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Confederation of Indian Industry

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CII DELHI MSME SUMMIT

<u>Background Paper</u>

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Section 1: Introduction to MSMEs in India

Introduction

The Micro, Small and Medium Enterprises (MSMEs) play a pivotal role in the economic and social development of the country and its entrepreneurship spirit. The MSME sector contributes significantly to the country's manufacturing output, employment and exports and is credited with generating the one of the highest employment growth and a major share of industrial production and exports. The sector has emerged as a major supplier of mass consumption goods as well as a producer of electronic and electrical equipment and drugs and pharmaceuticals. An impetus to the sector is likely to have a multiplier impact on economic growth.

The MSME sector in India is highly heterogeneous in terms of the size of the enterprises, variety of products and services, and levels of technology. The sector not only plays a critical role in providing employment opportunities at comparatively lower capital cost than large industries but also helps in industrialization of rural and backward areas, reducing regional imbalances and assuring more equitable distribution of national income and wealth. MSMEs complement large industries as ancillary units and contribute enormously to the socioeconomic development of the country.

MSMEs have been defined based on investment in plant and machinery, excluding land and building with no licensing required to set-up such a unit. This was before 1991. In 2006 MSMED Act brought in a more comprehensive definition and a revised classification as per Micro, Small and Medium.

MSME Definition

Micro Enterprises
Manufacturing : Investment uptil Rs. 25 lakhs
Services: Investment uptil Rs. 10 lakhs

Small Enterprises
Manufacturing : Investments more than Rs. 25 lakhs but doesn't exceed Rs 5 crore
Services: Investments more than Rs. 10 lakhs but doesn't exceed Rs 2 crore

Medium Enterprises
Manufacturing : Investments more than Rs. 5 crores but doesn't exceed Rs 10 crs.
Services: Investments more than Rs. 2 crores but doesn't exceed Rs 5 crs.

Proposed Change of Definition of MSMEs

The Cabinet, in its meeting held on 25.3.2015 approved the proposal of the ministry for the introduction of MSME Development (Amendment) Bill, 2015 to amend the MSME Development Act, 2006. The objectives of the proposed amendments are to-

(i) Enhance the existing limit for investment in plant and machinery considering changes in price index and cost of inputs consistent with the emerging role of the MSMEs in various Global Value Chains,

(ii) Include in such classification, the micro or tiny enterprises or the village enterprises, as part of medium enterprises apart from small enterprises so as to enable the aforesaid category of enterprises to avail the benefits and become competitive, and

(iii) Empower the Central Government to revise the existing limit for investment, by notification, considering the inflation and dynamic market situation.

Steps have been taken to introduce the bill in parliament.

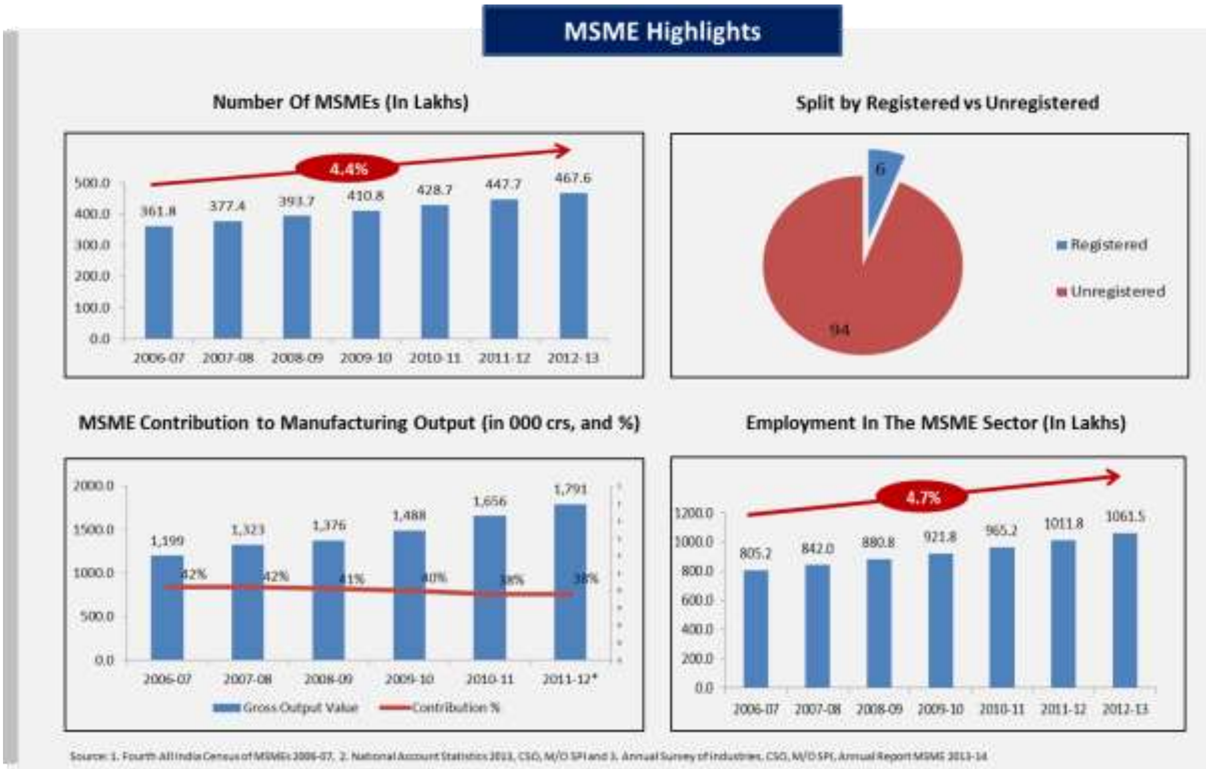
MSME Sector Highlights

- As per the last Census of 2006-07, there are 361.7 lakh MSME units. The corresponding figures have been used by the Ministry to project size of the sector and as per MSME Annual Report for 2013-14 the projected estimate of the size of number of MSMEs for 2012-13 is 467.6 lakhs. This has grown at CAGR of 4.4% over a period of 6 years ending 2012-13. The Annual MSME Report for 2012-13 pegs the composition of the MSME sector as: Services 68.2% and Manufacturing 31.8%.

- In terms of the split by registered & unregistered-as per the 4th (All-India) Census of MSMEs estimates, out of the total number of MSMEs, almost 94 percent are still in the unregistered segment.

- Based on the results of Third and Fourth All India Census of Small Scale Industries / Micro, Small & Medium Enterprises, an attempt has been made to estimate the share of MSME Sector in manufacturing output and GDP revising the existing ratio-based estimation procedure adopted by the Planning Commission in the year 1992. As per the Ministry's Annual Report 2013-14, the contribution is pegged at 38% for 2011-12

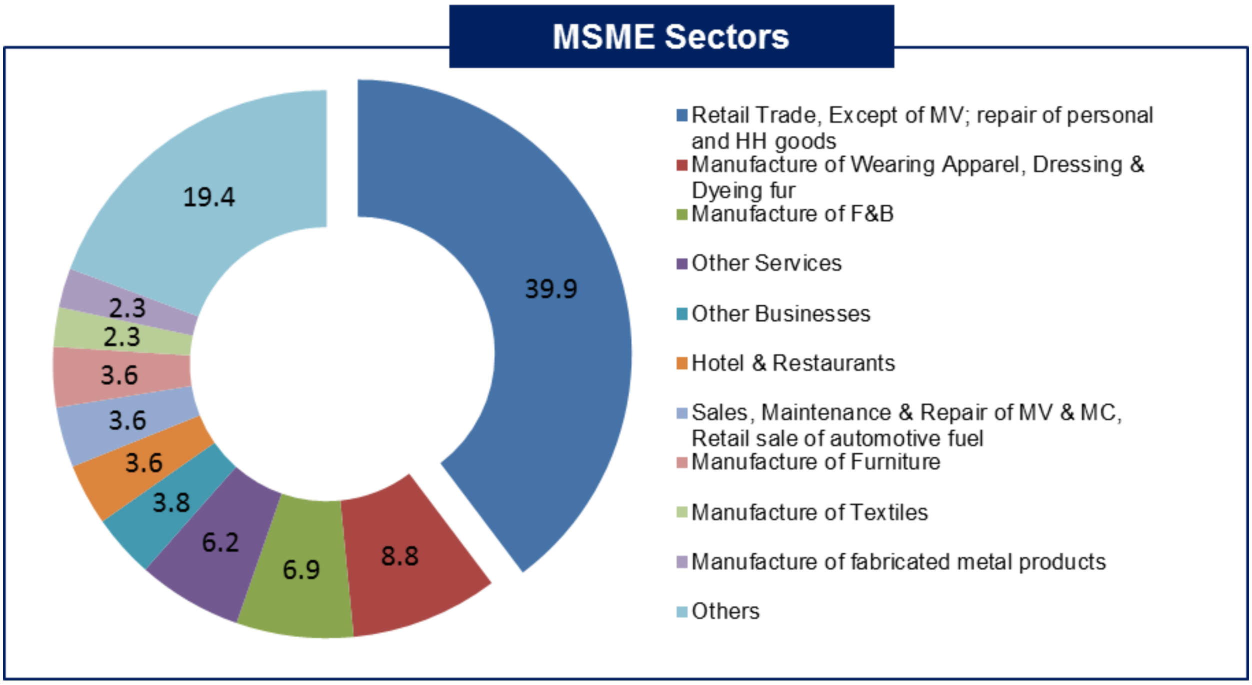
- Similarly for the employment figures, the MSME Annual Report for 2013-14 puts the projected estimate of employment at 1061.52 lakh, having grown at a CAGR of 4.7% during the period 2006-13



MSME Sector Composition

Retail trade is one of the key sectors within MSME. In terms of manufacturing, Apparel, Food & Beverage, Furniture and Textile constitute the majority share. However in terms of gross output, IFC/ World Bank Inetllecap Analysis 2013 pegs the share of food products and beverages segment as the highest followed by textiles, basic metals and chemicals. Overview provided below:

