


# Reigniting Sustainable Growth of MSMEs in the Aftermath of Covid-19 Pandemic

This policy brief summarizes key policy recommendations from the ISID-ICSSR-UNIDO Policy Roundtable on *Reigniting Sustainable Growth of MSMEs in the Aftermath of Covid-19 Pandemic* held on July 30, 2021. The Roundtable was addressed by Dr Rajiv Kumar, Vice-Chairman, NITI Aayog; Shri S K Misra, Chairman, ISID; Prof V K Malhotra, Member-Secretary, ICSSR; Mr Rene Van Berkel, Representative of UNIDO; Mr Sivasubramanian Ramann, CMD, Small Industries Development Bank of India (SIDBI); Mr Sudhir Garg, Joint Secretary (ARI), Ministry of MSME; Prof M H Bala Subrahmanya, Management Studies, Indian Institute of Science; Dr Rajni Aggarwal, President, Federation of Indian Women Entrepreneurs (FIWE), Mr Animesh Saxena, President, Federation of Indian MSMEs (FISME), Mrs Sushma Morthania, Director-General, India SME Forum; and Dr Akhilesh Kumar Sharma, Faculty, ISID. It was moderated by Prof Nagesh Kumar, Director, ISID. The YouTube link of the Policy Roundtable is available at <https://youtu.be/hG2vtXy-wuw> 

## Introduction

The Covid-19 pandemic and related measures have led to a sharp -7.3 percent contraction in India's GDP in 2020-21. The pandemic has affected all firms. However, micro, small and medium enterprises (MSMEs), that form the backbone of the Indian economy, are key drivers of sustainable economic growth, and account for a significant share of employment and gross domestic product (GDP), have been the worst sufferers.

The MSME sector has for long been facing impediments to its growth despite several policy initiatives by the government. The major constraints to the growth of MSMEs include high informality, limited access to credit, restricted economic and social opportunities, restrained enterprise growth, shrinkage in demand, delayed payments, obsolete technology, limited access to market, and lack of availability of skilled workers. These problems are multi-dimensional in nature and require

coordinated collective action to reignite the MSME sector to achieve its potential growth in terms of output, export, and employment.

## Impact of Covid-19 on MSMEs

The ongoing Covid-19 pandemic has affected all aspects of the economy, both consumption and production demand, and has caused unprecedented disruptions in supply chains of the economy. While the pandemic has affected all firms irrespective of their size, the adverse impact on MSMEs and start-ups has been particularly severe as they are largely ill-equipped to bounce back swiftly amidst widespread job losses and livelihoods, and reduced sales and profits. Majority of MSMEs are informal, own account, and cater more to local demand with less presence on e-commerce platforms which makes them more vulnerable during the pandemic-induced-lockdown. Studies suggest that many MSMEs shut their businesses down due to the lockdown during the first phase of the pandemic while

some scaled down their operations. Many workers have lost their jobs or are working at reduced wage. With the increase in unemployment and uncertainty about the revival of the economy, demand is squeezed that has further thwarted the revival of MSMEs. Consequently, their pre-existent vulnerabilities have been accentuated by the pandemic with sharp declines in revenue. Most businesses have not returned to pre-pandemic levels of production, or sales.

Recent studies show that there are a number of underlying factors that affect the recovery processes of MSMEs. Apart from the need for finance and working capital, formulating policies under uncertainty; addressing market disruption where one doesn't know how, when, and where to sell; disruption in labour supply; additional provisions for making the workplace safe and hygienic; stranded assets, inventory, and machinery that have deteriorated and cannot be restarted; and, disruption of supply chains are among the many challenges that need to be addressed. While the large listed companies have managed to survive the pandemic and shown greater resilience, the smaller and the more vulnerable segments have not been able to keep pace with the changes and have folded in many areas, especially in the close-contact service sector. Collectively, these factors have accentuated inequitable growth.

