

THE ECONOMIC TIMES

**INDIA MSME
SUMMIT**

Friday, 13th February 2009, The Oberoi Hotel, New Delhi

in association with



Federation of Indian Micro and Small & Medium Enterprises (FISME)

Interim Findings

India MSME Summit

Theme: Markets

(Feedback received from SMEs and 543 associations. Collated by FISME)

| Issues | Needs |
|---|--|
| <p>Payments Delay</p> <ul style="list-style-type: none"> • Payments are routinely delayed by large buyers of MSMEs and even Government/ PSUs; they have almost held up during recession • The provisions under The MSMED Act have not yet proved effective | <ul style="list-style-type: none"> • Clear instructions need to be issued to Government Departments and PSUs for timely payment with penalty clauses for non-compliance; CAG needs to oversee compliance • Need insertion of a provision in Section 43-B of the Income Tax Act: "(g) any sum payable by the assessee to a micro and small unit as defined under MSMED Act and outstanding for more than thirty days." • An advertisement campaign for sensitizing buyers as well as auditors on the provisions against delayed payments • Government should sample scrutinize balance sheets of a few large buyers and take stringent action against defaulting buyers/ auditors |
| <p>Protectionism through Tariff and non-tariff barriers</p> <ul style="list-style-type: none"> • There is marked rise in pushing use of protectionist tactics by lobbies for their narrow interests since last year • NTBs have been put into place on import of Steel, Polyester Filament Yarn; petition for antidumping duties filed for Cold Rolled SS flat products • Most of these products are manufactured by one or a few large companies • In steel e.g. international steel prices are hovering around US \$ 300-320 (www.lme.co.uk). Adding freight, customs, CVD and other taxes, maximum landed price shall be Rs. 22,000 while it is available in the market at 33,000 just because of BIS ! | <ul style="list-style-type: none"> • MSMEs are adversely affected by tariff and non-tariff barriers on key raw material such as steel, Copper, Aluminum, plastics etc. Government should guard against policies else these policies render large number of user MSMEs uncompetitive • If government considers it important to protect certain sectors, it should enhance Customs duties across the board and not selectively to ward off inverted duty structure • Mandatory BIS standard on steel imports should be immediately reviewed and done away forthwith • Anti-dumping directorate should prominently advertise prior to taking up investigations and must listen to user industries |
| <p>Government/ Public Procurement</p> <ul style="list-style-type: none"> • Globally countries mandate special set asides in public procurement for MSMEs. US procurement targets ranges from 20% to 30%, whereas in EU and Japan 5~7%, In India the public procurement (Central govt.) is less than 1%. • Govt. procurement is one of the most neglected areas. There is no Act governing it. | <ul style="list-style-type: none"> • As promised through the MSMED Act, there is a need to set-aside 20% of all public procurement for Micro and Small enterprises • An Act needs to be promulgated to ensure the Competition Principles are followed and problems like 'bundling of orders', prohibitory registration charges, unrealistic standards to crowd out small suppliers should be addressed • E-procurement should be encouraged |
| <p>Impediments in Exports</p> <ul style="list-style-type: none"> • One of the biggest problems encountered by MSMEs is in claiming refund of taxes • The tax refund mechanism is neither transparent nor efficient; makes exports uncompetitive | <ul style="list-style-type: none"> • Big-bang reforms are urgently needed to rid exports completely from taxes; GST needs to be hastened • The refund mechanism should take cue from best practices in South Korea, Thailand, Singapore, Australia and other countries • In the interim simplified mechanism could be devised for MSMEs |
| <p>Exports through MSMEs</p> <p>Hardly 0.5% of MSMEs are in exports. Participation in international trade is desirable not only from the perspective of macro economic trade management but from perspective of MSMEs themselves.</p> | <ul style="list-style-type: none"> • Need a comprehensive long-term SME export support promotion programme to increase SME participation in exports from current levels of 0.5% of registered SMEs to 5% in next 10 years using global best practices • Review mechanism of sole reliance on Export Promotion Councils for exposing MSMEs to export markets; need to open up the policies to more players and associations • Allow access to MAI funds to national associations (to begin with members of Board of Trade) for breaking grounds for MSMEs in exports • Fund/ facilitate development a mechanism through which SMEs could take services of recovery agents in importing countries in case of defaults |
| <p>Specific Issues</p> <ul style="list-style-type: none"> • Free Sales Certificate for Medical devices | <ul style="list-style-type: none"> • Till a comprehensive Drug Act is put into place, DGFT should issue Free Sales Certificate for medical devices not yet covered under prevailing Act |

