

**Report of the  
Expert Committee on  
Micro, Small and Medium Enterprises**

**June 2019**


## Letter of Transmittal

Shri Shaktikanta Das  
Governor  
Reserve Bank of India  
Mumbai 400001


Dear Sir

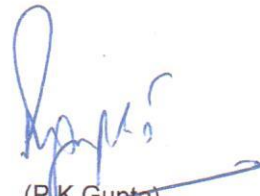
We are pleased to submit the Report of the Expert Committee on Micro, Small and Medium Enterprises. We had the privilege of working on a topic of economic and national importance. We had the occasion to interact with various stakeholders across the country and also with international experts. We sincerely thank you for entrusting this responsibility to us. We hope the recommendations of the Committee will go a long way in furthering the growth and development of the MSME sector.

Yours sincerely,

  
(U K Sinha)  
Chairman

  
(Ram Mohan Mishra)  
Member


  
(Pankaj Jain)  
Member

  
(P K Gupta)  
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## ABBREVIATIONS

AA	Account Aggregators
ADB	Asian Development Bank
AIF	Alternative Investment Fund
ANBC	Adjusted Net Bank Credit
APCTT	Asian and Pacific Centre for Transfer of Technology
API	Applications Programming Interface
APSL	Adjusted Priority Sector Lending
ASPIRE	A Scheme for Promotion of Innovation, Rural Industries & Entrepreneurship
BIRAC	Bio-technology Industry Research Assistance Council
BMO	Business Membership Organisation
CERSAI	Central Registry of Securitisation Asset Reconstruction and Security Interest of India
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CGFMU	Credit Guarantee Fund for Micro Units
CLCSS	Credit Linked Capital Subsidy Scheme
CPSE	Central Public Sector Enterprise
CSIR	Council of Scientific and Industrial Research
CSR	Corporate Social Responsibility
DC MSME	Development Commissioner MSME
DFS	Department of Financial Services
DIC	District Industries Centre
DRDO	Defence Research and Development Organisation
DSA	Direct Selling Agents
DST	Department of Science and Technology
EAP	Entrepreneurship Awareness Programme
EDC	Enterprise Development Centre
e-KYC	Electronic-Know Your Customer
FinTech	Financial Technology
FLC	Financial Literacy Centre
GDP	Gross Domestic Product
GeM	Government e-Marketplace
GoI	Government of India
GST	Goods and Services Tax
GSTN	Goods and Services Tax Network
GVA	Gross Value Added
IBBI	Insolvency and Bankruptcy Board of India
IBC	Insolvency and Bankruptcy Code
ICAR	Indian Council of Agricultural Research
IFC	International Finance Corporation
IGP	Innovators Growth Platform
IRAC	Income Recognition and Asset Classification
IU	Information Utility
KVIC	Khadi and Village Industries Commission

KYC	Know Your Customer
LLP	Limited Liability Partnership
LSP	Loan Service Providers
MDA	Market Development Assistance
MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MLI	Member Lending Institution
MSE-CDP	Micro and Small Enterprise Cluster Development Programme
MSEFC	Micro and Small Enterprises Facilitation Council
MSME	Micro, Small and Medium Enterprises
MSMED Act	Micro, Small and Medium Enterprises Development Act, 2006
MSME-DI	MSME Development Institute
MUDRA	Micro Units Development and Refinance Agency Ltd.
NBC	Net Bank Credit
NBFC	Non-Banking Financial Company
NCGTC	National Credit Guarantee Trustee Company Ltd.
NCLT	National Company Law Tribunal
NDP	Net Domestic Product
NIF	National Innovation Foundation
NITI	National Institution for Transforming India
NMCP	National Manufacturing Competitiveness Programme
NPA	Non-Performing Asset
NRDC	National Research Development Corporation
NRLM	National Rural Livelihood Mission
NSIC	National Small Industries Corporation
NSS	National Sample Survey
PAN	Permanent Account Number
PCR	Public Credit Registry
PMEGP	Prime Minister's Employment Generation Programme
PMJAY	Pradhan Mantri Jan Arogya Yojana
PMJJBY	Pradhan Mantri Jeevan Jyoti Bima Yojana
PMMY	Pradhan Mantri MUDRA Yojana
PMSBY	Pradhan Mantri Suraksha Bima Yojana
PSE	Public Sector Enterprise
PSL	Priority Sector Lending
PSS	Priority Sector Shortfall
PSU	Public Sector Undertaking
PTC	Pass Through Certificate
QMS	Quality Management Standards
QTT	Quality Technology Tools
RBI	Reserve Bank of India
RIA	Registered Investment Adviser
RRB	Regional Rural Bank
RSETI	Rural Self-Employment Training Institute
SARFAESI Act	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
SCB	Scheduled Commercial Bank
SFB	Small Finance Bank

SFURTI	Scheme of Fund for Regeneration of Traditional Industries
SFC	State Financial Corporation
SGST	State Goods and Service Tax
SIDBI	Small Industries Development Bank of India
SME	Small and Medium Enterprise
SPV	Special Purpose Vehicle
STPI	Software Technology Parks of India
TAT	Turn Around Time
TCO	Technical Consultancy Organisation
TDB	Technology Development Board
TIFAC	Technology Information Forecasting and Assessment Council
TReDS	Trade Receivables Discounting System
UAM	Udyog Aadhaar Memorandum
UIDAI	Unique Identification Authority of India
VC	Venture Capital
ZED	Zero Effect Zero Defect

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The Committee benefitted from the interactions which the Chairman had with Shri Nitin Gadkari, Minister of MSME; Shri Arun Jaitley, former Finance Minister; Shri N K Singh, Chairman of the Fifteenth Finance Commission; Shri Shaktikanta Das, Governor, Reserve Bank of India; Shri Subhash Garg, Secretary, Department of Economic Affairs, Ministry of Finance; Shri Rajeev Kumar, Secretary, Department of Financial Services, Ministry of Finance; Shri Arun Kumar Panda, Secretary, Ministry of MSME; and Shri Junaid Ahmad, Country Director, World Bank (India). The Committee is also grateful to Shri Ramesh Abhishek, Secretary, DPIIT, Ministry of Commerce & Industry; Shri Amarjeet Sinha, Secretary, Ministry of Rural Development; Shri Yaduvendra Mathur, Special Secretary, NITI Aayog; and other representatives of Ministries and organisations who made presentations before the Committee.

The Committee invited submissions from members of the public and is grateful for a number of helpful suggestions received.

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## **PREFACE**

Micro, Small and Medium Enterprises form a vital component of the Indian Economy. The Government and Reserve Bank of India have taken a number of measures from time to time to support this sector. A number of committees appointed by the Government/RBI have identified issues and made recommendations in the past. Many of these recommendations have guided different policy initiatives. However, MSMEs continue to face challenges of formalization, access to knowledge services, access to timely and adequate finance, improving competitiveness, availability of skilled man-power, access to latest technology and marketing. The MSME sector is yet to benefit from the advances in digitization, which can substantially reduce the cost and time for this sector. SHGs and rural entrepreneurship have made very good progress in the last few years, but creating the environment for the next stage of their growth is a task yet to be accomplished. The sector was also affected in the recent past due to structural changes in the economy. In this backdrop, Reserve Bank of India constituted the present Expert Committee on MSMEs to undertake a comprehensive review of the sector and to identify causes and propose long-term solutions, for their economic and financial sustainability.

The Committee held fifteen meetings, had consultations with industry associations and State Governments across the country. It met representatives of Central Government in different ministries and several experts and other stakeholders. The Committee also examined the experiences in other countries. Inputs received during these discussions have considerably helped the Committee in its deliberations. The Committee has looked into areas of capacity building, policy changes and financing needs so as to unlock the potential of this sector.

I hope that RBI and the Government will find proposals made in the report useful.

U K Sinha  
Chairman

## EXECUTIVE SUMMARY

1. Micro, Small and Medium Enterprise (MSME) sector has emerged as a very important sector of the Indian economy, contributing significantly to employment generation, innovation, exports, and inclusive growth of the economy. The MSMED Act, 2006, was enacted to provide enabling policy environment for promotion and development of the sector by way of defining MSMEs, putting in place a framework for developing and enhancing competitiveness of the MSME enterprises, ensuring flow of credit to the sector and paving the way for preference in Government procurement to products and services of the MSEs, address the issue of delayed payments, etc. However, in the changed circumstances, it is imperative that the thrust of this important legislation should be focused more on market facilitation and promoting ease of doing business for MSMEs. Accordingly, the legislation may be reimagined as a comprehensive and holistic MSME Code having a provision for sunset on plethora of complex laws scattered all over the legislative framework. Under this new law, the territorial jurisdiction based and arbitrary inspection system may be substituted with a policy based and transparent inspection system. It is expected that the new law will be able to address the major challenges, relating to physical infrastructural bottlenecks, absence of formalisation, technology adoption, capacity building, backward and forward linkages, lack of access to credit, risk capital, perennial problem of delayed payments, etc. These problems are hindering the development of a conducive business environment for expansion of the sector. The Committee noted that a thriving entrepreneurial eco-system is a policy imperative for realizing the potential of the sector and ensuring sustainable growth of the sector.

2. Global trends in classifying the MSMEs show that it widely differs across jurisdictions and depends upon the government policies of the country. Though, a comparison of some of the countries revealed that most of them are using number of employees as a variable to define MSMEs, in India, MSMEs are presently defined based on investment in plant and machinery / equipment. To facilitate ease of doing business, the Government has proposed turnover based definition by replacing the current investment-based definition of MSMEs. The Committee deliberated upon the proposed definition and found it rational, transparent, progressive and easier to implement with the introduction and operationalization of Goods and Services Tax (GST). Further, the registration under GST has also led to formalization of the sector to a certain extent. The Committee also felt that in view of the need to adjust the definition criteria from time to time in the context of the changing economic scenario, the Parliament may consider delegating the power of classifying MSMEs to the Executive.

3. MSEs face problems of delayed payments and hesitate to enforce the legal provisions available to them under the MSMED Act due to their low bargaining power. As timely payments to MSEs is of least priority to the buyers, the solution must be necessarily designed around the buyers. The Committee recommends amendment to the MSMED Act requiring all MSMEs to mandatorily upload all their invoices above an amount to be specified by Government, from time to time, to an Information Utility. Further, a monitoring authority should be set up under DC MSME and should be notified under IBBI IU Regulation No. 23. While this mechanism will entail automatic display of the names of the defaulting buyers, it will also act as a moral suasion on the buyers to release payment to MSE suppliers. Further, majority of the States have only one MSE Facilitation Council (MSEFC) which is not adequate to cater to delayed payment cases arising in the entire State. Hence, there is a need to increase the number of Facilitation Councils particularly in larger States.

4. As per the MSMED Act, Government has notified procurement policy wherein PSUs/ Government Departments have to make 25% of their procurement from MSEs. To further strengthen the procurement mechanism, the Government has also launched the GeM portal. The Committee recommends that Government should make it mandatory for PSUs/ Government Department to procure from MSEs up to the mandated target of 25% through the GeM portal only. Further, the portal can be developed as a full-fledged market place enabling MSE sellers to procure raw-material as well. The Committee also recommends that the General Financial Rules (GFR) and Departmental Procurement Codes/ Manuals, as the case may be, be amended to prohibit placing of purchase orders in excess of the annual budget approved by the Legislature/ Government.

5. Presently, MSMEs must do multiple registrations with various entities such as Udyog Aadhaar portal, GSTN, NSIC, etc. This leads to cumbersome registration process and duplication of efforts. It is, therefore, recommended that the Government should make PAN as a Unique Enterprise Identifier (UEI) and the same should be used for various purposes like procurement, availing government sponsored benefits, etc.

6. Enabling environment, encompassing tax concessions, well developed infrastructure, ease of doing business, exit policy, etc. available in other countries is incentivising the Indian startups to migrate. It is recommended that suitable financial and non-financial incentives must be deployed to retain successful Indian startups entities in India.

7. Capacity building of the entrepreneurs is an essential pre-requisite for development of the sector as it equips the entrepreneurs with the necessary knowledge and wherewithal to function. It has been proposed to establish Enterprise Development Centres (EDCs) within District Industries Centres (DICs) in each district. These institutions should be strengthened to be able to run professionally and facilitate development of entrepreneurs into full-fledged, self-sustaining enterprises. Support extended to these entities by national and state level SPVs for knowledge creation and dissemination will be crucial for their success. The Committee observed that such a step, if implemented, effectively would provide necessary handholding support in various aspects such as technical know-how, managerial skill, filling up of the knowledge gap, etc., leading to a multiplier effect. They should also be equipped to assist rural enterprises in respect of GST, IT, UAM registration, PAN application, loan document preparation, etc.

8. Presently, MSME clusters are inadequately equipped in areas such as tool rooms, innovation centres, testing facility, etc. The Committee recommends that these clusters should collaborate with companies having innovation infrastructure, R&D institutions and universities that specialize in a specific industry or knowledge area. Most cluster development initiatives are funded to a large extent by the public agencies and private sector contribution for such common initiatives is miniscule. It is recommended that ways and means to enhance private sector contribution must be found, viz., through debt instruments like bonds, CDs, etc., with tax incentives through SIDBI, so that larger number of clusters can be supported.

9. MSMEs lack expertise in product development, technology adoption and marketing strategy. To alleviate these problems, it is recommended that Government should build networks of development service providers that can provide customized solutions to MSMEs in the area of technology, product development and marketing techniques. Further, the Committee recommends for strengthening of MSME Export Promotion Council.

10. Ministry of MSME may consider setting up of a Non-Profit Special Purpose Vehicle (SPV) to support crowd sourcing of investments by various agencies particularly to pave the way for conducive business ecosystem for MSMEs. Further, for convergence of policies and creating a promotional ecosystem, it is recommended that a National Council for MSMEs should be set up at the apex level under the Chairmanship of the Prime Minister with the Ministers for MSME, Commerce & Industry, Textiles, Food Processing, Agriculture, Rural Development, Railways and Surface Transport being members. The States should have a similar State Council for MSMEs, for better co-ordination of developmental initiatives.

11. SIDBI is the apex body responsible for the development of the MSME sector. The Committee has made wide ranging recommendations for expanding the role of SIDBI. The Government should deploy the PSL shortfall to SIDBI on the lines of RIDF fund of NABARD, for lending to State Governments as soft loans for infrastructural and cluster development. SIDBI should deepen credit markets for MSMEs in underserved districts and regions by handholding private lenders such as Non-Banking Finance Companies (NBFCs) and Micro Finance Institutions (MFIs). Further, they must develop additional instruments for debt and equity which would help crystallise new sources of funding for MSMEs and MSME lenders such as first loss guarantees, Pass Through Certificates (PTCs), etc. SIDBI should gradually take on the role of a market maker for SME debt on select platforms.

12. SIDBI, as a nodal agency, should ideally play the role of a facilitator to create platforms wherein various Venture Capital Funds can participate and in turn create multiplier effect for providing equity support to MSMEs. A Government sponsored Fund of Funds (FoF) to support VC/PE firms investing in the MSME sector should be set up to encourage them to invest in the MSME segment.

13. Insolvency and Bankruptcy Code provides for a differentiated regime for insolvency / bankruptcy of firms, proprietary firms and individuals. Delegated legislation/ rules in this regard are currently under discussion. The finalization of these rules can boost lender confidence because lenders will have more certainty and predictability regarding the recovery of defaulted loans. Considering their vulnerability and size, Insolvency Code / delegated legislation should provide for out-of-court assistance to MSMEs, who are predominantly proprietorships, such as mediation, debt counselling, financial education, etc.

14. The Committee recommends for the creation of a Distressed Asset Fund, with a corpus of ₹ 5000 crore, structured to assist units in clusters where a change in the external environment, e.g. a ban on plastics or 'dumping' has led to a large number of MSMEs becoming NPA. This fund could then operate on the lines of the Textile Upgradation Fund Scheme (TUFS) which has been in existence over many years. This would be of significant size in order to make equity investments that help unlock debt or help revive sick units.

15. Credit guarantee is an important risk mitigating tool which provides cushion to the lender for lending to MSEs. Currently, CGTMSE and NCGTC have devised credit guarantee schemes for MSE loans. However, these entities are currently outside the purview of regulation. It is, therefore, recommended that all Credit Guarantee Schemes should be subject to the regulation and supervision of RBI. While framing the regulatory and supervisory guidelines RBI can draw upon the well acknowledged principles for design implementation and evaluation of Public Credit Guarantee Schemes for SMEs, which has been evolved by the World Bank Group.

16. MSMEs lack the wherewithal to cope with situations like natural calamities. Government should take active efforts to provide insurance coverage to MSME employees on the lines of PMSBY and PMJJBY schemes. Workers at urban and rural formalised MSEs need to be specifically covered under Ayushman Bharat - PMJAY.

17. The Committee observed that MUDRA would require enhancement of in-house (or outsourced) capabilities, including underwriting, risk management, fund raising based on its own AAA rating and sharper focus on emerging trends in the market. Hence, a reimagining of MUDRA is necessary including assessing the rationale for continuing it as a subsidiary of SIDBI. The Committee further recommends that SHG enterprises may be brought under the purview of MUDRA's guarantee programme.

18. With the increased availability of data from several sources, including GSTN, Income Tax, Credit Bureaus, Fraud Registry, etc., it is now possible to do most of the due diligence online and appraise the MSME loan proposals expeditiously. It is recommended that banks should have access to such surrogate data for speedier and robust credit underwriting standards.

19. The PSBLoansIn59Minutes portal as of now caters only to existing entrepreneurs having information required for in-principle approval such as GSTIN, Income Tax returns, bank statement, etc. The Committee recommends that the portal should also cater to new entrepreneurs, who may not necessarily have such information, including those applying under PMMY loan and Standup India. A timeline of 7 – 10 days needs to be fixed for disposal of applications, which have received in-principle approval and threshold of loan should be enhanced upto ₹5 crore. Further, the portal should be linked with land records, CERSAI and CGTMSE.