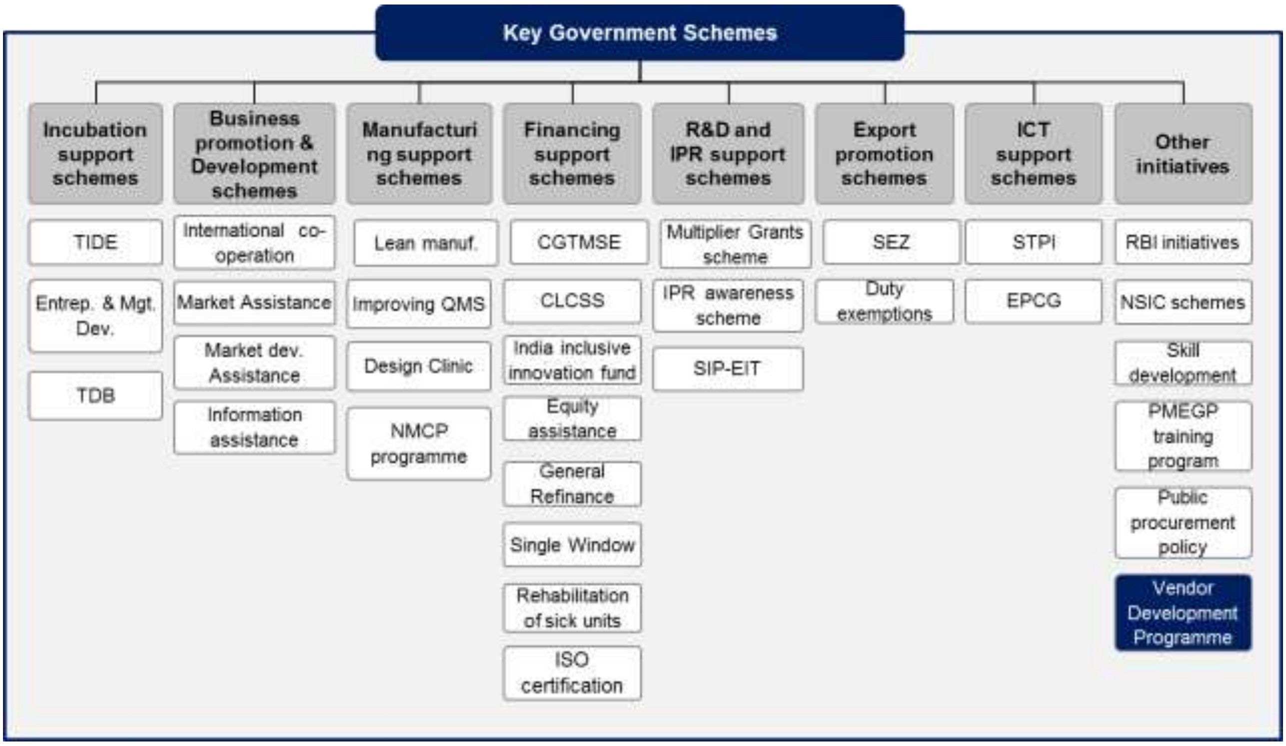
Exhibit 1: MSME Sector Composition



Section 2: Key Government Policies and Support for MSMEs

To a large extent, the growing number of MSMEs across the nation can be attributed to a slew of available government schemes and initiatives. Over the last decade, many new schemes for the development of MSMEs have been launched by the central and state governments.

The government institutes like SIDA, NSIC etc. provide for the relevant ecosystem that encourages and supports MSMEs in India. The same has been detailed later in the chapter alongside the key role played by them.



1. **Incubation Support Schemes**

   1.1. **Technology Incubation and Development of Entrepreneurs (TIDE) Scheme** - The scheme aims to support institutes of higher learning to strengthen their Technology Incubation Centers so as to nurture technology MSMEs, especially start-up companies. Key initiatives undertaken by the Host institute includes mentoring, infrastructure and financial support, entrepreneurial training, IPR facilitation, initiate contact with AIs/VCs, etc. Host institute/TIDE center receives financial support from government up to INR 155 lakhs. These funds can be used for improvement in infrastructure - up to INR 30 lakhs and for providing financial support to the incubating companies – INR 125 Lakhs (@ INR 25 lakhs per company).

   1.2. **Support for Entrepreneurial and Management Development of SMEs through Incubators**- The Scheme aims to provide early stage funding for nurturing innovative business ideas in select fields including electronics and software. Under this scheme, financial assistance is provided for setting up of business incubators. The objective of the scheme is to promote development of knowledge based innovative start-ups and improve the competitiveness and survival ability of the MSMEs. Under this scheme, BIs are to be set up under Technology (Host) Institutions which are normally the Indian Institutes of Technology (IITs), National Institutes of Technology (NITs), engineering Colleges, Technology Development Centers, etc. Each BI is given financial assistance between INR 4 lakh to INR 8 lakh per idea/unit subject to an overall cap of INR 62.5

lakh per incubator. The Scheme is implemented in a Public Private Partnership (PPP) mode with private participation ranging b/w 15 per cent to 25 per cent.

1.3. **Technology Development Board** – GOI set up TDB to provide financial assistance to the industrial concerns and other agencies undertaking development and commercial application of indigenous technology or adapting imported technology for wider domestic application. TDB provides – a) Financial assistance to research and development institutions b) Financial assistance to Venture Capital Funds for assisting technology MSMEs c) Grants to Technology Business Incubators in IITs/Labs/ Institutions for giving loans/equity support to small technology start-ups d) Loans and grants to Labs/ Institutions/ Indian Companies to co-develop and commercialize technologies of national importance.

2. Business Promotion and Development Schemes

2.1. **Scheme to promote International Cooperation** – This scheme offers assistance to MSMEs for exploring new areas of technology infusion/up gradation and identifying new markets through Joint ventures and foreign collaborations. Financial assistance up to 95% of airfare and space rent is provided to entrepreneurs to participate in international exhibitions, trade fairs and buyer-seller meets in foreign countries and India.

2.2. **Marketing Assistance scheme** offers assistance to MSMEs for undertaking marketing promotion activities. Under the scheme, MSMEs can avail financial assistance for organizing exhibitions, trade fairs, buyer-seller meets and other marketing promotion events.

2.3. **MSME Market Development Assistance scheme** offers financial assistance to MSMEs for using Global Standards in bar coding. The scheme also has provides funding to MSMEs for participation in the international exhibitions / fairs, producing publicity material and sector specific studies and for contesting anti-dumping cases.

2.4. **Information assistance**- Ministry of MSME launched 'Udyami helpline' in 2010. This call center acts a single-point facility for a wide spectrum of information and accessibility to banks and other MSME-related organizations. It also gives information on a wide range of subjects, including guidance on setting up units, access loans from banks, project profiles and about various MSME schemes.

3. Manufacturing Support Schemes

3.1. **Lean Manufacturing Competitiveness for MSMEs** aspires to enhance the manufacturing competitiveness of MSMEs through the application of various Lean Manufacturing (LM) techniques. Under this scheme, manufacturing MSMEs can receive financial assistance up to 80% of the cost from the GOI on the implementation of lean manufacturing techniques.

3.2. **Enabling Manufacturing Sector to be Competitive through Quality Management Standards and Quality Technology Tools** – This scheme seeks to encourage MSMEs to understand and adopt latest Quality Management Standards (QMS) and Quality Technology Tools (QTT) in the manufacturing process.

3.3. **Design clinic scheme -** The design clinic scheme is an initiative of the Ministry of MSME and National Institute of Design. The main objective of the scheme is to bring the MSME sector and design expertise onto a common platform and to provide expert advice and solutions on real-time design problems, resulting in continuous improvement and value addition for existing products. It aims to enhance industry competitiveness and productivity with the help of design intervention at various functional levels.

3.4. **National Manufacturing Competitiveness Programme**- The NMCP is the nodal programme of the government of India to develop global competitiveness among Indian MSMEs. There are 10 components under the NMCP targeted at enhancing the entire value chain of the MSME sector. It includes programs like establishment of new tool rooms, benchmarking of the global competitors, enhancing of product and process quality, cost reduction through lean manufacturing techniques, etc. The programme is to be implemented through the public-private partnership mode with close physical and financial participation of the MSME sector.

4. Finance and Credit Rating Support Schemes

4.1. **Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) scheme** was launched by the GOI in 2000 to strengthen credit delivery system and facilitate flow of credit to the MSME sector. To operationalize the scheme, GOI and SIDBI set up the Credit Guarantee Fund Trust for MSMEs. The scheme provides collateral free funding up to INR 1 Crore for individual MSMEs. The CGS assures the lender that, in the event of a default on the part of the MSME unit, which availed collateral free credit facilities, the Guarantee Trust would make good the loss incurred by the lender, up to 75/80/85 per cent of the credit facility with a maximum guarantee cap of INR 62.50 lakhs / INR 65 lakhs. The CGTMSE Scheme is operated through a network of Banks and FIs called Member Lending Institutions (MLIs). All scheduled commercial banks (PSU, Private or Foreign), specified Regional Rural Banks, National Small Industries Corporation Ltd, North Eastern Development Finance Corporation Ltd and SIDBI, which have entered into an agreement with the trust (CGTMSE) are considered as MLIs. The scheme had 125 Member Lending Institutions in 2011.

4.2. **Credit Linked Capital Subsidy Scheme** – This scheme aims at facilitating technology up-gradation of MSMEs by providing 15 per cent capital subsidy for purchase of Plant & Machinery / Improved technology. Maximum limit of eligible loan for calculation of subsidy under the scheme is Rs.100 lakhs. At present, more than 1500 well established/improved technologies under 51 sub-sectors have been approved under the Scheme. Since inception of the scheme in the year 2000, more than 28287 MSME units have availed subsidy of Rs.1619.32 crore till 31.03.2014.

4.3. **GOI launched 'India Inclusive Innovation Fund'**, jointly created by National Innovation Council and MSME Ministry with an initial corpus of INR 500 Crores which could be scaled up to INR 5000 crores over the next 2 years. Of the INR 500 crore, the ministry of MSME has committed INR 100 crore and the remaining INR 400 crore will come from 12 public sector banks. Under the fund, the plan is to fund anything between INR 50 lakh to INR 2 crores to 70 and 200 ideas with special focus on MSMEs which address social needs like healthcare, agriculture, education, financial inclusion and water, etc.

4.4. **Growth Capital and Equity Assistance scheme** aims to provide adequate capital to MSMEs so as to enable them to make investments in marketing, brand building, creation of distribution network, technical know-how, R&D, and ICT adoption / software purchase, etc.

4.5. **General Refinance** – Under this scheme financial support is provided to MSMEs for new business set up, expansion, modernization or diversification of existing business.

4.6. **Composite Loan scheme** offers assistance up to INR 25 lakh for purchase of equipment and/or working capital requirements.

4.7. **Single Window scheme** provides support to entrepreneurs, both term loans for fixed assets and loan for working capital through a single agency.

4.8. **Rehabilitation of Sick Industrial Units scheme** provides financial assistance for rehabilitation of potentially viable sick units which are capable of being restored to normal health within a reasonable time.

4.9. **Development of Industrial Infrastructure for MSME Sector scheme** provides financial support for development of industrial infrastructure / industrial estates/industrial areas

4.10. **ISO 9000/ISO 14001 Certification Reimbursement scheme** for MSMEs offers reimbursement of expenses up to 75% (subject to a maximum of INR 75,000) incurred towards the acquisition of ISO 9000/ISO 14001/HACCP certification.

