



Micro, Small and Medium Enterprises

(MSMEs): Backbone of the Indian Economy





Introduction

MSME sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. It contributes significantly in the economic and social development of the country. But, the sector was among the most affected sectors by the pandemic.

It has been reported that lockdown induced closing of thousands of MSMEs in the country, despite Government of India's Rs 20-lakh-crore COVID-response package. According to a recent report by the Small Industries Development Bank of India (SIDBI), two-thirds of MSMEs in India were shut for a period of three months or more in FY2021 and, over half of all MSMEs saw a decline of over 25 percent in revenue.

The impact of the pandemic has highlighted the importance and vulnerabilities of the MSME sector. This warrants a closer examination of questions like- What are MSMEs and what role do they play? What are the challenges that MSMEs face in India? What are the recent initiatives taken by the Government to promote MSMEs? And, what more can be done to further enable and empower the MSME sector?

What are MSMEs?

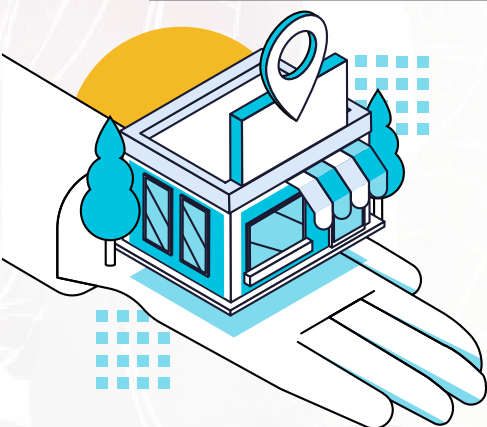
The MSMEs are **micro, small and medium** enterprises categorized on the basis of investment in plant and machinery and the annual turnover in accordance with the **Micro, Small and Medium Enterprises Development (MSMED) Act, 2006**.

- ◇ MSMEs in India have evolved considerably since independence. From being referred to merely as the **Small Scale Industries (SSI) sector in 1960s and 70s**, the MSME sector has progressed in scale and in scope of business activities over the years.
- ◇ In India, the MSME consists of **both 'traditional' and 'modern' small industries**.
- ◇ **Small industries are further divided in eight subgroups:** handlooms, handicrafts, coir, sericulture, khadi, and village industries, small scale industries and powerlooms.



Composite Criteria: Investment and Annual Turnover

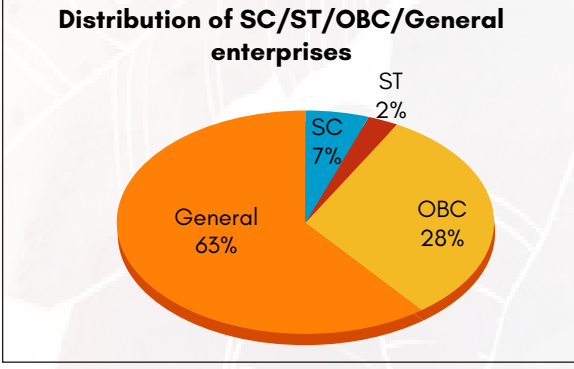
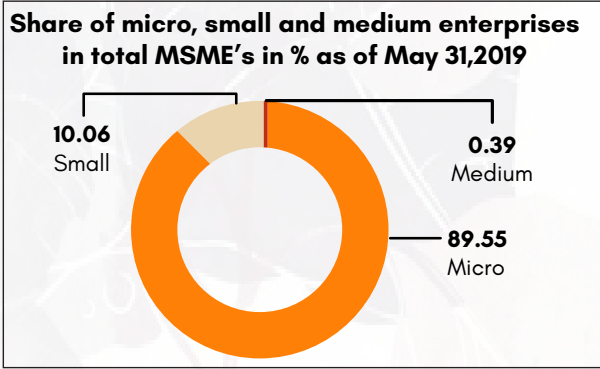
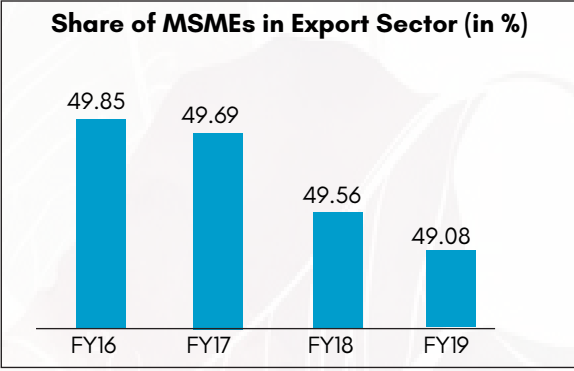
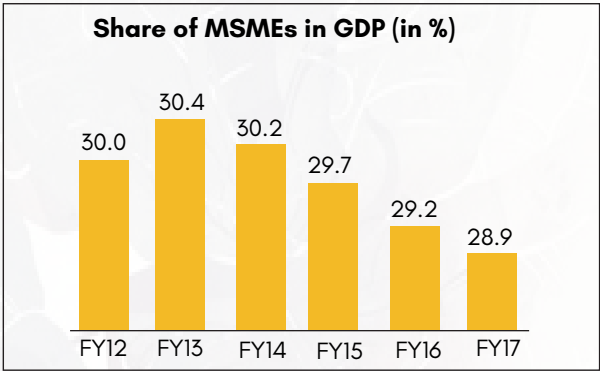
Classification	Micro	Small	Medium
Manufacturing & Services	Investment < ₹ 1 cr. &	Investment < ₹ 10 cr. &	Investment < ₹ 50 cr. &
	Turnover < ₹ 5 cr	Turnover < ₹ 50 cr	Turnover < ₹ 250 cr



