

MSME – Critical Evaluation of the Backbone of Indian Economy



■ *CA S. Badri Narayanan

Introduction – Lives and Livelihoods

Humanity is facing one of its worst health crisis and it is very likely that the economic impact of this crisis will be comparable with that of the Great Depression of 1929. The COVID-19 pandemic has impacted both lives and livelihoods. Lockdown was imposed in India since 25th March, 2020. Currently, the global count of confirmed COVID positive cases are around 40 Million, out of which 30 Million have recovered and there has been a loss of 11,17,553 lives. In India alone, there has been around 75, 47,759 plus confirmed cases, with 66, 58,937 recoveries and loss of around 1, 14,629 lives. The health emergency is deeply linked with the economy and livelihood, one of the indicators of which is the stock market crash the world over, with the Indian NIFTY plunging below the 8000 level, in what was being considered worse than the 2008 subprime mortgage crisis which triggered recession across the globe. The market volatility index has been moving in a frenzied direction. Further, the pandemic has resulted in mass lay-offs across the industries which is on a cost cutting spree. According to Centre for Monitoring Indian Economy (“CMIE”), India's unemployment rate had spiked from 8.75% in March to 23.5% in April when around 122 Million Indians lost their jobs and had further peaked up to 27.1% in May. As per *Poverty and Shared Prosperity Report* of World Bank, nearly 150 million people could be pushed into poverty in 2021.

To prevent an economic collapse which could be far more devastating than the COVID-19 induced health crisis, the Government started relaxing the lockdown restrictions. The country was facing a slow-down in growth even prior to COVID-19 outbreak and the pandemic worsened it further. The Government, pursuant to the clarion call of “*Atmanirbhar Bharat Abhiyan*” from the Prime Minister, announced a fiscal stimulus package of around INR 20 Lakh Crores, equivalent to 10% of GDP, in order to support the economy. The mission was to be *vocal about local*, and the package would focus on the four L's being land, labour, liquidity and laws.

The special package is based on five pillars and five phases. The pillars being Economy, Infrastructure, System, Vibrant Demography and Demand. The five phases depict the roadmap for the package and first phase pertains to “Businesses including MSMEs”. This underscores the importance placed by the Government on the MSMEs for kick starting the Indian economy and enabling “*Atma-nirbharta*”.

This importance is not without a well-founded reason. MSMEs have an indispensable role in our country's economy and is crucial for our GDP growth, exports, tax revenue and employment generation. As per the 73rd round of National Sample Survey, conducted during 2015-16, there were 6.3 Crores unincorporated non-agriculture MSMEs in the country. Out of these, 31% were engaged in manufacturing activities, while 36% were in Trade and 33% in Other Services. The Micro sector accounted for more than 99% of total number of MSMEs. Small sector and Medium sector with accounted for 0.52% and 0.01% of total MSMEs, respectively. 51.25% of MSMEs were in rural area and 48.75% were in the urban areas.

These 6.3 crore MSMEs provide employment to over 12 crore people, contribute to 45 percent of exports and over 30 percent of manufacturing value added including service and manufacturing. 90% of India's estimated 450 million-strong workforce is informal and MSMEs employ about 40 percent of these workers. The Ministry of MSME had set a target to up its contribution to GDP to 50% by 2025. Globally, MSMEs represent 90% of the businesses and more than 50% of employment worldwide. In emerging economies, 7 out of 10 jobs are created by Small and Medium Enterprises (“SMEs”). The SMEs play a super critical role in the global value chains and any crisis beckoning on their financial and operational health has a bearing on overall supply chains and will have a domino effect on the entire economy.

This article is an attempt to understand the crisis which has beckoned upon our MSMEs, the reforms & initiatives of the

Government and the crucial role of MSMEs in achieving country's goal of self-reliance.

Impact on MSMEs – Crisis and Course Correction

The Indian economy was lagging even before the onset of the pandemic. COVID-19 has worsened the economic prospects to an unanticipated level. In March 2020, our GDP growth at 3.1% was the worst in eight years and our economy had contracted by 23.9% in the June quarter. The World Bank and International Monetary Fund expect India's GDP to contract by 9.6% and 10.3% respectively for the fiscal year ending March 2021. The MSMEs owing to their size and resource constraints are the most probable victims of this economic meltdown. It is important to understand the MSMEs role in a global context as the sector is heavily export oriented and plays a significant role across nations and supply chains.

