforts to simplify and secure digital transactions have not only enhanced operational efficiency but also instilled trust among MSMEs towards digital adoption. (Asian Development Bank, 2022) (Sur, 2023)

Digital payments and MSME Financing: Digital payment platforms offer revolutionary opportunities for MSME financing, enabling the use of cash flows as collateral for loans and creating new markets through e-commerce (ADB, 2020). These platforms, coupled with government-backed initiatives like Bakong in Cambodia, demonstrate the potential of digital payments to enhance financial inclusion and support MSME growth in developing economies. (Asian Development Bank, 2022)



Whereas an RBI analysis states that the share of digital

transactions in the total volume of non-cash retail payments increased to 98.5 per cent during 2020-21, up from 97 per cent in the previous year.

Among the cashless payment options, the mobile payment app BHIM (Bharat Interface for Money) overtook debit card payments from 2018. The value of BHIM transactions increased significantly between 2018 and 2021. Also, the number of Points of Sale (PoS) terminals increased by 6.5 per cent to 47.20 lakhs and the number of Bharat Quick Response (BQR) codes deployed increased by 76 per cent to 35.70 lakhs by the end of March 2021. Further, the number of ATMs marginally increased by 2 per cent from 2.34 lakh at the end of March 2020 to 2.38 lakh at the end of March 2021.

Talking about the rise of the cashless economy and digital payments, SMEs can be seen as a case of an acute dichotomy. While on one hand they have been the most badly impacted segment, but at the other end of the spectrum, they have been the fast movers on the digital adoption front, more than the others. (SME Futures) (Singh, 2021)

Economic Implications and Benefit:

Economic Growth and Competitiveness: Digital payment adoption is not merely about transitioning from cash to digital transactions; it encompasses a broader economic agenda. By facilitating seamless and efficient transactions, digital payments can significantly contribute to the economic growth and competitiveness of MSMEs, enabling them to tap into new markets and customer segments (Sur, 2023)



Today, a significant portion of rural India has become digitally connected, giving people more freedom to communicate and conduct business online. This resulted in the creation of millions of new customers for e-commerce and digital marketing. (Palak Agarwal, 2023)

Role of Technology and Innovation: Innovation in technology plays a pivotal role in driving merchant acceptance of digital payments. Companies like Hitachi Payment Services Pvt. Ltd. have been instrumental in developing and deploying secure and reliable digital

payment solutions across India, facilitating ease of transactions for customers and merchants alike. The deployment of technologies such as Bharat QR and UPI, alongside traditional card payments, exemplifies the strides made in providing versatile payment options. (Dilip Sawhney, 2020)

Future options and Technological Advancements: The advent of 5G technology presents new opportunities for enhancing the digital infrastructure for MSMEs. This could facilitate real-time connections with suppliers and customers, modernising legacy processes and further promoting the digital economy. (Dilip Sawhney, 2020)

Recommendations and Approaches:

Regulatory Approaches and Future Directions: To address the challenges and leverage the opportunities presented by digital payments, governments and regulators must adopt innovative and inclusive regulatory approaches. This includes enhancing digital literacy among MSME owners, strengthening digital infrastructure, and fostering collaborations between public and private sectors to support the sustainable growth of MSME. (UNCDF, 2021)

The Reserve Bank of India (RBI) highlights the importance of developing a robust infrastructure, including credit and payment systems, to support DFI. Innovations such as the establishment of a national identification system and a credit registry database have been pivotal in advancing financial inclusion. Moreover, the focus on last-mile delivery and consumer protection is crucial for ensuring that financial services are accessible and beneficial to rural MSMEs and their communities. (RBI, 2023)

Enhanced Support and Training: To overcome barriers to adoption, the government, in collaboration with private sector partners, should intensify efforts in providing targeted support and training programs for MSMEs. These programs should aim at enhancing digital literacy, familiarizing MSME owners with digital payment systems, and highlighting the benefits of digital adoption. (Widayani, 2022)

Innovative Solutions and Partnerships: The government should encourage innovation in digital payment solutions tailored for the unique needs of MSMEs. Establishing partnerships between financial institutions, technology companies, and MSMEs can lead to the development of user-friendly and secure digital payment platforms. (Kakkar, 2021)

Conclusion: It's evident that the role of government and policy in encouraging digital payment adoption among MSMEs in India is both pivotal and multifaceted. Government initiatives, such as the Digital India campaign, and the introduction of the Unified Payments Interface (UPI) have significantly reduced barriers to digital payment adoption, enabling MSMEs to participate more fully in the digital economy. (Digital Report MeitY, 2020) (Kakkar, 2021) The literature review underscores the critical role of government and policy in facilitating digital payment adoption among MSMEs in India. Through a combination

of strategic initiatives, supportive policies, and addressing existing challenges, there is a significant opportunity to enhance the digital payment ecosystem for MSMEs.

However, challenges persist, including digital literacy, trust in digital systems, and the digital divide between urban and rural enterprises. Government policies must continue to evolve to address these challenges, ensuring that digital payment systems are accessible, reliable, and user-friendly for MSMEs across all regions. (Douglas W. Arner, June 2022)

In conclusion, the concerted efforts of the Indian government and policy makers have been instrumental in catalyzing the adoption of digital payments among MSMEs, thereby enhancing their operational efficiency, market reach, and financial inclusivity. Ongoing and future initiatives should aim to further reduce the digital divide, promote digital literacy, and foster an environment of trust and security in digital transactions.

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