



RIMMY E TOMY

In Budget 2025-26, Finance Minister Nirmala Sitaraman positioned Micro, Small, and Medium Enterprises (MSMEs) as a key engine for India's economic growth. These enterprises are the backbone of the economy, contributing 30 per cent to the nation's GDP and providing livelihoods to over 11 crore people.

Yet, despite their undeniable importance, micro-enterprises struggle with a persistent credit gap. Although various government initiatives aim to bridge this gap, including several proposed in the latest Budget, an overwhelming 70 per cent of MSMEs operate outside the formal economy, rendering them largely invisible to official schemes designed to improve credit access.

To better understand how enterprises in the informal sector navigate this credit gap, we studied bazaar traders in Iewduh, Shillong — an epicentre of trade in the region and a microcosmic representation of a bazaar economy. These traders are often too small and fall outside the purview of most government-backed credit programmes. Bazaar traders also tend not to access credit from banks or other formal institutions. Instead, they rely primarily on credit arrangements with suppliers and wholesalers.

However, access to such credit arrangements is limited and is often based on social ties — community membership and long-term relationships. "We still do business the old way...we know each other," says a textile trader who has operated in Iewduh for generations.

At first glance, this might seem like a practical way to manage risk in a world without formal contracts. However, preference for familiar faces comes at a cost — both for individual traders and for the long-term growth of enterprises operating in the informal sector.

LENDING WITHIN THE COMMUNITY

Our study suggests that bazaar wholesalers often lend within their community even when doing so is not the most financially viable option. Lending in the bazaar extends beyond immediate monetary consideration; it is also about securing a safety net for the future. For instance, during the Covid-19 lockdowns, traders who had previously extended credit to community members were more likely to receive financial help in return — such as a reduction in rent or extended repayment terms from suppliers.

This dynamic is an example of indirect reciprocity — the idea that if you help someone today, someone else in your community will help you when you need it. Such norms may have



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Tackling the trust factor in informal sector credit

FINANCE FIX. Finding ways to integrate financial data into informal lending arrangements without undermining the social structures can create a more resilient credit system

emerged to deal with income shocks in the absence of formal insurance and limited support from the government. Laboratory experiments have demonstrated that indirect reciprocity exists.

For example, in donor-recipient games where one player gives money to another, those known for being cooperative tend to receive larger amounts. While this provides a form of informal insurance against economic shocks, it also reinforces lending patterns that favour social connections over business fundamentals.

As India modernises, societies will change, and people will migrate more, leading to the erosion of institutions rooted in norms and moral codes. Without alternative credit arrangements, the weakening of these institutions could adversely impact informal credit markets.

AN ALTERNATIVE

We set out to examine whether credit decisions based on tangible financial data — such as sales and profits — could

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help traders in the informal sector access the funds needed for growth. We designed an experiment where we presented wholesalers with hypothetical retailer profiles containing financial data and social information (relationship length and community membership) to understand the types of information traders value when making lending decisions.

We found that wholesalers do value financial information. They were willing to offer more trade credit to retailers with strong sales and profits compared to those with no financial data.

These findings raise the question: If bazaar traders recognise the value of financial information, why don't they use it in their lending decisions? The barrier, we find, is not a lack of financial understanding. It is trust.

Although the majority of bazaar traders don't maintain formal financial records, many, including those with little or no formal education, value such information.

However, wholesalers worry that retailers might manipulate or fabricate their financial records. Retailers, on the other hand, fear that their financial data could be misused. This mutual distrust creates a deadlock, preventing the use of formal financial information in credit arrangements.

Breaking this cycle of mistrust is crucial for encouraging record-keeping and improving credit access in bazaars. Increasing financial literacy will not solve the problem if traders do not trust

formal financial information. Instead, we need mechanisms that ensure the reliability and security of financial information.

Digital platforms that can verify transactions and minimise opportunities for manipulation could offer a viable path forward.

Several public and private sector initiatives have the potential to solve the credit gap problem in the informal sector.

Digital payment infrastructures like UPI and mobile wallets enable faster transactions, improving cash flow management. B2B platforms like Udaan can verify transactions and provide credit, accelerating informal MSMEs' growth.

Bazaars have survived for centuries by relying on informal credit arrangements. However, for MSMEs to drive economic growth, they must expand. Relying on lending based on community membership and relationship length limits their potential.

Finding ways to integrate financial data into informal lending arrangements — but without undermining the social structures that underpin the bazaar economy — can create a more inclusive, efficient, and resilient credit system for informal businesses.

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