As per International Trade Centre Report titled, "SME Outlook" issued in June 2020, it is observed that there is no one-size-fits-all solution and small business travel through four phases as they travel through COVID-19 crisis

- Shutdown Impacts
- Supply Chain
- Demand Depression
- Recovery

The accommodation and food services, followed by non-food manufacturing, retail & wholesale, and travel and transport were the most impacted and there are mostly SMEs. One Fifth of surveyed SMEs reported that they risk shutting down permanently within 3 months and highlighted need for rapid government action.

As per the report, given the difficulty of identifying and reaching businesses in the informal sector, the most popular way to support SMEs during the pandemic has been through direct cash transfers to their employees. India's state of Uttar Pradesh ("UP") has transferred INR 1,000 to 2.3 million people who have participated in the National Rural Employment Guarantee Scheme. UP has also facilitated working capital loan of INR 26,000 Crores benefitting around 9,75,000 MSMEs creating 2 million employment opportunities.

The Report suggests that four long-term trends will characterize the 'new normal' and MSMEs are required to be involved in these four trends:

1. **Resilience:** This can strengthen the ability of the firms to ride out of crisis.
2. **Digital:** In the near future, digital facilities will no longer be optional. Cash payments and paper-based documents will be substituted with digital payments and cloud computing.
3. **Inclusive:** Inclusive economy requires decent jobs and social protection for all. SME plays a significant role in job

creation and without a strong SME sector, it will be impossible to achieve Sustainable Development Goals framed by the UN.

4. **Sustainable:** Environment friendly development is the foremost requirement for businesses.

As per a recent CRISIL Report titled "The epicentre of an existential crisis", MSME sectors revenue growth will plunge into deep red this fiscal because of the COVID-19 pandemic. The fall in revenue for MSMEs has been estimated at 17-21%, while the EBITDA margin may shrink by 200-300 basis points to 4-5%. Demand destruction caused by COVID-19 has far outweighed the benefits of weak commodity prices. As per the Report, the impact on operations due to COVID-19 induced lockdown will additionally impact the creditworthiness and worsen the already existing liquidity crunch for MSMEs. The average interest coverage ratio could deteriorate to 1-1.15 times from the 2.4 level witnessed between fiscal 2017 and 2020. This is post factoring of the moratorium benefit provided by RBI, absence of which could have driven the ratio below 1. Micro Enterprises, which account for 32% of MSME debt are fronted with the maximum complications in view of stretched balance sheet and liquidity issue, particularly working capital.

The Report also observes the following sector specific challenges:

1. Small real estate contractors, ceramics and textile makers are the ones having most vulnerable credit profile.
2. Revenue growth of MSMEs in the real estate EPC segment could almost halve with sliding demand, rising cost, labour disruptions and margin pressure.
3. Working capital is highest for MSME sectors that have higher B2B clientele or dominant export share such as gems & jewellery, ready-made garments and real estate contractors.
4. In upstream sectors like construction, auto component and textiles, inventory build-up and stretched receivables have triggered working capital requirement and rebound is not expected before 2022. Construction units have seen an 80-85% drop in enquiries.
5. In downstream sector, in FMCG, initial benefit was visible by reason of panic buying, however, majority distributors reported 5-10% dip in sales in May due to product and manpower availability. Auto Distributors have reported near zero sales in April and seen more than 50% dip in enquiries in May, signalling a slow recovery.

A recent survey of over 46,000 MSMEs published by All India Manufacturers Organisation ("AIMO") found that 1 out of 3 MSME considers its enterprise beyond recovery whereas a further 32 percent expect recovery to take at least six months. This will impact the lives and livelihoods of MSME workers and their families.

