Inter-Ministerial Committee (IMC) for Accelerating Manufacturing in the Micro, Small and Medium Enterprises (MSME) Sector

Discussion Paper

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

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Background: Causes of Concerns

- India's population has crossed 1.2 billion mark in 2011. Today, we are one of the youngest nations in the world with 75% of our population under 35 and by 2020 the median age of the population will be 29 years. The gigantic task ahead before the policy makers is how to harness and convert the demographic dividend by unleashing their productive energies. The Approach Paper to 12^{th} Five Year Plan spells out that India will have to create 220-250 million jobs between now and 2025. It is in this context that the National Manufacturing Policy envisages increasing the sectoral share of Manufacturing in GDP to 25 % over the next decade and generating additional 100 million jobs through an annual average growth rate of 12-14 % in manufacturing sector. However, the share of manufacturing in GDP has stagnated around 15% against targeted/needed 25% and growth moderated around 6.8%.

- India's ranking in World Bank's Ease of Doing Business report at 132th place, alludes to some of the impediments which are holding growth. There are more worrying signs emanating from ground which signal a trend away from manufacturing. Devesh Kapur of Centre for the Advanced Study of India, University of Pennsylvania recently wrote in Business Standard (16^{th} April 2013) that:

  "In manufacturing, India is facing de-industrialization *(as imports are displacing local produce at rapid pace)* even as the labour force is growing exponentially. Today, the Indian state has stacked the deck against SMEs so starkly that it would be foolish to advise someone to become an entrepreneur in manufacturing, rather than in services or speculate in land or real estate" *(Italics are ours).*

- In consultation with our constituent MSME associations, FISME has tried to analyze the Constraints- Institutional, Regulatory and Infrastructural on the one hand, and Strategic initiatives needed in the realm of Finance, Marketing and Technology on the other and made suggestions to address many of these issues. Our special emphasis is on creating institutional mechanisms, as pointed out by Prof. Dani Rodrik, Harvard University during his recent visit to India during discussion on National Manufacturing Policy, 'It's not policies, but institutions that matter to replace "quick fixes" with "deep fixes"…*(it is important)* how do we institutionalize the diagnostic/ policy design process in view of the fact that the nature of binding constraints will change over time.

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1. Constraints in business environment

a. Creating an institutional mechanism: Inter-ministerial Standing Committee on MSMEs with Ministry of MSME as its Secretariat

Problem/ Constraint
A large number of impediments are faced by MSMEs with different Ministries and departments. The problem gets compounded as the MSME sector is largely unorganized, has weak representation and lacks an institutional arrangement for redressal of grievances and hold continuous dialogue.

Proposed Solution
An institutional mechanism 'Inter-ministerial Standing Committee on MSMEs' is created under Cabinet Secretary with Ministry of MSME as its Secretariat incorporating the following design elements:

- Standing Committee on MSMEs in each Central Ministry/ Institution (including Planning Commission) to cover specific issues coming under it especially issues such as Public Procurement, related PSUs, related regulation/ legislation, public schemes, consultative mechanisms, delayed payments etc
- Standing Committee on MSMEs (MoMSME) to cover all residual issues
    - Coordination with State agencies (leadership and advocacy; sharing of best practices)
    - Horizontal issues: Competition Policies etc
    - Issues under MSME Ministry
- Quarterly meetings of the Inter-ministerial meeting as well as at the level of each Ministry
- It is critical to include representatives from 3-4 major national associations as member of the Committees both at the Inter-Ministerial and Ministry level committees
- States could be encouraged to adopt the same model at the state levels

b. Starting a Business: Registering MSME with District Industries Center (DIC):

Problem:
Getting an MSME registered is an arduous process. It is generally contingent upon proof of ownership/ tenancy of the premises for setting up/running industrial/ commercial enterprise, acquiring environmental clearances and so

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on. Keeping in view that less that 10% of eligible enterprises are registered calls for massive easing on registration process.

Proposed solution

On-line registration of business should be allowed with identity proof and without any other conditions attached. The data may be made accessible by senior government functionaries and concerned applicant/industry associations. The State governments may be assisted to introduce on line registration. Alternatively the MoMSME could create a internet cloud based application in partnership with States.

c. Starting a Business: Getting industrial space

Problem

The urban planning ills in India are spilling over other domains especially availability of industrial and commercial space. Due to resultant scarcity of affordable, planned and approved industrial space, 90% of small businesses have little option but to operate from residential/ unapproved areas. Consequence of their working in such areas is that such MSMEs cannot claim legal title/ proof of occupancy, hence no DIC registration, no access to MSME support schemes, no access to institutional funds, meager investment in plant and machinery leading to uneconomical scale of operations, poor working conditions and finally weak competitive edge.

Further, high property registration charges create cascading affect making the sale-purchase of industrial space even more unaffordable. High rates also create incentives for under reporting of land value and increasing corruption.

Proposed solution

The following initiatives could be taken to address the current constraints:

i. A comprehensive study is needed to arrive at extent of additional infrastructure- land, sheds, power, industrial area etc needed to meet the goals of 12th Five Year Plan and National Manufacturing Plan. The urban development authorities in states need to be sensitized and oriented towards these national goals.
ii. There is a need to facilitate targeted investment in creating affordable industrial areas for manufacturing with integrated facilities for MSMEs on principles of cost recovery (cost of acquisition + development charges).
iii. To improve the lot of existing industrial infrastructure- which is in shambles all over the country, the administrative and tax collection powers need to be

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ceded to associations to maintain the Industrial areas in PPP mode. Some successful examples have already emerged such as in Vatva Industrial Area.

iv. On the pattern of China, Plug & play industrial sheds could be created in ration of population and expected enterprises needed by society in next 15-20 years. (Annexure-A)

v. A Regulator for real estate of all types industrial space may be thought of to frame rules to ensure planned development and induce fair competition. Ministry of Urban Development could create a legislative framework and model laws for the central and state governments to adopt.

vi. Registration charges should be very low to create incentives for people to register property at fair value say 1% and have minimum cascading effect. Further, Registration fee should become Vattable for industry to lower costs.

d. **Pollution Control:**

Problem

Nobody doubts that there is a need to balance the industrial development and controlling the damage to the environment. An elaborate institutional framework exists in the country to oversee that. However, increasingly, the present rules and provisions in most states have started using this critical function of management of environment to that of revenue generation! There are official 'Rate Lists' in many States and the State Pollution Control Boards levy exorbitant fees on even non-polluting industries separately for air and water that increases with investment! It is increasingly becoming unbearable Tax on industry which is not only exorbitant but also arbitrary.

Proposed solution

The following initiatives could be taken to address the current constraints:

i. The mandate of Boards should change from 'control of pollution' to 'management of environment.

ii. Boards should be mandated to provide Advisory services & Advance Rulings

iii. Boards should be re-constituted to include stakeholders and have Grievance Redressal Mechanism

iv. Fee should be kept minimal and should not be treated a source of revenue. Unrealistically higher fees is a recipe for graft culture and lead to more corruption

v. Compliance inspections could be delegated to external accredited agencies.

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e. Access to Electricity

Problem

The country continues to suffer from acute power shortages and access to competitively priced, adequate electricity remains an elusive dream for most MSMEs. While theoretically, MSME clusters/ collectives can avail open access, most states and their Regulatory Commissions have shirked from the responsibility of implementing open access. The status quo hurts MSMEs more as large companies have alternatives of captive power and buying electricity through the exchanges.

