



Najneen, 2. Sumit Chadra

Financial Role Of Public Sector Banks In The Sustainable Development Of Micro, Small And Medium Enterprises In India

Research Scholar, 2. Associate Professor- Dept. of Commerce, Govt. Degree College, Cant Agra (U.P.) India

Received-18.07.2026,

Revised-26.07.2026,

Accepted-03.08.2026,

E-mail:najninusmani786@gmail.com

Abstract: *Micro, Small and Medium Enterprises (MSMEs) are central to India's strategy of inclusive, employment-intensive and sustainable economic development. According to the Economic Survey 2025–26, MSMEs account for approximately 31.1 per cent of India's GDP, 35.4 per cent of manufacturing output and 48.58 per cent of exports. More than 7.47 crore registered enterprises provide employment to over 32.82 crore persons.¹ Despite this contribution, inadequate and untimely access to formal finance remains a major constraint on MSME survival, technological modernisation and green transition. This research article critically examines the financial role of public sector banks (PSBs) in supporting the sustainable development of Indian MSMEs. It employs a descriptive and analytical research design based on secondary data obtained from the Reserve Bank of India, Ministry of MSME, Department of Financial Services, SIDBI and government reports. The study finds that PSBs perform a developmental role through priority-sector lending, collateral-free credit, MUDRA loans, CGTMSE guarantees, working-capital support, restructuring, digital credit assessment and financing of rural, women-owned and socially disadvantaged enterprises. MSME credit outstanding reached approximately Rs.31.3 lakh crore in March 2025, recording annual growth of 14.8 per cent, while public sector banks recorded 19 per cent year-on-year growth in MSME credit demand during the relevant reporting period.^{2,3} Nevertheless, an addressable MSME credit gap of nearly Rs.30 lakh crore, regional concentration of credit, collateral-related difficulties and limited green finance continue to restrict sustainable growth. The study recommends sustainability-linked MSME lending, cash-flow-based appraisal, cluster financing, stronger credit guarantees and mandatory reporting of the social and environmental outcomes of PSB credit.*

Key words: *Public sector banks, MSMEs, sustainable development, priority-sector lending, financial inclusion.*

1. Introduction- "Micro, Small and Medium Enterprises" constitute the productive foundation of the Indian economy. They generate employment with comparatively low capital investment, promote entrepreneurship, utilise local resources and encourage the geographical dispersal of economic activity. MSMEs are particularly important in rural and semi-urban areas where large industries have limited presence. The sector also supports large industries through ancillary production, intermediate goods, repair services, logistics and supply-chain participation.

The "Economic Survey 2025–26 reports that India has more than 7.47 crore registered MSMEs employing over 32.82 crore persons. The sector contributes approximately 31.1 per cent of GDP, 35.4 per cent of manufacturing and 48.58 per cent of exports."¹ These figures establish that sustainable development of MSMEs is essential not only for industrial growth but also for poverty reduction, balanced regional development, gender inclusion and employment generation.

Finance is the key external input for a Micro-Small Enterprise (MSME) which is necessary for establishing the business; providing working capital; acquiring machines or equipment; digitalising products; obtaining product certification; increasing sales and accessing new markets. However, micro and small businesses often do not have fixed assets as security; audited accounts; a formal credit history or sufficient knowledge of how to create a "bankable" report. Therefore, it can be difficult for these enterprises to access formal lending from traditional banking channels. Many MSMEs instead rely on informal lenders who provide loans at higher interest rates.

As such, public sector banks (PSB's) play an essential role in facilitating the delivery of formal finance to those enterprises which would otherwise not receive this type of financing. The primary reason for this lies within their dual mandate. While they are commercially driven like all other financial institutions, they are also mandated to contribute to the nation's economic development goals.

2. Objectives of the Study- The primary goals for this research include:

1. To analyze how the finance functions of public sector banks contribute to the development of Indian MSMEs.
2. To identify and analyze some current trends related to MSME credit and a variety of sustainable development indicators.
3. To assess the contributions made by priority sector lending, credit guarantee programs and other government sponsored programs.



4. To identify major limitations in PSB financing of micro and small enterprises.
5. To recommend measures for strengthening sustainable and inclusive MSME finance.