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Board Cultural Analysis

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Evaluation Report with Actionable results and Company specific recommendations by the Board experts

Key Areas Evaluated

- Board Structure, Diversity and Skill matrix
- Board's compliance with its legal, regulatory and fiduciary responsibilities
- Board Dynamics & Functioning
- Board Committees - Structure, Functioning & Effectiveness
- Corporate Governance Compliance Status and Disclosures
- Stakeholders Relationship Management
- Risk Management and Internal Controls

A joint study report by CEEW & NIPFP, titled “Jobs, Growth and Sustainability”, has identified following broad parameters in relation to MSMEs:

1. The Government had announced INR 3 Lakh Crore collateral free loan facility for MSMEs, however, only a fraction of MSMEs are connected to any banking channel. It is suggested that an accurate, scalable and real time information system is built to identify and serve genuine beneficiaries of government schemes.
2. MSME information is currently scattered across datasets as Udyog Aadhar Memorandum, MSME databank and the GST Network. These are either self-certified data or a mandatory requirement based on a turnover threshold and hence not reliable.
3. A fresh MSME census should be carried out and Unique Business Identity number should be allotted.
4. It is recommended that MSME Ministry prepares a vulnerability assessment framework based on economic importance and business risk dimension, to efficiently target support measures.
5. Enterprises in critical supply chains and markets, specially export oriented need special attention. MSME sector is India's largest employer after agriculture. The viability of MSMEs decide the livelihood of 12 Crores workers and targeted interventions will preserve these workers and create new opportunities.
6. Textiles, the largest commodity in India's merchandise export basket, is predominantly manufactured by MSMEs. This sector contributed 12.2 per cent of total exports in 2018-19 and is crucial for India's forex earnings.
7. As of April 2020, an estimated amount of INR 10,582 Crores were owed by Central and State Government Departments and PSE's to MSMEs, and 40,000 delayed payment application filed by MSMEs in SAMADHAAN portal since 2017. Such delays pose a huge challenge for MSMEs, which are already constrained by high fixed cost and disruption of revenue streams due to COVID-19. In a major relief, Finance Minister had announced the clearing of all MSME dues from Government and PSE within 45 days. Recently, significant amount was cleared by CPSE's.
8. In order to improve credit worthiness of MSMEs, the Government should mandate the lenders to introduce a mechanism to track fund utilisation and financial health of the borrowers on monthly basis and intervene at the sign of first distress.

Government Reforms for MSMEs and the Atmanirbhar Bharat Abhiyan

The government has, over past many years, initiated steps to formalise the financing of MSMEs by setting up a nationwide network of banks and financial institutions.

The otherwise rapidly growing MSME sector was facing Pre-COVID distress due to a perceived lack of creditworthiness. Hence, it was important to usher in fiscal reforms and infuse economic support to address the financial and operational concerns of the key enabler of our growth story.

Subsequent to the Prime Minister's announcement regarding mega stimulus package for the economy under *Atmanirbhar Bharat Abhiyaan*, the Finance Minister announced several measures. Out of 16 measures announced under the package, 6 were targeted MSME Reliefs which again emphasizes on the prioritization. The six measures are briefly as under:

1. **Collateral Free Automatic Loans:** INR 3 Lakh Crores outlay, benefitting approximately 45 Lakh MSMEs. MSMEs with INR 25 Crores outstanding in loans and INR 100 Crores in turnover will get credit guarantee backed loans of 4 years tenure, with a 12 months moratorium on principal amount and a capped interest rate. The scheme can be availed up to 31st October.
2. **Subordinate Debt for stressed MSMEs:** INR 20,000 Crores outlay, benefitting 2 Lakh MSMEs. Government to provide INR 4,000 crores towards partial credit guarantee support to banks and banks will do onward lending to promoters who can use it to infuse equity.
3. **Fund of Funds for MSMEs:** With a corpus of INR 10,000 Crores, operating through primary and secondary funds, and will help leverage INR 50,000 Crores fund at secondary level enabling MSMEs to expand in size. The scheme proposes the purchase of 15% growth capital in high credit risk MSMEs.
4. **MSME definition amendment:** Amendment in MSME definition to ensure efficient targeted reform intervention and in line with global standards and synchronised with GSTN framework.
5. **Only Local Bids for Government tenders upto INR 200 Crores:** This will act as a boost to MSMEs and protect it from foreign competition.
6. **MSME dues and Market Access:** E-market linkages for MSMEs is on the anvil to promote trade. All receivables of MSME from Government and PSUs to be cleared in 45 days.

Further, to ensure liquidity to NBFC, MFI and HFCs with low credit rating and to enable fresh lending to MSMEs, a INR 45,000 Crores Partial Credit Guarantee Scheme is also introduced, wherein existing partial guarantee scheme will be extended to cover borrowings such as primary issuance of bonds/commercial papers and first 20% of loss will be borne by Government of India.