Proposed solution

The following initiatives could be taken to address the current constraints:

i. The open access threshold could be brought down to 1 MW in all states
ii. The licencing condition for distribution of electricity could be eased for MSME collectives (cooperatives/ associations) and cross subsidy charges waived for distribution by MSMEs' collective to explore and execute collective generation/ distribution of power.
iii. A Fund could be created to support initial technical and managerial support to MSME collectives
iv. Dedicated Industrial feeders could be established to ensure uninterrupted supply of electricity

f. Taxation

Problems

It is increasingly becoming evident that the tax administration in India is frequently pressing taxpayers to pay money that is not required under law, and which will not stand up to judicial scrutiny or review. Studies[1] point out that over 80 per cent of the revenue department's claims were overturned by the tribunal and over 90% of them by the Supreme Court[2] . But with little resource at their command to fight long legal battles MSMEs are forced to cough-up unjustified demands. As most revenue related legislation provide for powers of search, seizure, arrest and detention, the chances of abuse are also much higher. Taxation related excesses are termed by MSMEs as the single biggest cause for fomenting widespread informality in the sector as they want to remain hidden from authorities.

[1] Editorial- Taxation, not litigation, Business Standard Jan 17, 2013
[2] India Legal News on Arbitration in India: SC Disapproves of Retired Judges Charging Heavy Fees, 18th May 2010

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Special case: Central Sales Tax

Being an indirect tax, liability of collection of Sales Tax rests ultimately with the last/end buyer or consumer. It is for their own convenience that the Governments have framed laws/rules that mandate the 'seller trader/dealer' to collect tax as agents of the Government from someone actually liable for it and deposit the same in the Government accounts. Most businesses operate with a long supply chain in which goods change hands several times. Though, payment of State Sales Tax/VAT and/or CST, basically is the liability of the purchaser of goods, however, the Government as a dominant player has made the sellers (Traders) liable for collection of tax from the buyers and payment thereof into the treasury. In case of inter-state sale of goods by a registered trader situated in one state to another registered trader situated in another state, CST is payable at concessional rates. To establish that both the parties are registered traders a declaration form (called C-Form) has to be provided by the buying dealer to the selling dealer. At the time of his assessment or even before, the selling dealer has to produce such form to his Assessing Officer to be assessed at concessional rates; In case the selling dealer is unable to provide the form to his assessing officer he becomes liable for the amount of difference in tax at normal and concessional rates along with interest and penalty. The buying dealer being free from any liability for not providing C forms does not bother about furnishing the form to the seller. Moreover there are instances of Assessing office refusing to issue C forms due to some pending dispute with the buyer dealer.

It may be observed there is no recourse for the selling dealer to save himself from punishment and harassment for someone else's default.

Proposed solution

The following initiatives could be taken to address the current constraints:

i. The tradition of automatic appeal and confiscation of money in the interim needs to end. If tax department wishes to appeal once it has lost at a particular judicial level, it should pay a punitive interest rate on the money it holds.
ii. Facility of Advance Ruling should be made available to MSMEs at least in matter of Excise, Service & Income Tax.
iii. Advance Tax must be allowed to adjusted to the final Tax payments.
iv. Direct penalties need to be levied on officers who hand out a disproportionate number of subsequently overturned orders.

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v. Essential CST reform: The responsibility for not issuing C form has to be fixed on buyer instead on seller of goods. To be fair and equitable to all, CST Act and Rules should be so amended that it is the selling dealer who becomes liable for his acts of omissions and commissions and is made to bear the consequences like differential tax, interest and penalty burdens for non-issue of the required forms.

g. Enforcing of contracts, dispute settlement and controlling cheque bouncing

Problems

i. Enforcing Contracts: Businessmen in India are wary of long delays in judicial process in settling commercial disputes. The alternative mechanism, introduced in India in 1996 in form of Arbitration and Conciliation Act displacing the dysfunctional 1940 legislation, has also proved to be a white elephant because of exorbitant fee charged by retired judges as arbiters. Supreme court itself has criticized the prevalent practice which has rendered the alternative mechanism useless.
ii. The bouncing of cheque is a phenomenon prevalent in no other country as frequently as in India. Legislative measures to control the menace introduced by way of introduction of sec138 in Negotiable Instrument Act making offence punishable with upto 2 years imprisonment and/or penalty upto 3 times the amount of the cheque have all but failed. With backlog of 40 lac cases of cheque bouncing , the Supreme Court has also expressed its helplessness. The systemic failure of the mechanism is particularly worrisome for MSMEs with meager resources to fight out protracted legal battles

Proposed solution

The following initiatives could be taken to address the current constraints:

i. Arbitration Act: Guidelines needed to be framed in appointing arbiters; expanding arbiter's definition by allowing people from different sections to play the role. A is mechanism is needed to determine fair charges and ensure prompt disposal.
ii. Controlling the menace of Cheque bouncing: In case a cheque is bounced, the issuing bank may mark a lien (in favour of the payee) to the extent of the amount of the bounced cheque in the account of its constituent-drawer. Once the court issues decree, the amount frozen may be paid to the decree-holder. (Similar practice is in vogue in Ireland.) Secondly, CIBIL

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may also be simultaneously strengthened to enlarge its operations to capture bouncing of cheques.

h. Mechanism for revival of sick units and exit for failed enterprises

Problems

If we classify productive economic activities as large and small, in Indian context, the large activities are those where in case of bankruptcy the company (or the owner) can approach BIFR. No such provision exists for small enterprises. Secondly, as over 97% of MSMEs are proprietorships or partnerships, they do not have recourse to winding up provisions of Companies Act or of LLP. In case of failure to meet demands of creditors (mostly Statutory dues, Tax liabilities, Electricity, Municipal Taxes etc) or repayment of loans etc. the legal proceedings 'to recover dues as arrears of land revenue' are invoked with confiscation of assets and ultimately imprisonment of entrepreneur. For farmers, individuals, businesses, there is no recourse available for honourable settlement of dues. A large number of farmers and small businesses commit suicide because of dysfunctionality of insolvency mechanisms.

Unlike corporate entities which are governed by the Companies Act, 1956 or the LLP Act 2008 – both central legislations, non-corporate entities are state subjects. The Provincial Insolvency Act 1920 enacted prior to independence has been retained as legislation amenable to state amendments. Thus any change in the act would require consultation with states. Because of a lack of single institutional mechanism which could coordinate the demands of multiple agencies, rehabilitation or re-structuring or closure becomes extremely difficult to enforce. A large number of MSMEs get stuck in a state of 'suspended animation'. The backlog of such units as on March 2007 was 1,14,132 (Working Group on Rehabilitation of sick SMEs, 2008, RBI).

Proposed Solutions

i. There is a crying need that for individuals and non-corporate entities a revised and reformed insolvency code needs to be enacted as almost all the entrepreneurs irrespective of legal entity they head- company, LLP, Prop/ partnership etc, are made personally liable because of involvement of their personal guarantees in all aspects of business. The Center Govt. may bring out a model Act for the states on the above lines and encourage the states to adopt the same through a suitable scheme of incentives.