Theme : MSME Finance and Credit Policies

| Issues | Needs |
|---|---|
| <p>Overarching concerns</p> <ul style="list-style-type: none"> • Access to adequate credit • Four issues: <ol style="list-style-type: none"> a. Poor quality of service b. High cost of credit to MSME sector c. Lack of transparency d. Deficiency of domain knowledge • RBI too occupied with macro management of economy; current dispensation lacks customer service orientation on lines of other regulators such as TRAI • Over due reforms in banking and financial sector | <ul style="list-style-type: none"> • Greater competition in banking sector • Effective Regulator of banks who can check and ensure compliance to its own instructions and guidelines • Balancing of rights of lenders with rights of borrowers; currently skewed in favour of former • Incentives for adoption of innovative models for enhancing outreach through local/ regional intermediaries • Alternative information channels for bank customers as bad news is not reported from ground |
| <p>Working Capital shortages:</p> <ul style="list-style-type: none"> • A large segment of MSMEs particularly those that are part of supply chains are facing problems due to unpaid or delayed bills. In majority of cases the delay is greater than 180 days. NPA norms classify a bank a/c NPA after 90 days (extended to 120 days now). What should MSMEs do when the 'norm' of payment cycle is 180 days and beyond? • Impediments in use of Factoring • Inadequacy of working capital in any case has been a standing problem. The slow-down has exacerbated it. • Additional collateral is being insisted during enhancement | <ul style="list-style-type: none"> • Problems continue at branch level; WCL enhancement is time consuming and is neither transparent nor time bound; • Sanction ad-hoc demand loans by 20% <hr/> <ul style="list-style-type: none"> • Establish Task Force to identify policy/ legal impediments in use of Factoring (with or without recourse) <hr/> <ul style="list-style-type: none"> • Bring out status report on banks not following RBI guidelines on earmarking sub-limits of their corporate customers for MSME suppliers |
| <p>Commodity Crash</p> <ul style="list-style-type: none"> • Many MSMEs that contracted for import of raw material during 2008 suffered heavy losses as by the time the consignments arrived the prices have got halved choking their working capital | <ul style="list-style-type: none"> • There being no precedence of such situations, most bankers fail to come to their rescue • One-time waiver needs to be considered with government help |
| <p>Term Loans</p> <ul style="list-style-type: none"> • Many progressive companies that went for expansion or started a new unit during boom period (last 4-5 years) are finding extremely difficult to service periodic re-payments as market conditions have suddenly reversed. • In current situation neither top line nor bottom line targets could be met by borrowers. Therefore repayments plans have gone awry and defaults become imminent | <ul style="list-style-type: none"> • Moratorium for one year is needed for affected MSMEs. • Sanction ad-hoc demand loans by 20% • More sensitive restructuring guidelines having strict time frames • Banks should clearly spell out their restructuring norms as branch managers remain clueless and MSMEs unaware what could they expect • Construction of 'land and building' may be covered under 'Housing Loans' for extending loans |
| <p>Access to funds for new projects/ start-ups:</p> <ul style="list-style-type: none"> • Have dried up. Either loan proposals are not acknowledged or are not disposed; but delayed at branch level. • Venture funds and private equity funds have also disappeared. • Banks continue to discourage Credit Guarantee cover in lieu of collateral • Banks have deposited more money under SLR/CRR than what is required instead of lending • In the name of being prudent banks have turned pusillanimous | <ul style="list-style-type: none"> • Need to reverse incentives for not lending; reduction of Repo/reverse Repo may be considered further • Reduce loan margin requirement by 5~10%; allow longer gestation by 12 months • For an year make collateral free lending up to Rs. 25 lac against Credit Guarantee mandatory • Invite foreign SME dedicated funds and provide them suitable fiscal incentives for equity providers • Hasten putting in place alternative markets (SME Exchange) for raising equity |