Out of the INR 3 Lakh Crores outlay under 100% Emergency Credit Line Guarantee Scheme (“ECLGS”), as on 29th September, 2020, the total amount sanctioned by Public and Private Banks stood at INR 1,86,469 Crores with

disbursements of INR 132,246 Crores. Amount sanctioned by Public Sector Banks stood at INR 81,180.34 Crores of which INR 67,393.40 was disbursed. Private Sector Banks have recently overtaken the PSB's, with sanctions of INR 95,060.79 Crores and disbursement of INR 60,740.73 Crores. As a positive sign of the liquidity free play, NBFC's have sanctioned INR 10,228.07 Crores out of which INR 4,111.99 Crores is disbursed. The States of Maharashtra and Tamil Nadu received the highest sanctions with INR 8,411 Crores and INR 8,265 Crores respectively. On 1st August, the government widened the scope of the scheme. To ensure more companies can benefit from the scheme, it was decided to increase the upper ceiling of loans outstanding for being eligible under the scheme from INR 25 Crores to INR 50 Crores. The maximum amount of ECLGS funding under the scheme was correspondingly increased from INR 5 Crores to INR 10 Crores.

Tax relief measures like extension of due dates, reduction in TDS and TCS rates, speedy processing of income tax refunds etc, have been in the right direction to provide much required liquidity to MSMEs.

In line with the promises made, the Government brought in an amendment to effect change in definition of MSME with effect from 1st July, 2020.

The revised MSME classification, with composite criteria of investment and annual turnover, is as under:

Classification	Micro	Small	Medium
Manufacturing & Services	Investment < Rs. 1 Cr. And Turnover < Rs. 5 Cr.	Investment < Rs. 10 Cr. And Turnover < Rs.50 Cr.	Investment < Rs. 50 Cr. And Turnover < Rs.250 Cr.

The new definition classifies enterprises on the basis of combination of invested capital and annual turn-over. The turnover is excluding all export of products/services for all MSMEs, and hence increasing the coverage of MSME net.

Government has launched "Creation and Harmonious Application of Modern Processes for Increasing the Output and National Strength" (CHAMPIONS) in the MSME portal to register grievances around finance, raw materials, labour, regulatory permissions etc. and it has started to gain traction. It aims to be a one-stop-shop solution of MSME Ministry.

Another innovative platform which can be leveraged is the GeM Marketplace, which was launched in August, 2016, to bring in transparency and efficiency in the public procurement process. The portal has over 5.93 Lakh sellers out of which more than 1 Lakh are MSME sellers. Overall, there are more than 14.12 lakh products listed on the portal that has a transaction value of Rs. 66,975 crores. According to the government's Public Procurement Policy (2012) for MSMEs, every central ministry,

department, and PSU has been mandated to set an annual procurement target of minimum 25 per cent from MSMEs of their total annual purchases. Further, within this 25%, a sub-target of 4% is earmarked for SC/ST entrepreneurs and 3% for MSMEs owned by women, in order to bridge the societal inequalities. In her Budget 2020 speech, Finance Minister had proposed increasing the turnover of the GeM portal to Rs. 3 lakh crores.

On 24th June, MSME Minister, rolled out the subordinate debt scheme promised under the *Atmanirbhar Bharat* reforms, to provide INR 20,000 Crores guarantee cover to 2 Lakh MSMEs. This also entails a sub-debt facility to promoters of those operational MSMEs that are SMA-2 accounts (with principal or interest payment overdue between 61 to 90 days) or have become NPAs as on 30th April, 2020. Under the scheme, promoters of the MSMEs will be given credit equal to 15% of their stake (equity + debt) or INR 75 lakh, whichever is lower. In turn, promoters are liable to infuse this amount into the MSME unit as equity. This is expected to enhance the liquidity and maintain debt-equity ratio. In this sub-debt scheme, 90% of the cover will be given while the rest 10% will be upon the concerned promoters. The payment of the principal amount will be under moratorium for seven years. Maximum tenure for repayment will be 10 years. This is expected to somewhat ease the liquidity crunch faced by our MSMEs.

RBI has recently extended the interest subvention scheme on loans extended by co-operative banks to MSMEs till March 2021. The scheme covers all term loans and working capital loans upto INR 1 Crores and provides interest relief of 2% per annum to eligible MSMEs. Further, in a much sought-after relief to tackle issue of rising NPA among MSMEs, the RBI in August, 2020 allowed further restructuring of loans for small businesses till 1st March, 2021. This is an extension of scheme that was earlier available upto 31st December, 2020.