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ii. For the MSMEs, following on the recommendations of the PM's Task force on MSMEs, FISME with Amarchand Mangaldas- India's leading law firm, have proposed a way out for creating a revival and exit mechanism through MSMED Act. The proposed solution has following features:
    - Insertion of new Chapter Sec-25 of MSMED Act 2006
    - Establishment of Revival and Exit Committee as an adjunct to MSME Facilitation Councils (already present in almost all states)
    - Establishment of Appellate Authority: Attached to National Board of Micro Small and Medium Enterprises (NBMSME)
    - An automatic moratorium for a period of 180 days; revival plan prepared. If accepted by all, unit is revived or unit is sold/ liquidated and entrepreneur is given discharge

(FISME would be happy to share the draft legislation).

i. Labour laws and employing workers

Background

The days of exploitation of labour by 'mill owners' are long over. With growth in economic activities and schemes like MGNREGA in the backdrop, it is now the employers specially the smaller ones who are all the time in the look out for workers even unskilled. The trend is bound to continue and escalate. The labour market can therefore be considered to have matured. No doubt the need for government intervention by way of legislative measures and regulations continues to improve living conditions, but then this is an on going, dynamic exercise keeping the contemporary standards in view. It is in this context that the old laws – with totally different objectives of the time these were drafted- need to reviewed and overhauled considering the present day needs.

FISME suggests the following reforms to reduce the regulatory burden and harassment and create conditions for employing more people:

Issue	*Present Pain Point*	*Proposed solution*	*Related Act/ Sections*
Regulatory Burden	Most MSMEs lack both the competency to comply and resources to bear the regulatory burden of	The limit for applicability of all labour laws may be raised to 50 workers.	Multiple Labour Acts

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	numerous Labour laws. The net result of excessive regulation is MSMEs avoid more employment.		
Filing of Returns	The Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Act, 1988 presently provides for exemption allowing 'very small' establishment (up to 9 workers) to maintain only one register and submit one return; 'small establishments' (10 ~19 workers) maintain three registers and submit one return in respect of 9 Acts.	a. May be extended to all MSMEs upto 50 workers b. MoMSME and MoL can develop a Master Record to replace multiple filing of returns under different laws. c. A dedicated MCA 21 (MoCA) type e-platform could be developed for filing, record keeping and making payment electronically.	Multiple Labour Acts
Inspection	a. Problem of harassment through current Government inspectors b. Even senior officers, sometimes ministers, who though not 'inspectors' as per Acts, visit factories causing harassment	a. Powers of inspection & certification could be delegated to more designated agencies/ Associations b. Only designated officials should have power to inspect and they too should intimate the owners in advance of proposed date of their visit / inspection	Multiple Labour Acts
Minimum Wages	Many states arbitrarily increase the minimum wages under political compulsions for workers in specific sectors e.g. engineering sector or food processing sector.	A two sided in-depth view on minimum wages is needed. Lower wages can create more jobs and help MSMEs survive and grow. As it should principally be at 'just	The Minimum Wages Act, 1948 and related legislation

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		above subsistence level' min wages should vary from area to area. Arduousness of a job can be factored additionally.	in States
Contract Labour	Contract Labour is needed to give flexibility to the entrepreneur to adjust to the fluctuating outputs and demand needs. The Contract Labour (Regulation and Abolition) Act, 1970 itself takes care of the welfare of the workers of the contractors relating to their wages and other working conditions.	There should not be any power with the Government to prohibit employment of contract labour. This provision, in the present scenario, needs to be repealed.	Section 10 of The Contract Labour (Regulation and Abolition) Act, 1970.
Social Security related Laws	The costs of schemes are too high and benefits to workers too insufficient. Compliance is too tedious, cumbersome and harassing for MSMEs.	a. A package around Market based instruments like PPF, NPS, RSBY may be evolved and allowed as alternative to PPF, ESI, Retirement benefits. b. Alternatively, MSMEs could be asked to contribute one time annual contribution per employee to a designated agency which would be responsible for all Social security needs of the employee using her AADHAR identity.	Amendments in PF and ESI Acts; Providing for special dispensation for MSMEs Or through a separate Act for MSME
Record keeping	Demand of very old records/ payment challans etc to be produced during inspection is a cause of lot of harassment.	Time limit (time barring) should be fixed for inspection of old records / documents under all labour laws.	Multiple Acts
Administrative reform/ Labour	The dual executive and judicial power with which the officers of the labour	The dual power vested with labour departments should be done away	The Payment of Wages

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Courts	department are armed, is doing injustice to all concerned and is also a cause of corruption. While on the one hand they are not well conversed with the various laws and judicial procedures, on the other hand, their sole aim is not to adopt the judicial approach but to extract money from the parties.	with and all judicial function should be transferred to Labour Courts and Tribunal.	Act, Minimum Wages Act, Industrial Disputes Act, Workmen's Compensation Act, Payment of Gratuity Act etc.
Trade Union affiliation	External interference is often the cause of trouble in Factories. Multiplicity of Unions further complicates the industrial relations.	- The Act should be amended to the effect that the number of unions should be restricted to one if the total number of workers is not exceeding 100. Thereafter, per extra 100 workers, one additional union should be permitted, subject to a maximum of three registered unions. - Amended to the effect that non employees do not become office bearers of the union	Trade Union Act, 1926 Section 22 of the Act
Factories Act	Factories Act is so full of redundancies and remains a source of harassment. Few examples:	Factories Act requires a complete overhaul	
Closure of Factory	Those units, which employ a certain number of workers are required to close their business after obtaining prior permission from the appropriate Government. The number of workmen provided in the	The provision needs to be repealed	Different provisions on Center and state legislation

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	Central Act is 100 while it varies from state (in UP e.g. it is 300). The restriction on the closure of an industrial establishment is severe and no employer should be forced to continue to run the factory when it is not viable/ feasible. The law already provide adequate compensation to the workers who are retrenched as a consequence to the closure.		
Definition of Occupier	After amendment in 1987, only a Director is considered an 'occupier' and the provision for nominating a person as Director is also deleted. Even if a Director is not in control of factory's affairs, the Director can be picked out by the authorities for a criminal prosecution in the event of a mishap or for any other breach of the provisions of the Act. This amendment is wholly unconstitutional and the job of a director in the Indian company has become the most hazardous occupation in the world.	The definiton of the 'occupier' u/s 2(n) needs to be amended to include factory manager or any other person who is overall incharge of the unit and is physically present in the premises and is fully accountable for the functioning of the factory.	Factories (Amendment) Act, 1987, Sec. 2(n)
Penalties	Section of General penalty was amended after the Bhopal Tragedy and the penalty was increased from Rs. 2,000/- to Rs. 1.00 Lacs and an imprisonment up to 2 years. The excessive maximum penalty is used as a tool for arms twisting	In our submission, the violation should be categorized in three categories and their violation should attract a corresponding penalty which is proportionate to the gravity of violation:- (mentioned at bottom of the table)	(mentioned at bottom of the table)