3. Research Methodology- The study follows a descriptive and analytical research design. It is based on secondary data collected from the Economic Survey 2025–26, Reserve Bank of India reports and directions, SIDBI Annual Report 2024–25, SIDBI–TransUnion CIBIL MSME Pulse reports, Ministry of MSME publications, Department of Financial Services data and Press Information Bureau releases.

The latest consolidated information available up to January 2026 has been used. Percentages, growth rates and scheme-level figures have been compared to evaluate the magnitude, direction and inclusiveness of institutional credit. The study is limited by the non-availability of completely uniform bank-wise data on green MSME finance and the environmental outcomes of loans sanctioned by individual PSBs.

4. Recent Position of the MSME Sector and Institutional Credit

Table 1: Selected Recent Indicators of MSMEs and MSME Finance in India

Indicator	Latest available position	Period/date	Sustainable-development significance
Registered MSME enterprises	More than 7.47 crore	2025–26	Formalisation and access to institutional benefits
Employment associated with MSMEs	More than 32.82 crore persons	2025–26	Livelihood creation and inclusive growth
MSME share in GDP	31.1%	2025–26 estimate	Contribution to national output
Share in manufacturing	35.4%	2025–26	Industrial diversification
Share in exports	48.58%	2025–26	Foreign-exchange earnings and global integration
Outstanding MSME credit	Rs.31.3 lakh crore	March 2025	Expansion of formal financial support
Annual growth of MSME credit	14.8%	FY 2024–25	Credit growth exceeded overall advances growth
90-days-plus delinquency	1.79%	March 2025	Five-year low; improvement in credit quality
Estimated addressable credit gap	About Rs.30 lakh crore	2024–25 estimate	Indicates continuing financial exclusion
PSB share of reported credit demand	About 37%	2025 reporting cycle	Significant role of PSBs in MSME financing
Year-on-year growth associated with PSBs	19%	2025 reporting cycle	Growing PSB participation
CGTMSE guarantees since inception	More than 1.18 crore guarantees worth Rs.9.80 lakh crore	Up to FY 2024–25	Collateral-free credit expansion
CGTMSE guarantees in FY 2024–25	Approximately Rs.3 lakh crore	FY 2024–25	Record annual guarantee support
MUDRA cumulative lending	Rs.33.64 lakh crore to 53.31 crore accounts	March 2025	Micro-enterprise and self-employment finance

Source: Compiled from Economic Survey 2025–26, SIDBI Annual Report 2024–25, MSME Pulse, Ministry of MSME and MUDRA data.¹⁻⁶

Table 1 shows that the formal MSME credit market has expanded substantially. Credit outstanding reached Rs.31.3 lakh crore in March 2025, almost twice the pre-pandemic level. Its annual growth of 14.8 per cent was higher than the 11 per cent growth in overall gross advances.² At the same time, 90-days-plus delinquency declined to a five-year low of 1.79 per cent. This weakens the common assumption that MSME lending is necessarily characterised by excessively high default risk.

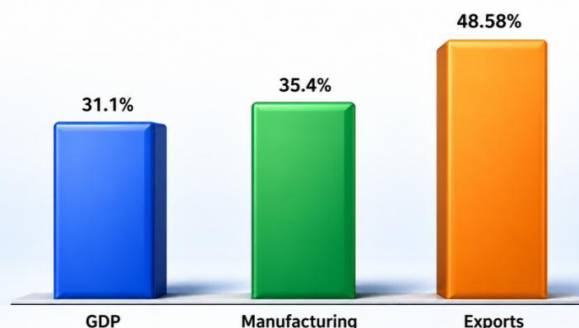
However, the estimated addressable credit gap of nearly Rs.30 lakh crore is almost equal to the formal credit already outstanding.² Thus, rapid growth in credit has not eliminated financial exclusion. Many micro enterprises continue to borrow informally because their requirements are small, irregular or inadequately supported by conventional documentation.

Figure 1: Selected Dimensions of the MSME Sector in India

Source: Economic Survey 2025–26.¹

The graph indicates that the MSME sector's role extends beyond domestic output. Its contribution of 48.58 per cent to exports makes access to affordable trade finance, foreign-exchange services and export credit particularly important. PSBs can therefore influence the international competitiveness of MSMEs through pre-shipment finance, post-shipment credit, bank guarantees and technology-upgradation loans.