5. R&D and IPR Support Schemes

5.1. R&D Funding scheme provides funds to institutions/ organizations in the area of research and development, for technical collaboration, etc.

5.2. Multiplier Grants scheme aims to encourage and accelerate development of indigenous products by establishing, nurturing and strengthening the linkages between the Industry and R&D Institutes. The objective of the scheme is to bridge the gap between R&D and commercialization by strengthening linkages between the industry and R&D institutes. The maximum funding ranges between INR 2 crore and INR 4 crore.

5.3. Building Awareness on Intellectual Property Rights scheme endeavors to enhance awareness among the MSMEs about IPRs. Under this scheme, financial assistance is provided for conducing awareness programs on IPRs including seminars, workshops, training, etc. Additionally, it also offers one time financial support limited up to INR 25,000 on grant of domestic patent and Rs.2 lakh for foreign patent to MSMEs.

5.4. Support International Patent Protection in Electronics and IT (SIP-EIT) – This scheme provides financial support up to 50% of total patent cost (subject to a max. of INR 15 lakh) to MSMEs for international patent filing so as to encourage indigenous innovation.

6. Export Promotion Schemes

6.1. SEZ – The Special Economic Zone provides simplified procedures and a single window clearance policy on matters relating to central and state governments. Key benefits offered under the scheme include Drawback/ DEPB benefits, CST exemption, Service Tax exemption and income tax holiday. Exemption from income tax is tapered down over 15 years from the date of commencement - 100 per cent exemption of export profits from income tax for the first five years, 50 per cent for the next five years and 50 per cent for the five years subject to transfer of profits to special reserves.

6.2. Duty exemption schemes enable duty free import of inputs required for export production.

7. ICT Support Schemes

7.1. Software Technology Parks of India (STPI) – STPI offers a single-window clearance for project approvals, import certification software valuation and certification of exports for software exporters. The STPI Scheme is considered as one of the most effective schemes for the promotion of exports of IT and BPM; ~ 51 STPI centers have been established under the scheme since inception. Key benefits offered include exemption from customs duty available for capital goods, exemptions from service tax, excise duty, and rebate for payment of Central Sales Tax. STPI is pan India Scheme with over 8,000 units registered under this scheme.

7.2. Export Promotion of Capital Goods (EPCG) scheme provides support to exporters of electronic products by allowing import of capital goods for pre-production, production and post-production at zero percent customs duty, subject to an export obligation equivalent to 6 times of duty saved on capital goods imported under EPCG scheme, to be fulfilled in 6 years reckoned from the date of authorization issue.

Other Scheme and Initiatives

8. **The Reserve Bank of India** has, from time to time, issued a number of directives to banks to facilitate lending to the MSME sector. Some of them are highlighted below-

8.1. **A**dvances to the MSME sector are considered in computing achievement under the overall Priority Sector target of 40 percent (32 percent for Foreign Banks) of adjusted Net Bank Credit

8.2. Banks are advised to achieve a 20 per cent year-on-year growth in credit to MSMEs

8.3. Banks are mandated not to accept collateral security for loans up to INR 10 lakh extended to units in MSME sector.

8.4. Public sector banks have been advised to open at least one specialized MSME branch in each district with special focus on key industrial clusters/ manufacturing centers.

8.5. Banks have been advised to fix sub-limits within the overall working capital limits to the large borrowers specifically for meeting the payment obligation in respect of purchases from MSMEs.

8.6. Banks have been directed to create separate cells to provide consultancy to MSMEs in areas related to operations, accounting and finance, business planning etc.

8.7. Banks have been advised to strengthen their existing systems of monitoring credit growth to the MSME sector.

8.8. Banks have been directed to allow restructuring of debt for all eligible MSMEs.

9. National Small Industries Corporation (NSIC) Program–

9.1. Credit Rating and Facilitation – This scheme aims to encourage MSMEs to upgrade their competence in terms of business and technologies by getting rated through the rating agencies empanelled with NSIC. The scheme strives to establish independent and trusted third party opinion on the capabilities and credit worthiness of MSMEs so as to facilitate swift loan approvals from Banks and FIs. Under the scheme, the MSME can seek partial re-imbursement of the rating fee, if the credit-rating is undertaken by an empanelled rating agency of NSIC. Additionally, NSIC has entered into a MOU with various nationalized and private sector banks to provide credit support from banks without any cost to MSMEs.

9.2. Raw Material Assistance scheme provides assistance to MSMEs by way of financing the purchase of raw material (both indigenous & imported).

9.3. Single Point Registration scheme aims at increasing the share of Govt. purchases from MSMEs. This scheme offers MSMEs a single point of registration for participation in Govt. schemes. The units registered under the scheme are entitled to special benefits such as issue of tender free of cost, exemption from payment of Earnest Money Deposit (EMD), etc.

9.4. Infomediary Services scheme provides a one-stop, one-window service office for information on business, technology and finance through its web portal- www.msmemart.com

9.5. Marketing Intelligence Services Lease scheme aims to support MSMEs seeking business collaboration or joint ventures, exporters and importers, etc. Under this scheme, MSMEs can avail information on bulk buyers in Government/public & private sectors, Exporters, International buyers, Technology suppliers, and units registered with NSIC under Single Point Registration Schemes, and also market intelligence reports pertaining to several sectors, trends analysis and export – import statistics.

9.6. Bill Discounting scheme covers purchase/discounting of bills arising out of genuine trade transactions i.e., sales made by MSMEs to reputed public limited companies / State and Central Government Departments.

9.7. NSIC Infrastructure scheme offers MSMEs – a) Enabling infrastructure supporting business incubation b) Exhibition halls / Complex in Hyderabad and New Delhi for organizing exhibitions/ conferences c) Office space to IT/ITES and non-IT/ITES MSMEs in STP's in New Delhi and Chennai

10. **Skill Development Initiatives -** GOI has recognized the importance of vocational education and skill up gradation of the existing workforce. As a result, it has taken initiatives to upgrade nearly 1,390 industrial training institutes (ITIs) in public private partnership mode across the nation.

11. **Prime Minister's Employment Generation Programme (PMEGP) -** It was launched to generate employment opportunities in rural as well as urban areas through setting up of new self-employment ventures / projects / micro enterprises. Under the programmed, beneficiaries can set up micro enterprises by availing of margin money subsidy of 25% (35% for special categories) of the project cost in rural areas. The maximum cost of the projects assisted under PMEGP is 25 lakh INR in the manufacturing sector and 10 lakh INR in the service sector.

12. **Public Procurement Policy for MSMEs -** The ministry of MSME formulated the Public Procurement Policy for MSMEs, which mandates every Central ministry/Department/PSU to achieve a procurement goal of at least 20 per cent of the total annual purchases of the products or services, produced or rendered by MSMEs. The policy seeks to promote MSMEs by improving their market access and competitiveness through increased participation in Government purchases and encouraging linkages between MSMEs and large enterprises

13. **Vendor development programme under the public procurement policy of the government for MSMEs** - As per the public procurement policy for MSMEs, every department under the Central ministry or public sector undertaking has to source at least 20 per cent of their total annual procurement through MSMEs only. To support this imitative, the ministry of MSMEs introduced the National Vendor Development Programme (NVDP) to grow and develop the MSMEs.

    There are two types of vendor development programmes – National level and State Level. Both these programmes are organized through the field offices called Micro, Small and Medium Enterprises Development Institutes (MSME-DIs)

    Typically, the national level programmes are organized over three days, during which the MSMEs interact with large scale organizations such as BEL, BHEL, TELCO, BSNL, NHPC, NTPC, defense, railway, etc., with the goal of and establishing themselves as potential vendors. Business enquiries ranging from INR 50 lacs to INR 20 crore are generated during these programmes. Similarly, the MSME-DI organizes state level vendor development programmes to help business promotion and industrial development at the State level.

    Objectives of the programme - The aim of the programme is to foster linkages between small and large enterprises. These programmes provide opportunities to SMEs to showcase their capabilities to various departments of the government such as railways, defense establishments, PSUs, etc. By providing an interactive platform, this programme strives to mutually benefit both the large-scale enterprises and MSMEs. While PSUs get the opportunity to identify and select potential vendors, the MSMEs get the chance to promote and develop their business.

    Programme performance- MSME-DI is helping SMEs by developing ties between buyers and sellers, hence providing opportunities to identify various potential products, develop services and evolve indigenized marketing strategies. MSME, along with different associations, has been organizing events and exhibitions where vendors can display their products and also organize interaction meets with the sellers.

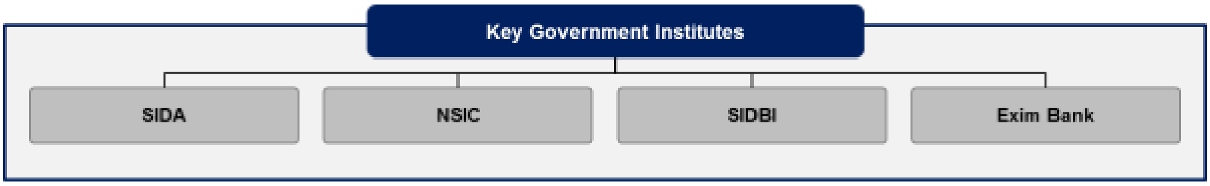
These activities are being conducted across the country to generate awareness about the government's procurement policy. In the past three years, an approximate number of 50 NVDPs have been conducted across the country covering automobile products, electrical and electronics machinery, components, etc.

Benefits to MSME- Majority of the MSMEs are reluctant to approach PSUs for business due to the stringent policies and lengthy procedures involved. This programme bridges this gap by helping the MSMEs understand the procedures and policies of PSUs and thus improves accessibility to potential buyers.

Process for availing benefits - To avail the benefits of this programme, the only criteria is that the companies need to be registered as Small Scale Industries (SSI)/Entrepreneur Memoranda 2 (EM2). Interested entrepreneurs can register and participate with a minimal amount of INR 6000, while a 50 per cent concession is provided to SC/ST enterprises. For Non-SSI, medium and large enterprises, there is a nominal fee charged.

Entrepreneurs individually or along with an industry association can approach Ministry for organizing the programme. In case individuals approach the ministry, the ministry waits for a certain number of similar requests to be submitted before it arranges vendor meets.