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Water Testing	Industries should get the water tested from laboratories of Public Health Department	Industries should be permitted to get water tested from approved laboratories apart from the labs of Public Health Department	Section 18 (Rule-39)
Shifts	Overlapping shifts is inevitable when one shift starts or is over but it is prohibited.		Section 58
Factory building	Approval of Factory building map	Industrial Building Maps approved by State SIDCs / Jt. D.I./etc. should also be treated as approval under Factories Act as well as under other provisions like fire safety.	
Misc. provisions	Prescriptions on: - white washing - light (intensity) - creche (even if no married women employed) - Fire safety - Spittoon - etc	Review of provisions in changed realities	Multiple sections
Other State Acts	Labour legislation in States are full of absurdities and redundancies.	Revision is warranted in all labour Acts in States such as: -Industrial Disputes act 1947 -Minimum Wages ct. 1948 -Employees Provident Fund Act 1952 -Employees state insurance act 1948 -Payment of wages act -Payment of bonus act 1965	Multiple Acts/ Rules in different states

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		-Workmen compensation act. 1923 -Employment exchange (compulsory notification of vacancies) Act 1959 -Dangerous machines (regulation) Act, 1983 -Employees liability Act, 1976 -Equal remuneration Act, 1976 Trade Unions Act	

Penalties under factories Act

In our submission, the violation should be categorized in three categories and their violation should attract a corresponding penalty which is proportionate to the gravity of violation:

CATEGORY – A

Minor offences inviting a fine of upto Rs. 2,000/- only.

- Section 7 rule 14 C and 14 D – notices by occupier.
- Sections 11, 13, 16, 17, 18, 19 and 20 and rule 17, 31, 32, 33, 36, 37, 38, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50 and 51 regarding health and cleanliness etc.
- Section 41 B regarding compulsory disclosure of information by the occupier of a factory involving a hazardous process.
- Section 42 rule 64.
- Section 43 rule 65.
- Sections 44, 45 rule 66 and 67.
- Section 46 rule 68.
- Section 47 rule 69.
- Section 48 rule 70.
- Sections 51, 52, 54, 55, 56, 58, 59 rule 76.
- Sections 60 and 61 rule 77.
- Section 62 rule 78.
- Sections 63, 66, 67, 68, 69, 71, 72 rule 99.
- Section 73 rule 100.
- Sections 74, 79 rules 102 and 103.
- Section 81 ruless 107 and 108.

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- Section 87 A rule 109.
- Section 88 rule 110.
- Sections 88, 89 rule 112.
- Section 108 rule 118.
- Section 110 rule 120.

CATEGORY – B

Offences liable for fine from Rs. 5,000/- to Rs. 10,000/- only.

- Section 6 rule 3 – approval licensing etc.
- Sections 7A and 7B – general duties of occupier regarding safety, health and welfare of workers.
- Section 12 rule 18.
- Section 14.
- Section 15 rules 20, 21, 23, 24, 25, 26, 27, 28, 29 and 30.
- Section 21 rules 52, 52A, 52B, 52C, 52D – fencing of machinery etc.
- Section 22 rule 53.
- Section 23 rule 54.
- Sections 24, 25, 26, 27, 28, 29, 30 and 31 rule 56.
- Sections 32, 33, 34 rule 57.
- Section 35 rule 58.
- Section 36 rule 59.
- Section 36A, 37, 38 rules 61 and 62.
- Sections 39, 40, 40A rules 61 and 62.
- Section 41C – specific responsibilities of the occupier in relation to hazardous process.
- Section 41F – permissible limits of exposure of chemical toxic substances.

CATEGORY – C

Major Offences inviting a fine of upto Rs. 1.00 lac only.

All deliberate breaches and violations of the provisions of the Factories Act, 1948 and rules framed thereunder set out in CATEGORY-B resulting in permanent disablement or death of a worker in an accident in the factory premises during working hours.

Process to be followed for penalisation :

Recognising the regulatory as well as the advisory role of officials and inspectors of the Labour / Factories and other related departments, the following process is suggested so that entrepreneurs could be advised about compliance of various requirements also rather than mere penalisation on some pretext or the other :-

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- On first violation found during inspection, the inspector should advise the proper system in consonance with the law.
- On second violation, the inspector should issue a memorandum but no fine.
- On third violation only, the inspector should prosecute/penalise the unit in accordance with the categorisation suggested.

j. Impediments in free Movements of goods across the country

Problem

One of major reasons why Indian produce are uncompetitive is because of impediments in movement of goods owing to plethora of agencies placing restrictions on free flow of goods across state borders 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 Tax, Toll etc)

In spite of reforms, the number of check-posts have risen tremendously resulting in greater delays and higher costs of transporting goods. With almost all the departments (mentioned above) having powers of search, seizure and imprisonment, goods in transit are vulnerable to extortion across the highways.

Proposed solution

There is a critical need to create an institutional mechanism – may be a unified Regulatory Commission/ Agency with participation of states, to ensure seamless movement of goods across states. Secondly, while the implementation of Goods and Services Tax is to begin soon, such a mechanism would further aid the process of implementation of GST.

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2. Strategic Initiatives

Addressing the irritants is important but not sufficient. Not only do we also need to address the persisting structural imbalances in India in the areas of Technology and Finance, but adopt a strategic approach to intervene in areas such as marketing to enable Indian MSMEs compete globally.

a. Finance

Context

Keeping in view that for a growing economy like India, the bank lending should be over 100% of GDP whereas it is less than 50%, in contrast to 200 % in OECD and 250% in japan. Because of low penetration of organized lending institutions, a large swath of population is dependent on unorganized lending sources. MSMEs are a case in point. In spite of a mandatory Priority Sector Lending in vogue for 50 years, only around 5% of MSMEs could access institutional funds through Banks and Financial Institutions. Therefore, the level of financial intermediation remains very low. The 'MSME' sector

consists of three distinct sub groups: micro, small and medium. Needless to say that these have varied needs and they face distinct challenges with respect to finance.

The units **Micro sub-group** largely belong to the traditional / cottage industry segment, promoted by individual first generation entrepreneurs having just a few employees- unskilled workers and often supported by family members. Most of them begin primarily with their own capital.

The **Small sub-group** is characterized with the promoters depending largely upon semi-skilled workers, operating at sub-optimal scale, usually serving 'Business to business' segments, with limited or negligible negotiating position with regard to trade partners both on supply side or customer side. Most of entrepreneurs begin with their own capital but have greater reliance on institutional credit to fund working capital and future growth, scarce availability of which hampers their growth.

The units in the **Medium sub-group** on the other hand constitute of forward looking who would have begun to tentative steps to professionalize their operations. Generally the enterprise would have graduated from small, often are in high growth phase yet they are way behind the large companies both in their capacity and capability. The segment is critical to the economy as well as to employment generation as has been found in several developed countries.