| Issues | Needs |
|---|---|
| <p>Interest Rates and service charges:</p> <ul style="list-style-type: none"> MSMEs get the raw deal in interest rates; made to pay higher charges for all types of chargeable services particularly non-fund based limits such as bank guarantees RBI has affected bold rate cuts and asked banks to reduce interest rates; nothing is passed on to MSMEs The interest is supposed to be charged based on performance of borrower. The process of judging is internal, non-transparent and subjective. Findings are never shared with borrower. Over the years if there is improvement on the some parameters, values are changed to keep the borrower in higher slab of interest. | <ul style="list-style-type: none"> RBI should benchmark maximum service charges as is done by TRAI and make continuous efforts for their reduction Create incentives for banks complying with RBI guidelines on interest rates To improve transparency, internal credit rating/scoring report must be shared with borrower |
| <p>Excess Collateral</p> | <ul style="list-style-type: none"> RBI should constitute a Committee for issuing guidelines on extent of collateral requirement Collateral greater than 100% (besides mortgage of plant and machinery) should be refunded |
| <p>Third party credit rating</p> <ul style="list-style-type: none"> Third party Credit Rating requirement under BASAL II for loans portfolio above Rs. 10 cr has unnecessarily burdened SMEs. The rating models are cut and dried corporate models being applied on SMEs | <ul style="list-style-type: none"> Review the efficacy of the Credit Rating models, fee structure and service quality Remove this condition for unlisted SMEs |
| <p>Losses due to Exotic Forex Derivatives and Forward Contracts</p> <ul style="list-style-type: none"> Exotic Forex derivative instruments were sold by some banks to unsuspecting SMEs to manage their Forex risks. Losses worth more than Rs. 2000 cr. are reported to be absorbed by SME exporters alone. RBI circular has given temporary respite but status quo remains. Similar is the fate of SME exporters that signed Forward contracts | <ul style="list-style-type: none"> Let there be one-time settlement of MSME cases with 'no-profit no-loss' |

Theme: Systemic Reforms and MSME Growth:

(a) Regulations

| Issues | Needs |
|---|--|
| <p>Overarching concerns Since 1991, Indian economy has gradually integrated with global economy based on market principles. However, the edifice of historical fossilized regulatory framework remains intact. The direction we want India to pursue as a market economy and the prevailing regulatory ecosystem is fundamentally in contradiction.</p> | <ul style="list-style-type: none"> • Review and reforms are needed across the laws urgently • Need to adopt best practices such as rigorous Regulatory Impact Analysis (RIA) for each legislation • Evolution from RTI to 'Duty to Publish' all rules, notifications, Acts wherefrom executive power is derived |
| <p>Business Laws</p> <ul style="list-style-type: none"> • Insolvency and Bankruptcy Codes • Competition Policy / Act • Business Laws | <ul style="list-style-type: none"> • Currently there is no Bankruptcy law. Insolvency codes are antiquated. The current legal system does not recognize failure of business as a possibility. (FISME's Policy paper investigates this issue in detail & suggests course) • Absolutely critical for MSMEs. Competition Commission needs to be made functional urgently to ensure MSMEs are not victimized by Monopolies and Cartels; not thrown out from Public Procurement by 'crowding out' and pooling. Competition principles needs to be embedded in all government policies/ services • Review of important business laws such as Negotiable Instrument Act, Contract Act, etc |
| <p>SEBI norms on Delisting The Securities Laws (Amendment) Act 2005 allowed delisting of securities, necessitating the creation of a delisting framework. Even after repeated announcements, simplified delisting names have not been announced as yet.</p> | <ul style="list-style-type: none"> • The de-listing norms for SMEs should be announced without delay as it is causing enormous burden on such SMEs that have applied for delisting |
| <p>Taxation</p> <ul style="list-style-type: none"> • GST • Location based Tax breaks create distortions in economy. Have induced artificial un-competitiveness for MSMEs • Stamp Duties • Income Tax • FBT is a retrograde step in direction of tax reforms and has proved to be the biggest nuisance tax | <ul style="list-style-type: none"> • Implementation of nation wide GST to reduce transaction costs and also to remove distortions • Location based Tax breaks should be immediately revoked • High stamp duties on transfer of property and on commercial transactions such as on financial instruments (Bank guarantees; Factoring etc) create huge cascading effect. There is a need to harmonize the Stamp Duties across states and to reduce them drastically • Income Tax rates on labour intensive MSMEs may be fixed at 50% of normal rate. This will help in capital formation and growth of this sector as has happened in IT sector • FBT has increased the tax compliance cost for MSMEs hugely; needs to be done away with |
| <p>Labour Laws</p> <ul style="list-style-type: none"> • Minimum Wages • Contract Labour Importance of Contract labour • Social (security related) Laws | <p>Nationally let there be a consensus on three issues:</p> <ul style="list-style-type: none"> • Basing minimum wages on rational criteria such as per capita income in the area; not specific to sectors or industry (unlike the current situation in many states where Minimum wage for a worker in engineering sector is different than the one in food processing sector) • Allowing contract labour for all the sectors • Providing an option to SMEs for using market-based mechanism for ESI and PF and after having contributed to them they should be spared of keeping records and unnecessary formalities |
| <p>Environmental Laws</p> <ul style="list-style-type: none"> • On one hand Environmental laws are ineffective, on the other hand, are used chiefly for rent seeking. • The situation has come to such a pass that there are fix rate cards in most states for permissions even for non-polluting industries. | <ul style="list-style-type: none"> • There is a need to thoroughly review the current legal dispensation on environment to make it effective at the same time transparent • To improve compliances third party audit on lines of ISO/ISI should be introduced |