Role of Government Institutes



1. Small Industry Development Bank of India (SIDBI): SIDBI enables promotion, financing and development of the MSMEs, and co-ordination of the functions of the institutions engaged in the development of the MSME sector. It also refinances institutions such as state financial corporations, state industrial development corporations, and commercial banks against loans granted to the MSMEs. In terms of its product and services, SIDBI focuses on refinance schemes operated through SFCs / SIDCs / primary lending institutions / Banks or Microfinance institutions. E.g. Finance to small transport operators, technology up gradation fund for textile units, loans for acquisition of ISO certification, single window finance for short term credit

    a. SIDBI Venture Capital Fund Ltd (SVCL) is a wholly owned subsidiary of SIDBI and manages funds set up by SIDBI at the national level - The National Venture Capital Fund for Software and IT Industry (NFSIT), The SME Growth Fund, India Opportunities Fund (IOF) and Samridhi Fund (SF)

2. EXIM Bank: It extends credit facilities for financing at all stages of the export cycle of MSMEs. The Bank's line of credit (LOC) is available to commercial banks, other financial institutions and overseas entities. This acts as a market entry mechanism for Indian MSMEs MSME exporters and provides a safe mode of nonrecourse financing option. The bank offers buyer's credit and supplier's credit for exports on deferred payment terms. These facilities aid MSMEs to offer competitive credit terms to the buyers and are able to explore newer geographical markets

3. National Small Industries Corporation (NSIC): The main functions of the Corporation are to aid and foster the growth of micro and small enterprises in the country, generally on a commercial basis. It provides a variety of support services in the areas of raw material procurement; product marketing; credit rating; acquisition of technologies; adoption of modern management practices, etc.

4. Small Industries Development Agency (SIDA) : Provides single window service for SSI units

Recent Key Initiatives by the Ministry and GoI

5. ASPIRE: A Scheme for Promotion of Innovation, Rural Industry and Entrepreneurship was launched by the Ministry on 18.3.2015. The scheme was formulated to set up a network of technology centers and to set up incubation centers to accelerate entrepreneurship and also to promote start-ups for innovation and entrepreneurship in agro – industry.

6. SFURTI: Significantly enhanced allocation and revamped the ongoing Scheme of Fund for Regeneration of Traditional Industries (SFURTI) to achieve better and more intensive coverage with professional/expert inputs.

7. New Initiatives under PMEGP : Under the Modified Guidelines, the following activities have now been allowed:
   a. Industries such as processing of pashmina wool and other products like hand spinning and hand weaving.
   b. All rural and urban transport activities.
   c. Value added Products for Tea,Coffee,Rubber etc.sericulture,Horticulture, Floriculture.

8. Revamped Coir Udyami Yojana (CUY) & Coir Vikas Yojana (CVY): .CUY is a credited linked subsidy scheme in coir sector, aims to integrate and develop coir units. CVY envisages training for men & women coir workers apart from providing assistance for setting up and expansion of coir units.

9. Technology Centre Systems Programs: Under Technology Centre System Programme, 15 New Technology Centers (Tool Rooms) would be set up and existing Tool Rooms would be upgraded with support of World Bank.

Section 3: Ease of Doing Business – The India story

India is one of the fastest growing economies in the world. However, India's position in the 'Doing Business' annual reports published by the World Bank continues to be less than favorable. Doing business sheds light on how easy or difficult it is for a local entrepreneur to open and run a small to medium-size business when complying with relevant regulations. It measures regulations affecting 11 areas across the life of a business : starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency and labor market regulation.

The latest rankings place India 142nd among 189 economies; lower than BRICS (Brazil, Russia, China and South Africa) counterparts. The performance on each of the key indicators is provided in the chart below.

Source: Doing Business Rankings, World Bank Group

Yearly movements in rankings can also provide some indication of changes in an economy's regulatory environment for firms, but they are always relative. Therefore, the table below looks at how far has India come on the areas measured by 'Doing Business' both at an absolute and relative level. The relative benchmarks being used include a) Best Performing b) China c) Russian Federation.

Indicator Ranking	Δ YoY India	China	Russian Federation	Best Performing
Starting a Business	-2 (158)	128	34	New Zealand
Dealing with Construction Permits	-1 (184)	179	156	Hong Kong SAR
Getting Electricity	-3 (137)	124	143	Korea Republic
Registering Property	-6 (121)	37	12	Georgia
Getting Credit	-6 (36)	71	61	New Zealand
Protecting Minority Investors	+14 (7)	132	100	New Zealand
Paying Taxes	-2 (156)	120	49	UAE
Trading across Borders	-4 (126)	98	155	Singapore
Enforcing Contracts	-- (186)	35	14	Singapore
Resolving Insolvency	-2 (137)	53	65	Finland

Source: World Bank, 2015

The Government has recently taken some concrete steps to address the issues faced on each of the parameters so as to improve the 'ease of doing businesses in the country. The Government is targeting to move to the top 50 in the 'Ease of Doing Business' rankings in the future.

	Parameter	Challenge / Issues faced	Recent measures introduced to address the challenges
1	Ease of doing business	India ranks a poor 142nd among 189 countries on Ease of Doing Business rankings	a)Focus on reducing paperwork, making rules easier for doing business b) Focus is on Delhi and Mumbai, the two centers that the International Finance Corporation will assess when deciding the country's rankings
2	Starting a business	Significant amount of time & steps required to start businesses - 27 days & 11 steps in Delhi and 30 days & 13 steps in Mumbai	a)In Mumbai, VAT & professional tax registration compressed into one Registration under Shops & Establishments Act b) ESIC registration made online, Easier to get PAN and TAN or Tax Account Number
3	Trading across borders	7 documents needed for export & 10 for imports	a) DGFT targeting to reduce the number of documents to 3 b) Online single window mechanism being put in place for customs clearances such as those for food safety, plant quarantine, clearance of medicines, etc.
4	Construction permits	India ranks 184th among 187 countries and the problem lies with local authorities who issue permits	a) Delhi launched common application forms to minimize time for getting permits; MCD to get clearances from all departments b)Online color-coded maps for Delhi and Mumbai airports for easier process to get a no-objection certificate from the Airports Authority of India. Similar steps being taken for approvals from Archaeological Survey of India and the National Monuments Authority
5	Enforcing contracts	India ranks 186th among 189 countries due to poor enforcement of contracts, including those between phone users and telecom companies	a)Special commercial courts have been set up in Delhi and Bombay High Courts to speed up cases
6	Resolving insolvency	India ranks 137th due to the cumbersome process	a)Government has announced introduction of a Bankruptcy Code
7	Paying taxes	India placed 156th; Total tax rate estimated at 61.7% in India, compared to 41.3% for OECD countries.	a)Govt. announced reduction in corporation tax rate to 25% in the coming years b) Introduction of GST will help reduce time taken, ease process
8	Electricity connections	Long & time consuming process to avail power connection	a) State electricity boards and the power ministry have been asked to simplify procedures of getting an electricity connection b)Maharashtra Govt has reduced the number of steps from 7 to 3, and number of days from 67 to 21. Similar steps underway in Delhi. b) Central Pollution Control Board announced that no approvals are required for a securing power connection
9	Registering property	Poor Rank of 121; India takes 47 days, compared to 24 in OECD. Cost estimated at 7% of property value compared to 4.2% in OECD countries.	Govt. is planning to introduce reforms to ease the property registration process

Besides the above, the Government will have to take more initiatives to project India as an attractive investment destination across each of these parameters. The Government would need to undertake reforms to help place the country on an equal footing amongst countries having favorable, liberalized and a transparent business environment. The government's 'Make in India' is one such initiative.

Role of Make in India initiative towards "Ease of doing Business"

The 'Make in India' initiative, launched by the honorable Prime Minister in September 2014, aims to facilitate investment, foster innovation, provide employment, enhance skill development and build manufacturing infrastructure in the country. The real objective of this Strategy is to ease the investment caps and controls to open up India's industrial sectors to global participation. This initiative also applies to MSMEs and relates to the various relevant departments which have been entrusted with the task of simplifying the rules for MSMEs

The 'Make in India' initiative invites global firms to set up manufacturing units in the country. This is expected to give a solid boost to the MSMEs especially in sectors such as automobiles, aviation, defense manufacturing, construction, chemicals and food processing among others.

The effort is to get global companies to manufacture goods for the Indian market as well as export them to third countries

India must become a manufacturing powerhouse in order to gainfully employ its demographic dividend. Its natural advantages like a big labor pool and a large domestic market are available enablers. In addition, China's competitive advantage in terms of cost is fast eroding, being only marginally better than other developed countries. India has the opportunity to take some share of global manufacturing away from China. This would be possible only if the prevalent process inefficiencies are addressed through—improved infrastructure, ease of doing business, rationalized tax policies, reform labor laws, and enhanced skills, ease of land acquisition, implement Goods and Services Tax (GST) and fast track approvals.

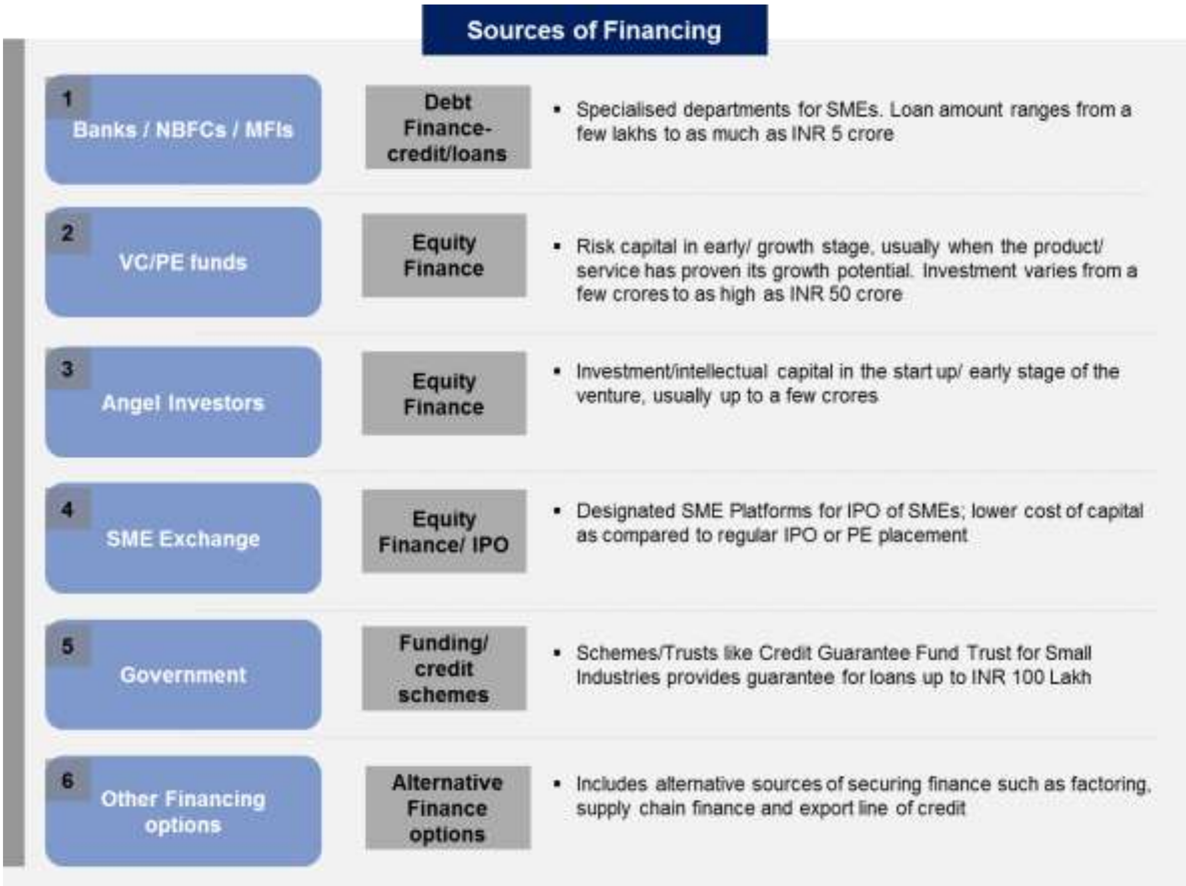
The "Make in India" initiative, will act as a first reference point for guiding foreign investors on all aspects of regulatory and policy issues, as also assist them in obtaining regulatory clearances. The Centre has already allowed 100% Foreign Direct Investment (FDI) under the automatic route in construction, operation and maintenance in rail infrastructure projects and increased FDI in defense from 26 to 49 per cent.