Figure 1: MSME Contribution to the Indian Economy (%)



Source: Economic Survey 2025–26.

5. Financial Role of Public Sector Banks- 5.1 Priority-Sector Lending: The “Reserve Bank of India classifies loans to MSMEs as priority-sector advances. Domestic commercial banks are required to direct a prescribed portion of their Adjusted Net Bank Credit towards priority sectors. A sub-target of 7.5 per cent of ANBC or the credit-equivalent amount of off-balance-sheet exposure, whichever is higher, is prescribed for lending to micro enterprises.”⁷

This regulatory framework prevents the systematic diversion of credit towards only large, established and low-risk corporations. PSBs translate the framework into credit delivery through term loans, working-capital limits, cash-credit accounts, bill discounting and composite loans. Their relatively large rural and semi-urban branch network enables them to identify first-generation entrepreneurs and enterprises operating outside major industrial centres.

5.2 Collateral-Free Finance and CGTMSE- Insufficient collateral is one of the most persistent barriers to MSME borrowing. “The Credit Guarantee Fund Trust for Micro and Small Enterprises enables banks to sanction eligible collateral-free loans by guaranteeing a substantial portion of the lender’s exposure. Up to FY 2024–25, more than 1.18 crore guarantees involving approximately Rs.9.80 lakh crore had been approved. A total amount of nearly Rs.3 lakh crore in guarantees was provided to be utilized during FY 2024-25 alone.”⁴ Public sector banks (PSBs) are also important as financial intermediary institutions under this system. The guarantee does not constitute financing itself - it is merely an instrument that can reduce the degree of risk associated with lending by a bank. Combining a PSB loan with a CGTMSE warranty provides access to formal banking services to otherwise un-bankable enterprises at no cost to them (i.e., they do not have to mortgage their residential or agricultural land). Therefore, this mechanism facilitates social sustainability through reducing entrance hurdles for new entrepreneurs, women, scheduled castes, scheduled tribes, etc. who do not have sufficient inheritances to secure traditional forms of collateral.

5.3 MUDRA and Micro-enterprise Finance- The Pradhan Mantri MUDRA Yojana provides institutional finance to non-corporate and non-farm micro enterprises through Shishu, Kishor and Tarun categories. By March 2025, cumulative lending under PMMY had reached Rs.33.64 lakh crore across 53.31 crore borrower accounts. Women constituted approximately 67 per cent of the borrowers, while nearly 50 per cent belonged to SC, ST and OBC groups.⁵

PSBs play a major role in originating and servicing these loans. The scheme demonstrates that MSME finance is not limited to industrial units; it includes small retailers, artisans, transport operators, repair services, food processors and home-based businesses. Such “lending advances Sustainable Development Goals relating to poverty reduction, gender equality, decent work and reduced inequalities.”

5.4 Working-capital and Emergency Support- Micro and small enterprises frequently experience mismatches between production expenditure and receipt of payment from buyers. Delayed payment for businesses will often inhibit a company’s ability to make wage payments; purchase raw material supplies; pay off other debts; etc. PSBs address the cash flow gaps that delay such business transactions by providing short-term financing options (cash/credit accounts, overdraft lines of credit, bills discounted with the bank at

face value less some small discount, etc.) in order to bridge this gap. PSBs can also create restructuring plans as well as emergency lending programs to help companies navigate times of financial uncertainty. The public service mission of PSBs enables governments to send a “counter-cyclical” lending message quickly using their established networks. For example, during the COVID-19 crisis period emergency loans and restructuring were used to preserve productive capital and jobs.

5.5 Digital Credit Assessment and Formalisation- Banks have been able to estimate cash flow of enterprises through data like Udyam Registration, Digital Payments (Bank Statements), Income Tax Returns etc., and to a lesser extent through traditional collateral. By 2025-26, the Udyam & Udyam Assists portal had helped enter over 74 million businesses register themselves as part of an official system.¹ Formalizing these business’s also allows Public Sector Banks (PSB) to utilize the digitally verifiable information for appraising them and providing them with Pre-Approved/ Turnover based Credit. The digitization of assessments will help lower transaction costs and processing time; however, it is important that automated systems do not exclude businesses operating in areas with limited connectivity nor businesses who are still transitioning from informal to formal status. Therefore, it would be wise for PSBs to incorporate digital scores along with Branch Level Assistance and Human Review.