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| <p>Other Laws</p> <ul style="list-style-type: none"> • There is a large set of laws applicable on businesses e.g. Fire, Weights and Measures, Health (besides Labour laws). • Although imports have opened up and India is largely a market economy, we continue to have such outdated laws as Essential Commodities Act which put utterly unrealistic conditions on movement and storage of goods. | <ul style="list-style-type: none"> • The need is to review and reform these laws in view of changed economic realities. They have become rent seeking instruments and also distort investment decisions • Industries such as agro based and food industries are the biggest sufferers |
| <p>Fertilizer Control Order</p> <ul style="list-style-type: none"> • Wave of liberalization has bypassed agriculture sector in general and the inputs industry of agriculture in particular. • Fertilizer Control Order (FCO) is one such antiquated regulatory regime which is used as a big rent seeking instrument; especially the manufacturer of Micronutrient manufacturers- a segment dominated by SMEs, are the its biggest victims. | <ul style="list-style-type: none"> • Review of FCO and its sampling and testing mechanism. (FISME has already commissioned a study to Indicus Analytics) |
| <p>Laws impeding seamless movement of goods across Restriction on flow of goods due to Commodities related Acts (Essential, Hazardous, Adulterated, Licensed, Forest, Endangered Species etc); Locational legislation (borders- national/state/district; municipal limits; law & order; bridges etc) Tax related (Customs, excise, VAT, Octroi, Entry</p> | <ul style="list-style-type: none"> • Establish unified Regulatory Agency to ensure seamless movement of goods across states • Reform laws that impede movement |
| <p>Reforms and States</p> | <ul style="list-style-type: none"> • Need to benchmark state laws applicable on businesses and highlight best practices. Provide actionable agenda of reforms to states |

(b) Industrial Infrastructure (Hard and Soft)

| Issues | Needs |
|--|--|
| <p>Overarching concerns</p> <ul style="list-style-type: none"> • Industrial infrastructure particularly for MSMEs is hugely inadequate and existing one in ruins. • An area consistently neglected for 20 years. Manufacturing becoming un-viable for want of affordable space. • Existing industrial space is being converted into Engineering/ Medical/ Management institutes. • Irony is, land has been given for song for SEZs (for exports); MSMEs are expected to buy at market rates and that too through a legal maze of land conversions to serve domestic market | <ul style="list-style-type: none"> • Allocating targeted investment in creating affordable industrial areas for manufacturing with integrated facilities for MSMEs on principles of cost recovery (cost of acquisition + development charges) • Ceding the administrative and tax collection powers to associations to maintain the Industrial areas in PPP mode • Earmarking of space in SEZs for MSMEs without export obligations • Review laws and rules related to land conversion, land ceiling and charges thereon |
| <p>Access to Electricity Unlike their larger counterparts MSMEs have access to electricity which is neither adequate, nor if quality nor economical. It has adverse implications on their productivity and competitiveness</p> | <ul style="list-style-type: none"> • Support collective SME initiatives for distribution of electricity in geographical concentrations, industrial areas and clusters • Remove policy impediments in open access particularly levy of subsidy element on collective initiatives • Accord top priority on providing electricity to manufacturing units (as has already been done in a few states) |
| <p>Access to skilled manpower Amidst sea of unemployed, the difficulty for MSMEs is to find employable people.</p> | <ul style="list-style-type: none"> • There is a need to fund 'district-wise skill deficiency mapping' exercise • Invite private parties to train people, develop skills, get them third party rated and pay fee-based on success. (there are already successful initiatives at a few places particularly in Gujarat) • Fund audio-visual and print aids for skill enhancement (on the lines of US) and also dedicate one Doordarshan channel for continuous skill development coupling it with distance education • Fund massive skill identification and grading programme for those not having any formal education but possessing requisite skills |