20. The traditional bank lending system by banks is based on financial statements and collateral of the borrower. Operationalization of GSTN has made available turnover related data. Further, when Account Aggregators (AA) gets operationalized, lenders will have access to borrowers' transactions at a single point. These new architectures would facilitate cash flow-based lending. It is, therefore, recommended that banks need to move towards cash flow-based lending.

21. TReDS is an effective mechanism to solve the problem of delayed payments and liquidity issues of MSMEs. The Committee deliberated upon scaling up of the platform and recommends for creation of pooled API of all TReDS platforms providers that would enable the financiers to understand the past repayment history of buyers thus enabling them to take more informed decisions. It will also rule out the possibility of dual financing. National Payments Corporation of India (NPCI) which acts as settlement entity for TReDS may consider creating such an API. The Committee observed that reverse factoring has not picked up on the platform, which needs to be promoted due to its inherent advantage. It is, therefore, recommended that a second TReDS window should be created for reverse factoring so that supplier financing can be provided easily. The Committee was apprised that GeM and TReDS platforms have worked out collaborative arrangement whereby invoices, which have a certificate of acceptance, will be put up for discounting on TReDS platform through an integrated system. This will enable the bill to be discounted, the PSE will get time to make the payment and the MSME supplier will get funds. The integration of GeM and TReDS needs to be completed within a time bound manner.

22. The PSL guidelines apply uniformly to all the lenders and mandates specific targets to banks to lend to priority sectors, i.e. agriculture, small and marginal farmers, micro enterprises, weaker sections, etc. The Committee recommends introducing a concept of adjusted PSL to enable the banks to specialise in lending to a specific sector. This will be a win-win situation for both lenders and borrowers as lenders will have the advantage to build expertise in lending to the specific sector and borrowers will benefit from customised financial products and services.

23. As per RBI's extant guidelines issued in 2010, banks are mandated not to seek collateral security for loans upto ₹10 lakh. Considering price rise, the Committee recommends to revise the collateral free loan limit to ₹20 lakh. The same should also apply to loans sanctioned under PMMY and to SHG based enterprises.

24. In order to provide loan portability in a seamless manner to MSMEs, the Committee recommends that RBI should come out with measures on portability of MSME loans with a lock in period of one year.

25. The Committee considered that there is a case for increasing the exposure limit of ₹5 crore for Regulatory Retail to at least ₹7.5 crore, which can benefit a large number of MSMEs.

26. With a view to reduce the credit gap, a new intermediary i.e., Loan Service Providers (LSPs) – who will be an agent of the borrowers is recommended for consideration by RBI. Further, the Committee recommends that the RBI should facilitate the creation of a Self-Regulatory Organization, on the lines of AMFI and RIAs, to organize and provide light touch regulation for this category of players. The LSPs will offer individualized advice and should act in borrowers' best interests, respecting fiduciary duties of disclosure, loyalty and prudence.

27. The Committee recommends for creation of Digital Public Infrastructure that will have the potential to reduce loan operating costs significantly. Furthermore, it will address information asymmetry that improves credit access and overall quality in the lending space. Under the Digital Public Infrastructure, deployment of E-Liens will lock the future incoming cash flows and would lead to better repayment rates.

## 1 INTRODUCTION

### 1.1 Background

1.1.1 Micro, Small and Medium Enterprises (MSMEs) are amongst the strongest drivers of economic development, innovation and employment. The MSME sector also contributes in a significant way to the growth of the Indian economy with a vast network of about 63.38 million<sup>1</sup> enterprises. The sector contributes about 45% to manufacturing output, more than 40% of exports, over 28% of the GDP while creating employment for about 111 million<sup>2</sup> people, which in terms of volume stands next to agricultural sector. The MSME sector in India is exceedingly heterogeneous in terms of size of the enterprises and variety of products and services, and levels of technology employed. However, the sector has the potential to grow at a faster pace. To provide impetus to the manufacturing sector, the recent National Manufacturing Policy envisaged raising the share of manufacturing sector in GDP from 16% at present to 25% by the end of 2022.

1.1.2 In order to enable identification and facilitate development of MSMEs, Government of India had enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. Prior to the enactment of this act, small industries encompassed tiny, cottage, traditional, and village enterprises and MSEs in India were collectively termed as Small Scale Industries (SSIs) under the Industrial Development and Regulation (IDR) Act, 1951. The MSMED Act, 2006 has provided the legal framework for identifying the concept of 'enterprise' which includes entities both in manufacturing and service sectors and has categorized the enterprises into three tiers viz., Micro, Small and Medium.

1.1.3 The definition of small scale industries differs from country to country as the classification is based on different parameters viz., turnover, number of employees, etc. Under the Industrial Development and Regulation (IDR) Act, 1951, the notion of small industries in India was conceived in terms of number of employees. In absence and difficulty in obtaining reliable data on number of employees, investments in plant & machinery / equipment was suggested as a proxy. Currently, the classification of MSMEs is done based on investment in plant & machinery/equipment in accordance with the provision of Section 7 of MSMED Act, 2006, as indicated below:

Table I : Definition of MSME		
Classification	Manufacturing Enterprise (Investment in Plant and Machinery)	Service Enterprise (Investment in Equipment)
Micro	Upto ₹25 lakh	Upto ₹10 lakh
Small	Above ₹25 lakh to ₹5 crore	Above ₹10 lakh to ₹2 crore
Medium	Above ₹5 crore to ₹10 crore	Above ₹2 crore to ₹5 crore

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<sup>1 & 2</sup> Annual Report Ministry of MSME 2017-18

## **1.2 Major Challenges faced by the sector**

The contribution of the sector in the economy is currently constrained due to several challenges affecting growth of the sector. Some of the major ones are mentioned below:

### **1.2.1 Policy and institutional interventions**

In order to provide support to the MSME sector and to facilitate its growth, there are numerous institutions in the country. At the apex level, the Ministry of MSME formulates policies for overall growth of the sector while the Office of Development Commissioner MSME implements these policies through its various organisations. MSMED Act, 2006 contains various facilitative provisions for the promotion and development of the MSME sector. SIDBI is the apex financial Institution for supporting financing and development of MSMEs. RBI and SEBI frame broad policies for facilitating funding support to the sector. The above institutions through their legislative and policy interventions are enabling growth of the sector. However, formulation of targeted policies in the areas of infrastructure development, formalisation, technology adoption, backward and forward linkage, credit gap reduction and timely payments to MSMEs and their effective implementation has been a challenge for all the stakeholders. Government interventions have tended to be fairly supply-side oriented and unable to effectively respond to demands of the market.

### **1.2.2 Accelerating growth and enabling formalisation**

The role of MSME sector is critical in job creation, innovation, and entrepreneurship and supply chains. Hence, there is a need to facilitate, nurture and support innovative business ideas and shape them into enterprises. Further, with limited number of entrepreneurial development and incubation centres, entrepreneurial ethos of the MSME eco- system is not evolving. Utilisation and reach of various schemes and credit support is constrained due to lack of formalisation and low level of registration of MSMEs in Udyog Aadhaar Memorandum (UAM). Promoting formalisation and digitisation amongst MSMEs and encouraging them to register in UAM has remained a challenge.

### **1.2.3 Addressing infrastructural bottlenecks**

Infrastructural bottlenecks affect the competitiveness of MSMEs and reduces their ability to venture into domestic as well as global markets. Inadequate availability of basic amenities such as work sheds, tool rooms, product testing laboratories, electricity, rural broadband and innovation hubs is acting as a deterrent to the growth of the sector. Development of MSME clusters has been largely confined to Government organisations with low level of private investment.

### **1.2.4 Facilitating capacity building**

Traditionally, MSMEs are subject to severe information asymmetry problems. Lack of information about various schemes for instance, deprive MSMEs from availing benefits offered by Government, banks and other agencies. Access to information about market opportunities is sub optimal and unstructured. In many cases, they also lack managerial, legal and technical knowhow and the necessary wherewithal to function effectively.

### 1.2.5 Facilitating access to credit and risk capital

Due to their informal nature, MSMEs lack access to formal credit as banks face challenges in credit risk assessment owing to lack of financial information, historical cash flow data, etc. Further, very few MSMEs are able to attract equity support and venture capital financing.

### 1.2.6 Technological interventions for improving underwriting standards and delivery

Implementation of GST has made turnover data available at a single network. However, MSMEs are not identifiable as the data on investments in plant and machinery is not captured under GSTN. Income tax data base contains information relating to financials of the units. On the other hand, Udyog Aadhaar portal contains registration related information of MSMEs. However, there is no single interface available for the lenders to access, map or triangulate data from these data sources and they have to primarily rely upon manual information furnished by borrowers. Further, absence of data protection laws and unique enterprise identifier limit ability of various agencies to share data.

### 1.2.7 Enabling market linkage and tie-up with public procurement platforms

MSMEs face the twin challenge of limited access to quality raw material and market for finished product. National Small Industries Corporation (NSIC) through market assistance scheme facilitates MSMEs to discover markets for their products and the Government e-Marketplace (GeM) portal has enabled MSMEs to connect with buyers from Public Sector Undertakings (PSUs) and Government Departments. However, the number of MSMEs availing benefits under the schemes are few. For example, the GeM portal has 38,609 registered MSMEs on the platform as on June 12, 2019.

## 1.3 Need for a Committee

1.3.1 The Government and RBI have taken several initiatives and measures to address the issues faced by MSMEs. However, the sector remains informal and vulnerable to structural and cyclical shocks, at times with persistent outcomes. Further, an increasingly globalized world, marked by competition and innovation is posing newer and varied challenges to the MSMEs. The increasing stress in the sector is a matter of concern and therefore, it was felt imperative that a comprehensive review should be undertaken of the entire MSME ecosystem along with global best practices for suggesting measures for a holistic development of the sector. For this, an all-inclusive approach was necessary to be adopted with special focus on appropriate policy and institutional interventions, accelerating incubation and enabling formalisation, addressing infrastructural bottlenecks, facilitating capacity building, enabling access to risk capital, credit and technological interventions for improving underwriting standards and delivery, supporting market linkage and tie-up with public procurement platforms, etc.

1.3.2 Towards this end, it was announced in the Fifth Bi-Monthly Monetary Policy Statement for 2018 -19, dated December 5, 2018, that RBI will constitute an Expert Committee on Micro, Small and Medium Enterprises to propose long term solutions, for the economic and financial sustainability of the MSME sector. As an outcome to this announcement, an Expert Committee was constituted under the Chairmanship of Shri U K Sinha with the following terms of reference:

- i. To review the current institutional framework in place to support the MSME sector;
- ii. To study the impact of the recent economic reforms on the sector and identify the structural problems affecting its growth;
- iii. To examine the factors affecting the timely and adequate availability of finance to the sector;
- iv. To study the global best practices with respect to MSMEs and recommend its adoption in India, wherever appropriate;
- v. To review the existing MSME focused policies and its impact on the sector;
- vi. To propose measures for leveraging technology in accelerating growth of the sector;
- vii. To suggest long-term solutions for the economic and financial sustainability of the MSME sector.

1.3.3 The Committee comprises of the following:

i	Shri U K Sinha Former Chairman, Securities and Exchange Board of India	Chairman
ii	Shri Ram Mohan Mishra Additional Secretary, Development Commissioner MSME	Member
iii	Shri Pankaj Jain Additional Secretary, Department of Financial Services, Ministry of Finance	Member
iv	Shri P K Gupta Managing Director, SBI	Member
v	Shri Anup Bagchi Executive Director, ICICI Bank	Member
vi	Shri Abhiman Das Professor, IIM-Ahmedabad	Member
vii	Shri Sharad Sharma Co-Founder, iSPIRT Foundation	Member
viii	Ms. Bindu Ananth Chair, Dvara Trust	Member
ix	Smt. Surekha Marandi Executive Director, Reserve Bank of India	Member- Secretary

#### 1.4 Approach / Methodology

The Expert Committee held fifteen meetings in various parts of India between January 2019 and June 2019. The details of the meetings are given in Annex I. During these meetings, the Committee interacted with all stakeholders including representatives of Ministries of Central, / State Governments Departments, NITI Aayog, MP Finance Corporation, Industry Associations, and MSME borrowers to deliberate on the issues of the sector and get suggestions for its improvement. The Committee also met representatives from SEBI, TransUnion CIBIL, GSTN, SIDBI, A-TREDS, CRISIL, Acuite Ratings & Research Ltd., Capital Float, LetsVenture, Omidyar Network India, etc., to understand their role in promoting growth of the sector. Further, the Committee had consultation with Multilateral Organization like World Bank and IFC to get cross country experience related to development of MSME sector. The Committee deliberated on the

various issues relating to its terms of reference. Various presentations were made to the Committee by the experts. The major findings and the recommendations of the Committee are discussed in the chapters that follow.

### **1.5 Structure of the Report**

The Report has nine chapters apart from Executive Summary. Chapter 1 provides an introduction outlining the role of the sector and its issues leading to the constitution of the present Committee. Chapter 2 presents growth in MSME sector under various parameters. Chapter 3 briefly outlines the success stories of various models adopted in other countries for the sector that are relevant for India. Chapter 4 deals with various legislations and Institutional framework for MSME sector. Chapter 5 touches upon the Infrastructural bottlenecks and capacity building for the sector. Chapter 6 deals with Government Schemes for the sector. Chapter 7 deals with various issues related to credit for the sector. Chapter 8 covers the new technological interventions required for MSME lending and Chapter 9 contains summary of recommendations.

## 2 GROWTH IN MSME SECTOR

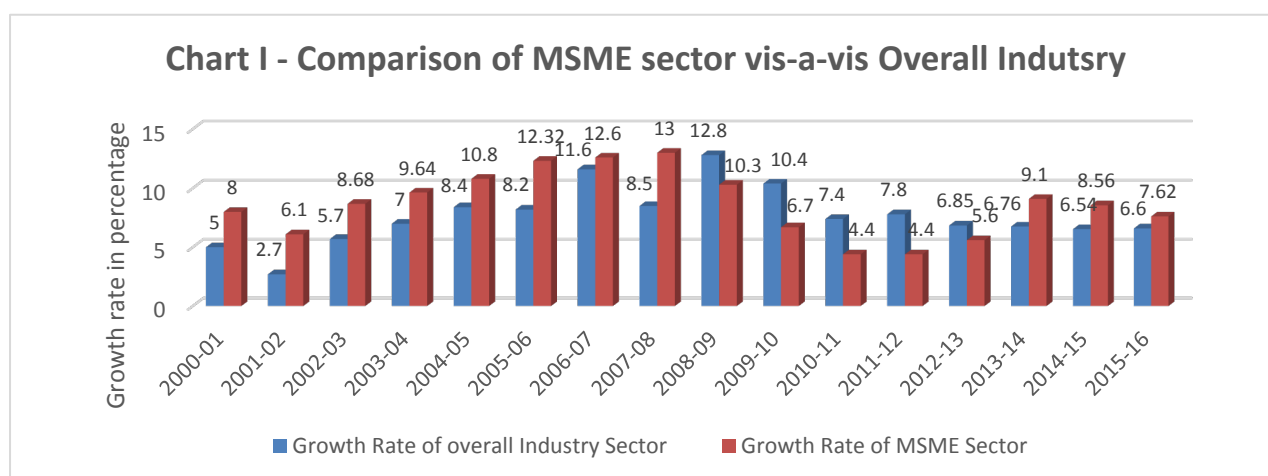
The MSME sector is universally regarded as an engine of economic growth and for promoting equitable development. The sector also helps the economy by promoting a balanced development of industries across all regions of the nation. The major advantage of the sector is its employment potential at low capital cost. <sup>3</sup>Small and Medium enterprises (SMEs) account for about 90 percent of businesses and more than 50 percent of employment worldwide. They are key engines of job creation and economic growth in developing countries.

### 2.1 Growth Pattern of MSMEs in India

India is currently one of the fastest growing economies of the world. MSME sector is likely to continue to play a significant role in the growth of the Indian economy. In the last ten years, MSME sector has shown impressive growth in terms of parameters like number of units, production, employment, and exports. Given the right set of support systems and enabling framework, this sector can contribute much more, enabling it to actualize its immense potential.

### 2.2 Growth rate of MSME Sector in comparison with the Overall Industrial Sector

MSMEs provide employment opportunities at comparatively lower capital cost and act as ancillary units for large enterprises to support the system in growth. Chart I depicts the growth rate of MSME sector in comparison with the overall industrial sector during last sixteen years. The MSME sector has in many years registered a higher growth rate than the overall growth of industrial sector.



Source: Annual Reports of Ministry of MSME

During 2000 to 2006, India witnessed industrial growth in the range of 5-8% annually. Subsequently, it recorded double digit growth for 4-5 years, before slowing down to around 6% growth during 2015-2016. The MSME sector improved its growth performance during 2003 – 2009 and recorded a growth of over 10% during 2008-09. Introduction of MSMED Act, 2006 apparently played a role here. However, post 2008 global financial crisis, MSME growth fell sharply and hovered around 4-7%.

<sup>3</sup> IFC Issue Brief / Small and Medium Enterprise

## 2.3 Contribution of MSMEs in Indian Economy

2.3.1 MSMEs have been contributing significantly to the expansion of entrepreneurial base through business innovations. MSMEs are widening their domain across sectors of the economy, producing diverse range of products and services to meet demands of domestic as well as global markets. There are over 6000<sup>4</sup> products ranging from traditional to high-tech items, which are being manufactured by the MSMEs in India.