5.6 Support for Green and Sustainable Transition- MSMEs need financing to acquire energy-saving machinery, rooftop solar systems, waste management equipment, technologies that conserve water, clean manufacturing processes, sustainable transportation options (e.g. electric vehicles) and methods to comply with environmental regulations. These types of expenditures may lead to lower operational expenses over time, however they are typically very costly upfront.

Public Sector Banks could support a “green” transition by providing low-interest green loans, increasing repayment terms and offering interest reductions based on verified energy cost savings. Additionally, banks should begin evaluating proposed projects using both environmental as well as social criteria. At present, however, standardised bank-wise data separating green MSME credit from general MSME lending remain limited. This restricts measurement of the environmental outcomes of public banking.

Table 2: PSB Financial Instruments and Sustainable-development Outcomes

PSB financial intervention	Immediate financial function	Expected sustainable outcome
Priority-sector MSME loans	Ensures minimum flow of institutional credit	Inclusive industrialisation
CGTMSE-backed lending	Reduces collateral requirement	Entry of first-generation entrepreneurs
MUDRA loans	Provides small-ticket enterprise credit	Self-employment and women’s empowerment
Working-capital finance	Maintains business liquidity	Continuity of production and employment
Export credit	Finances export orders and receivables	Competitiveness and foreign-exchange earnings
Cluster financing	Reduces appraisal and monitoring costs	Regional and sectoral development
Green machinery loans	Finances clean technology	Lower energy use and emissions
Digital cash-flow lending	Uses transaction data for appraisal	Formalisation and faster credit access
Restructuring and emergency credit	Protects viable stressed enterprises	Enterprise survival and employment retention

6. Major Findings- First, PSBs remain development-oriented financial intermediaries rather than ordinary commercial lenders. Their participation in priority-sector lending, government schemes and collateral-free finance gives them a central position in inclusive MSME development.

Second, formal MSME credit has shown strong growth. Outstanding credit of Rs.31.3 lakh crore in March 2025 and annual growth of 14.8 per cent indicate greater institutional participation.² The five-year-low delinquency rate of 1.79 per cent also indicates an improvement in portfolio quality.

Third, the sector continues to face a serious credit-access problem. The addressable credit gap of approximately Rs.30 lakh crore shows that formal lending remains insufficient, particularly for informal and micro enterprises.²

Fourth, PSB finance generates important social outcomes. MUDRA and guarantee-backed loans have expanded the participation of women and historically disadvantaged communities. Public bank lending therefore contributes simultaneously to enterprise development, employment generation and social inclusion.

Fifth, the environmental dimension of PSB lending is comparatively underdeveloped. Although banks finance renewable energy and efficient machinery, publicly available information does not adequately



identify the number of green MSME borrowers, energy saved, emissions reduced or jobs generated through such loans.

7. Challenges- PSB lending to MSMEs faces several operational and structural challenges. Conventional appraisal continues to place considerable emphasis on collateral, past balance sheets and established credit history. These requirements disadvantage newly formed and knowledge-based enterprises. Small loan applications also involve high appraisal and monitoring costs relative to the value of the loan.

Regional differences are an additional issue. The majority of credit is extended in developed and urbanized countries; however, many businesses in aspirational districts, northern England, and rural areas experience little access to banks. Delays in payment from large customers and/or governmental organizations diminish MSMEs' liquidity, while increasing their reliance on short-term financing for working capital.

Further complicating matters is that some entrepreneurs have limited knowledge of money management and are therefore not aware of how guarantees work, whether they qualify for reduced rates of interest, or if there are other restructuring options available to them. While digital lending has the potential to make the process of extending credit faster and more efficient it could still result in a borrower being incorrectly classified as having a high risk due to either inaccurate information used in developing the algorithms, or the biases embedded within those algorithms.

