

# Micro Small and Medium Enterprises Package

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## Manifest pedagogy

As MSME is a key focus area for Central and State governments especially after demonetisation and GST, it has particular relevance. Moreover, the recent proposals with respect to definition, and their concerns after key events such as entry of Amazon and Flipkart and online sale of medicines etc. may be focused upon.

### In news:

*A series of measures designed to help small businesses by giving them access to quick finance and sparing them the rigours of complying with some labour laws.*

### Placing in Syllabus

- Industrial Development Policies
- LPG reforms and their impact on MSMEs

### Static Dimensions

1. MSMEs and their contribution to Indian Economy
2. Priority Sector Lending
3. MUDRA Yojana

### Current Dimensions

1. Package for MSMEs credit- Loan up to 1 Cr in 59 Min.
2. Changes in Labour Laws
3. Demonetisation and GST
4. Competition from large players (Ex: Walmart-Flip kart)

# Content

MSMEs form a significant base of Industrial Output (40%) and contribute roughly 40% to total exports. They are critical for regional development and are drivers of job creation in Manufacturing and services sector.

## What is an MSME?

The Micro Small & Medium Enterprises (MSMEs) are defined in India under the MSMED Act 2006 on the basis of capital investment made in plant and machinery, excluding investments in land and building.

Recently the Cabinet has approved a draft which proposes to change the definition of MSMEs. The highlights of the proposal are:

	<b>OLD (Investment in Plant &amp; Machinery)</b>	<b>Proposal (Revenue)</b>
<b>MICRO</b>	<25 lakhs	< 5 cr.
<b>SMALL</b>	25 lakhs – 5 cr.	5cr. – 75 cr.
<b>MEDIUM</b>	5 cr. – 10 cr.	75 cr. – 250 cr.

- It does away with investment criterion and instead proposes to define MSMEs on the basis of annual sales turnover
- There is no distinction between manufacturing and service unit.

## What was the need to redefine MSMEs?

- The definition was frozen in 2006. After 12 years, with continued erosion of value of Rupee, the thresholds have become impractical. Adjusting for inflation would have required to enhance the limit by 2-3 times. Many sectors where MSMEs have substantial share such as

Pharmaceuticals, Auto-component, and Food processing among others have been demanding a many-fold increase in the investment limit needed to be compliant of the new mandatory and industrial standards. The *de-minimis* investment exceeded at least five crore even if one had low turnover.

- The investment based definition creates an uneven field for older enterprises vis-a-vis new enterprises. Setting up a unit to produce a product today would require several times more investment than the one set-up ten or twenty years ago to produce the same product with similar quantity. What could be a micro unit because of historical investment figures, would become medium or large if set up today. It becomes a barrier for new entrants. To prove that a unit fell in a specific category, the MSMEs ran around CAs to certify the value of plant and machinery. It is alleged that many large enterprises also under-reported the investment, got CA certificate and partook in the Public Procurement earmarked for MSMEs.

Therefore, change in criterion of defining MSMEs has been considered using Turnover as the basis.

**The advantages of having such a definition could be:**

- The Turn-over based criterion resolves many of the ills of earlier regime. It is transparent, as authorities could always cross check the turnover through platforms such as GSTN. No CA certificate would be required.
- Levels the field for new and old enterprises as the comparison is not between historical investments and current investments but between current turnovers.
- After inflation adjustment the definition of small enterprise on the basis of investment would have been Rs.15Cr today. Keeping turnover five times the investment, a very conservative figure, we have Rs.75 Cr as a threshold which is what is proposed in the new

definition.

## **Disadvantages**

- There are few sectors where investment is low but turnover is high for example gems and jewellery units, units producing Aluminum conductor steel-reinforced cable (ACSR) among others. Many of the units have been under small category owing to investment criteria but having high turnover ranging from Rs.100 Cr to Rs.30 Cr They enjoyed benefits under Public Procurement Policy for MSMEs which mandates 20% set-aside for Micro and Small Units in all central government purchases. Suddenly, the reserved pie of the cake is out of their reach. The PPP for MSE would not be available for units having more than Rs.75 Cr annual turnover.
- Another criticism about the new definition is that India still does not take into account the number of people employed. Globally, the two most important elements used to define MSMEs remain turnover and employment. The practice of underreporting number of people employed is widespread especially in smaller units to remain below the threshold of 10 employees to save on very high social security and compliance costs. Lack of labour reforms has exacerbated the situation. Adding such a criteria would have led to more paper work and corruption.

## **Impact of Package**

For nearly two years, the MSME sector has borne the brunt of the government's policy measures. With demonetisation first and then the haphazard implementation of the goods and services tax (GST), the MSME sector had been left cash-strapped.

This year has been particularly bad for the sector with loans being tough to come by. This is because 11 of the 21 public

sector banks are facing lending restrictions as they are under the Reserve Bank of India's prompt corrective action (PCA) framework. With a financing requirement of nearly Rs.4.5 lakh crore over the next two year, it was assumed that the non-banking financial companies (NBFCs) will step up into the space left vacant. However, in the aftermath of the meltdown of the biggest NBFC in the country, Infrastructure Leasing & Financial Services (IL&FS), the entire industry is strapped for cash.

### **Key Highlights of the package:**

- Loans up to 1 Cr in under an Hour: These loans can be accessed through a link on the GST portal.
- Further, all GST-registered MSMEs would get a 2% interest subvention for fresh and incremental loans. And for exporters who receive loans in the pre-shipment and post-shipment period, there would be an increase in interest rebate to 5% from the existing 3%.
- MSMEs with a turnover above Rs.500Cr would be brought on to the Trade Receivables e-Discounting System(TReDS) where entrepreneurs would be able to access credit from banks based on their upcoming receivables.
- Public sector companies have been asked to procure 25% of their total purchases from MSMEs and of this 3% should be from MSMEs promoted by women entrepreneurs.
- To improve the ease of doing business for MSMEs, clusters would be formed, initially for pharmaceutical sector MSMEs.
- Regulations with regard to labour laws have been relaxed; inspections would be done through a computerised random allotment.
- Environmental clearance has been simplified.

However, creditworthiness and market linkage of MSMEs is still a concern and outright approval without adequate due diligence could open a Pandora's Box for future health of banking sector in India.

## **Test yourself: Mould your Thoughts**

Highlight the benefits and drawbacks of the recent changes in policies for the MSMEs sector in India? Do you think the recent package for MSMEs will address these challenges?