Worldwide Trends in SME Sector

- ◇ **OECD countries:** SMEs account for about **99% of firms, 70% of all jobs, and more than 50% of GDP**.
- ◇ **ASEAN:** The SMEs account for **52%-97% of total employment and GDP 30%-53%**.
- ◇ **China:** SMEs contribute to over **68% of the exports**.

Birds Eye view of India's MSMEs



Why are MSMEs significant for India's development?

- ◆ **Acting as engines of entrepreneurship:** The indigenous skills and grass root innovations can be channelled into MSME business ideas as they require very limited capital investment, are low-risk and are not bureaucratically tedious.
 - Additionally, due to their small size, they can exhibit prompt decision making and take advantage of new economic opportunities.
- ◆ **Completing the economic supply chain:** MSMEs are complementary to large industries as ancillary units and form an integral part of value chain by filling the localized gaps.
 - For example, several MSMEs have sprung up around large plants like Bharat Heavy Electricals Limited (BHEL) to assist its day-to-day sourcing needs.
- ◆ **Equitably distributing the opportunities of development:** MSME units provide multiple sources of income, in wide range of non-agricultural activities and provide employment opportunities in rural areas, especially for the traditional artisan and weaker sections of the society.
 - An additional benefit of this is reduction in volume of rural-urban migration.
- ◆ **Encouraging inclusive growth via employment generation:** MSME are the second largest employers of human resources, after agriculture. They are, therefore, considered to be more labour intensive and less capital intensive.
 - They provide gainful employment to marginalised sections thus, contributing to other socio-economic aspects, such as reduction in income inequalities and poverty, improvement in health, education, etc.
- ◆ **Creating new local and efficient ecosystems:** MSMEs use locally available resources which are more cost effective, environmentally efficient and provide a unique and local flavour to the economic ecosystem. For example, Chizami village in Nagaland has created a unique model of economic development centred around traditional practices of the state.
 - These local networks further translate development of growing sense of community and bonding, resulting in betterment of overall well-being.