8. Suggestions-

1. Cash flow based lending: Instead of relying mainly upon collateral, lenders (PSBs) will be able to evaluate repayment capacity using GST invoices, bank statements, payment records, and confirmed purchase orders.
2. Sustainability Linked MSME Loans: Incentives for interest rate reductions can be tied to demonstrable increases in energy efficiency, renewable energy usage, waste elimination, and worker protection as part of MSME sustainability linked loans.
3. Separate Green MSME Reporting: The Reserve Bank of India and Public Sector Banks must make available data related to the number of green MSME loan approvals by banks; the number of MSME borrowers who were approved for green loans; the geographic distribution of these loan recipients across regions; and other relevant data regarding the environmental impacts associated with these green loans.
4. Strengthening Credit Guarantees: Coverage under the CGTMSE program needs to be paired with quicker processing times and less stringent documentation requirements for branch level personnel so they are motivated to approve viable collateral free loans.
5. Cluster Based Financing: Public Sector Banks need to develop specialized credit programs for specific industry cluster types such as textiles; food processing; handicrafts; leather products; engineering; and renewable energy.
6. Receivable Financing: Integration between public sector bank systems and the Trade Receivables Discounting System needs to be further developed in order to minimize the adverse effects of delayed payments.
7. Inclusive Lending Targets: Not only the quantity of MSME loans granted, but also the proportion of lending to female owned businesses, SC/ST entrepreneurs, rural businesses, and underserved districts must be used as criteria in evaluating the performance of public sector banks.
8. Credit Plus Services: Public sector banks, SIDBI, and MSME development organizations must provide financial literacy training; project development assistance; access to new technologies; and export assistance, in addition to providing loans to MSMEs.
9. Responsible Digital Appraisal: Decisions made by automated systems must be transparent and accessible to humans in reviewing applications submitted by micro-enterprises.

9. Conclusion- Public Sector Banks (PSBs) serve as a critical backbone for supporting both financial development and sustainable economic development of India's MSMEs. PSBs have been able to integrate public policies into financing requirements at the level of individual enterprises through various mechanisms such as; priority-sector lending, collateral free finance, MUDRA, CGTMSE, working capital support, export credit, and Digital Lending. Increased lending to this sector has demonstrated compatibility with bank stability.

However, this estimated Rs.30 Lakh Crore credit gap indicates that many viable business opportunities are being denied access to capital. Therefore, as a second phase in the public sector, banking must transition from using only the total volume of credit disbursed by banks as the sole measure of success.



It will be critical for credit assessment to take into account factors such as job creation, inclusion of underprivileged entrepreneurs, local economic growth, adoption of green technologies and environmentally friendly practices.

The role of PSBs in achieving inclusive industrialization through sustainable development goals in India will depend upon their ability to create enterprise as economically viable (through better credit assessment), socially inclusive (by ensuring that enterprise is owned/controlled by marginalized communities) and environmentally responsible (through less pollution). To do so effectively, PSBs need to report on all aspects of their lending - especially those related to social and environmental impacts. As well as adopting cash-flow based lending for MSMEs; increasing access to funding for MSMEs; creating a new class of "sustainability linked" loan products; and providing more comprehensive disclosure regarding the environmental and social impacts of their lending.

REFERENCES

1. Government of India, Ministry of Finance, Economic Survey 2025-26: Micro, Small and Medium Enterprises, 2026. Economic Survey MSME highlights.
2. Small Industries Development Bank of India, SIDBI Annual Report 2024-25: MSME Outlook, 2025. MSME Outlook.
3. SIDBI and TransUnion CIBIL, MSME Pulse Report, September 2025. MSME Pulse Report.
4. Ministry of Micro, Small and Medium Enterprises, Government of India, "MSME Sector Accounts for 30.1% of India's GDP," 4 July 2025. Ministry of MSME data.
5. Small Industries Development Bank of India, "MUDRA-Institutional Architecture and Outreach," data as on 31 March 2025. SIDBI ecosystem and MUDRA data.
6. Small Industries Development Bank of India, Annual Report 2024-25: Business Performance, 2025. SIDBI business performance.
7. Reserve Bank of India, Priority Sector Lending-Targets and Classification Directions, updated 2025. RBI MSME lending guidelines.
8. Reserve Bank of India, "Data on Sectoral Deployment of Bank Credit," various issues, 2025–26. RBI sectoral credit data.
9. Government of India, Ministry of Finance, "Budget 2025-26: Fuelling MSME Expansion," 2025. MSME Budget initiatives.
10. Ministry of Micro, Small and Medium Enterprises, Government of India, "Udyami Bharat-MSME Day 2025," 27 June 2025. MSME schemes and achievements.