2.3.2 As per the latest data available with Central Statistics Office (CSO), Ministry of Statistics & Programme Implementation (MoSPI), the contribution of MSME Sector in the country's GVA and GDP, at current prices for the last five years is given in Table II:

Table II: Contribution of MSMEs in Country's Economy at Current Price (in ₹ crore)						
Year	MSME GVA	Growth (%)	Total GVA	Share of MSME in GVA (%)	Total GDP	Share of MSME in GDP (%)
2012-13	2977623	15.27	9202692	32.36	9944013	29.94
2013-14	3343009	12.27	10363153	32.26	11233522	29.76
2014-15	3658196	9.43	11481794	31.86	12445128	29.39
2015-16	3936788	7.62	12458642	31.60	13682035	28.77

Source: Annual Report Ministry of MSME 2017-18

The contribution of the MSME sector to India's GDP remained stagnant around 30% in recent years. GVA of MSMEs decelerated marginally during the same period.

2.3.3 As a close proxy of the dimension of the diversity of MSME sector, composition of establishments and number of persons employed by broad activity groups, with break-up for each type of establishment based on 6th Economic Census is presented in Table III. <sup>5</sup>Retail trade', 'Manufacturing' and 'Other service activities not elsewhere classified (including membership organization, repair of computers and personnel household goods)' are the three most important activity groups in terms of number of establishments in the non-agricultural sector. Together these three activity groups account for 67% of the total establishments, of which 'retail trade' held a share of over 35%.

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<sup>4</sup> Annual Report of Ministry of MSME 2017-18

<sup>5</sup> Retail and Wholesale trade are not classified under MSME as per the notification issued by Ministry of MSME

Table III: Distribution of total number of establishments and number of persons employed by broad activity groups								
Broad Activity Code	Establishments				Employment			
	Without Hired Workers	With at least One Hired Worker	Total	% Distribution	Without Hired Workers	With at least One Hired Worker	Total	% Distribution
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
01 AOCP	474044	167435	641479	4.89	683441	678187	1361628	5.95
02 LS	10368736	1021590	11390326	86.74	16527898	2890544	19418442	84.86
03 FL	558790	43677	602467	4.59	1081388	143421	1224809	5.35
04 FA	427712	69589	497301	3.79	588971	288651	877622	3.84
<b>Agricultural Activities</b>	<b>11829282</b>	<b>1302291</b>	<b>13131573</b>	<b>100.0</b>	<b>18881698</b>	<b>4000803</b>	<b>22882501</b>	<b>100.0</b>
05 MQ	40859	44317	85176	0.19	62192	495282	557474	0.51
06 MFG	7219067	3110755	10329822	22.77	10350625	20006648	30357273	28.00
07 EGS	15770	45571	61341	0.14	20996	523246	544242	0.50
08 WS	96117	80531	176648	0.39	116164	301746	417910	0.39
09 CONS	661887	311661	973548	2.15	786982	1543112	2330094	2.15
10 WRTM	504902	515613	1020515	2.25	634701	2034926	2669627	2.46
11 WT	500227	446281	946508	2.09	674196	1810175	2484371	2.29
12 RT	12005744	4058743	16064487	35.41	14990489	12201983	27192472	25.08
13 TS	2356802	645066	3001868	6.62	2587850	2459405	5047255	4.66
14 AFS	1462745	981728	2444473	5.39	2048745	4038161	6086906	5.61
15 IC	167594	176674	344268	0.76	205720	1651173	1856893	1.71
16 FIN	427218	341903	769121	1.70	838251	1999971	2838222	2.62
17 RE	354707	85565	440272	0.97	402116	300345	702461	0.65
18 PROF	294596	268963	563559	1.24	355706	1229080	1584786	1.46
19 ADM	398579	317698	716277	1.58	502934	1565911	2068845	1.91
20 EDU	356687	1681267	2037954	4.49	482196	10114156	10596352	9.77
21 HSW	410620	572398	983018	2.17	521939	2975615	3497554	3.23
22 AESR	129022	113473	242495	0.53	210025	404733	614758	0.57
23 OTH	2731579	1430857	4162436	9.18	3475304	3488568	6963872	6.42
<b>Non-Agricultural Activities</b>	<b>30134722</b>	<b>15229064</b>	<b>45363786</b>	<b>100.0</b>	<b>39267131</b>	<b>69144236</b>	<b>108411367</b>	<b>100.0</b>
01 - Activities relating to agriculture other than crop production & plantation(AOCP); 02 – Livestock (LS); 03 - Forestry and Logging (FL); 04 - Fishing and aqua culture (FA); 05-Mining and Quarrying(MQ); 06-Manufacturing (including repair& installation of machinery and equipment)(MFG); 07-Electricity, gas, steam and air conditioning supply(EGS); 08-Water supply, sewerage, waste management and remediation activities(WS); 09-Construction(CONS); 10- Wholesale trade, retail trade & Repair of motor vehicles and motorcycles(WRTM); 11-Wholesale trade(WT); 12-Retail Trade(RT); 13-Transport and storage (including postal and courier activities)(TS); 14-Accommodation and food								

service activities(AFS); 15-Information and Communication (including computer programming, consultancy and related services)(IC); 16Financial and insurance activities(FIN); 17-Real estate activities(RE); 18-Professional, scientific and technical activities (including advertisement, market research and veterinary activities)(PROF); 19-Administrative and support service activities (including travel agency, employment activities, security services, activities of call centers and organization of conventions and trade shows)(ADM); 20Education(EDU); 21-Human health and social work activity (including residential and non-residential care centers)(HSW); 22-Arts, entertainment, sports and amusement and recreation (excluding illegal gambling and betting activities)(AESR); 23-Other service activities not elsewhere classified (including membership organization, repair of computers and personnel household goods)(OTH).

Source: The Sixth Economic Census, 2014, CSO.

2.3.4 As per the National Sample Survey (NSS) 73<sup>rd</sup> round, conducted by National Sample Survey Office (NSSO), MoSPI, during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities excluding the MSMEs registered under (a) Sections 2m(i) and 2m(ii) of the Factories Act, 1948, (b) Companies Act, 1956 and (c) Construction activities falling under Section F of National Industrial Classification (NIC) 2008. Table IV shows the distribution of MSMEs category wise.

Table IV: Number of MSMEs category wise				
Activity Category	Estimated Number of Enterprises (in lakh)			Share (%)
	Rural	Urban	Total	
Manufacturing	114.14	82.50	196.65	31
Trade	108.71	121.64	230.35	36
Other Services	102.00	104.85	206.85	33
Electricity*	0.03	0.01	0.03	0
All	324.88	309.00	633.88	100

Source: Annual Report of Ministry of MSME

\*Non-captive electricity generation and transmission and distribution by units not registered with the Central Electricity Authority

2.3.5 MSMEs require low capital to start the business, but create huge employment opportunities. As per the National Sample Survey (NSS) 73<sup>rd</sup> round conducted during the period 2015-16, MSME sector has been creating 1109 lakh jobs (360.41 lakh in Manufacturing, 387.18 lakh in Trade and 362.22 lakh in Other Services and 0.07 lakh in Non-captive Electricity Generation and Transmission) in the rural and the urban areas across the country. Table V shows activity- wise distribution of employment generated by MSMEs.

Table V: Estimated Employment in MSME Sector (Broad Activity Category Wise)				
Broad Activity Category	Employment (in lakh)			Share (%)
	Rural	Urban	Total	
Manufacturing	186.56	173.86	360.41	<b>32</b>
Trade	160.64	226.54	387.18	<b>35</b>
Other Services	150.53	211.69	362.22	<b>33</b>
Electricity*	0.06	0.02	0.07	<b>0</b>
<b>All</b>	<b>497.78</b>	<b>612.10</b>	<b>1109.89</b>	<b>100</b>

Source: National Sample Survey (NSS) 73<sup>rd</sup> round 2015-16

## 2.4 SME Employment share of select Asian Economies

As per the data of ADB 2015 report, the share of the workforce employed by SMEs varies greatly over countries. It ranges from 32% to 88% as shown in Table VI.

Table VI: SME Employment share of select Asian Economies			
Country	SME employment as a share of	SME share* (%)	Year
Republic of Korea	Enterprise employment	88	2012
Thailand	Enterprise employment	80	2014
Bangladesh	Nonagricultural employment	75	2014
Cambodia	Enterprise employment	72	2014
Japan	Enterprise employment	70	2012
China	Industry employment	65	2011
Philippines	Enterprise employment	64	2013
Singapore	Total Employment	68	2012
Malaysia	Total Employment	65	2014
Vietnam	Total Employment	47	2012
Sri Lanka	Total Employment	35	2013
Kazakhstan	Total Employment	32	2014

\*Decimal points rounded off

Source: Asian Development Bank (ADB), 2015

## 2.5 Comparison of MSME export to total exports

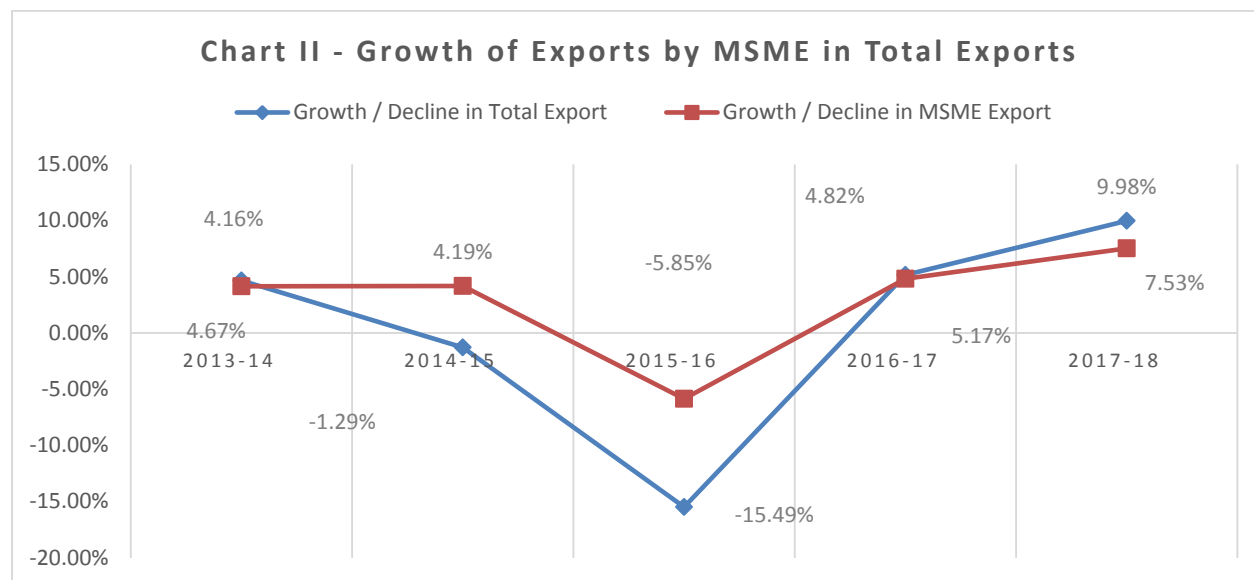
2.5.1 The MSME sector in India is contributing more than 40% to exports. It can be seen from the Table VII below that the share of MSME exports has increased from 43% in 2012-13 to 49% in 2017-18.

Table VII: Share of MSME exports in total exports (Amount in USD Million)			
Year	Total Exports	Exports by MSME	Share of MSME Exports *(%)
2012-13	300400	127992	43
2013-14	314415	133313	42
2014-15	310352	138896	45
2015-16	262291	130768	50
2016-17	275852	137068	50
2017-18	303376	147390	49

\*Decimal points rounded off

Source: RBI & Press Information Bureau/Directorate General of Commercial Intelligence and Statistics. (DGCIS)

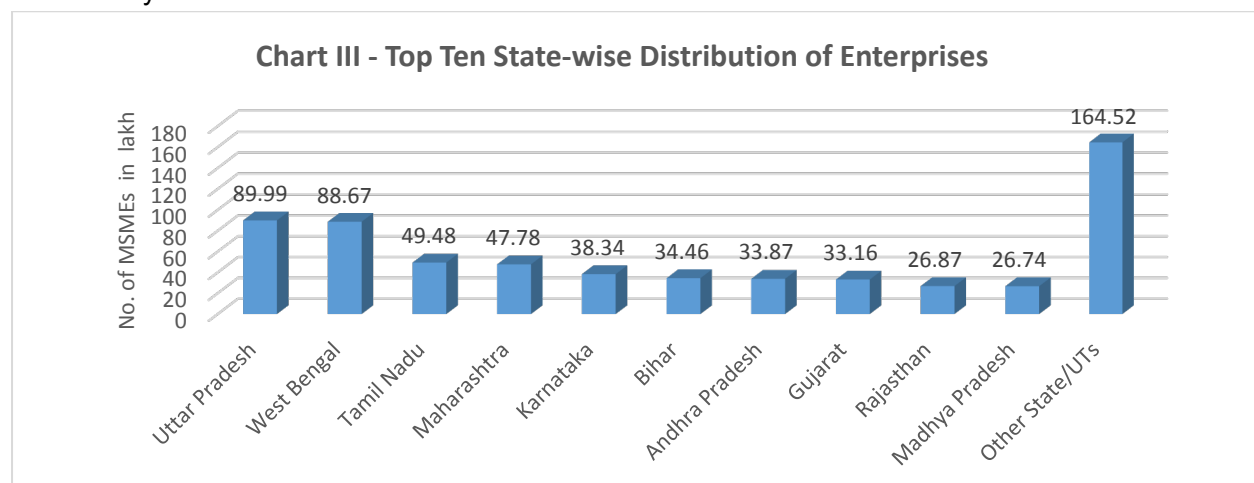
2.5.2 Further, the trend in growth of MSME exports is in line with the total exports of the country. As can be seen from Chart II, MSME exports grew by 4.19% in 2014-15, which declined to -5.85 % in 2015-16. During the same period total exports also declined from -1.29% to -15.49%. During 2016-17 and 2017-18 there was positive growth in case of both MSME exports and total exports.



Source: RBI & Press Information Bureau/Directorate General of Commercial Intelligence and Statistics. (DGCIS)

## 2.6 State-wise distribution of estimated MSMEs

In India, MSMEs are concentrated mainly in top ten states. Nearly 93% of enterprises comes from these ten States. Chart III shows the distribution of estimated enterprises in top ten States. It can be seen that Uttar Pradesh has the largest number of estimated MSMEs with a share of 14.20% of MSMEs in the country. West Bengal comes a close second with a share of 14%. The top ten States together accounted for a share of 74% of the total estimated number of MSMEs in the country.



Source: Annual Report 2017-18 Ministry of MSME

## 2.7 Registration of New MSMEs

2.7.1 One of the critical indicators to assess the successful development of the MSME Sector in an economy is the data on opening of new MSMEs; it depicts the conducive environment provided for the sector to grow. Before the MSMED Act, 2006, there was a system of registration by small scale industrial units to the District Industries Centre (DICs). Subsequently, as per the provisions of the MSMED Act, 2006, MSMEs used to file Entrepreneurs Memorandum (Part-I) at DICs before starting an enterprise. After commencement of production, the entrepreneur concerned used to file Entrepreneurs Memorandum (Part-II)/ [EM-II]. A total of 21,96,902 EM-II filings took place between 2007 and 2015.

2.7.2 Since September 2015, with a view to promoting ease of business, an online filing system under UAM based on self-declared information has been put in place. Till June 12, 2019, 68.98 lakh MSMEs have already registered on the Udyog Aadhaar Portal. This topic has been discussed in detail in Chapter 4 on – Legislation and Institutional Support.

## 2.8 MSME Census

A brief write up on MSME Census is given in Box I

### Box I - MSME Census data

Reliable data in respect of MSMEs continues to pose a challenge. There are primarily two data bases which provide data for MSME sector – All India Economic Census (conducted by CSO, MoSPI), the latest being the Sixth Economic Census, 2013 and All India MSME Census, the fourth and the last such census was carried out in 2006-07 (Conducted by DCMSME). The Economic Census provides the frame and thus works as principal mechanism for conducting the MSME Census. The Economic Census provides data on establishment basis and includes various establishments some of whom are not MSMEs as defined by the Ministry of MSME. For instance, traditionally establishments engaged in wholesale/retail trade, legal, educational & social services, hotel & restaurants, transports and storage & warehousing (except cold storage) were not considered under the MSME umbrella. This sectoral coverage issue has been a major concern for not using Economic Census data to study the growth and development of the MSME sector.

After the fourth MSME Census in 2006-07, there has been no census. Much of the extrapolation has relied upon data on new registration. As a part of ease of doing business, the registration process was simplified with the introduction of Udyog Aadhaar in 2015. It is an Aadhaar based electronic platform and requires a few basic entries including PAN details. Registration certificate is also issued electronically. At the same time, MSME Ministry has also introduced a Data Bank, through which data on basic parameters of MSME developments like turnover, number of employees, etc. are being collected. Both Udyog Aadhaar and the Data Bank are useful initiatives to address the data issues of MSME sector. However, both need further work. Establishments relating to retail trade have been registered under Udyog Aadhaar. It is proving difficult to conclusively distinguish if Udyog Aadhaar registered establishments are from MSME sector only. Similarly, being voluntary in nature, one cannot authenticate the quality of data filed in the Data Bank.

Recently GSTN has opened up another opportunity to boost the data of MSME sector. Based on turnover threshold, firms provide useful data on their performance. However, currently MSMEs are not recognized under GSTN as the existing definitions of MSMEs based on plant and machinery investments are not captured. Besides, there are many MSMEs which fall below the turnover thresholds. Therefore, in its present structure, GSTN data cannot provide necessary data for studying the MSME sector.

MSME sector is the most dynamic sector of the economy. Administrative data collected through the Data Bank initiative should be validated by independent surveys every 3 years. This data collection should be handled by the Ministry of MSME itself. Tagging the data collection to Economic Census of CSO, MoSPI may not serve the purpose. At the same time, there is a need to review the Udyog Aadhaar system so that development of the sector is monitored on real time basis.