- ◆ **Aiding achievement of Sustainable Development Goals:** MSMEs produce products using locally available resources, both material and labour. These products and processes help in achievement of SDGs both directly and indirectly. Following are some examples of the same-

<p>1 SDG 1 (End poverty) Alleviating poverty through micro-franchising. For example, selling of treadle pump in Bangladesh, India and Nepal have helped the small and marginal farmers.</p>	<p>3 SDG 3 (Good health and well-being) Helium Health (a Nigerian company) has developed a software system for health records and hospital management.</p>	<p>6 SDG 6 (Sanitation for all) SOIL (an NGO in Haiti) provides for sustainable household sanitation and ecological waste treatment</p>
<p>7 SDG 7 (Energy for all) Simpa Networks (India) provides a basic, portable solar home system in an off-grid utilities model to economically disadvantaged section.</p>	<p>10 SDG 10 (Reduced inequalities) Dignity kitchen (Singapore) is a social enterprise that runs community food court. It is operated by people with disabilities and the socially disadvantaged.</p>	<p>14 SDG 14 (Life below water) ECONcrete (Israel) provides bio-enhancing concrete solutions that enhance marine life and help reduce the ecological footprint of coastal and marine development projects.</p>

- ◆ **Growing role in technology intensive and rapidly emerging sectors:** Indian MSMEs are not limited to small business only but are rapidly increasing their presence in sectors like Financial Technology, Defence Manufacturing and Space among others.

In Conversation! Are MSMEs crucial to economy?



Vini: Hey Vinay! I was reading about MSMEs yesterday. Did you know that close to 90% of the business enterprises in India are MSMEs?

Vinay: That is a lot.

Vini: But I feel that having a large share of MSMEs is holding back India's Economy.

Vinay: Why do you feel so?

Vini: MSMEs are generally unorganized and informal entities. Also, they don't engage in high-performing sectors like Web 3.0, Space, etc. which will drive the future of the economy.

Vinay: No Vini. It is not like that. Many of the MSMEs are in formal sector. They are playing a huge role in various strategic sectors like defense, space, etc.

Vini: What kind of role you are talking about?

Vinay: For instance, Indian MSMEs in space sector are in a position not only to cater the domestic demand but also become a part of global supply chain.

Vini: But, Indian space sector is reserved for public sector, isn't it?

Vinay: It was, but in June 2020, the government opened up the sector to allow private participation.

Vini: Oh! That's really great to know. So, can we expect an Indian counterpart to SpaceX in time to come?

Vinay: Why not. Several Indian space sector companies are already coming up, like Agnikul Cosmos, Skyroot Aerospace and Pixxel etc.

Vini: Great! Will try to read more about them.



What challenges do MSMEs face?

Structural

- ◇ **Infrastructural bottlenecks:** MSMEs located in remote villages face difficulties in accessing water, power supply and a cost effective and efficient logistics/supply chain.
 - On the other hand, MSMEs located in cities suffer due to high cost of land (the circle rate of Industrial area is usually high making it unaffordable for the MSME entrepreneur).
- ◇ **Limited access to capital:** Many of the MSMEs **lack the credit worthiness** required to raise capital from the capital markets and financial institutions. As a result, they **heavily depend on local financial resources** and are frequently the victims of exploitation by the money lenders.
 - **Roughly 40 per cent of MSME lending** is done through the **informal sector**.
 - These units frequently suffer from **lack of adequate working capital**, either due to delayed payment of dues to them or locking up of their capital in unsold stocks.
- ◇ **Supply chain constraints:** The bargaining power of MSMEs is relatively low due to the small quantity of purchases made by them.
 - Also, they cannot afford to take the risk of buying in bulk as they have limited avenue to store the materials. This creates a trade-off between controlling the cost of the product and maintaining its quality.
- ◇ **Global competition:** MSMEs face competition from multinational companies which are giants in terms of their size and business volumes. For example, many retail sector MSMEs have to compare with the global giant Amazon.
- ◇ **Additional issues of disadvantaged sections:** Issues faced by MSMEs get aggravated if the enterprise is owned by vulnerable sections like women, SCs, STs due to **systematic discrimination, stereotyping, societal prejudice** among others.
 - About 90 per cent of MSMEs owned by women in the country still rely on informal ways of securing capital or loans.
- ◇ **Slow adoption of technology:** Generally, a majority of the Indian MSMEs are still in the nascent stage of the technology, especially IT adoption.
 - High cost, poor infrastructure, low skilled human resource, remain the major constraints in its adoption.
- ◇ **Compliance challenges:** MSMEs faced significant challenges vis-à-vis taxation, labour laws and environmental compliance among others (refer to the infographics).