The investor facilitation cell will provide assistance to the foreign investors from the time of their arrival in the country to the time of their departure, with focus on green and advanced manufacturing and helping these companies to become an important part of the global value chain. Key imperatives that have been undertaken to improve business process efficient include:-

a) Launch of e-Biz platform which aims to create a business and investor friendly ecosystem in India by making all business and investment related clearances and compliances available on a 24x7 single portal
b) Validity of Industrial license extended to three years.
c) States asked to introduce self-certification and third party certification under Boilers Act.
d) Major components of Defense products' list excluded from industrial licensing.
e) Dual use items having military as well as civilian applications deregulated.
f) Services of all Central Govt. Departments & Ministries will be integrated with the E-Biz – a single window IT platform for services by 31 Dec. 2014.
g) Process of obtaining environmental clearances made online.
h) Following advisories sent to all Departments/ State Governments to simplify and rationalize regulatory environment.
i) All returns should be filed on-line through a unified form.
j) Check-list of required compliances should be placed on Ministry's/Department's web portal.

By improving the "Ease of Doing Business" in India, the 'Make in India' initiative aims to make the country an important investment destination and a global hub for manufacturing, design and innovation.

Section 4: Financing Sources for MSMEs



Financing options available to MSMEs

1. **Funding from FIs :-**
   Scheduled Commercial Banks - Conventionally, banks have been the largest source of finance for SMEs. Amongst commercial Banks, Public Banks have a better access to MSMEs and take the lead in lending to the sector, as compared to private and foreign Banks. Public sector Banks have been the front-runners in providing financial support to the MSMEs which can approach them for loans under various schemes. Public sector banks also have considerable empirical knowledge of the MSME sector, and with the increased use of core banking technology, they are able to analyze historical data on MSMEs to develop targeted products and better risk management techniques.

   However, Banks have also aimed at limiting their exposure due to high risk perception and high transaction costs. Credit is usually extended against collateral equivalent to 100% of the loan amount. Majority of the MSMEs, especially those in the early / start-up stage do not sufficient assets to offer as collateral for lending, thereby making the banking system inaccessible to them.

   Further, Banks appraise loan proposals based on the financial ratios of the MSME. As majority of the MSMEs do not follow proper accounting processes, the task of generating clean financial statements becomes quite difficult.

   SMEs are part of the priority sector lending for banks along with agriculture, rural markets and microfinance. As per RBI guidelines, priority sector lending should be 40% of the total credit lending of banks. However, there are no sub-targets within the priority sector lending requirements. This has limited the quantum of credit which banks have extended to MSMEs.

Non-Banking Finance Companies – NBFCs have also been a significant source of MSME debt. Large share of the funding is for purchase of asset / plant & machinery. Major share of the loan portfolio comprises of business related to transport, engineering, vendor supply chains and retail trade. According to Frost & Sullivan, the MSME Small Loan Credit Market for NBFCs in India stood at INR 7,200 crores in FY 2012 and is expected to grow to INR 38,400 crores by FY 2020 at a compounded growth rate of 23 %.

Small Banks- Small banks such as RRBs, UCBs and government financial institutions such as SFCs, SIDCs enjoy significant branch outreach, and have been able to leverage their local presence to get better knowledge and understanding of MSME financial needs. Small Banks have also exhibited the potential to serve a much larger MSME customer base than they are currently serving.

It was felt that the risk-averse lending practices of banks were hindering credit disbursal to the MSME sector. In order to counter this, the RBI allowed collateral-free lending up to a limit of INR 5 lakh for all enterprises covered under the definition of the MSMED Act 2006.

Further, in an effort to minimize the impact of default on loans, the GOI and SIDBI launched the Credit Guarantee Trust for MSMEs. The CGTMSE aims to comfort the financier that in the event of MSME default (which availed collateral-free credit facilities), the Guarantee Trust will make good the loss by up to 75 to 85% of the credit availed.

2. **Equity funding –**
   Venture capital provides financial assistance primarily by way of equity or equity-linked capital investment. Typically, MSMEs which are involved in commercializing innovations and high-end technologies need access to the VC fund. These firms need finance during the initial stages of conceptualizing their product offerings (seed phase) and during development and marketing phase. Besides infusing capital, VCs also bring expertise, superior advice and other skills that helps the MSME to develop marketable products. They also seek to provide overall guidance and mentoring support to MSMEs so as to enable them to realize their growth potential and gain competitive edge in both domestic and global markets. Typically, the VC provides assistance to the entrepreneur in recruiting key personnel, providing contacts in international markets, introductions to strategic partners, etc. Their main aim is to earn higher returns on their investments. In addition to that, they also take active part in the management of the company and provide expertise / involve in the board decisions of the firm. Furthermore, VC funding improves the credibility of the MSME and increases the chances of receiving Bank finance.

   Angel investors – An angel Investor is typically a HNI or network of affluent individuals who/which provides capital to a start-up in exchange of equity. Angel investors normally invests their own funds, unlike venture capitalists who manage the pooled money of others in a professionally-managed fund. Typical investment made by the Angel investor ranges between INR 25 lakhs to 5 crores. Indian Angel Network is one of the largest angel networks in the country with almost 90 individual members and institutional members like SIDBI, IBM, etc. Angel investors are also attuned to the start-up or venture they invest in, thus benefiting the venture not only financially but also by providing the intellectual capital.

Accelerators – Though at a nascent stage, the accelerator model in India has witnessed a significant surge in the number of accelerators in recent years. Typically, accelerators provide assistance around 4 core areas – Strategic, Financial, Operational and Collaboration.

3. **SME exchange** –
   GOI and regulators have initiated several measures to address the low level of MSME financing through the capital markets. In March 2012, post issuance of SEBI guidelines, both BSE and NSE have set up institutional trading platforms in the SME segment to allow MSMEs to list and raise equity capital through venture funds, private equity and wealthy individuals, without initial public offerings.

   The listing process in this platform can be completed within a month and this also involves lower costs compared to regular IPO route. Besides offering a suitable platform to raise capital, it also provides easier entry and exit options for investors. It also offers better visibility and wider investor base while offering tax benefits to long term investors. The platform offers relaxed compliance and cost effective listing to SMEs.

   Since this facility involves minimum regulatory procedures to be followed, it has already encouraged a host of MSMEs to tap the BSE's SME platform. A total of 70 companies with a collective market capitalization of Rs.8,200 crore now trade on these platforms. There companies are from various sectors like trading, manufacturing, steel, textile and finance spread across the geography of India.

4. **Export lines of credit-**
   This financing option supports export oriented segments such as leather, gems and jewelry, etc. EXIM Bank has launched several initiatives for the benefit of such exporters - Export lines of credit to overseas financial institutions, regional development banks and foreign governments and their agencies and buyers credits (BC) to foreign corporates.

   Line of credits serve as a market-entry mechanism to Indian exporters and provide a safe mode of non-recourse financing option to Indian exporters. LOCs and BCs are particularly relevant for Indian MSME exporters as the payment risk is borne by Exim Bank without the need for insurance from Export Credit Guarantee Corporation.

5. **Microfinance -**
   Leading national financial institutions like the SIDBI, the NABARD and the Rashtriya Mahila Kosh (RMK) have played a significant role in making micro-credit an important movement. These groups also adopt a variety of approaches. However, most of these organizations tend to operate within a limited geographical range.

6. **Electronic bill factoring exchange –**
   In a recent move, RBI permitted the setting up of an exchange-based trading platform (Trade Receivables Discounting System) to facilitate financing of bills /invoices raised by MSMEs to corporate buyers including government departments and PSUs. This

initiative was taken to make the MSMEs capable of converting their trade receivables into liquid funds.

Despite the many policies and measures to provide financial assistance to the MSMEs, they continue to face difficulties in raising timely and adequate credit at reasonable cost. This has led to the emergence of alternative sources of financing, some of which have been detailed below.

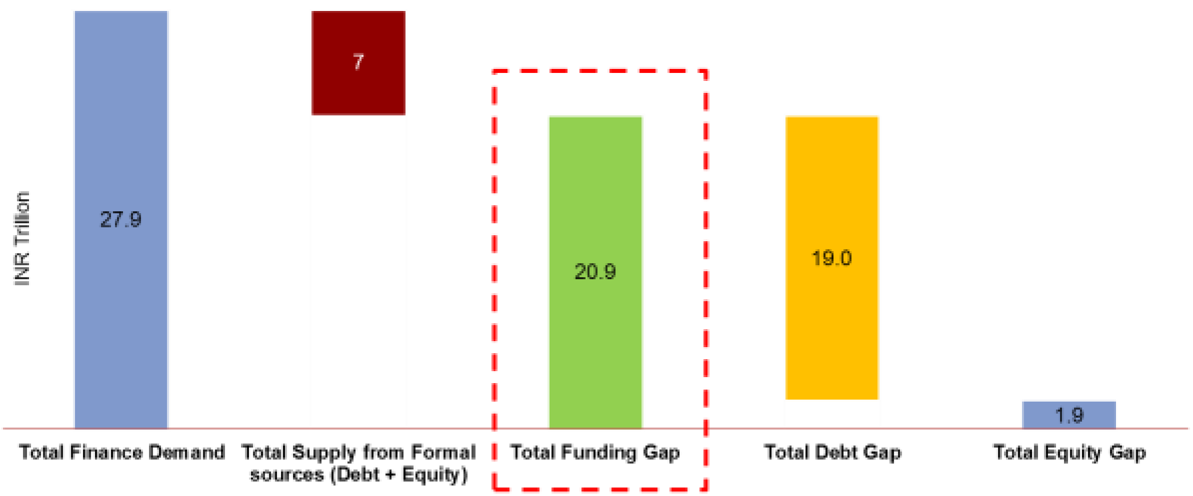
7. **Factoring** - Under this mode of finance, the MSME sells or assigns its accounts receivables to a finance company (a factor) at a discount to meet its immediate funding requirement. This method of financing evolved so as to minimize the adverse effect of delayed payments by large scale customers on the operations of MSMEs. Factors buy the right to collect on invoices raised against any sales by the MSME and releases 80-90% of the invoice value to the firm. The Indian factoring market is still at a nascent stage. There are approximately 10 factoring companies in India, and the oldest among them are Canbank factors and SBI Global Factors.