To penetrate MSME lending domain, leading Public Sector Banks are appointing zonal officers to establish direct contact with MSMEs and to improve its market share with MSMEs which is currently controlled 30-35% by NBFC and MFIs.

Conclusion - Way Forward

COVID-19 has underlined the importance of devising an alternate survival strategy. Those, who build up resilience and invest in diversification, will fare out much better than those who do not. Diversification of MSMEs into defensive sector like FMCG, pharmaceuticals, food products, hospitals, telecom etc. will make their credit profile less vulnerable and secure their revenue streams. A departure or change in portfolio of verticals may be required if the MSMEs are engaged in automobiles, construction, gems & jewellery, hospitality, textiles etc as recovery is not expected anytime soon.

Additionally, MSMEs should leverage technology and cloud in order to capitalise on upcoming opportunities. This will enable their entry into sectors based on Artificial Intelligence, Robotics,

and Commercial Drones etc.

It is essential to analyse and evaluate the ground realities, including supply and demand bottlenecks, higher fixed cost, industry sentiments and labour issues, before entering into any business ventures.

The sheer statistics with regard to quantum of MSMEs, and their contribution to our GDP, exports and employment, highlight their indispensable role as a catalyst to reset the path to economic recovery and drive sustainable economic growth.

With passage of time, there have been certain notable improvements. In view of the Unlock measures, the core sector activities have shown significant improvement. The manufacturing PMI has shown a sharp increase from 52 in August to 56.8 in September, the highest in 8 years. Automotive companies having zero sales for almost 3 months, are operating at full production capacity to cater to the festive demand. Real Estate has seen significant pick up in enquiries and sales, especially in Delhi and Mumbai. FMCG has tapped on well into product diversification and are tying up with logistic partners to meet the rising demand. E-commerce platforms are going aggressive on marketing and are expected to do business worth 7 Billion USD during festive season and the main focus is on MSME suppliers. The unemployment rate has dipped to 6.67% in September 2020, coming close to pre-COVID levels. As icing on cake, NIFTY had recently crossed the 11000 mark and had nearly erased the losses during the year.

The criticality of the role to be played by MSMEs cannot be stressed enough. They are the backbone of our economy and their fate will decide the fate of millions of our employees and the dependent families. The UN General Assembly in its 74th Plenary had declared 27th June as Micro, Small and Medium-sized Enterprises Day, recognizing the importance of MSMEs in achieving sustainable development goals and in promoting innovation, creativity and sustainable work for all. The International MSME day was celebrated in the midst of worst economic sentiments.

MSMEs across the globe, should be provided with the required support and infrastructure to truly achieve their potential as the catalyst to the global growth.

Recently, the Kerala Government has launched an online portal for speedy and transparent delivery of concessions, including interest subsidy for the revival of MSMEs. The interest subsidy on capital credit and term loans availed by MSMEs from financial institutions is a major component of the package. Under the scheme, MSME units which had availed additional capital credit or additional term loan, either separately or together, from April 1 to December 31, 2020, will be entitled for 50 per cent interest subsidy for six months. A ceiling of Rs 30,000 has been set for single loan and Rs 60,000 for both the loans under this facility. The benefit of interest subsidy is also eligible for MSMEs that have availed loans under the ECLGS.

Similarly, the Finance Minister has launched “MSME Prerana”, an online business mentoring programme for MSMEs initiated Indian Bank, a public sector bank. It is for empowering entrepreneurs through skill development and capacity building workshops in the local language.

These are merely some examples and we have a long way to go before the economy can be brought back to pre-COVID levels. Such proactive reforms and measures highlight the intent of the policy makers and throw weight behind growth story. The MSME growth story will have the potential to make or break the Indian & the Global growth story. For all that is worth, it will be the ideal for MSMEs to become “Prerana” for an “Atmanirbhar Bharat”.

***CA Mr. S. Badri Narayanan** is a Consultant at Brahmaya&Co. He is a qualified Chartered Accountant and Company Secretary. He holds over 5 years of experience in statutory audit, insolvency and restructuring under IBC, and specialises in MSME advisory. ■