Operational

- ◇ **Limited managerial resources:** MSMEs are generally promoted and operated by a single person, who may not possess all the managerial skills required to efficiently run a business.
 - For example, several MSMEs are not able to tap their export potential simply because they are not able to manage the export conditionalities.
- ◇ **Marketing:** MSMEs have to depend excessively on middlemen, who at times exploit them by paying low price and delayed payments. Further, direct marketing may not be feasible for small business firms as they lack the necessary infrastructure.
 - According to a FICCI report, less than 6 per cent of Indian MSMEs with access to personal computers advertise online and a majority of these enterprises use traditional media.



- ◇ **Suboptimal capacity utilisation:** Due to lack of marketing skills or lack of demand, many firms have to operate below full capacity. Thus, their operating costs tend to increase. Gradually this leads to economic sickness and closure of the business.
- ◇ **Poor quality products:** Many MSMEs do not adhere to desired standards of quality. Instead their margins are dependent on cost-cutting and keeping the prices low.
 - This problem is further compounded by inadequate resources to invest in quality research and maintenance of industry standards.

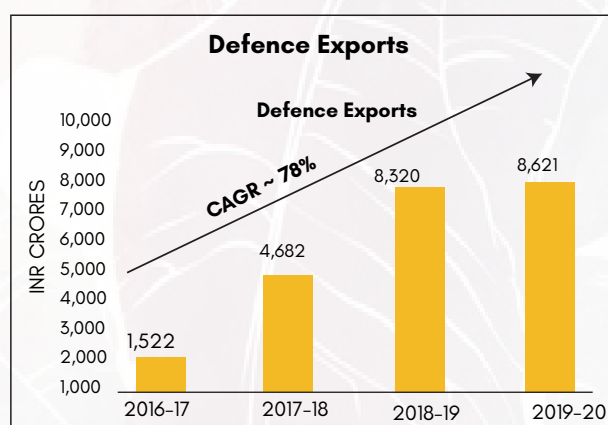
What are the recent initiatives taken by India for MSMEs?

- ◇ **Improvement in overall performance and quality:**
 - **Raising and Accelerating MSME Performance (RAMP):** It is a World Bank assisted Central Sector Scheme, supporting various COVID Resilience and Recovery Interventions of the MSMEs.
 - ▶ It is aimed at improving access to market and credit, strengthening institutions and governance at the Centre and State, improving Centre-State linkages and partnerships, addressing issues of delayed payments and greening of MSMEs.
 - **ZED certification scheme:** The revamped Zero Defect Zero Effect (ZED) Certification Scheme, aims at making Indian businesses more globally competitive and facilitating capital access. It will also make MSMEs environmentally conscious.
- ◇ **Access to Finance:**
 - **Credit facility:** Emergency Credit Line Guarantee Scheme (ECLGS) was launched to provide 100% guarantee coverage to banks and NBFCs to enable them to extend emergency credit facilities to business entities/MSMEs to meet their additional term loan or additional working capital requirement.
 - **59 minute loan portal:** Loans of up to Rs. 1 crore can be granted in-principle approval through this portal, in just 59 minutes.
- ◇ **Access to Markets:**
 - **Procurement by Public Sector Enterprises (PSEs):** PSEs are required to compulsorily procure 25% of their total purchases from MSMEs. Out of the 25% procurement mandated from MSMEs, 3% must be reserved for women entrepreneurs.
 - **International Cooperation Scheme:** It provides financial assistance to MSMEs on reimbursement basis for airfare, space rent, freight charges, advertisement & publicity charges and entry/registration fee.
 - **Marketing Assistance Scheme:** MSMEs are given assistance for organisation of exhibitions abroad and participation in international exhibitions/ trade fairs; co-sponsoring of exhibitions organised by other organisations/industry associations/agencies; etc.
- ◇ **Technology Upgradation:**
 - **Tool rooms:** Multiple new tool rooms are being set up along with upgrading the existing centres to assist MSMEs in their technical upgradation and also to create skilled manpower required to make India a manufacturing hub.
 - **Credit Linked Capital Subsidy Scheme for Technology Upgradation:** The objective of the Scheme is to facilitate technology up-gradation in MSMEs.
 - ▶ It seeks to provide an upfront capital subsidy of 15 per cent (on institutional finance of up to Rs 1 crore availed by them) for induction of well-established and improved technology in the specified 51 sub-sectors/products approved.
- ◇ **Ease of Doing Business:**
 - **Randomized inspection:** The establishments to be visited by an Inspector will be decided through a computerised random allotment.
 - **Clearances and certification:** For establishing a unit, an entrepreneur needs two clearances namely, environmental clearance and consent to establish. Under air pollution and water pollution laws, now both these have been merged as a single consent.
 - ▶ Additionally, the return is accepted through self-certification.