Proposed suggestions

i. **MSME dedicated commercial bank**
For the sector wide impact, there is a need to establish a national, large capital based, fully commercial SME dedicated Bank. Such a Bank should identify and adopt global best practices in SME lending and develop financial instruments based on deep understanding of MSME segments/ sectors and their specific needs. It should have a branch presence in all major 400 industrial MSME clusters. Now that RBI is already considering new bank licenses, such a bank could be floated by SIDBI in collaboration of well-run large banks having SM focus such as Wells Fargo of USA. Such an institution should provide full bouquet of services: short/ term long term loans; working capital; investment and banking services, non-fund based services etc.

ii. **For Micro sub-group**

a) The sector can be best served under the **directed credit program** which presently provides loans below Rs. 2 lakhs at concessional rate and upto Rs. 10 lakhs without collateral.

b) For compulsory and maximum of collateral free credit to the micro sector, **CGTMSE** cover could be useful to the lenders in reducing their risks. For increasing coverage – CGFTMSE may offer cover upto 90% of the credit for which it would need additional capitalization. Further, the guarantee fee for guarantee cover on the term loan should be levied in the subsequent years on the outstanding amount rather than on the initially sanctioned loan amount. In other words, the micro enterprise should get the benefit of reducing balance on the loan account.

c) **Micro-credit institutions** for the micro enterprises can be promoted with capacity building support from SIDBI and funding from FIs.

d) **Urban Self Help Groups or Joint Liability Group model** for micro enterprises can be introduced by banks, to improve the credit worthiness in the sector. The schemes can have good synergy if the sector's credit needs are addressed by banks under cluster oriented approach.

e) **Skill development and mentoring support** can help make the business of micro enterprises more sustainable and hence these measures should be promoted. Banks/ FIs could tap their CSR funds to create skill sets and mentor new entrepreneurs.

f) There is a need to increase the working capital limit assessment if the units are operating under the 'Business to business' model, in which case banks may be advised to assess **working capital** needs more liberally at upto **33%** of the annual turnover considering the fact that the delayed sales realization from customers continues to be the primary reason for failures. Increased finance cost due to borrowings from informal sources, which the units have to resort to under such circumstances, is not sustainable in the long run.

g) RBI could consider reducing the **minimum balance requirement** in current account managed by micro enterprises to Rs. 3000 from the present level of Rs. 10000. Also RBI could consider introducing a nominal interest payable on the average balance maintained in the current account.

h) Further **fee based and transaction charges** should be uniform across all the banks for micro enterprises.

i) The criteria for classification of an account as **NPA** can be made flexible for considering period of 180 days for enterprises operating in businesses having seasonal characteristics.

iii. Small sub-sector:

a) **Liberal assessment of the Working Capital** is needed in the form of 33% or quarterly cash flow assessment methods would help the sector which faces severe challenges in timely realization of sales from its customers resulting in cash crunch.

b) Securitization of MSME Trade Receivables and Bond Market Creation: Delayed payments with underfunding of MSMEs' working capital requirements continue to be a cause of serious concern. Now that both Finance Ministry and RBI are taking steps to deepen Corporate Bond Market, it is high time a Debt Capital Market got created by promoting Companies for securitizing Trade Receivables of MSMEs. These Companies may issue Bonds based on their performance track record and against their securitized pools of Trade Receivables. A market based solution like this can make a huge impact.

c) **Factoring** services can be offered/allowed to be accessed by the banks to the small enterprises to ease their sales realization woos.

d) Additional assistance should be offered on more liberal terms or lower finance costs if the enterprise adopts better governance and transparency, including conversion into **LLP or Pvt Ltd** structure.

e) Setting up of **Advisory Committees for nationalized banks at District levels** can be considered with representation from the local level MSME associations to consider cluster level issues w.r.t. understating the MSME needs and banks' challenges in lending to them.

f) For **Bill discounting** facilities, increase in the tenure upto120 days be considered. This will also take care of enterprises facing extremely tough time due to acute power crisis particularly in some states.

g) For **Temporary Overdraft** sanctioned to the small enterprises, the terms of sanction should permit at least 3 months for utilization and repayment. This will also obviate the crisis situation being faced by units especially in states with acute power crisis.

h) A practice be introduced to provide **moratorium / term loan repayment** breather of 12 months to enable units facing force majeure situations for better cash flows management without fear of classification as NPA. Units in states facing acute power crises should automatically be covered.

iv. The Medium Sub-sector

a. Urgent need to improve **quality of bank assistance**: time taken in disposing off cases, service quality and flexibility.

b. **Additional collateral securities** insisted by the banks for additional facilities from fast growing enterprises, is a source of much impediment. Some clarity or transparency is desired on this issue

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c. **Equity/Mezzanine Capital:** The enterprises in the medium sector are ideally suited for growth capital. Banks could consider conversion of part of their credit exposure into equity to some of their well-run medium sector clients. Option for enterprises to list on the SME Exchange platforms provides ideal market making and exiting opportunity and good return for the banks.

d. **Mandatory External Credit Rating:** There are serious concerns among MSMEs related to external Credit Ratings prescribed by RBI for units having exposure more than Rs. 5 Crores. At the moment the credit rating process is highly subjective. In the absence of clearly defined parameters and the weightage assigned to each, the result of the exercise depends largely on the analysts. The rated firm therefore has no clue as to what improvements, in which area will result in how much improvement in achieving better grades during the next rating process.

   Besides, the rating granted being just an opinion of the Rating Agency, it is necessary to measure the divergence of forecasts with the actual results obtained in the banks. Similarly the ratings given by the agency need to be cross checked with the internal ratings of the banks to ascertain the divergence in the assessments. The defaults/NPAs of externally rated firms also requires an in depth study to determine the efficacy of their rating processes.

   The Mandatory requirement for **Bank Loan Rating (BLR) ratings may be done away with**. Or until thorough examination of usefulness of the rating are completed, the **threshold limits for BLR ratings may be re-fixed at a higher level of say Rs. 50 Cr for Fund based and Rs.100Cr for non-fund based limits**. The reason for this request is that most Medium firms get inferior ratings and consequently find it extremely difficult to obtain enhancements/new facilities, competitive pricing etc, even though their accounts may have been unblemished over long years. The reasons attributed to inferior ratings are low market share, uncertain government policies, volatile global markets etc besides analysis of financial results.

e. **Foreign Currency loans**: The medium firms often face direct competition from large companies with big resources and strong institutional backings and capital market support. Many a times the large companies are able to bypass banks' intermediation and access External Commercial Borrowing (**ECBs**) to obtain cheaper funds. With handicap of scale already weighing down their neck, the relatively

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higher cost of funds puts medium companies in great disadvantage vis-à-vis large Cos. The external commercial borrowings may be made possible for the MSMEs as well through FI intervention of pooling requirement of several potential MSME candidates.

f. **Non Fund Based Bank Facilities:** MSMEs face difficulty in obtaining non fund based limits for providing performance BGs etc. Conditions for these facilities need to be relaxed to help them overcome impediments to their growth.

ii. Marketing and Exports

Context

In a perfect market, there cannot be case for market support programme funded by public money for private enterprises. Unfortunately, neither the markets within the country nor outside operate freely or fairly. Domestic markets suffer from many impregnable supply chains, abuse of dominance by large buyers of MSME products as well suppliers of raw materials and other inputs and other anti-competitive practices. Public procurement also has been largely out of reach of MSMEs prompting the Central government to bring out a mandatory procurement policy recently whereby 20% of goods and services are required to be procured from MSMEs by all central government agencies.

Globally, almost 75% of trade flows are within the Transnational Corporations or their subsidiaries. Similarly, 65% of world trade occurs within OECD having lower tariff but various kinds of NTBs/ NTMs/ TBTs etc restricting market access from developing countries.

a. Marketing (domestic)

i. Public procurement

Challenge

The Ministry of MSME has already notified the Public Procurement Policy mandating all central government agencies to procure 20% of goods and services from Micro and Small Enterprises (MSEs), excluding the medium enterprises. The challenge now is to implement the policy and take the quantum of procurement from around 5% at present to 20%.