MSMEs voices often remain unheard and their economic and social contributions are simply taken for granted. The crisis ensued by the pandemic underscores the need to treat the MSME sector with more respect and dignity and to commit to inclusive growth and sustainable recovery. In particular, the policy intervention and environment need to be such that manufacturing units can turn this necessity into an opportunity for recovery, rejuvenation, and growth based on the principles and practices of manufacturing excellence sometimes referred to as *Swachchha*

Work. This approach has three complementary angles. The first is efficiency of all inputs including materials, energy, water, and chemicals. The second is the effectiveness in terms of outputs, meeting customer demand through lean manufacturing concepts and methods. The third is maturity which relates to the firm's ability to observe, understand, predict, and adapt its business process for optimal outcomes.

### Key Government Initiatives during the Pandemic for the MSME Sector

Acknowledging the severity of the pandemic-induced crisis particularly for MSMEs, the government as well as the Reserve Bank of India (RBI) have taken several measures to help the sector to revive and recover. The key initiatives are summarised below.

- In May 2020, the Government of India announced a relief package - *Atmanirbhar Bharat* - worth Rs 20 lakh crore for the economy. For the MSME sector, the initiatives by the government included an emergency credit line guarantee scheme, loan moratorium, infusion in the equity market, launching the *Udyam* registration portal as well as focusing on employment generation through Prime Minister Employment Generation Programme (PMEGP) in selected blocks.
- The government revised the MSME definition to a composite criterion in terms of turnover and investment in plant and machinery for both manufacturing and service enterprises. More recently on July 7, 2021, the government has included the retail and wholesale trade in the MSME category. By registering on the *Udyam* portal, enterprises will be eligible for priority sector advances by financial institutions and banks. Now pandemic-affected traders can restore their businesses by getting the necessary finances from banks, and traders can

also avail immediate term finance from various schemes announced under the *Aatmanirbhar Bharat Abhiyan*.

- The RBI took several steps to ensure liquidity and provide support to MSMEs that have been hit by the pandemic. This included help to re-structure MSMEs loans to an aggregate exposure of up to 25 crores. In May 2021, the RBI permitted restructuring of the borrower account by September 30, 2021.
- Apart from these measures, the government has introduced several other initiatives which include knowledge centres, incubation centres, MSME59, TReDS platforms, and CHAMPIONS portal.

### Major Challenges faced by MSMEs

It stands uncontested that MSMEs are the backbone of the Indian economy in terms of their contribution to economy, job creation, exports, and as suppliers of essential goods and services to the government and large transnational corporations. Even though SMEs contribute significantly to GDP, they are still not regarded as a force to reckon with. The MSME sector therefore requires careful attention of academicians, policymakers, and other stakeholders as some of their challenges remain largely unmet despite government interventions. The roundtable brought out the following challenges sharply:

*Ambiguity in MSME Definition:* Defining MSMEs is important as it describes the eligibility criteria of a firm to avail benefits meant for it. The revised definition of MSMEs with effect from July 1, 2020 is based on a composite criterion of investment in plant and machinery, and total turnover excluding exports, with expanded thresholds to include much larger units. This classification has significant ramifications. For example, there are many

enterprises with export turnover between Rs 5–200 crores; these are now classified as micro units as export turnover has been excluded from total in the definition criteria. There are conflicts in the way the RBI, the Ministry of Corporate Affairs, and MUDRA loan schemes approach to support the MSME sector.

*Huge Diversity:* The MSME sector is heterogeneous and varied in nature in terms of size and structure, variety of products and services, and scale of operation. Moreover, a substantial segment is unorganised, which makes it hard for the policymakers to design and implement appropriate policies for robust growth of the sector. Hence, challenges such as absence of adequate and timely banking finance, limited capital and knowledge, low production capacity, and ineffective marketing strategy should be kept in mind while designing policies.

*Low Productivity:* In comparison to medium and large enterprises, the micro and small enterprises underperform in terms of productivity, quality, waste, affluent, emissions, work environment, safety and employment condition. This is of major concern as it means that economic and job opportunities are wasted and the health and safety of workers and communities are put at risk. Therefore, it is important to look at strategies to cover up this differential and to address the issue of low productivity of MSMEs, particularly of micro and small enterprises in the manufacturing sector.