8. **Supply chain finance** - Supply chain finance is fast emerging as another route to facilitate MSMEs access to enhanced working capital from bank and non-bank sources. This mode of financing enables MSMEs, which are suppliers to large OEMs to receive short-term credit against the volume supplied during the payment receivable period.

Overall funding demand and gap for MSMEs

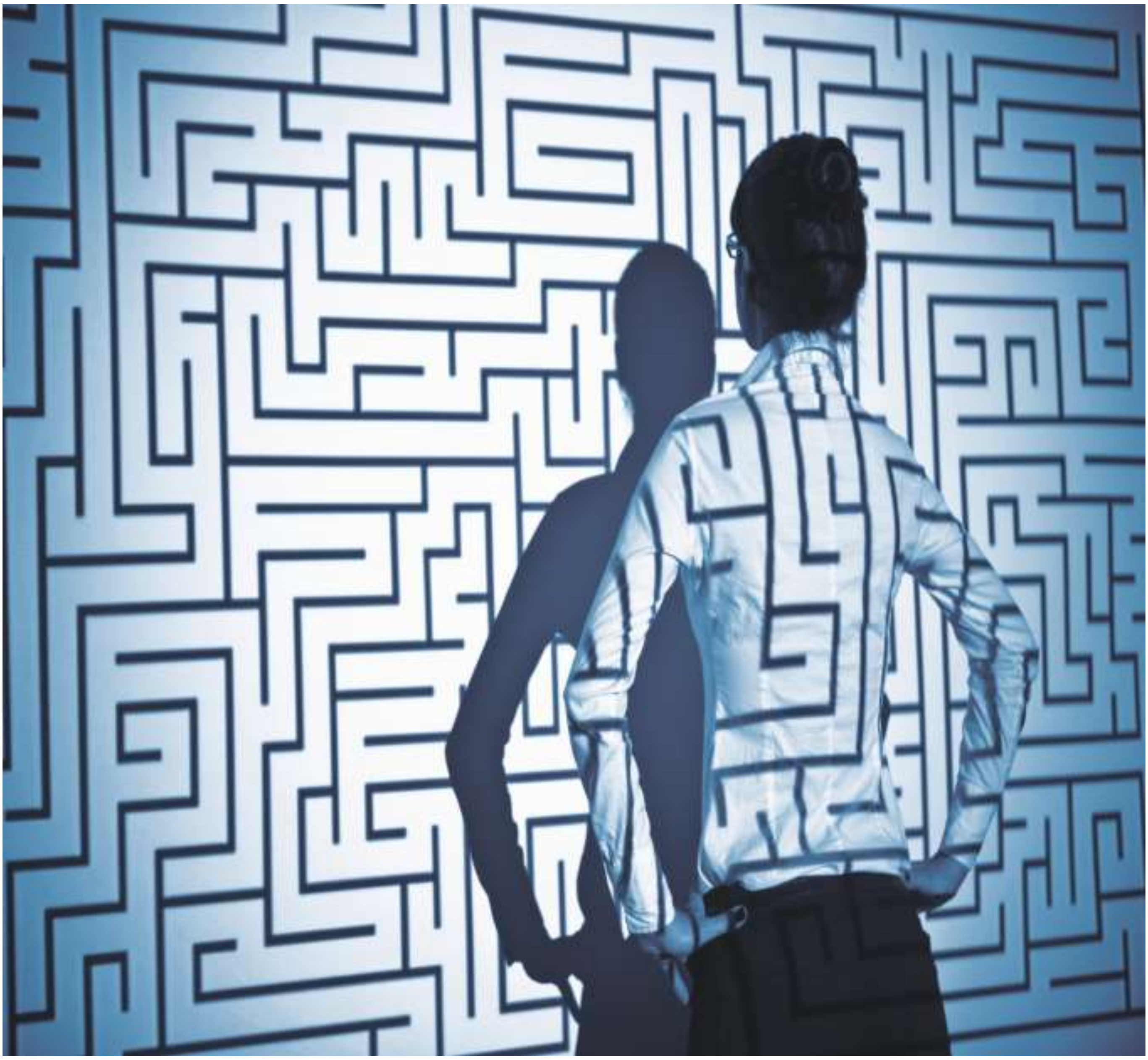
The overall finance gap in the MSME sector is estimated to be INR 20.9 trillion. The demand for finance form external sources is estimated to be INR 27.9 trillion, while the total finance channeled by formal sources is estimated to be INR 7 trillion. The overall finance (debt and equity) gap of INR 20.9 trillion is split into a debt gap of INR 19 trillion and an equity gap of INR 1.9 trillion. This gap largely remains unmet, with a significant share met through informal channels, which is often at higher cost than the institutional finan

Exhibit 2: Current Funding Gap

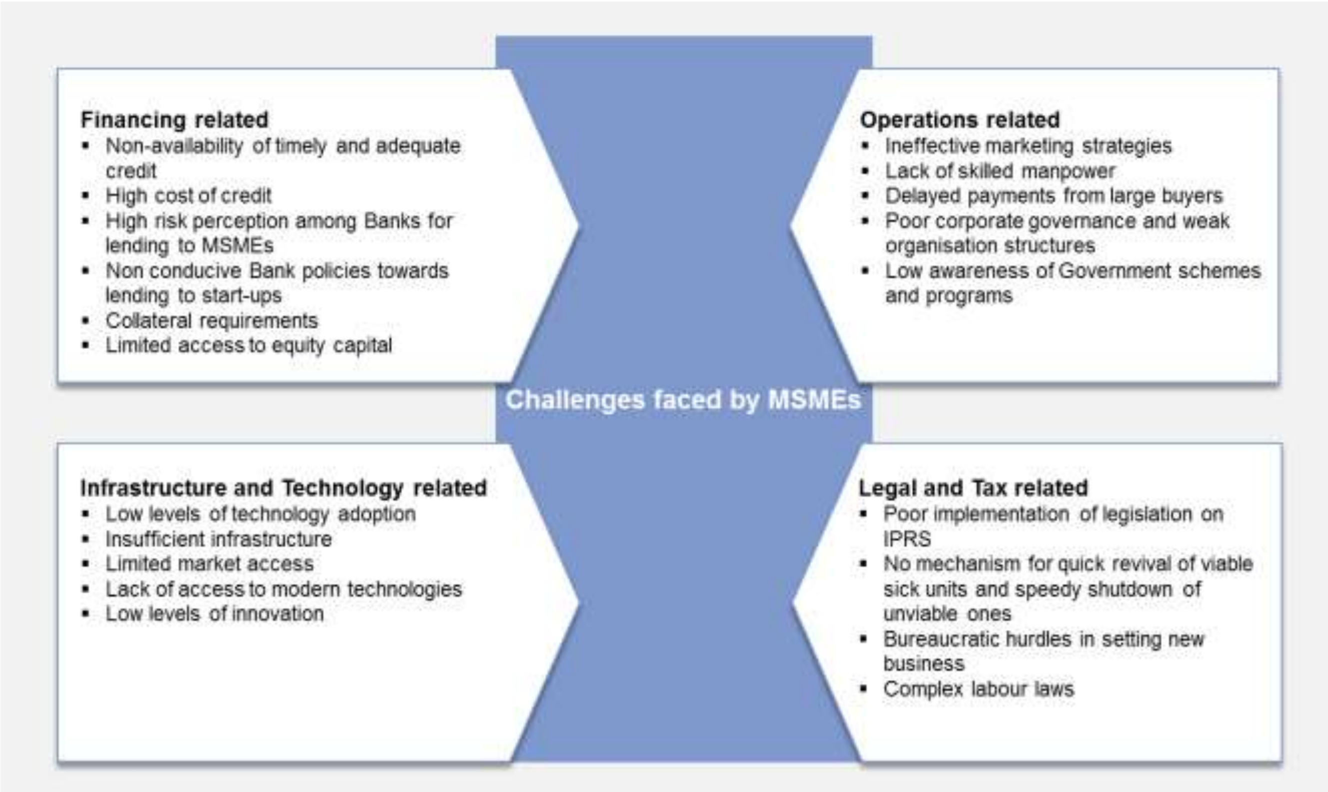


Source- IFC-Intellecap report

Section 5: MSME Issues and Challenges



MSMEs face several challenges in the fields of technology, finance, operations, and marketing. Further, they also face challenges from a disruptive competitive environment, in which they must compete with established players in the marketplace and imports.