Proposed solution

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There is a need to create an Inter-ministerial coordination mechanism (also proposed earlier) to make concerted efforts to achieve the national policy goal. Its tasks should include and collating data on public procurement, coordination of training of buying agencies and operate a grievance redressal cell.

ii. Marketing Initiatives:

The following initiatives are proposed which could utilize planned funds:

- **Assistance for establishing Market Development Companies (MDCs)**
  The scheme may be implemented by NSIC to facilitate setting up of 'Market
  Development Companies (MDCs) floated collectively by at least 10 or more MSMEs or cluster units (of same/ similar products/ customer segment specific) or by private companies (if they undertake to exclusively market MSME products) to take up comprehensive marketing and sales function including funding sales on behalf of MSMEs.

  25% of operating cost could be borne by MSMEs, 75% by govt. for 3 years up to a max. Rs. 25 lac per year. 1000 MDCs could be targeted for XII- FYP. More than one public and private programme managers should be designated to market the scheme, identify the beneficiary groups and execute the scheme.

- **Fund for supporting collective Marketing initiatives**

  A Marketing Support Fund could be created to provide support to MSMEs for creating forward linkages- setting up warehouses/ show- rooms etc or creating collective brands, franchising, licencing covering professional consulting/ legal expenses. Support under the programme could be given to a company having exclusive marketing tie-up with 10 or more MSMEs.

  25% of the cost of such initiatives could be borne by MSMEs, 75% by govt. for 3 years up to a max. Rs. 10 lac per year. 1000 such collective initiatives could be planned to be supported in XII FYP

- **Voucher Scheme for MSMEs to avail Consulting Services**

  The MSME consulting markets are weak and MSMEs typically hesitate to engage external Professional Consultants or Business Development Services (BDS) providers. A Voucher scheme is proposed with which an MSME could engage BDS providers/ Consultants from the list of accredited consultants for a range of strategic BDS in areas such as marketing strategies, market research, market intelligence, bench

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marking, advertising, brand building, distribution, service after sales etc. An MSME could purchase a voucher and avail services of a BDS provider of its choice from a list of accredited consultants/ BDS

25% contribution from MSME; 75% grant up to max Rs. 100,000 in a year to an MSME. Pooling could be allowed (so that group of eligible MSME could use the scheme to tap more expensive services). The voucher could be encashed by the BDS. Could be administered through NSIC as the central hub of the scheme with MSMEDIs and select associations as its spokes. If need be negative list of services could also be notified in consultation with associations. 25,000 beneficiaries to be targeted in the XII-plan period

b. Exports Rebooting MSME Exports Promotion

Background

While less than half a percent of MSMEs are exporting directly, their contribution to India's total exports exceeds 40%. The MSMEs are dominant players in some of India's major export sectors namely Textiles and Garments, Leather products, Gems and jewelry, Handicrafts among others. They also contribute substantially in industrial goods segments in sectors such as electricals, engineering, rubber and plastics.

Beyond India's macro-economic needs of more exports earnings, the engagement with exports is very important for MSMEs for three major reasons:

i. Firstly, in today's globalized world with increased lowering of trade barriers and massive competition in domestic markets, it is essential for SMEs to keep benchmarking their competitiveness. Ability to export is a reliable barometer of their competitiveness vis a vis their counterparts in other countries.
ii. Secondly, active participation in exports exposes SMEs to evolving market trends, quality and standards enabling them make informed decisions.
iii. Thirdly, it has been observed that participation in exports induce positive externalities in the firms in the form of better management practices, higher wages and better working conditions.

Though currently MSMEs are just a fringe player in international trade, considerable scope exists for them to expand India's export base. The business at this point in time in India is enjoying significant currency advantage. The Chinese firms in the past decades, backed by their Government have made inroads in various markets sometimes even at political

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costs. With adequate Government support, Indian MSMEs can also quickly develop capacities and capabilities to nibble away Chinese monopolies.

However, the export promotion policy needs to change both conceptually and functionally if MSMEs' participation in exports is to be increased considerably. As emphasized by Prof. Dani Rodrik (Harvard) during his visit last year in India, that policies mean little, it is the institutions that matter the most. A few important steps are suggested to alleviate the problems and create institutional framework required to make a difference:

i. Rebuilding institutional framework for exports promotion

a. Niryat Bandhu – Inter-ministerial grievance redressal mechanism

Export Promotion is a national priority. Unfortunately it has suffered because of Ministerial turf-wars. There is a crying need to set up an institutional mechanism to address the issues of exporters related to DGFT and Central Ministries such as Agriculture, Commerce and Industry, External Affairs, Finance, Labour, Railways, Road Transport & Highways, MSME, Shipping, Textiles etc. and also related to the States.

First and foremost is– making sure the difficulties faced by the MSMEs are carefully heard and promptly settled at empowered institutionalized inter-ministerial forums in the presence of Industry Association representatives so that right signals go across the length and breadth. Let the 'affected' set the agenda and the highest in the Government oversee the functioning of the redressal mechanism. As many State Governments as are willing, should be involved in these 'ease of doing business' and 'export push' exercises.

Alongside, the above mechanism should have capacity to listen to what type of promotional support the MSMEs want from the Government in order to expand and/or take up exports. This group representing the Government will again have to be of inter-ministerial in order to bring on the table whatever is feasible for the Government to do.

Affected exporters could enlist their problems with Niryat Bandhu directly or through associations. The cases could be pleaded by exporters themselves or through their association representatives. Agenda and minutes of the meetings could be placed in public domain. Two things are sacrosanct in making such mechanism successful: Firstly, it should be chaired by senior most authority- in this case ideally by Cabinet Secretary. Secondly, the periodicity should be maintained at all costs. It will have a salutary effect on reducing friction and inducing efficiency in export promotion processes particularly for MSMEs.

b. Rejuvenating Board of Trade

Board of Trade has become largely dysfunctional. There is a need to revive and rejuvenate the Board to discuss export strategy, continuously monitor progress of

execution and suggest course correction. Surprisingly, in spite of contributing towards half of India's exports, SME bodies are seldom given representation. SME bodies should be given due representation.

c. Need to make Export Promotion inclusive

The policy of export promotion needs to be freed from the holds of just a few increasingly inbred institutions (EPCs, Boards etc) and stake-holder institutions should be used for delivering export promotion programmes and services. Efforts need to be made to bring competition in every sphere of export promotion initiatives that utilize planned funds: Research, Trade Fairs, Buyer-seller meets etc. Making Export Promotion programmes needs to be made more inclusive by opening up MDA & MAI fields to MSME associations and collective initiatives of cluster based entities.

Secondly, keeping in view of the contribution they make, MSME associations need to be in policy level decision making bodies: Board of Trade, Bi-lateral and multi-lateral trade negotiations, high level official delegations etc.

ii. Specific Schemes Proposed for Consideration

a. Urgently finding a suitable replacement of DEPB

Problem

In a highly competitive world, it is extremely difficult to export a product in international market with local taxes. All countries have tax reimbursement schemes for exports. In India the most popular and effective scheme for reimbursement of local taxes for exports has been Duty Entitlement Pass Book (DEPB) scheme. The phase-out of scheme has had a huge adverse impact on exporters' ability to compete. The downfall of exports could, to a large part, be also directly linked to DEPB's phase out. There could be valid reasons for its phase out, the problems arising due to its phase out for MSMEs are however not fully thought through.