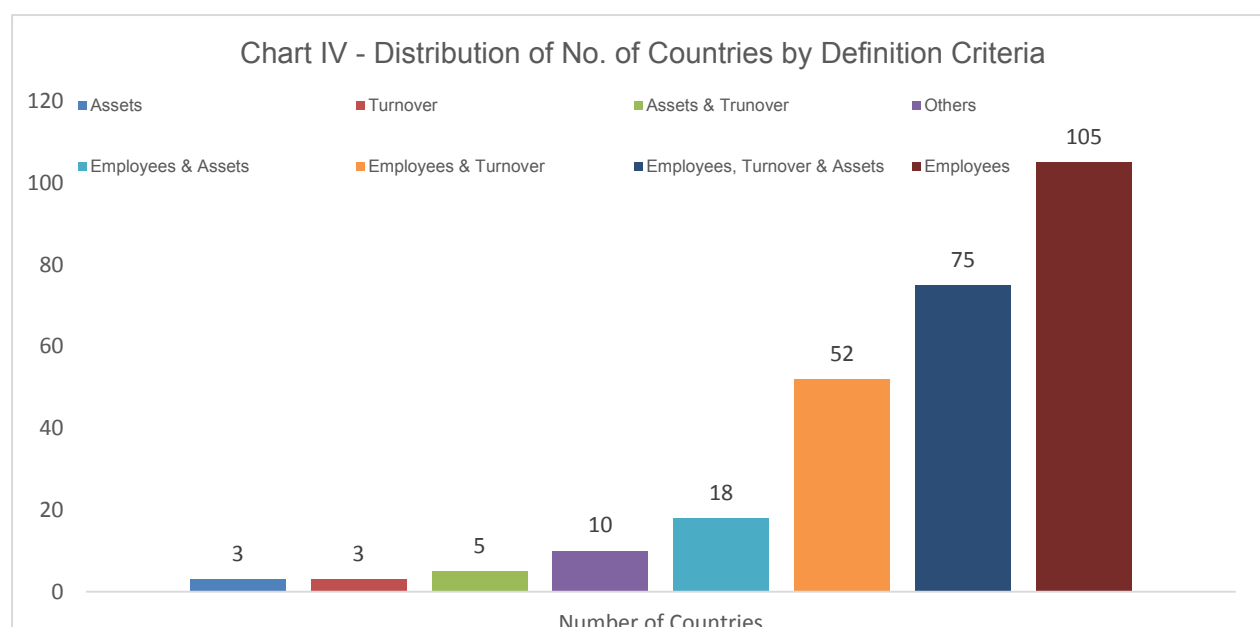
### 3 GLOBAL BEST PRACTICES

Development of a dynamic MSME sector is perceived as a policy priority in both developed and emerging economies. A few successful and effective MSME models adopted by various countries have been identified in the areas related to Definition of MSMEs, Credit Guarantee, Single Nodal Entity, Cluster Development, Risk Capital Financing, Capacity Building, etc. In this context, the models adopted in Italy, Malaysia Turkey, Mexico and China are very relevant.

#### 3.1 Global trends in classifying MSMEs

3.1.1 The definition of MSMEs differ widely across countries due to heterogeneity in MSMEs themselves as well the economy specific issues in which they operate. According to the World Bank definition, a business is classified as MSME when it meets two of the three criteria viz., employee strength, assets size, or annual sales.

3.1.2 As per IFC (2014) report, among the 267 definitions used by different institutions in 155 economies, the most widely used variable for defining an MSME is the number of employees (92 % of the analysed definitions utilize this variable). Other variables commonly found in MSME definitions are turnover as well as value of assets (49% and 36%, respectively). Overall, 11% (out of 267) of the analysed definitions make use of alternative variables such as loan size, formality, years of experience, type of technology, size of the manufacturing space, and initial investment amount, among others. However, most of the countries are using only one variable to define MSMEs. Chart IV below shows the distribution of number of countries by their definitions of MSMEs.



Source: MSME Country Indicators, IFC

3.1.3 A brief description of criteria used by countries to define SMEs is shown in Table VIII. It also gives an account of acts/policies under which SMEs are defined in different countries and measures to promote their growth.

Table VIII - Criteria used by countries to define SMEs				
Economy	Number of employees	Capital/ Assets	Turnover/ Sales	Act/ Law/ Policy
Bangladesh	✓	✓		Industrial policy announced in 2005
Brazil	✓			SEBRAE
China	✓	✓	✓	SME Promotion Law of China, 2003
European Union	✓	✓	✓	European Commission Recommendations, May 6, 2003
Japan	✓	✓		The Small and Medium Enterprise Basic Law, 1999
Malaysia	✓		✓	SME Corporation, Malaysia, 2014
United Kingdom	✓	✓	✓	Companies Act, 2006
United States	✓		✓	The Small Business Act of July 30, 1953

Irrespective of how MSMEs are defined, many countries have put in place institutions, systems or processes which open up possibilities for learning and replication. Some of these are highlighted below:

### 3.2 United States

Small Business Administration (SBA) - Set up under the Small Business Act of 1953, SBA acts as a nodal, independent agency of the federal government. Through an extensive network of field offices and partnerships, the SBA assists and protects the interests of small businesses. Helping in starting, building and growing businesses, creating jobs and serving as the voice for small businesses by providing an advocacy role are some of the key functions of SBA. It plays various roles to help the small businesses by providing access to capital, entrepreneurial development, access to government contracts and fostering a small business friendly environment by reducing unfair regulatory burdens.

### 3.3 Italy

Cluster Development - Italy has been considered as the leader of cluster development. Although there is strong competition among firms, often there is also a high degree of cooperation among firms which is famously known as 'Competition by cooperation'. In this system, the production processes are divided into distinct phases with separate firms responsible for different phases. The competitive advantages of SMEs grouped in clusters are based on three aspects 'specialization, cooperation and flexibility'. The advantage of specialization is related to individual firms, but also to the cluster as a whole. Furthermore, local infrastructure and training institutions become increasingly specialized in the cluster activity. Cooperation amongst firms also help them to be flexible in terms of type of production by grouping different contractors together according to the specialties required in the product.

### 3.4 Colombia

Equity Financing - Colombia has advanced in recent years on structuring financing instruments that address needs at different stages of a company's life cycle. In the area of seed financing, the National Learning Service (SENA) manages the Emprender Fund, which over 2005-14, has supported 4,141 projects and allocated USD 137.1 million in seed capital resources, generating 19,723 jobs. A number of new financing instruments are also being introduced, with the creation of networks of angel investors and capital funds.

### 3.5 Malaysia

3.5.1 Central Coordinating Agency - SME Corporation Malaysia is the Central Coordinating Agency (CCA) under the Ministry of Entrepreneur Development Malaysia (MED) that coordinates the implementation of SMEs development programmes across all related Ministries and agencies. It ensures that financial assistance schemes by all relevant ministries and government agencies are monitored for their effectiveness in facilitating SMEs to progress up the value chain. It acts as the central point of reference for research and data dissemination on SMEs and entrepreneurs, as well as provides business advisory services for SMEs.

3.5.2 Development Policies - SME Master Plan 2012-20 has set four goals, to increase business formation, expand number of high growth and innovative firms, raise productivity and intensify formalization. The Action Plan has 32 initiatives with six High Impact Programmes (HIPs):

- i. Integration of Business Registration and Licensing to create a single registration point.
- ii. Technology Commercialization Platform (TCP) in order to establish a national network to promote innovative ideas.
- iii. SME Investment Partner (SIP) to provide early stage financing.
- iv. Going Export (GoEx) Programme to offer customized assistance to new exporters and SMEs venturing into new markets.
- v. Catalyst Program for human capital development.
- vi. Inclusive Innovation to empower the bottom 40% of income group.

### 3.6 Turkey

Turkish Economy Bank (TEB) SME Academy provides guidance to SMEs trying to expand their businesses through its free training and workshop programs and leads SMEs to gain more success and income. Some of the programs conducted by the Academy relates to Corporate Development Training Programs, Business Analysis Workshop, Strategic Management Workshop for SMEs Management and Planning Workshop for Foreign Trade.

### 3.7 Mexico

The state-owned Nacional Financiera (NAFIN) is one of the well-recognised models of the Mexican Development Bank that operates receivables financing platform. It also provides contract financing which is explained in Box II.

#### **Box II - The Nacional Financiera (NAFIN) Factoring Program in Mexico - Contract Financing**

Contract Financing provides financing that allow creditors to buy raw materials to complete new orders and is an example of how factoring can be extended to provide pre-delivery financing. This product provides financing to suppliers up to 50% of confirmed contract orders from big buyers with NAFIN supply chains, with no fees or collateral, and a fixed rate. Suppliers permitted to use this product must be recommended by a buyer, based on a strong performance history (e.g. no returns or late deliveries) and a stable average balance of receivables over time. Suppliers that receive contract financing must sign a contract with NAFIN stipulating that the supplier will factor its receivables to NAFIN when its goods are delivered and the buyer posts a negotiable document to its NAFIN website. NAFIN factors the negotiable document and takes as payment the amount of the negotiable document equal to the outstanding line of credit plus interest.

### **3.8 Brazil**

Government Procurement - Brazil is not a signatory to the WTO Agreement on Government Procurement (GPA). Under the national law, all government tenders up to R\$80,000 in value must be granted exclusively to small and micro enterprises and 25% of the contract value of those tenders with a value exceeding this threshold, must be reserved for micro-enterprises and small companies (MPes). In addition, 30% of subcontracts from large and medium businesses are to go to small and micro enterprises. Micro and small enterprises would also be favoured with an allowance up to 10% difference in price between the small or micro enterprise's price and the medium or large firm's price. The government uses demand driven procurement approach in which it buys from SMEs, while at the same time providing technical assistance in all phases of the businesses involved in procurement. The government does not purchase from individual SMEs but through associations of small manufacturers.

### **3.9 China**

3.9.1 To fast forward the SME sector growth, the Chinese government came out with a law on SME promotion in 2003, which provided the legal basis for government involvement in the promotion of the SME sector. The SME Promotion Law emphasizes on fair treatment and level playing field for SMEs. The Law also ensures greater access to finance and encouragement to venture capital investments in SMEs.

3.9.2 Credit Guarantee Agencies - Recognizing the limited access to finance to MSMEs, the Chinese Government has created a network of credit guarantee agencies. In contrast to other countries, China does not have a centralized government institution providing credit guarantees to MSMEs. From 203 in the year 2000, the number of guarantee organizations is reported to have increased to 4800 at the end of 2010. Operating at either the provincial level or the city level, about two thirds of these companies are privately owned, while others are either fully or partly owned by local governments. The amount of SME loans, guaranteed by the credit guarantee companies, has increased rapidly since 2000.

3.9.3 Industrial Clusters - China has also witnessed rapid growth of industrial clusters in accordance with the principles of socialization, specialization and market-orientation. Three important features of these clusters are small products but big markets; small enterprises but large-scale cooperation and small clusters but great achievements. The cluster economy is made up of professional towns and villages functioning as production hubs, with one or more towns focusing on one product enabling economies of scale. Some areas have set up large-scale specialized production and marketing, which shows great potential for success. This essentially illustrates the concept of - one village, one product or —one town, one industry as exemplified by provinces like Jiangsu, Zhejiang, and Guangdong. The concentration of production of certain products in these areas has given rise to such catch phrases as Shengze textiles, Hengshan sewing machines, Ningbo costumes, Wenzhou shoes, Shaoxing synthetic textiles, Haining leather coats, Yiwu small commodities, Yongkang hardware, to name a few. Local government units provide an enabling environment through appropriate policies and regulations as well as vital infrastructure, which are essential for business. Shenzhen's

Municipal Government has made it a priority to encourage more innovation led startups for which they have introduced several financial incentives which are given in Box III.

### **Box III - Financial Incentives - Shenzhen's Success Story**

Shenzhen is a technology hub in China. Of late, Shenzhen has become the favorite of budding high-tech startups. Global giants such as Tencent & DJI also call it home. There is a high concentration of high-tech talent not just because of the city's predominant industry - hardware manufacturing but also because the city spends over 4% of its GDP on Research and Development. Shenzhen's government is also doling out several incentives to lure more tech startups and foreign talent to the city.

Shenzhen's Municipal Government has made it a priority to encourage more innovation led startups to be based out of the city. And, to further this goal it has introduced several financial incentives. For instance, Shenzhen's "Peacock Initiative" awards an average of USD 3 Million to teams with deep tech talent. Subsidies are available for teams engaging in startup businesses in the fields of IT, new-gen IT, biology, new energy, energy conservation, new materials, environmental protection, marine sciences, aerospace engineering, health, robotics, wearable equipment, smart equipment, and other emerging industries. This could be availed by both foreign nationals and Chinese citizens alike.

Shenzhen Municipal Government is offering a series of subsidies of up to USD 450,000 for foreign talents in possession of a Permanent Residence Permit. This is mostly earmarked for the individuals with excellence in STEM (Science, Technology, Engineering, and Mathematics) areas. Further subsidies cover spouse's employment expenses, education for children, residence permits of both the beneficiary and dependents, medical care, social insurance, and tax. In 2016 alone, Shenzhen attracted 10,509 talented people with overseas education background through financial incentives and housing subsidies.

## **4 LEGISLATION & INSTITUTIONAL SUPPORT SYSTEM**

### **4.1 Legislations/ Acts relating to MSMEs**

4.1.1 Government and regulators through various legislations and directives have attempted to create a conducive environment for development of MSME sector. One of the major steps in this direction was enactment of the MSMED Act, 2006. The Act defines enterprises as MSME based on value of investment in plant and machinery / equipment to enable focused policy interventions in this sector. Further, provisions of the Act facilitate MSMEs in terms of public procurement, delayed payment, marketing support, etc. It also empowers Central and State Government to establish institutions for promotion of MSMEs.

4.1.2 With the passage of time, new challenges have emerged and the composition of economic activities has undergone a change. For instance, the services sector has gained greater importance within GDP. MSMEs in services have increased in number and range of activities, formalisation of MSMEs has increased, value chains have become longer, payment systems have become electronic, alternate data is being used for lending decisions and so on. Changing realities of the economy and the MSME sector necessitate concomitant amendments in the MSMED Act and a review of what it should aim to achieve.

#### **4.1.3 Recommendation**

*The MSMED Act, 2006 may be reimagined as a comprehensive and holistic MSME Code having a provision for sunset on plethora of complex laws scattered all over the legislative framework. Under this new law, the territorial jurisdiction based and arbitrary inspection system may be substituted with a policy based and transparent inspection system. The major challenges are related to physical infrastructural bottlenecks, as well as other complexities like absence of formalisation, technology adoption, capacity building, backward and forward linkages, lack of access to credit and risk capital as well as a perennial problem of delayed payments. This may also include sunset clauses on inspections.*

### **4.2 Definition of MSMEs**

Across the world, MSMEs are defined in different ways based on various criteria viz., turnover, investment in assets and number of employees. In India, MSMEs are defined based on investment in Plant and Machinery / equipment. In terms of Chapter III – 7 (1) of MSMED Act, 2006, MSMEs are classified into Manufacturing and Service Enterprises and are defined as mentioned in Table - I.

#### **4.2.1 Issues relating to existing definition**

Definitions based on investment limits in plant and machinery/ equipment were decided when the Act was formulated in 2006 and does not reflect the current increase in price index of plant and machinery / equipment. Furthermore, MSMEs due to their informal and small scale of operations

often do not maintain proper books of accounts and hence find it difficult to get classified as MSMEs as per the current definition.

#### 4.2.2 Proposed Definition

Presently, Government of India has proposed to classify MSMEs based on turnover as mentioned below:

- i. A micro enterprise will be defined as a unit where the annual turnover does not exceed five crore rupees;
- ii. A small enterprise will be defined as a unit where the annual turnover is more than five crore rupees but does not exceed seventy-five crore rupees;
- iii. A medium enterprise will be defined as a unit where the annual turnover is more than seventy-five crore rupees but does not exceed two hundred and fifty crore rupees.

#### 4.2.3 Recommendation

*The Committee deliberated upon the proposed turnover based definition of MSMEs with various Ministries, Associations and other Stakeholders. The Committee also debated the merits of an employment-based definition and recognized that while this was an additional feature preferred in some countries, this definition would pose challenges in implementation. The proposed definition has been considered progressive and suitable because of introduction of Goods and Services Tax (GST). Under the new tax regime, turnover details of enterprises are being captured by Goods and Services Tax Network (GSTN) and turnover declared by GST registered MSME units can be easily verified through GSTN. Hence, turnover based definition would be transparent, progressive and easier to implement. It would also help in removing the bias towards manufacturing enterprises in the existing definition and would improve the ease of doing business. The Committee also felt that in view of the need to adjust the definition criteria from time to time in the context of changing economic scenario, the Parliament may consider delegating the power of classifying MSMEs to the Executive.*

### 4.3 Delayed Payments to MSMEs

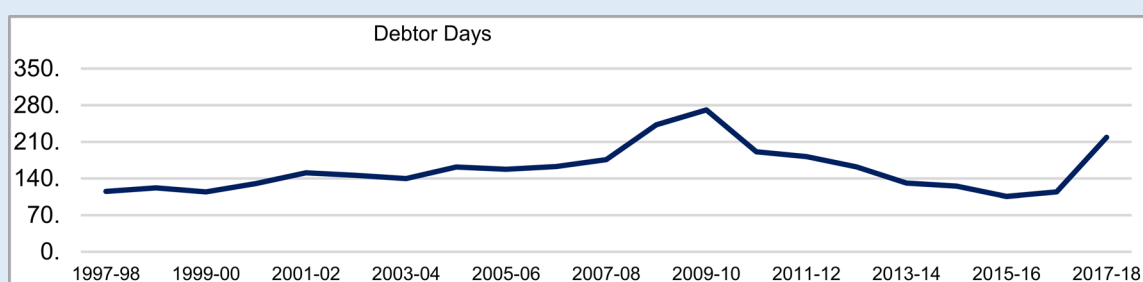
4.3.1 To solve the problem of delayed payments of small-scale (Micro and Small) sector, Delayed Payments Act was promulgated on April 2, 1993. In MSMED Act, 2006, the provisions of Delayed Payments Act, have been strengthened and the following provisions have been made:

- i. The buyer must make payment to the supplier on or before the date agreed upon between him and the supplier in writing or, in case of no agreement, before the appointed day.
- ii. The period agreed upon between the supplier and the buyer shall not exceed forty-five days from the date of acceptance or the day of deemed acceptance. In case the buyer fails to make payment of the amount to the supplier, he shall be liable to pay compound interest with monthly rests to the supplier on the amount from the appointed day or, on the date agreed on, at three times of the Bank Rate notified by Reserve Bank.
- iii. MSEs face problems of delayed payments due to lower bargaining power. The analysis of delayed payments is given in Box IV.