*Limited Access to Finance:* Even as entrepreneurs devise strategies to expand their businesses, a large number of them lack access to easy and affordable credit. Micro firms are mostly proprietorships or partnerships at best; on the one hand, they do not have either inventory or assets that they could offer as collateral for financing, on the other their credit requirements are

usually liquidity requirements. So, while they are the firms that have credit needs to finance the day-to-day functioning of their business, the credit delivery mechanism is not easily available to them. Additionally, though microfinance institutions (MFIs) and non-banking financial companies (NBFCs) have performed well in terms of credit delivery to MSMEs, their cost of finance is high.

*Delayed Payments:* Despite having a law which assures payment within 45 days from the date of delivery, delayed payment continues to be a major problem for MSMEs. The TReDS platform has limited success as big companies can influence their MSME suppliers to not post invoices on the TReDS platform if they want to continue receiving orders. While most of the states have created a facilitation council for any payment related disputes, their decision is not binding. The larger companies can approach higher courts, while fighting a legal case if often not in the interest of MSMEs. These measures have thus, failed to address the challenge of delayed payments. In the present scenario, concerted efforts to enable easy cash flow and fast payments are much-needed interventions to ensure MSMEs survival.

*Poor Quality Products:* Lower spending on research and development (R&D) poses a threat to innovation, particularly for product innovation. As a result, MSMEs have poor efficiency. Delivering quality products has become increasingly important. India will have to enhance the quality of its products, by establishing modern incubation and technology resource centres where entrepreneurs can learn about new technologies and better work practices.

*Ineffective District Industries Centres:* District industries centres (DICs) provide the necessary services and support to entrepreneurs in setting up MSME units. They have a presence in each district, but over time they have not updated and

modernized as per changing needs of MSMEs. Further, their functional efficacy has reduced. Therefore, there is a need to revive DICs as they can play an important role in developing and promoting industries in the respective districts.

*High Cost of Business Operations:* Large number of big units are in or near big towns and big cities. This creates a conducive environment for the growth of other business opportunities due to the availability of better infrastructure and related resources and provides opportunities for MSME clusters to grow around them. However, this increases the cost of running small businesses as high land and labour costs impact the profit margins of MSMEs.

*Lack of Reliable Data on MSMEs:* There has been no MSME Census after 2006-07 and no survey of unincorporated enterprises after 2015-16. Moreover, there is no official data to shed light on graduation of business units among different categories such as micro, small, medium and large. It is important to know to what extent MSMEs are linked or are networked in their immediate or external ecosystem both internationally and within the country. Lack of reliable data on MSMEs hampers designing appropriate policies.

*Lack of Congruence in Policies:* Apart from the way various government schemes deem the eligibility of firms to qualify as MSMEs to avail benefits, policies for MSMEs are not congruent. For example, while the Make in India initiative aims to promote manufacturing in India, the move to include traders and retailers in the MSME category may disincentivise manufacturing enterprises if same facilities are offered to both categories. The production linked initiative (PLI) does not cover the MSME sector. It is only for the large enterprises. Small businesses are suffering because of the policy-implementation gap as well as

the lack of congruence across government initiatives. To turn intention into results, policies need to be aligned with national and development priorities to help scale-up the businesses of MSMEs.

*Information Asymmetry:* Small business owners lack an understanding of financial products and services, and banking procedures, which in turn, hinders their growth. Credit schemes to help MSMEs are also not utilised to their full extent due to lack of awareness. Lack of registration by MSMEs admits the high degree of information asymmetry about government schemes and financial literacy.

### Recommendations for Reigniting the Growth of the MSME Sector

The key recommendations that emerged in the roundtable are summarised below.