In absence of DEPB, there are two existing instruments for tax reimbursements: Advance Licence and Duty Drawback. In case of MSMEs, the Advance Licence route

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is impractical because the value of their export consignments are low and therefore import of smaller quantities of raw materials as per Advance Licence is not viable. Secondly, the cost and time of acquiring Advance Licence is a big deterrent.

So far as Duty Drawback is concerned, the rates are notified for few specific items only whereas number of export items exceeds 10,000 and there are enormous qualitative variations which a general duty draw back rate does not/ cannot take into account. MSMEs find brand rate route of Duty Drawback scheme too cumbersome and time consuming.

In absence of an efficient and easy to use reimbursement scheme, MSME produce cannot compete in international market.

Plausible Solutions
Though, we do not have a perfect solution and we would be happy to work with the DGFT/ DoC in developing an ideal alternative mechanism for MSMEs, yet in the interim we may propose the following for consideration:

a. Commissioning of a study to identify on priority products of MSME interests and liberally fix general rates of Drawback to considerably enlarge coverage for the Drawback scheme. The mechanism for payment of drawback also needs easing on consultation with stakeholders.

b. A Duty Credit Advance Licence could be considered combining the better parts of DEPB as well as Advance Licence. It is similar to Advance Licence where quantity and both import duty element is mentioned. In the proposed scheme, instead of specified quantities for each input, an exporter may be allowed to import all or any one of items duty free of duty equivalent of the total duty element suffered. It could also be made transferable. It is far more transparent than erstwhile DEPB. However, the mechanism of applying Advance Licence needs to be eased considerably.

(Details of the proposed scheme are appended as Annexure-1)

b. Mega MSME Export Support Programme
A structured export support programme (on the lines of CBI-Netherland and President's Obama's flagship National Export Strategy-NEI) could be envisaged to double the number of SME exporters in next five years.

A 'difficult to refuse package of benefits' may be thrown by the Government at sectors such as Engineering, Chemicals/ Pharma, Electronics, Textiles, Leather etc. Interventions under the programme may include:

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- Deputation of short-term experts at MSMEs for training, handholding and capacity building for human resources; systems development
- B2B linkages through (overseas) market development offices & Trade fairs/ delegations
- Export finance and back office support

c. Developing SME Marketing arms

(i) Establishing Export Development Companies (EDCs)

In spite of the obvious benefits and the positive externalities of exporting, MSMEs hesitate to enter exports. They suffer from a range of handicaps owing to their small size and limited human and material resources. On top of it, developing export markets usually entails a sunk cost in exploring opportunities, taking risks while experimenting and developing new buyers. Individually, MSMEs find meeting such costs insurmountable. In Europe particularly in Italy, many MSMEs collectively form their Export marketing arms- usually termed as Export Development Companies (EDCs), to spread risk and leverage their collective strenths. Through EDCs, MSMEs can hire international trade professionals which individually they cannot afford.

It is proposed to provide financial assistance to develop hundreds of EDCs.

- A Private limited co./ SPV floated collectively by at least 10 MSMEs or cluster units (of same/ similar products/customer segment/country specific or by an association

- 25% operating cost to be borne by group of MSMEs, 75% by govt. for three years up to a Max. Rs. 50 lac

(ii) Trading houses for SMEs

Keeping in view that the average size of MSMEs are too small to bear the risks of international trade. There is a need to invite aggregators as Trading Houses - both Private and public sector, with competencies of market development and international trade and incentivized to procure goods from MSMEs for further exporting especially from the labour intensive sectors

- 5% export incentive could be given to them in the form of Duty Credit Scrips (issued under Focus Market Schemes, Focus Product Scheme and Vishesh Krishi Gramin Udyog Yojana (VKGUY))

e. India outbound scheme

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Problem

MSME exporters seldom supply to big buyers directly rather they cater to wholesalers or other intermediaries. It is not surprising that most Indian MSMEs have very little or no intelligence about their buyers and particularly of end consumers, their tastes and buying habits, state of competition and prevalent market prices. This severely limits their understanding in picking market signals and responding to threats and emerging opportunities. In absence of market intelligence, their approach to exporting remains ad hoc instead of being strategic and long term.

Major exporting nations devote enormous resources in this direction. More than 1000 European chambers, sectoral and product associations have set-up shops in China to understand local market and help their members to penetrate- mostly supported by their own governments or the EC. Back-home, dozens of foreign sectoral associations have established their offices in India too and such sectoral associations have started establishing their offices as: German Engineering Federation (VDMA) to push exports of machinery covering 14 sectors, European Business and Technology Center (EBTC)- an India specific programme entirely financed by EC to push machine/ technology exports to India; associations from Italy, Korea, Spain etc.

Proposed Solution

There is a need to address the issue both at the firm level as well as at the level of associations. The following three initiative should help:

(i) Assistance to develop forward linkages for associations

The proposed initiative could support MSME Associations to set-up offices in select markets (e.g. ASEAN, Africa..) to be permanent outposts in market of interest:

- to gather and send back home feedback on Political-Economic-Market issues from specific market segments;
- to Identify norms, standards & procedures
- to create linkages with institutions, BDS/ consultants..
- to facilitating trade delegations, participation in trade fairs, setting up companies and hiring local staff
- to have space to incubate SMEs' branch offices in initial entry phase

25% cost could be to be borne by associations, 75% by govt. for 3 yrs (max. 2 crore)

(ii) Support for making forward linkages for MSMEs

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The proposed scheme could support MSMEs in:
- Setting up show rooms, acquire sales outlets and acquire small companies that could be door openers
- Enter market through Non-Equity Modalities (NEMs) such as Franchising, Licencing (in sectors such as fast food, health and well being, Indian spices, organic food besides electronics, pharmaceuticals etc)

One time grant; 25% cost to be borne by MSMEs, 75% by govt. (max. 50 lac)

(iii) Challenge Fund for Studies/ short term interventions

Currently there is no mechanism to fund targeted, short term interventions to address contemporary issues. This is an effective financing instrument to channel public money for development. The core feature of a challenge fund is its open and competitive application progress, providing successful applicants a once-off, limited duration grant to carry out a task- Study, Research, engamenet of external Consultant to help address specific problem areas:

- Product specific studies
- Country specific studies
- Short term specific interventions to address impediments such as for Logistics, Commercial, TBTs/ NTBs; Standards etc,

Grants may be considered ranging from Rs. 5 lac to Rs. 50 lac.

f. Inland Freight subvention

Problem

Competitiveness of the MSMEs situated far away from ports stands obviously reduced by the incidence of inland freight their goods have to suffer. Over and above such units have to bear the burden of additional transit time and consequent transaction costs en-route. North Indian states – housing export clusters of engineering and auto components, leather, textiles and garments, handicrafts, furnishings etc, suffer from excessive pricing of inland haulage charged by Indian Railway's monopoly organization CONCOR.

Proposed Solution

i. A subvention may be provided/ considered on this count to extend level playing field to such units.