Finance related – As per the 4th Census on MSMEs, only 5.2% of MSMEs availed credit from financial institutions.

a) **Non-availability of timely and adequate funds at reasonable cost is one of the most critical problem faced by the MSME sector-** The banks are usually found to be averse to offer credit to the MSMEs for a several reasons, the foremost of which originates from a wide-ranging perception that the credit risk in lending to MSMEs is very high. Banks regard this sector as high risk segment for different reasons like low capitalization, lack of appropriate accounting records, and unavailability of complete financial statements and business plans. Precisely because of this banks demand heavy collateral, charge higher interest rates and transaction costs from MSMEs. The lack of adequate collateral further hampers availability of funds to the sector and hinders their competitiveness.

b) **High cost of credit Interest Rates-** Interest rates for non-collateral as well as collateral backed loans to SMEs are often very high and at times prohibitive. The reason is attributed to the high risk of lending to SMEs.

c) **Non-conducive bank Policies towards lending to start-ups-** It has been observed that the Banks give undue significance to business vintage and financial statements / track record to compute eligibility for loan. Banks solely consider the financial statements to compute loan eligibility of MSMEs. The credentials/ background of the entrepreneur, the business potential of the organization and the product, markets served and future cash flows are not given much importance while computing the credit offer. Since most start-ups / early stage organizations do not record profits in initial years they fall outside the ambit of bank funding.

d) **Lack of sufficient collateral**: Banks seek tangible assets to secure their loans against default. MSMEs normally do not have sufficient collaterals to obtain debt finance. MSMEs especially start-ups/early stage firms do not possess sufficient collaterals, and in case they do, the personal assets do not meet the loan to value norms of the bank. Lack of adequate collateral translates to lack of adequate funds required for working capital and/or capital expansion which further leads to a lower growth rate. In some of the cases, the entrepreneurs are mandated to provide home/office premises/land as collateral to secure funds from the banks. Banks typically ask for a collateral value of up to 150 per cent of the loan amount sanctioned. For example, on a property value of INR 100 lakhs, the bank sanction a loan of INR 65 lakhs only.

e) **Inadequate information available on Credit Guarantee Scheme at Banks -** Banks generally target to promote there conventional loan products and are often reluctant/not aware to offer information on the CGS scheme. Consequently, most of the MSMEs are not able to get relevant information regarding the credit guarantee scheme from banks.

f) **Lack of equity support** inhibits the growth of the MSME sector. Further, equity also acts as leverage for raising debt finance from Banks.
   - Limited Accessibility of VCs / Angel investors – It has been observed that MSMEs find it difficult to initiate contact with the VCs and Angel investors in the absence of a reference or a previous relationship. VCs typically show greater confidence in the idea/concept if it is referred by a credible source/contact. This problem is more profound in tier 2 / tier 3 towns. Further, entrepreneurs in these locations are not aware of the process/mechanism to reach out to VCs.
   - Funding norms not favoring early stage firms- Stringent conditions set by VCs such as minimum funding criteria, expectation of high returns, detailed documentation requirements and acquisition of substantial equity stake are some of the key reasons deterring MSMEs from approaching VCs.

g) **Lack of owners capital reduces eligibility to raise debt finance-** It has been seen that MSMEs typically bring in capital into the business from their own / borrowed money from relatives, which is a normally a small amount. Lending agencies are reluctant to fund when they discover lower risk /capital contributed by the entrepreneur.

h) **Difficulty in loan proposal evaluation and high transaction costs involved: -** It has been observed that several areas of MSME businesses are challenging to evaluate due to lack of adequate information / absence of proper records. In such a situation, it becomes difficult for the lending agencies to appraise the loan proposal. Further, due to low level of technology adoption and poor record keeping-keeping and lack of efficient systems and processes, the whole process of evaluation of loan application is extremely resource intensive and costly for the lending agencies.

<u>Operations related</u>-

a) **Ineffective Marketing strategies -** Limited understanding of new age marketing strategies cripples MSMEs especially in smaller / Tier 3 towns. Limited access to market intelligence and marketing tools such as packaging, labeling, barcoding, brand building, advertisement, etc. limits the survival / growth prospects of MSMEs. Further, lack of sufficient selling outlets and adequate infrastructure is a key concern disrupting marketing of MSME products to the remote parts of the country.

b) **Lack of skilled manpower**- In spite of the fact, that India enjoys favorable demographic dividend with large pool of human resources in the productive age group, the industry continues to lack skilled manpower required for manufacturing, marketing, servicing, etc. Further, MSMEs also face challenges around retaining talent and low productivity levels of labor.

c) **Unduly delayed payments especially from large-scale buyers**- This disrupts the cash flows and the ability of MSMEs to divert funds towards capex requirements and R&D.

d) **Poor corporate governance mechanisms and weak organization structures-** Majority of the MSMEs are owner driven with lesser inclination towards formal organizational structures. There is one (or two) owner and selected few core people working under them co-handling key functions like accounts, production and sales. There are no established governance mechanism with no clear process of functioning, workflow or instruction flow. The non-corporate structure and small size of the majority of MSMEs makes the venture capitalists and other risk capital providers reluctant to investing in them due to higher transaction costs and difficulties in exits out of such investments.

e) **Low awareness of Government schemes and programs** – Limited and low levels of knowledge on key government schemes restricts their ability to avail benefits under them.

Infrastructure related-

a) **Low levels of technology adoption** - For a country which boasts of strong IT labor poll and world's top most technology firms, the penetration of ICT in MSME sector has been rather low. Consequently, large number of MSMEs miss out on the greater benefits of increased efficiency, better market linkages, and improved customer service.

b) **Insufficient infrastructure**- The state and maintenance of infrastructure in industrial estates (mainly maintenance of roads, drainage, sewage, power distribution and captive power generation, water supply, dormitories for workers, common effluent treatment plants, common facilities, securities, etc.) is poor and unreliable.

c) **Limited Market access -** MSMEs are primarily small family run businesses which mostly cater to domestic market. They majorly rely on traditional media like telephone directory, customer references and tenders floated in the newspaper to reach customers. It has been observed that MSMEs do not respond efficiently to the evolving market trends and innovations thereby lag behind mid and large players in the market.

d) **Low levels of modernization and technological up-gradation** - Due to their small size family driven nature, MSMEs have low access to new technology and face challenges in modernization and technological up-gradation. This leads to cost inefficiency and poor quality products. These result in the manufacturing processes being cost inefficient and of poor quality standards.

e) **Lack of innovation to develop new products with unique differentiators-** There is a growing need to innovate and develop products with unique differentiators among the MSMEs to offset the rising threat from established players and global counterparts in the marketplace. Over the years, MSMEs have largely ignored R&D requirements and have not embarked on new product development or technological up-gradation at the requisite pace.

<u>Legal and Tax related</u>-

a) Low relevance and innefective implementation of legislation on Intellectual property rights (IPR)

- Low relevance of IPRs in raising funds- It has been witnessed that majority of the MSMEs are unable to leverage IPRs to raise funding from VCs or Banks in the absence of formal mechanisms for evaluating IPRs.
- Ineffective implementation of legislation on IPRs has adversely impacted innovation-driven MSMEs. In the absence of stringent laws protecting inventions, MSMEs are unable to monetize their innovation, thereby discouraging future innovation in products.

b) No mechanism for quick revival of viable sick units and speedy shutdown of unviable ones- At present there is no formal mechanism for systematic handling of sick units even though financial assistance by way of debt restructuring for rehabilitation of sick MSE is provided by primary lending institutions.

c) Bureaucratic hurdles in setting new business- Most SMEs suffer from the setup stage due to systematic problems of bureaucracy at most government agencies/bodies like taxes to labor. The ease of setting up a business index measured for various countries considers this as a major make or break parameter.

d) Complex labor laws – Labor policies, especially multiplicity of labor laws and procedures for compliance of various labor regulations have added to the woes of the MSME sector

Section 6: Role of Information Technology and Innovation

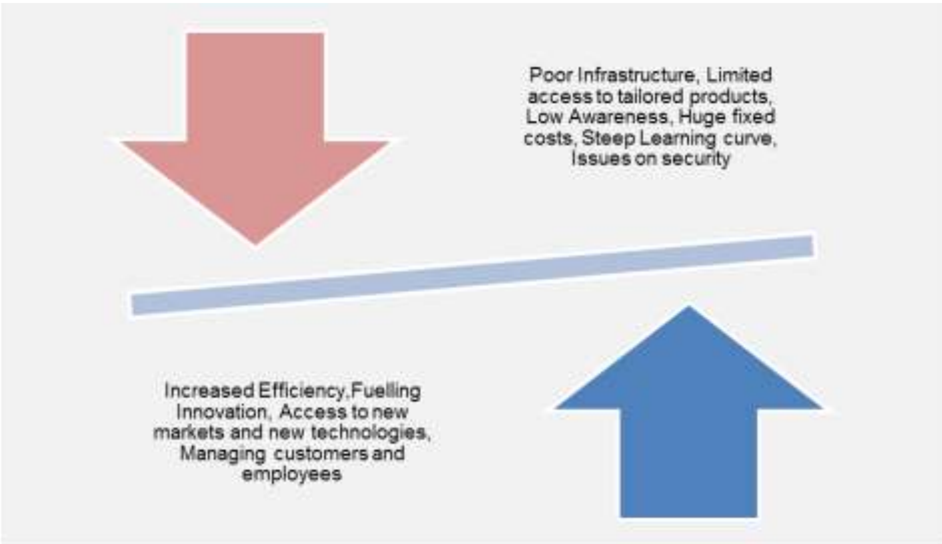
While the growth of the Indian MSME sector is impressive, the adoption of Information Technology in this sector has been quite low compared to other countries with large MSME sector. For a country, which boasts of a strong IT labor pool and world's topmost technology firms, the penetration of Information and Communication Technology in MSME sector in India has been rather low. Under National Manufacturing competitiveness program, Ministry of MSME recognizes the 'Promotion of Information and Communication Technology' as one of its major initiatives in the MSME sector.

As per the study conducted by Boston Consulting Group (BCG), an increase in the adoption of technology by MSMEs in India can add USD 56 billion to the country's economic output and create more than one million additional jobs.

Benefits MSMEs can derive with IT adoption

Benefits from increased IT adoption are manifold.In a study done by IDC, the top benefits derived with ICT adoption were around:- a) Improved communication & Collaboration within the organization, b) Stronger linkages with Customers and Suppliers c) Competitive advantage d) Future growth and expansion d) Creation and delivery of products &services e) Reduction in Inventory

Exhibit 3: Triggers & Barriers



Source : Red Seer Consulting Report, 2011 & Intuit study in collaboration with the Government of India's Ministry of Micro, Small and Medium Enterprises, the National Institute of Entrepreneurship and Small Business Development and the National Small Industries Corporation

The benefits of technology are undisputed and yet majority of the MSMEs are lagging behind in this space. Some of the key barriers that hinder IT adoption are:

a) **Reluctance to incur initial investment:** IT adoption requires initial investment along with recurring costs on maintenance, which the MSMEs are reluctant to incur due to budget constraints. Further, these concerns are exacerbated by low awareness of the devices and solutions, such as software, systems and processes.

b) **Poor Infrastructure**: Most of MSME clusters are around Tier-2, Tier-3 cities, which lack adequate information and communication infrastructure, be it high speed broadband connectivity or basic power outages.

c) **Low understanding of business benefits of technology**: Typically, MSMEs perceive technology as heavy devices and systems and is seen as more of a distraction than value-add to the business. MSMEs are also not aware on the IT products that are available in the market and also that there is potential for customization to meet their specific requirement.

d) **Poor awareness of govt. schemes supporting technology adoption -** There are multiple government schemes and programmes under which SMEs can access technology. However, education and awareness about these initiatives is dismally low

e) **Lack of skilled manpower to manage technology:**Most ICT implementations consume a lot time and resources of the SME promoters and employees. Poor planning and low levels of training among the employees to manage this initiative has often led to unsuccessful implementation.