What can be done to empower and enable MSMEs further?

- ◇ **Encouraging Cluster-based Development:** MSME Clusters have been effective in promoting industrial growth all over the world by overcoming infrastructure bottlenecks and issues of raw materials. Individual small firms of the cluster closely collaborate and collectively share resources for various business processes viz., manufacturing, technology, marketing, quality control, testing, purchase, etc.
- ◇ **Creating conducive regulatory ecosystem:**
 - **Streamlining compliance requirements:** Government needs to be conscious of the challenges faced by MSMEs, and opt for legislation and standards that take different firm sizes into account, instead of opting for a one-size-fits-all approach.
 - **Generating data for the sectors:** No survey has been undertaken yet to assess the impact of Covid-19 on small businesses in the informal sector. Assessing the loss faced in the informal sector is a prerequisite to understand the gravity of the problems being faced by the MSMEs.
- ◇ **Financial and management support:**
 - **Cash flow-based lending:** Financial institutions should disburse credit to MSMEs through alternative data sources such as UPI transactions, income tax returns, GST returns, bank statements, CIBIL score, point-of-sale data, and more.
 - ▶ Cash flow-based loans are generally **working capital loans required for short-term to manage operational expenses** in a business such as rent, salaries, raw material purchase, and more.
 - **Establishing SME Finance companies** in the country on the lines of infrastructure finance companies (IFCs) or micro-finance companies that are not engaged in real economic activity but help in the financing of SMEs.
 - **Voluntary management training:** Smaller firms are less likely than larger enterprises to provide external training to all grades of workers, including managers. Therefore, providing voluntary external training to all grades of workers, including managers of MSMEs can significantly decrease failure rate.
- ◇ **Marketing support:**
 - **Facilitate the marketing side of innovation** and assist MSMEs to on-board 'B2B' and 'B2C' e-commerce marketplaces.
 - Utilize existing **Technology Centres (TCs)** across the country for providing **access to information** on Indian and external markets for innovative products.
 - Facilitate MSMEs in **procuring complete and low-cost ICT solutions.**
 - Strengthening of schemes like '**Consortia Formation**', '**Brand Building**', '**E-marketing** through specialized MSME portals'.

MSMEs - An untapped force multiplier for the Indian defence sector



- ◇ India has set for itself an ambitious target of **Rs. 35,000 crores in defence exports to be achieved by FY24.**
- ◇ **Ministry of Defence (MoD)** has set a target to engage with over **16,000 MSMEs in the next 03 years** and is continually taking steps towards a higher degree of indigenisation.

Key initiatives to tap this potential

- ◇ **Defence Procurement Procedure (DPP), 2016** has introduced new procurement categories such as **Buy-Indigenously Designed Developed and Manufactured (IDDM), Make-I and Make-II**, to supplement the 'Make in India' initiative and inclusion of MSMEs.
- ◇ **Defence Acquisition Procedure (DAP) 2020** has **reserved procurement orders up to Rs 100 crore per year for MSMEs.**
- ◇ **Innovation for Defence Excellence (iDeX)** was launched in 2018 for funding MSMEs, start-ups, individual innovators.

◦ **Strengthening of MSME export promotion council.**

◊ **Encouraging technology adoption:** Technology adoption by MSMEs eases their working, and improves their performance. This in turn enhances their global competitiveness.

◦ **E.g., Financial strengthening** through Alignbooks - Established in September 2016, Alignbooks is a cloud-based accounting software designed to help MSMEs automate their invoicing system.