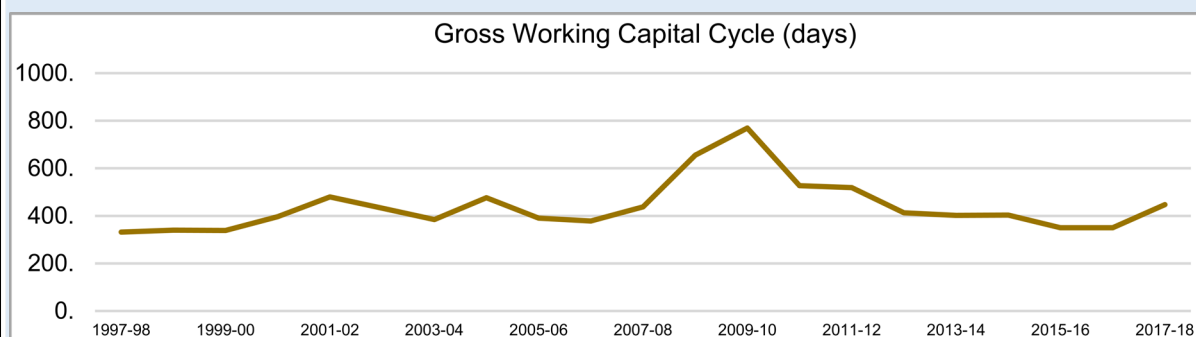
#### Box IV - Analysis of Delayed Payments

Despite such rigorous provisions, MSEs face problems of delayed payments because of low bargaining power not only from corporates but also from PSUs and Government Agencies, both Central and State which adversely affects their working capital cycle/requirements and ultimately affects their operational efficiency. Though there is very little empirical basis supporting this argument an attempt was made by the Committee to work out the average debtor days from 1997-98 to 2017-18. The estimate has been based on Prowess, CMIE data (in absence of any other credible data source). The database considered has 15,000-20,000 companies, each year, of which the smallest size class (10<sup>th</sup> decile) have been used to get close parity with the definition of MSMEs. Around 1500-2000 companies are in the smallest size (10<sup>th</sup> decile) class across years. Size classes are defined using net fixed assets value which is a kind of proxy for investments in plant and machinery.

The data clearly shows that average debtor days of the MSMEs is quite large and it has been consistently running over 90 days as given below:



The gross working capital cycle (days) has also been estimated for these firms as given below. It is over 300 days always (very high). While higher debtor days contributes to the high working capital cycle, high inventory turnover ratio and very small bandwidth available from the creditor (as measured by creditor turnover ratio) make things worse.



#### 4.3.2 Micro and Small Enterprises Facilitation Council (MSEFC)

With a view to solve the delayed payments issue of MSEs a provision had been made in the MSMED Act, 2006 for setting up of Micro and Small Enterprises Facilitation Council (MSEFC). As per Chapter V, Section – 20 of the Act, the State Government shall, by notification, establish one or more Facilitation Councils. The Council examines the case filed by MSE unit and issue directions to the buyer unit for payment of due amount along with interest as per the provisions under the MSMED Act. However, the mechanism of facilitation council has not been uniformly effective primarily because of the limited bargaining power of the MSEs and the fear of retaliation from the buyers. In order to expedite the disposal of cases, the Ministry of MSME has launched MSME Delayed Payment Portal – MSME Samadhaan for empowering MSEs across the country

to directly register their cases relating to delayed payments by Central Ministries/Departments/CPSEs/State Governments. These will be viewed by MSEFC for their actions. Total number of cases filed with MSEFC and reported on the Samadhaan portal as on June 14, 2019 is given in Table IX:

Table IX - Total number of cases filed with MSEFC		
Data as on June 14, 2019	Number	Amount involved (in ₹ Crore)
Application filed by MSEs	18,647	4,816.80
Mutual Settlements with Buyer	1,413	201.79
Applications disposed by MSEFC Council	1,120	212.29
Applications converted into cases by MSEFC Council	4,800	-
Applications rejected by MSEFC Council	3,120	-
Cases filed in MSEFC	11,015	3,765.31
Cases disposed in MSEFC	3,899	1,171.74

Source: Samadhaan Portal

### 4.3.3 Recommendations

The Committee deliberated on strengthening of facilitation council and recommended the following:

- i. *The scope of Facilitation Council is limited to redress cases of MSEs. Presently, Medium enterprises supplying to large corporates are deprived of redressal forum. Hence, the ambit of Facilitation Council may be extended to Medium enterprises also.*
- ii. *As per Section 80 of Arbitration and Conciliation Act, 1996 unless otherwise agreed by the parties, the Conciliator shall not act as an arbitrator in any arbitral proceedings in respect of a dispute that is subject of the conciliation proceedings". However, sub-section 18(4) of MSMED Act, 2006 states that Council can act as an arbitrator or conciliator in a standing dispute where supplier located within its jurisdiction and a buyer located anywhere in India. As MSMED Act, 2006 is silent on this aspect, specific provision is required by a suitable amendment to the aforesaid Act.*
- iii. *There has to be specific mention in MSMED Act, 2006 for cases already taken up by NCLT. Suitable amendment needs to be done in MSMED Act as NCLT came into effect in the year 2016 much later than MSMED Act, 2006. Although section 14(1) of IBC 2016 clearly states that "subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority. There is no clarity about process to be adopted after moratorium period is over.*
- iv. *Some supplier units filed cases before High Court about matter not decided within 90 days as stipulated in the sub-Section 18(5) of the MSMED Act, 2006. Completing the proceedings (Conciliation & Arbitration) within 90 days is difficult. Hence, MSMED Act, 2006 may be amendment by way of inserting "shall be decided 'preferably' within 90 days" or within 180 days instead of "shall be decided within 90 days.*

- v. *During meetings with State Government officials and MSME Associations, the Committee was informed that MSE borrowers lack awareness about Samadhaan Portal. Therefore, there is a need to publicize the portal amongst the MSME entrepreneurs.*
- vi. *It is observed that majority of the States have only one Facilitation Council which is not adequate to cater to delayed payment cases arising in the entire State. Hence, there is a need to increase the number of MSEFCs particularly in larger States such as Madhya Pradesh, Uttar Pradesh, etc., and in areas of large concentration and volume, so as to meet the time specified for resolving cases.*

#### 4.3.4 Delayed payment to MSMEs

- i. Buyers tend to use MSMEs as an alternative to banks. In order to delay payments, buyers have incentives to raise objections or point errors in submitted bills. Credit notes or adjustment notes are often used to avoid cash payment. Strict legislative measures of payments within fixed days (and penalty in the form of charging interest) have had limited effect on account of inhibitions on the part of the MSME sellers to complain, as loss of future business is feared. Electronic bill discounting systems (such as TReDS) have provided a partial solution but the problem persists. Naming and shaming are being used quite effectively in countries like UK and other European nations.
- ii. Like in many other markets, in India, most large corporates operate with MSMEs only on a credit basis. When the buyer does not honour the invoices on time, MSMEs face a financial crunch in the business. Their interest burden increases, cash flow becomes stressed and business continuity is impacted. Such MSMEs hesitate to file complaint against large buyers to MSEFC or fight a legal battle with the buyer to enforce the contract.
- iii. An Information Utility (IU) could help resolve this problem. IUs are set up under the Insolvency and Bankruptcy Code (IBC) and regulated by the Insolvency and Bankruptcy Board of India (IBBI). An IU is a repository of electronic legal evidence pertaining to any debt/claim as submitted by a financial or operational creditor that is verified and authenticated by parties thereby making the information non-refutable or prima facie evidence. For a small user charge, creditors (in this case MSMEs) can electronically file their outstanding or default amounts on the IU and invoke IBC provisions.
- iv. IBC mandates financial creditors to submit information to an IU, but only encourages operational creditors to submit information. When a case is admitted under IBC, management of the defaulting company vests in the Resolution Professional, thereby bringing much needed discipline in enforcing contracts. Operational creditors have been in the forefront of availing this benefit under IBC having filed the maximum number of defaults with NCLT (of a total of 1858 resolution processes triggered as at the end of March 2019, operational creditors have caused 920 cases).
- v. Filing of default by the operational creditors and submission of information to IU serves as an early warning signal to other financial or operational creditors with exposure to the defaulting debtor. The IU issues a 'Record of default' that is attached to the filing by operational creditors with the Adjudicating Authority for initiating corporate insolvency process. Call for "Record of Default by Adjudicating Authority from the Information Utility", has been declared by Hon Supreme Court as a prima facie evidence (case of Swiss Ribbons) in such cases. For example,

let us assume that the bill is due to be paid in 90 days. On the 90<sup>th</sup> day, payment is made. At this point, the bank or the buyer uploads fact of the payment on the IU. The MSME is required to do this. The transaction is complete. The other situation is that bill is not paid on the due date i.e., the 90<sup>th</sup> day. At this point the MSME may choose to invoke usual provisions.

#### 4.3.5 Benefits for MSME

- i. Authenticated Information - prima-facie evidence in legal proceedings.
- ii. Recovery of Receivables – as under IBC, if the Corporate Insolvency Resolution Process (CIRP) were to be initiated against corporate debtor, the Board loses control. Hence, in many cases corporate debtor prefers to settle the outstanding amount.
- iii. MSME gets better loan terms against Bills receivables, if bills are authenticated on IU
- iv. IU system disseminates information of default to all registered users having business relationship with defaulter. These alerts will help MSME to keep an eye on financially sick debtors. This will help to put the claim of debt on time, against the defaulter under IBC or any other legal proceeding.

4.3.6 In turn, the operational debtor (large buyer) is also benefitted, if its disputes are registered on the IU at the earliest, thereby preventing operational creditors from approaching the Adjudicating Authority with frivolous claims. Yet, as noted above, MSMEs may still hesitate to file default against their large buyers, fearing loss of future business/debarment. There is a need for a system to handle cases where the MSME fears to complain as there is a huge difference in negotiating strengths of MSMEs and large corporates.

#### 4.3.7 Recommendations

- i. *An amendment may be made to the MSMED Act, 2006 requiring all MSMEs to mandatorily upload all their invoices above an amount to be specified by Government, from time to time. To begin with, this could be for invoices above ₹1 crore.*
- ii. *To take care of the situation where the MSME is unable or unwilling to complain a designated authority under the DC MSME may be identified. This authority will be able to request/ obtain information on unpaid bills, of say, all corporates including PSUs above ₹1000 crore turnover to begin with, on the first working day of each month. For the IU to respond to this request, the Authority set up under the DC MSME will have to be notified under IBBI IU Regulation No. 23. With access to this information, the Designated Authority will write to/ email each of the corporates concerned, bringing to their notice, MSME supplier bills which have remained unpaid beyond the due date.*
- iii. *It is likely that on receipt of this communication, the corporate will take steps to clear dues. If it does not do so before the first working day of the next month, when the next statement will be generated, then the Authority may send a communication to both the buyer and the seller that payment has not happened as evidenced by the IU in spite of a communication been sent to the corporate buyer. This communication could then be disclosed on the Authority's website for information of lenders, rating agency and other MSMEs as a means of naming and shaming. The MSME will now also have a stronger basis to initiate action, should it choose to finally do so.*

#### 4.4 Public Procurement Policy

4.4.1 Due to their lack of scale and in-house capabilities, MSEs find it difficult to access proper market for selling their products. Inaccessibility to remunerative market affects their growth and sustainability. In order to support MSEs in selling their products at a competitive price various countries have framed public procurement policy wherein certain percentage of goods manufactured by them are procured by the Government, Government Departments, etc.

4.4.2 Legislative backing for procurement preference to MSMEs exists. Chapter IV – Section 11 of the MSMED Act, 2006 states that for facilitating promotion and development of MSEs, the Central Government or State Government may, by order notify from time to time, preference policies in respect of procurement of goods and services, produced and provided by MSEs, by its Ministries or Departments, as the case may be, or its aided institutions and Public Sector Enterprises. In India, Public Procurement Policy for MSEs was introduced in the year 2012, the policy was revised in November, 2018, and came into effect from April 1, 2019. The objective of Policy is promotion and development of MSEs by supporting them in marketing of products produced and services rendered by them. Complexity of the public procurement system and its process deters MSEs to participate in public procurement. MSEs are disproportionately affected due to their internal constraints in terms of financial, technical and administrative capacities to access procurement opportunities, prepare tender documents, apply the procedures and execute the contracts. Study conducted by World Bank on barriers for SMEs in Procurement Process is given in Box V.

Box V - Barriers for SMEs by stage of Procurement Process	
Pre-bidding Stage	<ul style="list-style-type: none"><li>- Restricted communication and publication of contract opportunities</li><li>- Overly narrow pre-qualification criteria, placing too much emphasis on past experience or firm size</li><li>- Uncompetitive bidding process</li><li>- Difficulties due to size of contracts</li><li>- Access to relevant information</li><li>- Quality and understandability of information provided is limited</li></ul>
Application Stage	<ul style="list-style-type: none"><li>- Excessive bureaucracy and documentation requirements</li><li>- Excessive requirements of financial guarantees (i.e. bid security deposit)</li><li>- Grant enough time to prepare quotations</li><li>- Lack of capability in writing a formal bid proposal</li><li>- Unclear selection criteria – How best to meet Government's need unclear</li><li>- Excessive information requirements (although this could hurt Government not having enough information)</li></ul>
Selection Stage	<ul style="list-style-type: none"><li>- Preference for large bidders with long track record</li><li>- Institutionalized discrimination</li><li>- Too much focus on the price and not on value for money</li></ul>
Post-Selection Stage	<ul style="list-style-type: none"><li>- Absence of rationale for awards</li><li>- Payment terms are not complied with i.e. delayed payments</li><li>- Unsuitable payment terms offered</li><li>- No feedback shared for future learning</li><li>- Difficulty in business complaints being heard and addressed</li></ul>

4.4.3 The Procurement Policy, 2012 mandated Government Departments, CPSEs, etc. to achieve 20% procurement target for MSEs. It is observed that in the year 2016-17, CPSEs achieved 19% against the target of 20%. However, in the year 2017-18 they could achieve only 15%. As per the revised procurement policy, PSUs /Government Departments have to procure 25% from MSEs:

Table X : Procurement Status of CPSEs from MSEs (₹ crore)			
Years	No. of CPSEs	Total Procurement	Procurement from MSEs
2014-15	113	143665.03	9601.01
2015-16	132	162659.75	12566.15
2016-17	141	134409.70	25329.44
2017-18	168	161652.98	24226.51

Source: Public Enterprises Survey 2017-18

#### 4.4.4 Recommendations

- i. *There is need to strengthen the procurement mechanism amongst the PSUs / Government Departments so that mandated procurement of 25% can be achieved by them. In this regard, GoI has already launched GeM portal for connecting MSEs to Government Departments / PSUs. As on May 29, 2019, there were 2,34,507 registered sellers on the portal, out of which 38,873 were MSEs comprising only 17% of the total registered sellers. This may be due to lack of awareness amongst the MSEs about GeM portal. The Committee recommends to scale up the portal and create awareness about the benefits of the portal and encourage MSEs to register on the portal.*
- ii. *Government may consider making GeM as a full-fledged market place and permit MSME sellers on-boarded on the portal to procure raw-material as well.*
- iii. *The Committee was apprised by GeM that it takes average 22 days for MSMEs to receive payment through GeM. Further, the delayed payment cases are pushed to Samadhaan for resolution. The Committee recommends that Government may make it mandatory for PSUs / Government Departments to procure from MSMEs through GeM portal only. This would bring in transparency in procurement process. Further, it would also address the problem of delayed payments.*
- iv. *The Committee was also informed that certain Government Departments have been placing orders for supply of equipment and materials that are well in excess of their anticipated or available annual budget. Execution of such orders is made in good faith and thereafter payments are delayed, at times, for months on end. The Committee recommends that the General Financial Rules (GFR) and Departmental Procurement Codes/ Manuals, as the case may be, be amended to prohibit placing of purchase orders in excess of the annual budget approved by the Legislature/ Government.*

#### 4.5 Formalization of MSMEs

As per 73<sup>rd</sup> round of National Sample Survey (NSS), there are 63.39 million MSMEs in the country. However, a large number of MSEs exist in the informal sector and are not registered with any statutory authority. Reasons for lack of registration are many and varied. For nano/household type of enterprises, in their view, not obtaining registration is an escape from official machinery, paperwork, costs and rent seeking. For them, it is perhaps “the art of not being governed”. Registration offers them little by way of tangible benefits. There are other MSEs

who, upon reaching a minimum size seek legitimacy and acknowledgement of their existence to seek benefits or credit for instance, but they too struggle. While Udyog Aadhaar offers a simple mode of registration, it is usually not enough. Often, more is needed e.g., Shops and Establishments, PAN, GST, etc. Lack of formalization impacts the sector in terms of development and also impacts in availing credit from financial institutions like banks and in terms of policy making as well as development interventions. Registration provides information on nature of business, location, segmentation, etc. In the absence of a robust system of registration for capturing information on operational units, new units and exits, reliance has to be placed on surrogate data or on national census/ surveys, which are infrequent. The various avenues available to the MSMEs for formalization are discussed below:

#### 4.5.1 Registration of Enterprises

i. The Committee deliberated on the lack of formalization of a large number of MSMEs particularly in the micro category. The registration requirements of Indian enterprises is primarily governed by the First Schedule to the Industrial Development and Regulation (IDR) Act, 1951. It is mandatory only for a class of Medium enterprises which are engaged in the manufacture of goods. The registration of MSEs and Medium enterprises engaged in services activities is discretionary. However, over a period of time, registration has been an intrinsic part of the development of MSMEs itself. Having a registration certificate entitles an MSME for numerous benefits. Particularly after the MSMED Act, 2006, which came into effect from October 2, 2006, availability of registration certificate has assumed greater importance. Some of the direct incentives provided by the Government are summarized in Table XI below.