(c) Promotional

| Issues | Needs |
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| <p>Seamless growth from Micro to Small to Medium Currently sector is largely unorganized and is characterized by compartmentalization exacerbated by policies</p> | <ul style="list-style-type: none"> • Need to fund comprehensive study to map reasons for informality in India to identify areas of reforms in regulatory and taxation regime • Special fiscal and tax incentives to encourage vertical growth and building of scale |
| <p>Cluster Development Approach</p> <ul style="list-style-type: none"> • Over last few years, MSME Development policies have become synonymous with Cluster development policies in India. It is too simplistic and flawed approach. • The gap between promise and reality is alarmingly wide and huge waste of resources is suspected under cluster development programmes | <ul style="list-style-type: none"> • There is an urgent need to review the cluster development approach (as is understood and being applied in India by different agencies/ ministries), based not on promise but on delivery. • Before committing more resources a White paper needs to be brought out on Cluster Development Schemes being used by several Ministries • A review is warranted of MSME development schemes on efficacy, outreach and sustainability • There is further need to proactively involve user groups and associations in design and execution of such schemes |
| <p>Productivity: Cutting waste</p> <ul style="list-style-type: none"> • Due to scale as well as due to host of reasons, MSMEs suffer from waste. In clusters there is path dependency on a specific technology sometimes quite outdated. • Schemes under NMCC also suffer from the same malice of cluster development schemes | <ul style="list-style-type: none"> • There is a need for benchmarking studies in identified product categories and support schemes to encourage MSMEs use of expert services to cut waste • Fund technological upgradation in plants & machinery suppliers for top 20 SME dominated export impacting embedded services • There is further need to proactively involve user groups and associations in design and execution of such schemes |

(d) Other Specific Issues

| Issues | Needs |
|---|---|
| <p>Pharma Sector</p> <ul style="list-style-type: none"> • More than 5000 SMEs account for 40% of total pharma production. • In recent past, in the garb of noble looking cause of quality, a string of restrictions have been imposed on the SMEs: GMP compliance, MRP based excise; unrealistic hike in License fees; Minimum Turnover clause of around Rs.50 Crores in government purchase; Schedule-L amendment mandating setting up testing lab etc. • Further, in spite of serious reservations expressed by experts, Drugs Act (Amendment bill) was cleared on 5th January 2009 without debate; another Central Drug Authority (CDA) is being lobbied to be passed in same fashion in budget session • Spurious goods-against which the drive is supposedly targeted, are not manufactured in registered SMEs but they operate clandestinely in connivance with authorities. All these measures cannot stop that but may close thousands of genuine MSMEs. | <ul style="list-style-type: none"> • India is perhaps the only country where drugs are still affordable thanks to massive competition; globally a few dozen large corporations rule the roost with monopolies, cartels and anti-competitive behaviour • A pragmatic view needs to be taken in Indian context • A high-powered committee needs to be framed to look into the serious problems faced by MSMEs in the pharma sector. Till a considered view is evolved the current measures should be suspended |
| <p>VAT in UP</p> <ul style="list-style-type: none"> • Tinkering with VAT rates particularly industrial items distorts the entire supply chain and can make products uncompetitive. In UP, VAT has been suddenly raised for Transformers, Cables & conductors, switchgears etc have been hiked from 4% to 12.5%. As the products are bought by institutional buyers-the electricity utilities, there is incentive for them to buy these products from other states at CST rates i.e. 2%. • Ironically with such inverted rates the State is a net loser of revenue as revenue goes to other states and at the same time hurts its own industry. | <ul style="list-style-type: none"> • VAT rates of products consumed by industry should not be tinkered owing their cascading effect • Establishment of GST needs to be hastened |
| <ul style="list-style-type: none"> • Other Taxes in States | <p>Central Government should use its influence in discouraging such taxes in States as Entry Tax, Octroi etc. All such taxes should be subsumed in GST</p> |



Follow up and updates shall be available at :
<http://www.fisme.org.in>

Suggestions and Comments are welcome

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