◊ **Strengthening Government policies:** The Parliamentary Standing Committee on Industry has recommended following recommendation to the government:

◦ **Setting up a Central Market Intelligence Centre:** This body shall work to replace goods imported by MSME with domestic manufacturing.

◦ **Ease of certification:** Using existing Technology Centres for subsidised testing and certification of regional MSMEs.

◦ **Forming separate policies for medium enterprises** vis-a-vis micro and small enterprises based on their divergent needs.

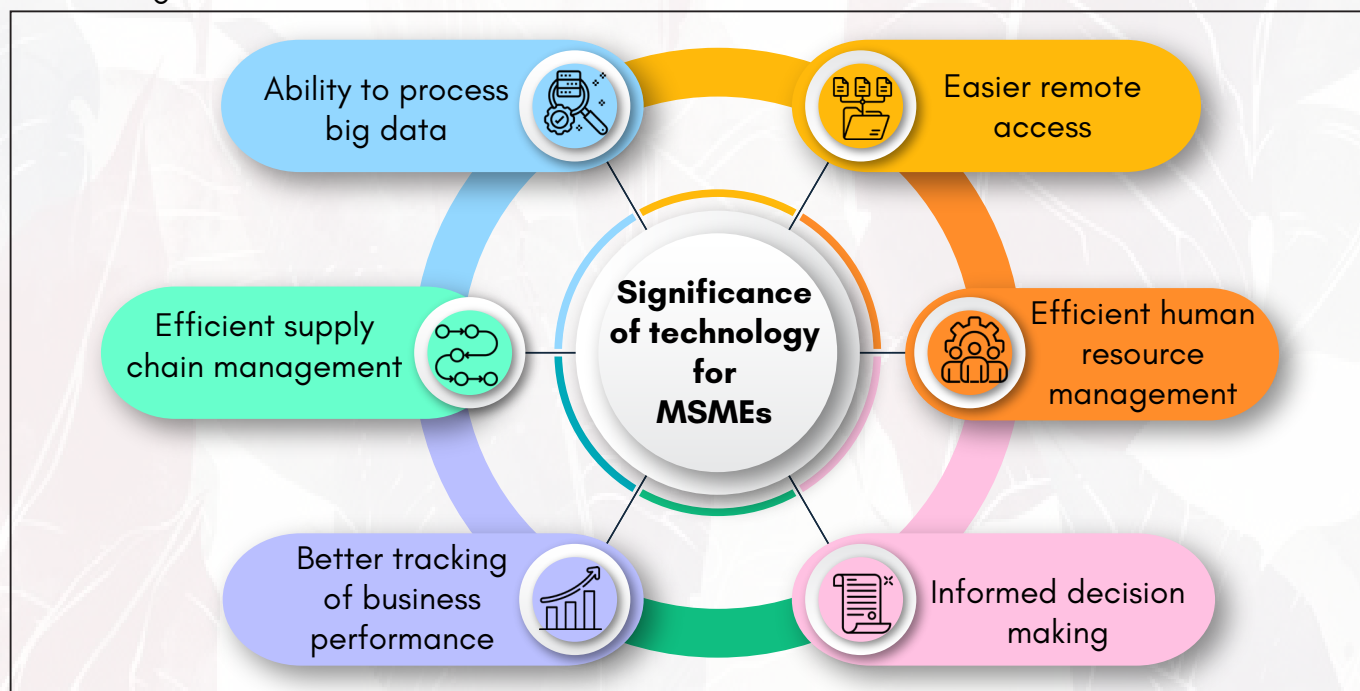
Global best practices to support MSMEs

◊ **United States:**

- An independent body, namely Small Business Administration (SBA) is created which assists and protects the interests of small businesses.
- It helps in starting, building and growing businesses, creating jobs and serving as the voice for small businesses by providing an advocacy role.

◊ **The Nacional Financiera (NAFIN) Factoring Program in Mexico - Contract Financing**

- It provides financing that allows creditors to buy raw materials to complete new orders and is an example of how factoring can be extended to provide pre-delivery financing.