Table XI : Benefits of having MSME registration	
Collateral Free loans from banks	Ease of getting Licenses, approvals and registrations
Reservation policies to manufacturing / production sector	Special consideration on international trade fairs
Octroi benefits	Waiver of Stamp Duty and Registration Fees
Exemption under Direct Tax Laws	Bar Code registration subsidy
Subsidy on NSIC Performance and Credit ratings	Eligibility for IPS subsidy
Counter Guarantee from Government of India through CGSTI	Protection against delay in payment
Reduction in rate of Interest from banks	15% CLCSS subsidy to purchase fully
Waiver in Security Deposit in Government	Concession in electricity bills
Reimbursement of ISO Certification	Excise Exemption Scheme
Preference in procuring from Government	P15% weightage in price Preference
1% exemption on interest rate on OD	50% subsidy for patent registration

Source: Ministry of MSME

ii. The registration process of MSMEs was radically simplified with the introduction of Udyog Aadhaar, with effect from September 18, 2015. It is an Aadhaar based electronic platform and requires a few basic entries including PAN details. Registration certificate is also issued electronically. In terms of coverage, 68.89 lakh MSMEs (as on June 12, 2019) have registered through this system. Udyog Aadhaar has facilitated registration of MSMEs in a user friendly way. However, given that this data is self-verified, it is often not a reliable source of information for lenders and buyers. During interactions with the Committee, State Government officials, MSME Associations and MSME borrowers have highlighted other challenges in respect of Udyog Aadhaar. The Committee was informed that the Udyog Aadhaar database needs cleaning up as retailers have obtained Udyog Aadhaar registration. Instances have also been reported of UAM being filed product wise. The Udyog Aadhaar system is based on self-certification and there is no evidence of whether the unit was set up at all. The concept of provisional registration, which helped in pre-start up stage, is missing. In addition to Udyog Aadhaar, there are several other registrations which MSMEs need. For example, for public procurement, all MSME units are to be registered with NSIC.

iii. Registration with NSIC is called single point registration. But for all practical purpose, this registration is not accepted by most of the organizations. MSMEs have to register separately with each organizations. For example, MSMEs have to register with DQA for defence related procurement; ONGC, Engineers India for Oil and Gas, RDSO for Railways, etc. This registration process is cumbersome, time consuming, leading to duplication of efforts. On the other hand, without this registration, MSMEs cannot participate in any tendering, primarily because NSIC registration is neither trusted nor accepted by these organizations.

iv. This needs to change. NSIC should be the nodal agency for all MSME units. When the units apply for registration/renewal, they can inform the NSIC that they need registration with whichever organization they want to do business and NSIC should coordinate with them for being registered. This should be done completely electronically. Presently, these procuring organizations maintain vendor registration cell at very high cost. For units seeking registration with them, one expert may be asked to join the team from NSIC. The MSME unit may then be given graded registration or a clear direction/ road map to improve the set up to get registration.

#### **4.6 Goods and Services Tax Network (GSTN)**

4.6.1 GSTN is a nonprofit non-government company, which is providing shared IT infrastructure and service to both central and state governments including tax payers and other stakeholders. The frontend services of registration, returns and payments to all MSMEs are being provided by GSTN. Implementation of GSTN under GST has integrated the entire indirect tax ecosystem.

4.6.2 Under GST, MSMEs are not defined as per the definition of MSMED Act, 2006 as it is not possible to ascertain the investment in plant and machinery/equipment in GST return. Hence, there is no mapping of MSME definition in the GSTN data. As on date 1.21 crore tax payers have registered with GSTN, out of which majority of the units are estimated to be MSMEs, if the proposed turnover definition were to be applied. PAN information collected in Udyog Aadhaar filing could be suitably used with PAN information registered with GSTN so that MSMEs and GSTN are integrated and monitored on real time basis.

4.6.3 To ascertain the standing of the business entity (say registration, compliance with tax codes and other regulations) for various purpose (lending or delivery of services) is a time-

consuming process due to the multiple silos of information storage and lack of a common identifier across the various databases. This lack of common identifier may be a barrier towards implementation of single window registration processes for businesses, a policy initiative that is envisaged as a major thrust under the Business Reforms Action Plan 2017 released by the Department for Promotion of Industry and Internal Trade (erstwhile DIPP), Ministry of Commerce and Industry, in partnership with the World Bank Group. Lack of a proper identification mechanism for the MSMEs may also lead to significant inefficiencies in the delivery of the benefits enumerated under the MSMED Act, 2006 and various policies.

4.6.4 The Committee deliberated on the issue relating to registration in GSTN and UAM. Since, UAM is not mandatory, large number of MSMEs have not registered. Therefore, the objective of Government to promote formalization amongst MSMEs through registration has not yet yielded the desired result. Further, UAM is completely self-declared and there is no verification of authenticity of data contained therein. As regards GSTN, MSME units having turnover above ₹40 lakh are mandated to register under GSTN but most MSMEs fall below that threshold. Also, unit operating in multiple States can have multiple GSTN. The Committee, therefore, felt the need for a unique identifier for MSME units.

4.6.5 Taking a long-term view to build an enabling environment for businesses in the country to grow based on their unique merits, the Committee concluded that it is imperative to develop a 'Unique Enterprise Identifier' to identify all the entities across the country. This will enable tax compliance, delivery of service under various MSME schemes and provide seamless integration with financial institutions. A similar approach, for creation of a unique business identifier and amalgamation of the various data silos of the government has been adopted by other nations. A brief synopsis is presented in Box VI. The detailed modalities on Unique Enterprise Identifier (UEI) are discussed in Chapter 8.

#### **Box VI - International Learnings from Unique Business Identifier**

The idea of a Unique Business Identifier (UBI) has been embraced by the countries of Albania, Canada, Georgia, Jordan, New Zealand and Norway to name a few. The objectives of introducing a UBI was different for each country such as improving tax compliance, streamlining business startup procedure, improving business environment (through integrated registration system), improving government services, enabling data-sharing and links across multiple agencies and reducing the size of the informal economy. Despite the varied objectives, most of the countries saw a similar impact in: increase in tax compliance and reduced administrative burdens as observed by the businesses.

## **4.7 Registration of Startups**

4.7.1 Startup India Scheme is an initiative of the Indian government, the primary objective of which is the promotion of startups, generation of employment, and wealth creation. It was launched in January, 2016. Startups are incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India. These enterprises can be called Startups upto ten years from the date of incorporation/ registration provided turnover for any of the financial years since incorporation/ registration has not exceeded ₹100 crore. The profits of recognized Startups are exempted from income-tax for a period of 3 years out of 7 years since incorporation.

4.7.2 However, in the recent years many Indian startups which were well-funded and primarily operated in India have chosen to relocate. These next-generation technology startups are choosing foreign countries as their base primarily because of the enabling environment available in these countries.

4.7.3 By far the single biggest concern for investors wanting to invest in Indian companies has been the tax liability. For instance, progressive tax regimes such as Singapore have 0% capital gains taxes which incentivizes flow of capital. Also, these investors are likely to plough back the profits from startup entities into new startups thereby, creating a virtuous cycle of investment. Higher tax rate for investors in India is hindering investment in startups.

4.7.4 On the other hand, maturing startups that have achieved or are on the precipice of achieving profitability are eyeing lower corporate taxes. Countries such as Singapore are offering a simplified tax regime which charges 17% on corporates compared to the global average of approximately 22% (in 2015). Singapore boasts of 0% Capital Gains taxes and a low corporate tax of 17% whereas India charges 30% for corporate tax on domestic companies if taxable income exceeds ₹1 Crore. Startups which have not yet reached this level are still liable to pay the Minimum Alternate Tax (MAT) at 18.5%. Though the MAT credit has been extended to 15 years it has not been eliminated completely.

4.7.5 The issue of corporate taxes assumes significant importance for maturing startups, especially when they are about to go public and the high taxes impact their profitability. This clearly incentivizes them to move their base to a lower tax country. Therefore, the successful companies not only move their headquarters away from India but also take with them the Intellectual Property (IPs), and the proceeds from any possible Initial Public Offerings. Furthermore, it's a double whammy for India because most retail Indian investors would not be able to participate in such companies' IPOs if they list on foreign exchanges such as NASDAQ.

4.7.6 Singapore is ranked consistently in the top 3 in World Bank's Ease of Doing Business (EODB) rankings. Although India improved significantly from 100 to 77 it still lags behind countries such as China and Vietnam. There are multiple procedures to be followed before a business can start functioning in India. Even though a lot of states have been taking progressive steps (as in the case of Telangana – mentioned in Box VII) in providing single window clearances and self-certifications, the sentiment is still weak and more needs to be done.

### **Box VII - Telangana Startup Model**

Telangana, aims to promote innovation and entrepreneurship, leveraging upon its natural demographic assets as well as its base of skilled technology and research professionals. The innovation policy of the Government of Telangana is based around five broad pillars:

- Developing physical infrastructure & program management capabilities
- Focus on creating sustainable funding models, through funds and other instruments
- Develop human capital, by creating the right environment and support systems for learning, experimentation and innovation from the early phases of education
- Proactive engagement with industry to continuously promote and identify innovation
- Encourage startups in the Rural and Social Enterprise space by providing additional incentives

#### **Incentives for Incubators:**

Reimbursement of paid Stamp Duty and Registration Fee – Incubators and Host Institutes shall be eligible for 100% reimbursement of the Stamp Duty and Registration Fee paid on sale/ lease deeds on the first transaction and 50% thereof on the second transaction.

#### **Incentives for startups:**

- i. Reimbursement of SGST: The unit can pay SGST to the concerned department and avail reimbursement on a yearly basis. This will be applicable only on the SGST paid to the State of Telangana and for a maximum total turnover of ₹1 Crore/annum for the first three years of operation.
- ii. Promotions: Government shall provide reimbursements of 30% of the actual costs including travel incurred in international marketing through trade shows. This incentive will be subject to a maximum of ₹5 lakh per year per company.
- iii. Patent Filing Cost: The cost of filing and prosecution of patent application will be reimbursed to the incubated startup companies subject to a limit of ₹2 lakh per Indian patent awarded. For awarded foreign patents on a single subject matter, upto ₹10 lakh would be reimbursed. The reimbursement will be done in 2 stages, i.e., 50% after the patent is filed and the balance 50% after the patent is granted.
- iv. To promote idea stage companies, the government shall offer recruitment assistance of ₹10,000 per employee for the first year.
- v. Startups that record a year-on-year growth rate of 15%, as per audited accounts, shall be eligible to get a grant of 5% on Turnover, subject to a limit of ₹10 lakh within a period of three years from the date of incorporation.

#### **Non-Fiscal Incentives:**

Startups and incubators in the state will be permitted to file self-certifications, in the prescribed formats under the following acts and rules framed there under barring inspections arising out of specific complaints. The same shall be facilitated through the startup cell:

- i. The Factories Act, 1948
- ii. The Maternity Benefit Act, 1961
- iii. The Telangana Shops & Commercial Establishments Act, 1988
- iv. The Contract Labour (Regulations & Abolition) Act, 1970
- v. The Payment of Wages Act, 1936
- vi. The Minimum Wages Act, 1948
- vii. The Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959.

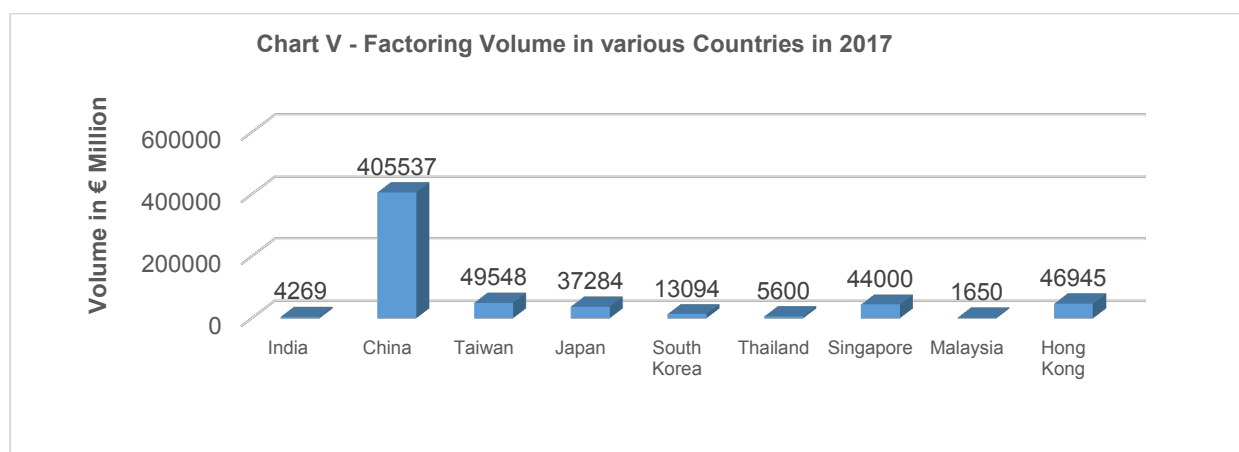
#### 4.7.7 Recommendation

*The Committee deliberated on all the aspects relating to Startups in India. The major reason for migration of startups to other countries is because of better enabling environment such as tax concessions, well developed infrastructure, ease of doing business, exit policy, etc. Hence, the Committee is of the view that financial incentives and excellent infrastructure facilities must be deployed to retain successful Indian startups and to lure the best talent from across the world to start businesses in India. Telangana has adopted an innovative model for startup which may be assessed for possible replication in other States.*

#### 4.8 Factoring Act, 2011

4.8.1 Receivables form a major part of the current assets of MSMEs and management of such receivables is the most important concern for them. Factoring is a financial option for the management of receivables. It is a tool to obtain quick access to short-term finance and mitigate risks related to payment delays and defaults by buyers. In the process of factoring, the seller sells its receivables to a financial institution ("Factor") at a discount. After the sale, there is an immediate transfer of ownership of the receivables to the Factor. In course of time, either the factor or the MSMEs, depending upon the type of factoring, collects payments from the debtors. Factoring helps the MSMEs to improve their cash flows and cover credit risk.

4.8.2 The Factoring Regulation Act, 2011 deals with the issues relating to assignment of debt to factor, registration requirements for factoring and debtor protection. The Act also provides special provisions for MSEs where the debtor of assigned receivables is liable to them within the stipulated time mentioned in the MSMED Act, 2006. As per the Act, an NBFC engaged in factoring business as its principal business registered with RBI may carry on the factoring business. In terms of Chapter II of the Act, every factor for the purposes of registration, shall file the particulars of every transaction of assignment of receivables with the CERSAI within a period of thirty days. Present status of Factoring in Asian Countries is as below:



Source: Annual Review 2018 FCI (Factors Chain International – a Global level representative body of Factoring Companies)

4.8.3 Factoring is an accepted method of receivables financing across the globe and is regulated by a stringent set of rules and procedures. Initially, in India, factoring was not a typical or mainstream financial service in the absence of legislation. However, with the enactment of

Factoring Regulation Act, the necessary legal framework is now in place for factoring to gain traction. But unfortunately, reservations on part of corporates and PSU buyers to accept assignment of receivables made in favour of factors, issues with the legal system and dominance of banks in factoring business have been hampering the growth. Recommendations relating to Factoring Act are given under the section on TReDS in Chapter 7.

#### **4.9 Monitoring and Review Mechanisms at Apex Level**

##### **4.9.1 National Board for MSME**

The Chapter II, Section 3 to Section 6 of the MSMED Act, 2006 provides for establishment of National Board for Micro, Small & Medium Enterprises (NBMSME). The National Board consists of 47 members including Chairman, Vice Chairman and Member Secretary in accordance with the Section 3 (1) of MSMED Act, 2006 and NBMSME Rules, 2006. The Minister in-charge of Ministry of MSME is ex-officio Chairman of the National Board.

##### **4.9.2 Functions of the National Board**

- a. Examines the factors affecting the promotion and development of MSMEs and reviews the policies and programmes of the Central Government regarding facilitating the promotion, development and enhancing the competitiveness of such enterprises and the impact thereof on such enterprises.
- b. Make recommendations on the above matters or any other matter referred to it by the Central Government which, in the opinion of that Government, is necessary or expedient for facilitating the promotion and development and enhancing the competitiveness of the MSMEs.
- c. Advise the Central Government on the use of the Fund or Funds constituted under Section 12 of the MSMED Act.

##### **4.9.3 Recommendation**

*National Board may continue to function as the body for reviewing and steering the overall implementation of various policies / schemes of MSMEs impacting all aspects of the MSME ecosystem, involving all stakeholders, particularly in terms of bringing MSMEs out of informal category, improving infrastructure, skill and capacity building, technical and financial know-how, etc. The functioning and scope of the Board may be reviewed to strengthen its role.*

##### **4.9.4 Standing Advisory Committee**

The Standing Advisory Committee (SAC) was constituted by RBI in 1986, in terms of orders of the then Governor. It is a permanent Committee which meets twice a year. The Committee is chaired by Deputy Governor, RBI and has participation from Ministry of MSME, DFS, Banks, Industry Associations, etc. The purpose of the Committee is given below:

- i. To review the flow of institutional credit to MSME sector, identify deficiencies, if any and suggest remedial measures.