- MSMEs related policies and schemes need congruence, alignment, uniformity, and standardisation in terms of meeting the actual requirements of the sector at the ground level. It requires a coordinated approach by all the policy making authorities. MSMEs need incentives for import substitution. Discrimination in terms of importer, exporter, trader and retailer needs to be removed.
- Encourage registration of MSMEs so that formalisation of the sector can be achieved. It will enable more MSMEs to avail benefits under various promotional schemes.
- Revamp District Industries Centres (DICs) through serious administrative reforms to make them more relevant and effective. An industry-academia-government interface is required where all stakeholders can come forward and assist the revamp of DICs and help the MSME sector proactively in terms of the awareness, training, skill, resource, and facilitation. Further, these should be converted into knowledge or facility centres for MSMEs. Every district should have incubation centres with modern technological resources where any entrepreneur can learn about the new technology and best work practices at world class levels.
- Responsive and inclusive banking services for MSMEs are required. Easy availability of affordable credit without asset base collateral can help. Apart from traditional banking system, alternative approaches such as microfinance institutions (MFIs), non-banking financial companies (NBFCs), fintechs, and debt and equity markets should be explored to finance the MSME sector. At the same time, a common KYC database can be developed for lending by using digital tools such as IndiaStack. This will enable micro units to be KYC ready in a standardised format that would be acceptable to the conventional lenders.
- To address the problem of delayed payment, a platform where MSMEs can upload every invoice raised under the GSTN framework is mandated. Banks can purchase invoices and give money right away to the MSME supplier. The existing provisions under MSME Development Act 2006 to address issues pertaining to delayed payments through facilitation council are not mandatory. It was recommended that legal provision for payment of 75 percent of credit should be instituted after the verdict of facilitation council; only then can a buyer firm approach higher courts so that at least MSMEs are covered of their costs.
- Develop infrastructure in smaller towns and hinterlands to promote the shift of enterprises to smaller towns and local areas. Availability of cheaper land and labour, may reduce the operational cost of small businesses which may enhance competitiveness of MSMEs.

- Increased expenditure on R&D and innovation, particularly product innovations in order to improve the competitiveness of small firms. There is urgent need to set up a non-profit making institution under the CSIR network to bring out product innovations for MSMEs. The distance between lab and factories need to be reduced.
  - Develop strategies in collaboration with employers, employees, professionals, and associations to address the issue of underperformance and low productivity of MSMEs, particularly the micro and small enterprises for equitable and sustainable economy.
  - In the post-Covid world, the biggest challenge is to remain competitive while reducing costs and developing new products within a short time, keeping manufacturing and supply chain flexible, and improving manufacturing quality in the era of e-commerce. This can be done by setting up technology centres and promoting public-private partnership models.
  - Urgent need to have a reliable database for clearly tracking the rate of graduation across sub-categories of MSMEs, their rate of exit, inter-firm linkages, innovation, and internationalisation. A periodic survey of MSMEs is recommended. This can aid designing appropriate and timely policies.
  - Explore possibilities in CSR rules where CSR funding is available for micro sector through NGOs working in the rural areas. NGOs may come forward to channelise or mobilise availability of funds for the growth of MSMEs, particularly micro enterprises.
  - With the changing industrial landscape, there is a need for supporting MSMEs for new opportunities such as remanufacturing through waste, development of smarter villages, additive manufacturing and new areas like e-mobility, artificial intelligence, and VR based solutions.
  - MSMEs engaged in service related activities, which are around two-thirds of total MSMEs, face similar challenges as those engaged in manufacturing activities. Banking sector lacks appropriate schemes and products which promote MSMEs in the service sector. They need policy support for modernisation.
- To conclude, success and sustainability of MSMEs in a globalised economy increasingly depends on their efficiency and competitiveness. In order to be competitive, they need to be innovative, overcome resource constraints, and develop inter-firm relationships with large-scale enterprises or network with similar other MSMEs. Therefore, inter-firm linkages, innovation, and internationalisation should become the watchwords of Indian policymakers in their strategy for MSME development in the immediate future.

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