CONCLUSION

MSMEs in India are the second largest employer after agriculture with more than a million jobs created annually. Therefore, it has huge potential to facilitate reaping the benefits of demographic dividend, bridging gender inequality and reducing income inequality along with paving the way for India becoming 5 trillion economy. However, MSMEs in India are very sensitive to economic or natural shocks. Hence, there is a need to focus on adaptation strategies that can help Indian MSMEs withstand and quickly recover from unforeseen shocks like COVID-19 pandemic. This is a multi-dimensional issue which requires continuous research, innovation, awareness, training, and most importantly inclusion of MSME considerations in the larger scheme of policies.

TOPIC AT A GLANCE

MSME are **micro, small and medium enterprises** categorized on the basis of investment in plant and machinery and the annual turnover in accordance with the **Micro, Small and Medium Enterprises Development (MSMED) Act, 2006**.



India's MSME sector

MSMEs contribute almost 30% of the GDP	Almost half of the exports come from MSMEs	Around 90% of MSMEs are Micro enterprises	More than half of the MSMEs are owned by General category entrepreneurs
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Significance of MSMEs

- ◆ **Acts as engines of entrepreneurship** by channelising grassroots innovation
- ◆ **Completing the economic supply chain** by complementing the large scale industries
- ◆ **Equitably distributing the opportunities of development** by providing gainful, non-agricultural employment in rural areas
- ◆ **Encouraging inclusive growth via employment generation** for marginalised sections like women, SCs, STs, OBCs, etc.
- ◆ **Creating new local and efficient ecosystems** as they use locally available resources
- ◆ **Aiding achievement of Sustainable Development Goals** by producing sustainable product and processes
- ◆ **Growing role in technology intensive and rapidly emerging sectors** like space, defence, etc.



Challenges faced by MSMEs

- ◆ **Infrastructural bottlenecks** due to high cost of land in cities and lack of easy accessibility, water and power supply in rural areas
- ◆ **Limited access to capital** owing to the lack of credit worthiness required to raise capital from the capital markets and financial institutions
- ◆ **Supply chain constraints** due to their low bargaining power, inability to purchase in bulk
- ◆ **Competition from multinational companies** which are giants in terms of their size and business volumes
- ◆ **Systematic discrimination, stereotyping, societal prejudice** faced by MSMEs owners belonging to disadvantaged sections like women, SCs, STs, etc.
- ◆ **Slow adoption of technology** due to high cost, poor infrastructure, low skilled human resource, etc.
- ◆ **Compliance challenges** vis-à-vis taxation, labour laws
- ◆ **Operational challenges** like limited managerial resources, inadequate marketing, suboptimal utilisation of resources, and poor quality products

Recent initiatives taken by India for MSMEs

- ◆ **Improvement in overall performance and quality:**
 - **Raising and Accelerating MSME Performance (RAMP):** It is a World Bank assisted Central Sector Scheme
 - **The revamped Zero Defect Zero Effect (ZED) Certification Scheme**
- ◆ **Access to Finance:** Collateral free loan, 59 minute loan portal
- ◆ **Access to Markets:** Mandating PSEs to compulsorily procure 25% of their total purchases from MSMEs, International Cooperation Scheme, Marketing Assistance Scheme
- ◆ **Technology Upgradation:** Setting up 15 new and upgrading 18 existing tool rooms
- ◆ **Ease of Doing Business:** Randomized inspection through a computerised random allotment, reduced environment clearance and certification burden



Way ahead

- ◆ **Encouraging Cluster-based Development:** It helps in overcoming infrastructure bottleneck and issues of raw materials
- ◆ **Creating conducive regulatory ecosystem:** Streamlining compliance requirements, generating data for the sectors, checking additional bottlenecks faced by vulnerable sections
- ◆ **Financial and management support:** Cash flow-based lending, establishing SME Finance companies and Voluntary management training
- ◆ **Marketing support:** Facilitate the marketing side of innovation, Utilize existing Technology Centres for providing access to information, Strengthening of schemes like 'Consortia Formation', 'Brand Building'
- ◆ **Encouraging technology adoption:** This will ease their working, and improve their performance
- ◆ **Strengthening Government policies:** Setting up a Central Market Intelligence Centre, ensuring ease of certification, forming separate policies for medium enterprises vis-à-vis micro and small enterprises based on their divergent needs