- ii. To examine the support available from State Government agencies, in particular, DICs to financial institutions for ensuring adequate and smooth flow of credit to MSMEs and suggest measures for improvements, where necessary
- iii. To look into the arrangements available for up gradation of entrepreneurial skills and modern technology in respect of MSME units and make suitable recommendations
- iv. To review the problem of stress in MSME units in relation to the role of various agencies concerned and recommend suitable remedial action

#### **4.10 Institutional Support System developed by State Government**

##### **4.10.1 District Industries Centers (DICs)**

DIC programme was started in 1978 with a view to providing integrated administrative framework at the district level for promotion of small scale industries in rural areas. The DICs were envisaged as a single window agency at the district level providing service and support to small entrepreneurs. DICs act as the implementation body for several schemes of both the State and Centre. Typically, the organizational structure of the DICs consists of General Manager, Functional Managers and Project Managers to provide technical services in areas relevant to the district concerned. The management of the DIC is under State Governments. DICs have the following as their main objectives:

- i. identify and nurture entrepreneurs by providing them support on their ventures
- ii. enable and enhance the industrialization efforts of the districts
- iii. enhance the handicrafts and rural cottage industries of the districts
- iv. provide implementation mechanism of various schemes of State and Centre
- v. provide various procedures, permissions, licenses and registrations, etc., for new units

##### **4.10.2 Need for Improvement of DICs**

DICs have become integral in shaping industrial development at district level. The State and Centre deploy various schemes to reach the entire country through this network of DICs. To continue to benefit the citizens at the district level, the DICs must be able to evolve and remain relevant with the times. The following problems persist with the DICs:

- i. Although the General Managers of DICs have been empowered, the “single window” concept has not been fully implemented due to statutory constraints.
- ii. Only few of the states have an active monitoring cell for regular monitoring of DICs.
- iii. The training programs delivered by the DICs are not relevant in many districts and have very poor attendance.
- iv. The collection of statistics and information related to the requirements of raw material, machinery and know-how is not adequate.

4.10.3 A new Central Scheme is proposed for setting up of Enterprise Development Centres (EDCs) within DICs. The key features of EDCs are given in Box VIII.

<b>Box VIII - Enterprise Development Centers - Key Features</b>	
i.	The EDCs will be set up at District level, within the administrative control of the MSME Development Institutes/ Technology Centre, under whose jurisdiction they fall.
ii.	The EDCs would primarily have two verticals viz., Enterprise Development Vertical and Skill Development Vertical. The two verticals will ensure that aspirations of the youth are well addressed in terms of hand holding support to those who aspire to be self-employed and create business enterprise and imparting Skill training to those who intend to get employed.
iii.	Enterprise Development Vertical inter alia among other thing would focus primarily on: a. Ideation; b. Mentoring and incubation; c. Credit facilitation & Market accessibility; and d. Enterprise Clinic: Diagnostic studies in the event of sickness, counselling and other facilities.
iv.	Skill Development Vertical would provide information such as potential jobs availability in the market based on in-depth market intelligence and advise the potential job seekers to get relevant skill sets through prominent institutions/agencies in pertinent sector(s).
v.	These EDCs shall be connected with National Resource Centre to be set up in the office of DCMSME
vi.	The EDCs will offer benefits to entrepreneurs viz. access to common tools and infrastructure, collaboration and sharing, networking, business infrastructure.

#### 4.10.4 Recommendations

*The DICs can be made more effective through the measures discussed below:*

- i. *A new Central Scheme to be initiated for supporting setting up of Enterprise Development Centres (EDCs) in DICs. These EDCs while being principally funded by GoI must have the operational flexibility to partner with the private sector, particularly in the areas of skilling and technology development. Contribution of companies to capacity building via EDCs must be eligible for CSR spending.*
- ii. *Planning for Training Programmes - The need of training for entrepreneurs in various fields may be assessed and included in the action plans of DICs. The training should be based on contemporary requirements and should be relevant to the needs of the entrepreneurs. As much as possible, training must be imparted by corporates engaged in the relevant field and practitioners rather than to staff of DIC only.*
- iii. *Empowering DICs - DICs should be given more powers for providing tangible services such as arranging terms, and other inputs including technologies for the development of industries and artisans.*
- iv. *Data Collection and Statistical Analysis - The data banks created by the DICs should be strengthened and trained persons to be deployed to keep the data up-to-date. Proper collection of statistics on the requirements of entrepreneurs should be undertaken by DICs.*
- v. *DICs need to be professionalized and corporatized into not for profit entities. This would enable DICs to engage in partnerships with private sector for delivering extension services to MSMEs.*

#### 4.11 State Financial Corporation (SFC)

4.11.1 State Financial Corporations were set up to promote industry through extension of term loans and help them unlock equity financing. Their focus was Small Scale Industries (SSI). The authorised Capital of a SFCs is fixed by the State Government within the minimum and

maximum limits of ₹50 lakh and ₹5 crore and is divided into shares of equal value which were taken by the respective State Governments, RBI, Scheduled Banks, Co-operative Banks, other financial institutions such as insurance companies, investment trusts and private parties. At present, there are 18 SFCs and only a handful of them are active.

#### 4.11.2 Functions of State Financial Corporations

- i. Grant loans mainly for acquisition of fixed assets like land, building, plant and machinery.
- ii. Provide financial assistance to industrial units whose paid-up capital and reserves do not exceed ₹3 crore (or such higher limit up to ₹30 crore as may be specified by the Central Government).
- iii. Underwrite new stocks, shares, debentures etc., of industrial concerns.

4.11.3 At the time when SFCs were conceptualized, credit markets were under developed. SFCs were accordingly envisaged as an integral part of institutional finance structure in the country. Over the years, the number of lenders in the market have multiplied manifold. Apart from a vastly expanded banking sector, the NBFC sector is today reaching out in a real and meaningful way. Term loans have given way to composite loans which banks are able to provide. On the liabilities side, SFCs are unable to access low cost funding. They are unable to raise money directly on account of inadequate rating and are forced to rely upon the State Government and banks. High NPAs at most SFCs are symptomatic of poor lending decisions. Clearly, the role of SFC as a financial intermediary has diminished. The challenge facing States has also changed – from ensuring credit to MSMEs in general to ensuring that MSMEs across the State are able to tap opportunities. Private sector lending activity is robust in centers of economic activity. Online lending is also reducing the need for physical interface. Interventions are needed to make credit available in areas which are remote or have low levels of economic activity.

#### 4.11.4 Recommendation

*The Committee recommends that State Governments should re-examine the role of SFCs. Financial resources will need to be programmed accordingly, within the context of the State. For instance, should funds be used to support the SFC or should they be used to incentivize private sector to move to areas where more competition amongst lenders is needed. The Committee also recommends a review of the SFC Act for enhancing the role of States so that more operational freedom is given to SFCs.*

#### 4.12 Role of Khadi and Village Industries Commission (KVIC)

Khadi and Village Industries Commission is a statutory body formed by the Government of India, under the Act of Parliament, 'Khadi and Village Industries Commission Act of 1956'. KVIC is charged with the planning, promotion, organisation and implementation of programs for the development of Khadi and other village industries in the rural areas in coordination with other agencies engaged in rural development wherever necessary.

#### **4.12.1 Recommendation**

*The Committee recommends KVIC should be corporatized with focus on promotional work. The marketing function may be hived off and also corporatized to enable private participation and enabling use of Khadi in the private sector.*

#### **4.13 Role of Small Industries Development Bank of India (SIDBI)**

SIDBI was set up on April 2, 1990 under an Act of Parliament, to act as the principal Financial Institution for promotion, financing and development of the MSME sector as well as for co-ordination of functions of institutions engaged in similar activities.

##### **4.13.1 Framework and Scope of Activities**

SIDBI was set up as an apex bank for tiny and small industries. In the almost three decades of its existence, SIDBI has been primarily engaged in the re-finance business, much of which has been through funds provided to it from shortfall of priority sector lending by banks. SIDBI has also made forays into direct lending, equity support and in supporting the setting up of institutions such as Rating Agency (Acute Ratings & Research), an Asset Reconstruction Company (ISARC), a Trustee Company (STCL), a Venture Capital Company (SVCL), MUDRA, a TReDS platform (R-XIL), a Technology Company (ISTSL), a lending platform (PSB loans in 59 minutes) etc. It also holds equity shares in many SFCs and Technology Consultancy Organisations. SIDBI has also been extensively involved in supporting Startups.

4.13.2 SIDBI's re-finance book has been steadily increasing but its contribution to overall MSME finance remains negligible. Its attempts at direct lending and equity support have been marked by very high level of delinquencies. During its visits across the country, the Committee repeatedly received feedback from State Governments regarding SIDBI's lack of connect with State Governments or with State programmes for MSME development.

4.13.3 Some recent initiatives by SIDBI such as the PSBLoansIn59Minutes, publication such as MSME Pulse, Micro Finance Pulse, MSME Sentiments Index, etc., have been commendable initiatives and highlight its ability to induce new ways of lending and make available knowledge products for a wider audience. These knowledge products anticipate what SIDBI should be doing more of. Instead of attempting to become another direct lender along with Public Sector Banks, Private Sector Banks, RRBs, Small Finance Banks and a number of NBFCs and FinTech Companies, as an apex bank, SIDBI has to be proactive in addressing market failures in MSME credit, develop new instruments for adoption by the market, play the role of market maker and foster partnerships aimed at capacity building of lenders so that supply side improvements occur thereby helping meet unmet demand for MSME credit.

##### **4.13.4 Recommendations**

*i. The Committee recommends a more focused engagement of SIDBI with State Governments for MSME development and promotion. This could take various forms as indicated below:*

- a. Use of Priority Sector Shortfall (PSS) funds to create a low cost lending window for State Governments for infrastructure projects in clusters, civil works for rehabilitation of existing industrial estates and setting up of new industrial estates. This would*

*require RBI approval and could be structured on the lines of the Rural Infrastructure Development Fund (RIDF).*

- b. Helping State Governments in designing or operating schemes for equity support, interest subvention, resolution of stressed MSMEs, learning events for MSME entrepreneurs including field visits to well performing clusters, etc.*
  - c. Collaborating with State Governments to get MSME units from the State onto digital platforms such as PSBLoansIn59Minutes, Stock Exchange listing, e-commerce platforms, etc.*
- ii. SIDBI should help deepen credit markets for MSMEs in underserved districts and regions by handholding private lenders such as NBFCs and MFIs for increasing their presence and reach, working with local level bankers, differential pricing for refinance, awareness programmes, etc. The other areas where SIDBI can contribute viz., developing and deploying additional instruments for debt and equity which help crystallise new sources of funding for MSMEs and MSME lenders such as first loss guarantees, Pass Through Certificates (PTCs), etc. For this it needs partnership arrangements and may, if required, raise funds directly from the market based on its AAA rating.*
- iii. SIDBI should gradually take on a role of a market maker for SME debt on select platforms.*
- iv. SIDBI should review investments in SFCs, TCOs and other such subsidiaries/ associate companies where the responsibility of incubation is over.*
- v. SIDBI should continue to roll out of knowledge products including in vernacular languages.*

#### **4.14 Exit Policy for MSMEs**

4.14.1 Often, in spite of best efforts by the promoter and accommodation by the lender, MSME units fail and such units move towards insolvency or individual bankruptcy. In many economies, MSMEs are among the largest commercial users of the insolvency system. Yet, many jurisdictions treat them at par for insolvency purposes, as other corporate entities, or consumers, without regard to their unique attributes. MSME sector, particularly micro enterprises, are in informal segment. Indeed, in India by an overwhelming majority, MSMEs are proprietorship or partnership firms. Therefore, there is a need for an appropriate legal system to address insolvency, which can play a critical role for smoother exit of MSMEs from their present business. Effective insolvency regimes, if properly implemented, may mitigate many of the challenges facing MSMEs. The IBC provides for a differentiated regime for insolvency/bankruptcy of firms, proprietary firms and individuals. Delegated legislation/rules in this regard are currently under discussion. The finalization of these rules can boost lender confidence because lenders will have more certainty and predictability regarding the recovery of defaulted loans. This can increase the amount of credit available to MSME in Indian economy and in turn reduce the credit gap. Having an efficient, expeditious insolvency system in place that helps MSME or swiftly reallocates their productive assets to more efficient activities is paramount.

#### **4.14.2 Advantages of Insolvency and Bankruptcy Code for MSMEs**

Better legislation can reduce the cost of credit. This is important for MSMEs because a lower cost of credit makes financing more accessible and affordable. In Brazil, reforms to its insolvency legislation caused an average reduction in the cost of credit ranging from 7.8 percent to 16.8

percent from the level prior to the reforms being enacted. A study involving SMEs in France, Germany, and United Kingdom found that banks priced their loans based on their expected rights in the event of a default. Conversely, “creditor unfriendly” insolvency regimes resulted in higher costs. In United Kingdom, revised reorganization laws resulted in new owners retaining all employees of enterprises in 65 percent of receivership and administration cases, where the business was sold as a going concern. Job preservation for MSME employees is particularly important because MSMEs are the largest source of employment in many economies.

#### **4.14.3 Recommendations**

- i. The IBC provides for a differentiated regime for insolvency/ bankruptcy of firms, proprietary firms and individuals. Delegated legislation/rules in this regard are currently under discussion. The finalization of these rules can boost lender confidence because lenders will have more certainty and predictability regarding the recovery of defaulted loans. This can increase the amount of credit available to MSME in Indian economy and in turn reduce the credit gap. Having an efficient, expeditious insolvency system in place that helps MSME or swiftly reallocates their productive assets to more efficient activities is paramount.*
- ii. Due to the lack of sophistication on the part of MSMEs, Insolvency code/ delegated legislation should provide for out-of-court assistance to MSMEs such as mediation, debt counselling, financial education, or the appointment of a trustee.*

## **5 INFRASTRUCTURAL BOTTLENECKS AND CAPACITY BUILDING**

India embarked on the “Make in India” campaign from the year 2014. However, it has been ranked 30<sup>th</sup> on a Global Manufacturing Index (GMI) by the World Economic Forum (WEF), which is much below that of its competitor countries like China and Thailand. The “Make in India” campaign was launched by the Government of India, with the primary goal of making India a global manufacturing hub by encouraging both multinational as well as domestic companies to manufacture their products within the country. While MSMEs are major players in the manufacturing landscape of the country, availability of infrastructure and capacity building remains a matter of concern for the sector. Lack of financial literacy, operational skills, including accounting and finance, business planning, awareness about various schemes of Government, etc., represent a formidable challenge for MSME borrowers.

### **5.1 Infrastructural Bottlenecks**

5.1.1 Adequate infrastructure facilities are necessary for the overall development of all sectors of the economy and they assume greater importance for the sustainable growth of the MSME sector. Though efforts have been made to upgrade the infrastructural set up of various States/ Union Territories (UTs)/ Districts of the country by both the Central and respective State Governments, MSME units continue to face infrastructural bottlenecks, which not only restricts their day-to-day business operations but also their future growth prospects.

5.1.2 Infrastructure needed by entrepreneurs not only includes land/property, transportation facilities like railways, waterways, roadways and airways, proper channels of telecommunication and adequate supply of power but also other supporting facilities like tool rooms, testing labs, design centers, etc. Lack of access to any of these facilities can hamper the unit's production, consumption and distribution processes.

5.1.3 The transition of micro enterprises to small and to medium mainly depends on the availability of physical infrastructure including affordable place to do business, together with water and power connections, requisite permissions, etc. Some of the Infrastructural bottlenecks faced by MSMEs while setting up or carrying out a business which in turn also affects the country's march towards being a global manufacturing hub, are as follows:

- i. As the cost of land has increased considerably in past few years, the circle rate of Industrial area is usually high making it unaffordable for the MSME entrepreneur.
- ii. Lack of a model land agreement for Tribal States.
- iii. Difficulty in conversion of leasehold plots to freehold and challenges in conversion of agricultural land for industrial use.
- iv. Delay in getting access to power and electricity connection. Lack of adequate power supply in few parts of the country. Difficulty in getting access to water connection.
- v. Lack of a cost effective and efficient logistics/supply chain infrastructure.
- vi. Lack of dedicated infrastructure i.e. ready to move-in, built-in factories with plug and play facilities thereby eliminating the need to invest additional capital in acquiring and creating these facilities by micro enterprises on their own.
- vii. Lack of access to R&D Centres, Product and Prototype Development Centres, Testing Laboratories, Technology Transfer Centres, Common Environment Mitigation Facilities, Effluent Treatment Plants, etc.
- viii. Lack of infrastructure and industrial estates for services sector.
- ix. Need for up gradation of existing MSME clusters with adoption of latest technology.

## **5.2 Role of Ministry of MSME in Infrastructural Support and Capacity Building**

5.2.1 Ministry of MSME is at the helm of developing policies for the promotion and growth of MSMEs, including infrastructural support. The Ministry runs various schemes aimed at financial assistance, technology assistance and upgradation, infrastructure development, skill development and training, enhancing competitiveness and market assistance for MSMEs.

5.2.2 Further, DC MSME implements the policies and various programmes/schemes for providing infrastructure and support services to MSMEs. It functions through a network of MSME-Development Institutes (DI), Regional Testing Centres, Field Testing Stations and Technology Centres including specialized institutes for sectors like Footwear Training, Glass, Fragrance and Flavours, etc. It advises the Government in policy formulation for the promotion and development of MSMEs; providing techno-economic & managerial consultancy, common facilities & extension services, technology upgradation, quality improvement and infrastructure to MSME units; developing human resources through training and skill upgradation, etc.