Role of Cloud Computing

Cloud computing has become one of the main game changers in IT evolution over the past decade, offering many benefits to businesses, in particular MSMEs. Cloud computing can help MSMEs in growing revenue, reducing long-term IT cost, attracting new customers, improving cash flow, maintaining profitability, and most importantly, reacting to ever-changing market conditions.

Cloud computing is witnessing growing acceptance among MSMEs, as it reduces their capex substantially and also saves time spent on negotiations with banks for loans, procurement efforts, complex system deployments and the management of IT environments. By leveraging cloud solutions, MSMEs are becoming more productive, enhancing efficiencies and collaborating with overseas business partners and customers.

Cloud offers significant potential to reduce costs - As cloud services provide access on a usage-based pricing model, they can reduce costs of desktop software and specialized manpower. MSMEs are also able to quickly build and deploy applications at reduced costs and achieve faster return on investment.

Going forward, the MSMEs will have torecognize technology as a key business driver. From being an enabler of productivity and quality, technology must be leveraged for transformation and as a key influencer of competitive advantage.

Role of Innovations in MSME growth

Innovation refers simply to the creation and application of a new idea to create value in a certain context. ‘Innovation’ is fast gaining policymakers’ attention for its recognized role in building a nationwide entrepreneurial ecosystem and thereby shaping India’s socio-economic growth and stature. Its growing importance can be assessed from the fact that 17% of the large companies rank innovation as their top strategic priority today and 75% rank it among their top three.

According to a recent World Bank report aimed at enhancing India’s innovation capacities, India would need to include following key imperatives in its MSME strategy:

- Grow competition as part of enhancing investment climate, backed by better information infrastructure, stronger skills, active public – private partnership and a secured funding environment

- Create and commercialise knowledge
- Ensure diffusion and absorption of existing local and global knowledge across the enterprise strata.
- Encourage & promote formal R&D efforts, indigenous creative ideas at the grassroots levels for an inclusive innovation culture.

Historically, India has seen abundant localised examples of creativity for the lack of resources and having to find creative means to the end. The problem has been to formalise such creativity and give it scale. Few companies go beyond the one innovative product or service. So, even while new technology start-ups embark on breakthrough innovations for building knowledge-intensive businesses, MSMEs should look at incremental innovation to ensure competitiveness.

Further, while developing nations work with 'Shift' and 'Adapt' or 'Shift' and 'Apply' innovation models, it is important for a country like India to have indigenous pervasive models. So, any innovation must think about sustenance and scaling up in the Indian context -- the target segment size, price point, intended reach, cultural sensitivities etc.

The other big piece is around academia and industry partnership, which happen to be the principal drivers and source of technological innovations. The collaboration helps bridge the gap between science and economy, thereby fostering the innovation potential. Some institutional set-ups of significance include technology and business incubators and academic technology licensing offices.

Fortunately, in India, we are seeing an institutional policy shift towards attuning research establishments to market needs. Recently, the Union Minister for MSME announced government's plan to encourage setting up of 500 incubation centres across the country. Further plans should include identifying areas of collaboration, bankable projects, addressing IPR issues and involving industry and financial experts in the process of economic value addition to the knowledge generated through research and development.

The government must also consider strengthening of IPR implementation. The lack of it currently impacts innovation-driven MSMEs. While the innovation gives the enterprises an opportunity to develop products & services before others, but ineffective IPR implementation cuts down the lead time towards effective monetisation.

On operations front, solving for problems of packaging and product display may remove hurdles and allow companies to focus on their core business of innovation.

Section 7: Recommendations

Recommendations on Credit & Finance

1. The corpus under the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) can be increased to benefit higher number of MSMEs by offering them collateral free credit.

2. RBI-registered 'AAA' and 'AA+' rated NBFCs should be made eligible for becoming Member Lending Institution of CGTMSE, subject to availability of additional corpus of CGTMSE.

3. SIDBI to play a pivotal role in developing and promoting specialized instruments that augment the access to credit for the MSMEs. Additionally, special exercises should be undertaken for meeting the credit gap in the MSME sector. In this regard, modifications in the existing CGSTMSE scheme can be debated to ensure a wider coverage, Banks can be directed to make fuller use of CGTMSE dispensation and collaboration can be sought with other relevant institutions in the state government and Development Institutes of Ministry of MSME so as to reach out to needy MSME units with credit offers.

4. RBI should firmly enforce its guidelines to Banks for not seeking collateral up to a loan of INR 100 lakhs. This will reduce the tendency to seek security, which is a foremost deterrent to fostering entrepreneurship.

5. Banks to simplify loan application forms and establish a common Scoring Model for loan up to INR 25 lakh.

6. The banks should issue directives to further enhance the awareness of CGS amongst its branch level functionaries in different parts of the country for securing greater coverage of MSME loans under CGS.

7. Banks should educate and clearly specify there requirements for assessing a loan proposal, i.e. what information they require from MSMEs, what essentially they look for while assessing a loan proposal and how they will be convinced.

8. Banks should create separate cells to provide consultancy to MSMEs to impart learning on data / information management so that their performance can be analyzed easily and thus expediting the loan sanctioning process.

9. Bank to establish robust credit evaluation systems and invest in training and development of loan officers. Additionally, proper credit evaluation systems / frameworks should be developed so as to ensure that valid due diligence checks are done with no scope for personal biases in assessment of loan proposals from MSMEs

10. Suggestions to improve access of MSMEs to Venture capital funds –
    a. Exposure of banks to dedicated MSME VC Funds be treated as priority sector lending.
    b. Permit investment up to 10% of corpus by Pension/Provident Funds in dedicated MSME VC funds.

Recommendations on Technology Up gradation of MSMEs

1. Government should disseminate information on Technology Acquisition Scheme so as to provide assistance in both, development of indigenous R&D products as well as procurement of global technology.

2. Ministry of MSME should organize Technology exhibitions with the assistance of Industry associations and technical Institutes for spreading information on modern technologies so that proven technologies can be adopted by MSMEs.

3. Increase budgetary limits under CLCSS scheme to drive technological up gradation of MSMEs- Ministry of Finance may consider increasing the budget outlay on Credit Linked Capital Subsidy Scheme (CLCSS) as the current budget levels are not adequate to meet the industry demand for modernized equipment.

4. The Government schemes should have special focus on emerging and innovative Sectors such as bio-tech, nano-tech, defense, civil aviation, aero-space, etc. Additionally, higher scale of assistance may be decided for adoption of clean manufacturing technologies, renewable energy sources and environment friendly processes.

5. Special focus on driving ICT adoption in MSMEs. Support to be offered to encourage use of new concepts such as cloud computing which offers effective and affordable solutions to MSMEs

Recommendations on Infrastructure for MSMEs

1. Provide space to MSMEs for manufacturing and industrial activity – Ministries of Urban Development and Urban Poverty Alleviation should incentivize the State Governments and local bodies to designate adequate areas to MSMEs. On the part of the State Government, it should streamline and simplify internal processes for allotment of vacant plots in industrial estates to MSMEs. Additionally, land parcels close to urban areas can be identified and allotted to MSEs at affordable prices.

2. Special efforts to be directed towards maintenance of industrial estates /area. Entrust Industry Associations, Local bodies, state govt. agencies, SPVs for maintenance by empowering them to collect charges for upkeep.

3. Adequate support should be provided for development of marketing infrastructure for MSMEs. Setting up of display halls / exhibition centers in each State capital or major industrial center having concentration of MSMEs is recommended so as to enable MSMEs to show case their products and capabilities to a large consumer base.

4. More packaging & designing institutes need to be set up to meet the training needs of large number of MSMEs. Additionally, efforts should be made to increase the awareness of these institutions among the MSMEs.

5. A mechanism should be established to assess the utilization and impact of the Government schemes on the MSME sector - Due to the absence of an appropriate mechanism, it is difficult to determine the benefits being availed by MSMEs under the offered schemes. A clearly established system should be in place to address these

questions - How many enterprises have benefitted and in what way? Why have others not gained? What should be changed in the schemes to bring more people under the umbrella of financial aid?

Recommendations on Skill Development and Training

1. Develop a labor market information system for identifying present and future skill gaps in the various sectors of the economy and accordingly, design and conduct skill development programs. Further, these programs should be established in close collaboration with other stakeholders - MSME Associations, SIDBI, etc. so as to ensure that skills are developed per the requirements of the local/regional MSMEs.

2. The MSME Development Institutes should be strengthened / upgraded with equipment and training facilities for providing quality skill training so as to meet the huge demand for skill development.

Recommendations on Legal, tax and Labor policies

1. Manufacturing MSMEs in the organized segment should be encouraged by offering lower corporate tax rates, exemptions and concessions in Direct Tax in the first three years of operations. Such a tax exemption may not lead to significant loss in Government revenue as the first few years generally involve considerable struggle for establishing a business.

2. State governments to be encouraged to approve public procurement policy at the State level. The policy measure, should not only be looked as a means for enlarging the market for MSMEs, but also as a means of building enduring professional relationships between the government enterprises and the MSMEs

3. Government should simplify procedures and reduce paper work for processes related to registration for VAT and other local taxes, land/property and provision of utilities. This is critical as majority of the MSMEs do not have much of knowledge and expertise in various company laws and taxation policies, and also do not want to approach legal experts or CAs for consultation because of the high cost involved. Additionally, Governments should encourage the use Information technology to simplify and ensure greater transparency in the services.

4. Simplify legal procedures and overhaul existing bankruptcy Laws to facilitate quick closures and exit. Ministry of MSME to conduct a detailed exercise on simplifying procedures for closure of a MSME units. The focus should be on streamlining the procedures and improving the access and understanding of information for MSMEs. These procedures relate to legal compliances under the company law, labor laws, direct taxes, excise and service tax, etc.

   The Department of Financial Services to also look into revamping of policies on bankruptcy laws to help viable companies survive while safeguarding the interests of the creditors. The intervention in the existing policy should be such, that it helps viable companies in distress, and make closing and re-starting easier.

5. Establish compliance assistance center for MSMEs in MSME Development Institutes to create awareness on better environment management practices, policies and procedures as well as for better compliance of environment regulations.

6. Establish strong legislation for IPR enforcement. Existence of weak legislative and enforcement mechanisms on IPRs have severely dented the country's commitment to promoting innovation.

7. The compliance of labor related enactments should be simplified and be linked with incentives so as to ensure better adherence by MSMEs.

8. The Government should initiate steps to ensure ease of setting up business. The Government should announce additional measures to fast-track decision making, provide quick clearances, reduce regulatory compliance burden and bring down the cost of doing business.

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