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ii. As CONCOR is a natural monopoly, the pricing mechanism needs to be done through an independent Regulator as in case of telecom or electricity transmission to arrive at a competitive and fair freight. Should the government needs to support OCNCOR, it could provide budgetary support.

iii. Technology and Innovation

Context

Technology Development has various connotations which may have to be addressed separately. At one end of the spectrum is technology not available easily but of great significance in the national interest. At the other end, technology required -more particularly by MSMEs- for specific processes, variants of existing products, through better machines, tools, operator skills etc. to take output quality and productivity to next level. In between obviously a vast array of technology needs exist and arise continuously.

There are a few important features that Indian MSMEs exhibit. Firstly, their scale of operations is relatively tiny and they have very low investment in plant and machinery. Though there may be reasons for this phenomenon such as limited access to funds or lack of approved industrial space. Secondly, almost all of them either work on self-fabricated machines or rely heavily on the plant and machinery supplier for their knowhow. Thirdly, their interaction with R&D institutions and specialized CSIR/ DSIR types of labs is negligible. Fourthly, conscious efforts to transfer know-how from PSUs or from large corporate sector to their MSME suppliers are conspicuous by their absence.

It is worthwhile to look at our own experience in technological development so far. Hardly any technological base for manufacturing existed at the time of independence. The government established Public sector undertakings which formed JVs with MNCs in 50s and 60s followed by aggressive vendor development which contributed immensely to technology diffusion particularly amongst MSMEs.

Further, the tax burden on acquisition of technology and knowhow is excessive. The Indian buyer of technology, has to deduct TDS ranging from 10%~25% depending upon whether the country has a Double Tax avoidance treaty or not. The seller is obviously not interested in getting the TDS deducted so the it is only the buyer who has to bear the cost. Then there is 5% R&D Cess as per Research and Development Cess Act of 1986 (Act). Finally, there is service tax12.5%!

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Proposed Solutions

- **Massive increase in outlay of CLCS scheme**
  The credit linked capital subsidy scheme is one of the most successful demand driven schemes being implemented by Ministry of MSMEs. Firstly, there is a need to enhance the outlay of the scheme manifold. If the Textile sector alone implemented technological upgradation schemes with outlay of Rs, 25000 crore, the MSME sector as a whole needs much larger outlay.

  Secondly, there is a need to discuss/ review the conditions and eligibility criteria of the scheme based on the experience with the objective of broadening the scope and enlarging its impact. Such discussion may include issues such as its linking with bank loans alone (The subsidy is not available if the entrepreneur arranges brings on her own); mechanism of enlistment of 'approved technologies' with possibility to include stakeholder representatives etc .

- **Including Tach-transfer to MSMEs as a deliverable for PSUs/Labs**
  Public Sector Undertakings and Labs under different Ministries are excellent source of technology. If explicit deliverables are articulated in the yearly MoUs these organizations sign with their respective Ministries, it could lead to a spurt in technology/ know transfer to MSMEs. Such desired indicators could be number of MSMEs assisted; number of MSME managers trained in PSUs etc.

- **Technology and Innovation Fund**
  There is a need to create a Technology and Innovation Fund to provide financial assistance ranging from Rs. 5 lac to 2 crore (to be made available to associations/ MSME collectives) for the following activities:

- Specialized focused Trade Fairs to invite technology providers/ machine suppliers from targeted countries (covering engagement of Consultants/ Experts)
- Innovation (multi-stake holder projects: 100% grant if jointly mooted by R&D institution and association)
- Training
- Funding of Research to address a technical issue
- Focus sectoral initiatives with greater funding in PPP
- Also focus non-technological innovation

A detailed scheme could be developed in consultation with stake-holders.

- **Orienting Public R&D institutions**

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There is also a need to review functioning of institutions set up with public funds to assist industry/ MSMEs in the area of technology. Some benchmarks proposed are:

- Institutions which were set up with funds from Ministry of MSMEs: 50% of beneficiaries should be MSMEs and at least 40% of business should also come from MSMEs.
- In other R&D labs/ Technology institutes, at least 25% of private sector beneficiaries should be MSMEs
- The major evaluation Criteria for R&D institutions should not be how many patents filed in an year but how many clients served

- **Comprehensive offset policy**
  Like in case of import of defence equipment, overseas suppliers to other government departments too may be put under an obligation to incur substantial percentage of their order value in Indian Rupees by way of procurement of domestic goods and services including compulsory licensing and technology transfer.

- **Harmonization of Standards**
  The multiplicity of standards for the same product has a serious implication for MSMEs. This phenomenon puts additional cost burden of accreditation with different agencies (especially Government/ PSUs), need for handling that many more inspectors etc. In effect the present situation is acting as an entry barrier for MSMEs to become vendors to major government buyers like railways, Defence and various PSUs that have specified their own standards for even ordinary products that are covered by the standards of BIS.

An inter-ministerial committee needs to be formed with BIS to address this issue.

- **Reducing Tax burden on imports of Technology/ knowhow**
  The import of technology and knowhow, in stead of machinery, needs to be encouraged. The Tax burden of TDS on such payments is an absurdity and needs to be abolished. The R&D cess is also a bad idea;the R&D institutions should learn to earn their bread and not survive on forced grants.

- **Tax incentives and subsidies to impulse technology upgradation**
  Technology development has attributes of public good. There is high risk and therefore globally technology development initiatives are incentivized to share the risk of developer. The following tax benefits could be considered:

  - R&D should be made a major imperative by providing simple methodology for encouraging investments through **self-certified tax breaks** like weighted

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deductions etc. The breaks should be available both for in-house R&D as well as on fees and on incurring expenditure on buying/sponsoring technology, R&D to government and other accredited institutions.

- Setting up of R&D labs, testing centres may be made commercially viable by **subsidizing capital expenditure**

- Expenses incurred in **scouting for technology may be subsidized** the way export marketing is.

- **Income earned from R&D/tech-transfer** activities may be exempt from payment of income tax.

Annexure-1

Duty Credit Advance Licence

The scheme may be called as Duty Credit Advance Licence having the following features:

i. To be Issued on post export basis
ii. Should be freely transferable
iii. CIF Value of advance licence should not exceed 75% of FOB Value
iv. Basis of calculation as per Standard Input Output Norms (SION)
v. Import of any of the item listed in advance licence to the extent of duty credit is permissible irrespective of CIF Value
vi. The proposed scheme is not-open ended and benefits are limited by duty credit based on FOB/CIF value obviating possibility of misuse.
vii. The scheme allows flexibility on two counts:

    a. The exporter can herself import one or all the inputs used in exported product and use the corresponding duty credit obtained through the scheme.

    b. The exporter can transfer the duty credit which could be used by any other importer in importing the inputs prescribed in the licence. It makes bundling of the smaller licences issued to MSMEs possible.

viii. Example: Basis of operation of scheme
    Item of export : X
    Fob Value : Rs1000

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Qty of Export : 1 Unit

Items Allowed as per I-O norms	Qty	CIF Value	Rate Of Duty	Amount of Duty
1 O	0.800kg	Rs. 500	20%	100
2 P	0.100kg	Rs. 100	5%	5
3 Q	0.100kg	Rs. 150	10%	15
4 R	0.100kg	Rs. 50	15%	7.5
	1.100Kg	Rs. 800		127.5

Hence Duty Credit available for utilization is Rs.127.50 for input of any or all item.

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