## **5.3 Cluster Development**

5.3.1 MSME Clusters have been effective in promoting industrial growth all over the world. The success of these clusters is largely due to the individual small firms of the cluster closely collaborating and collectively sharing resources for various business processes *viz.*, manufacturing, technology, marketing, quality control, testing, purchase, etc. Cluster development approach is being used by different countries to overcome the problem of fragmented nature and sheer magnitude of large number of MSMEs.

5.3.2 Cluster is generally understood as a geographical agglomeration of enterprises, which produce similar or related goods or services. Vibrant clusters have presence of effective intermediary and support institutions such as business associations, training and technical assistance providers, research and technology development organisations, and enterprises are expected to benefit from the presence of the integrated support system and dynamic networks and linkages. Key expected benefits to enterprises, that are part of a cluster, are collective action to solve common challenges, common facilities, enhanced innovation and productivity, access to specialised information and business support services and lower transaction cost because of presence of localised input suppliers

5.3.3 Over the last three decades, cluster development has been recognized by the policy makers as an effective policy tool to promote economic development through strengthening of MSME competitiveness and growth. Cluster initiatives are also considered to be efficient policy instruments in that they allow for a concentration of resources and funding in targeted areas with a high growth and development potential that can spread beyond the target locations (due to spill over and multiplier effects). National governments, international development agencies and other support institutions have also been giving prominence to the cluster development approach.

### 5.3.4 Typology and Categorization of clusters

Development of clusters can be broadly divided into four stages i.e. initial phase, growth phase, maturity phase and extinction phase. Duration of different cluster development stages depends on a variety of internal and external factors and it varies from cluster to cluster and country to country. In addition to stage of development, clusters also vary depending on the composition of firms, type of relationship between them and their genesis. Clusters can be categorized as:

- i. Horizontal or Product-based Clusters: Enterprises producing similar products and different stages of productions are undertaken by individual firms e.g. Pump clusters - Coimbatore, Sports good cluster - Jalandhar, etc.
- ii. Large Unit based cluster: Clusters based around one/few large units, wherein smaller firms of the clusters supply components to large firms or work as sub-contractors to the large firms e.g., General engineering clusters- Trichy, Auto component clusters - Jamshedpur.
- iii. Vertically integrated clusters: Clusters wherein production processes are carried out separately by different units, having a high degree of inter-dependence amongst the firms.

### 5.3.5 Cluster Development in India

A study by United Nations Industrial Development Organization (UNIDO) has mapped over six thousand Clusters in traditional handloom, handicrafts and modern SME industry segments. MSMEs constitute the largest segment of most Indian clusters. Few clusters produce more than 70 - 80% of India's total produce of certain products. Cluster development approach has been adopted by many central government ministries, state governments as well as financial and support institutions. Subsequently, Ministry of MSME has also launched cluster development scheme viz., SFURTI for traditional khadi and village industries. Certain interventions in the erstwhile National Manufacturing Competitiveness Programme (NMCP) of the Ministry of MSME also followed the cluster approach. Department of Industrial Policy and Promotion (now known as Department for Promotion of Industry and Internal Trade) launched an Industrial Infrastructure Upgradation Scheme (IIUS) in 2003 as a Central Sector Scheme with a view to enhancing competitiveness of industry by providing quality infrastructure through public-private partnership in selected functional clusters.

MSE CDP – Cluster Development Status as on 31.03.2019		
CFCs Approved	Ongoing	Completed
115	47	68

### 5.3.6 Recommendations

Cluster Development 2.0 - Despite large number of cluster development support programmes targeting almost entire spectrum of MSMEs, it is widely acknowledged that impact of cluster promotion programmes is sub optimal and there is an imperative need to draw up a roadmap for greater impact of the support programmes and ensure high growth of the MSME clusters. The Committee recommends the following to revitalize Cluster development programmes in India:

- i. *Cluster prioritization and selection criteria* - There are large number of clusters but the resource availability for undertaking cluster development activities are limited. Clusters are also not uniform in nature. There are several small and big; immature and mature; leading and lagging clusters in each sub-sector. Sub sectors are also characterized by employment intensiveness, sunrise, high tech and low tech, etc.
- ii. *Widening the definition of cluster constituents and optimal size of a cluster for holistic cluster development* - Cluster has been defined by various experts on the basis of geographical concentration, group of companies engaged in similar activities; cooperation and competition at the same time, etc. The scope of the cluster development schemes may be appropriately revised in order to ensure greater inclusion and coverage of vulnerable communities.
- iii. *Synergy and coordination within large number of support schemes* - The modest budget is not only distributed across large number of schemes but even further divided at activities /sub activities level within the schemes. Such a large number of small and fragmented schemes of assistance fail to make any meaningful impact. Currently, almost 140 schemes of assistance applicable to MSMEs are implemented by different Central Ministries including Ministry of MSME.
- iv. *Improving the scheme (design, implementation and monitoring process) so that it meets the priority needs of the sector and are outcome based and impact oriented* - There is a need for improving need assessment of cluster development and the inputs required for it. Schemes are designed with too many layers of decision making and guidelines are too rigid and straight jacketed, resulting in cumbersome procedures and unrealistic conditions. Stakeholder consultations prior to finalization of design and process of interventions under cluster development initiatives need to be made more effective.
- v. *Enhancing the funding contribution from private sector* - Most cluster development initiatives are funded to a large extent by the public agencies and private sector contribution for common initiative is very small. Ways and means to enhance private sector contribution must be found, viz., through debt instruments like bonds, CDs etc., with tax incentives, through SIDBI, financially sound SFCs, etc., so that larger number of clusters can be supported.
- vi. *Strengthening the cluster eco system and intensively involve local intermediaries such as business membership organizations in developing linkages with other stakeholders such as training, educational and research institutions* - Cluster development schemes need to give appropriate focus on soft interventions such as training, capacity building, skill improvement, marketing inputs, product development and design, etc. Capacity building of the stakeholders is essential to create necessary social capital for the cluster development. To have a wider reach, bigger impact and sustainability of cluster development initiatives, it is important that interventions are mainly driven by bottom up processes and only complemented by top down approach. As the MSME sector is fragmented and heterogeneous, any development interventions need an aggregator. Business Membership Organizations (BMO) (industry associations and chambers) are the natural aggregators and there are a large number BMOs in India. However, except a few, most of the BMOs suffer from capacity and capability constraints and it is difficult to identify suitable implementation partner on the ground at cluster level. The MSME BMOs therefore need to be strengthened by way of their capacity building, long term support and accreditation.
- vii. *Ensure continuous flow of data and information on clusters and avoid duplication of efforts by different agencies and institutions* - For a concerted cluster-based development, it is critical to coordinate the efforts of different institutions that in turn will build repository of clusters, update their vital statistics regularly. Information on the units within clusters is required for the Government to make demand driven and effective cluster development interventions. Performance parameters of individual unit as well as at aggregated cluster

*level, must be measured on continuous basis to identify the deficiencies and to prioritize area of intervention.*

- viii. There is a lot of dispersed knowledge available about clusters among a range of institutions, national and international. Within the country, several reports prepared by different institutions over several years have not been collated. Besides, methodologies, best practices, evaluation frameworks and experiences need to be put together as a public good. It is recommended that dedicated coordination of these isolated and dispersed information and knowledge must be undertaken with support from interested national and international institutions.*

## **5.4 Marketing Support for MSMEs**

5.4.1 Marketing is a strategic tool for business development and is critical for the growth and survival of MSMEs. Further, MSMEs also face challenge in terms of weak forward and backward linkages for sourcing raw materials at effective price and selling the produced goods in the market. These constraints not only make it difficult for MSMEs to reach global markets but also limit their performance in the increasingly open and competitive domestic markets.

5.4.2 With increased globalization, the competition between every industry has increased significantly over the years. To withstand this high competition, MSMEs need to respond promptly to the evolving marketing needs and innovations. The sector needs to be provided with better market access facilities to sustain and further enhance its contribution towards output, employment generation and exports. However, currently lot of MSMEs do not have a clear strategy for effective sales promotion because they lack the resources and knowledge for it.

5.4.3 Some of the evolved marketing strategies like niche marketing, database marketing, cluster specific marketing, guerilla marketing and relationship marketing are vital for a flourishing business without any significant hit to the bottom-line. These marketing strategies, if implemented, can give the MSMEs a platform to go beyond the generic marketing applications, create greater acceptance, strengthen the brand, devise a focused approach and compete globally. Hence, adoption and implementation of effective marketing strategies can act as a real game changer for MSMEs in the country. It will help MSMEs to expand their value chain and stay at par with their global competitors.

5.4.4 Challenges faced by MSMEs in Marketing - Some of the key challenges encountered by MSMEs in implementing marketing strategies are mentioned below:

- i. Lack of marketing expertise: MSMEs because of their size are unable to achieve economies of scale or hire a marketing specialist who can guide the respective industries about the new trends in marketing, which can be incorporated in their relative functions.
- ii. Lack of online presence of MSMEs: According to a FICCI report, less than 6 per cent of Indian MSMEs with access to personal computers advertise online and a majority of these enterprises use traditional media. MSMEs are unaware of the effectiveness, measurability and predictability of using online advertising to reach the target audience.
- iii. Lack of Awareness: MSMEs are mostly unaware of the required knowledge of potential world markets and the demand for their products and services. There is lack of

professional competence to make efficient use of government support programmes and lack of networking capabilities and skills needed to access international market.

#### 5.4.5 Government initiatives for extending marketing support to MSMEs:

- i. International Cooperation Scheme: Visit of MSME delegations to other countries in international exhibitions/ trade fairs, conferences/ summits/workshops, etc., for exploring new areas of technology infusion/up gradation, joint ventures, improving market of MSMEs products, etc. is supported by the Government.
- ii. Marketing Assistance Scheme: The maximum net budgetary support for participating in an international exhibition/trade fairs.
- iii. Procurement and Marketing Support Scheme: To encourage MSEs to develop domestic markets and promotion of new market access initiatives.
- iv. GeM facilitates online procurement of common use Goods & Services required by various Government Departments / Organisations / PSUs. GeM aims to enhance transparency, efficiency and speed in public procurement. Existing governments support schemes aim to provide support on market creation (mandatory public sector procurement from MSEs) as well as provisioning of marketing and trade promotion services to SMEs through direct service delivery and cost subsidy for buyer-seller meets, participation in trade events, provision of market intelligence, trade finance, etc.
- v. In addition to the support provided by the Office of DCMSME and other agencies of the Ministry such as NSIC, KVIC, Coir Board, specialised agencies such as the Export Promotion Councils and the Indian Trade Promotion Organisation (ITPO) have programmes that serve the needs of MSMEs. Provisioning of effective marketing support services depends on market intelligence infrastructure, distribution channels and last mile connectivity. However, there is no centralised mechanism for collating market data and performing regular analysis and distribution networks for SMEs.

#### 5.4.6 Recommendations

- i. *Facilitate the marketing side of innovation and assist MSMEs to on-board 'B2B' and 'B2C' e-commerce market places.*
- ii. *Technology tools like SMS, digital newsletter and electronic direct mail can be used efficiently to target segmented population by MSMEs. Broadly classified as push marketing, these media tools are cost efficient and easily accessible.*
- iii. *Utilize existing Technology Centers (TCs) across the country for providing access to information on Indian and external markets for innovative products and on how MSMEs can benefit from new technological inputs.*
- iv. *Facilitate MSMEs in procuring complete and low-cost ICT solutions to improve their capacity and productivity and build their capacity for adoption of digital tools and industry.*
- v. *Developing networks of development service providers that can provide customized solutions to MSMEs that are struggling with capability and resources constraints regarding adoption of advanced technology and marketing techniques.*
- vi. *Launch of incentive and financing mechanism for adoption and commercialisation of technology developed by R&D institutions. Enhanced focus on strengthening of industry academia collaboration to promote applied research targeted at industry's constraints.*
- vii. *Incentivizing large enterprises for providing assistance and guidance to MSMEs, particularly in terms of using the latest technology and bringing them up the value chain*

- viii. *Strengthening of schemes like 'Consortia Formation', 'Brand Building', 'E-marketing through specialized MSME portals', and holding of more domestic and international exhibitions in order to provide increased marketing support to MSMEs.*
- ix. *Strengthening of MSME export promotion council.*

5.4.7 Successful marketing models of Alibaba and Amazon are given Box IX.

#### **Box IX - Alibaba Model**

Alibaba Group is one of the biggest companies in China that provides consumer-to-consumer, business-to-consumer and business-to-business sales and various other services via e-commerce web as well as offline portals. The major revenue earning services include electronic payment services, marketplace, and data-centric cloud computing. The business model of Alibaba is different from other players like eBay and Amazon. It focuses more on trade between businesses. Unlike the usual business-to-consumer approach, Alibaba focuses on being a platform for suppliers to sell products in bulk at wholesale prices to small or medium-sized businesses worldwide, who then resell them for a profit in their domestic markets. Although *Alibaba* focuses on business to business trade it also supports other trade through e-commerce web portals. *Taobao* is for consumers to trade, whereas *Tmall* is for the upcoming middle class of China to purchase branded products. There are many other subsidiaries through which Alibaba makes money. The platform also allows exporters in China to connect with the buyers in over 200 countries which mainly constitute trade agents, wholesalers, retailers, manufacturers, and SMEs engaged in the import and export business.

#### **Amazon's Kala Haat**

Amazon India launched the 'Kala Haat' program in 2016 to give Indian crafts persons and their products a global platform to showcase their products. Today, Amazon reports an impact on over 750,000 weaver and artisan households through Kala Haat. Under the partnership with the Government of Uttar Pradesh for the state's 'One District One Product scheme', Amazon, through its 'Kala Haat' programme is helping traditional industries to scale up and access the Indian market. Amazon also provides these entrepreneurs training, account management guidance, marketing tools and world-class infrastructure of storage and delivery network to aid their progress through online selling.

## **5.5 Access to Technology**

5.5.1 There has been a paradigm shift in the role of technology from being an enabler of just productivity and process to a more strategic role as a key influencer of competitive advantage. Today, MSMEs across the globe are focusing on adopting appropriate and innovative technologies to build their path of competitiveness. It is very important for Indian MSMEs to equip themselves with the latest technology to mark their footprint in the global supply chain and increase their export competitiveness. Technology has important effects on business operations of MSMEs. Technological infrastructure affects the culture, efficiency and relationships of MSMEs.

5.5.2 The most formidable problem faced by MSMEs in India has been accessing technology and maintaining competitiveness. Though India has a vast pool of technical talent with well-developed intellectual capability, the country still scores low in terms of developing, commercializing and adopting new and innovative technologies. MSME sector in India, with some exceptions, is characterised by low technology levels, which acts as a handicap in the emerging global market. Technological obsolescence is a major problem affecting MSME sector in developing countries like India. To counter these problems, there is a requirement of technology upgradation and modernization of MSMEs through policy initiatives and financial incentives.

5.5.3 The primary channels through which MSMEs source their technologies are *viz.*, making use of an external R&D centre; licensing for technology acquisition; purchasing of existing technology through vendor / supplier; tradeshow, technical journals used for accessing technologies; sponsoring of R&D in Universities. Number of public funded research and

technology development organizations (CSIR Labs, IISc, BIRAC, NRDC, DRDO, ICAR, TIFAC, DST, TDB, NSTEDB, NIF, STPI, APCTT, etc.) have been facilitating development of new technology with potential for commercialization, apart from numerous government support programmes, aimed at promotion of applied research, technology transfer, commercialization, and social innovation. However, a very small fraction of these innovations are getting either commercialized or adopted by the MSMEs. Most innovation remains at “prototype/ proof of concept” stage. MSMEs particularly micro entrepreneurs and village industries are not being adequately served.

5.5.4 The main challenges and opportunities in India for promoting Technology and Innovation are:

- i. Understanding of business proposition of technology
- ii. Paying capacity of the MSMEs for acquiring technologies, due to lack of scale
- iii. Recognition of technology transfer for raising loans
- iv. Lack of linkages between industry, R&D institutions and academic institutions
- v. Lack of Availability and accessibility of adequate funding
- vi. Awareness on intellectual protection regime
- vii. Mapping of database for technologies not available with various Government /private agencies.
- viii. High cost or non-affordability of innovative technology
- ix. A huge divergence persists between research institutions (suppliers of technology) and the business requirements of MSMEs (consumers of technology)
- x. There is virtually no “matchmaking” or integration between large firms and MSMEs that can catalyze technological adoption in MSMEs.
- xi. Lack of skilled manpower

5.5.5 Initiatives taken by the Government

Government plays a key role in enabling new technologies and applications. Ministry of MSME has taken several initiatives in terms of launching various schemes and programmes to help MSMEs become globally competitive by *upgrading to latest technologies*. These are:

- i. Credit Linked Capital Subsidy Scheme (CLCSS) for technology upgradation of MSMEs
- ii. Intellectual Property Facilitation Centres for MSMEs
- iii. Financial support to MSMEs for “Zero Effect Zero Defect” certification
- iv. Design Clinics for design expertise to MSMEs
- v. Scheme for Incubation to promote emerging technological and knowledge based innovative ventures that advocates the use of energy-efficient technologies in manufacturing units
- vi. Enabling manufacturing sector to be competitive through QMS & QTT (now part of the ZED initiative)
- vii. Other central ministries e.g. Ministry of Textiles, Ministry of Food Processing, Ministry of Electronics and Information Technology also run different support schemes to facilitate technology upgradation, process improvement and quality enhancement.

### **5.5.6 Recommendations**

- i. *Technology Mission: Technology Missions related to water, literacy, immunization, oil seeds, telecom, jute, cotton and dairy had been set up by the Government. A Technology Mission should be launched by the Ministry of MSME for converging the efforts of various stakeholders for the technology upgradation of the MSMEs across the country.*

A. *The broad canvas for a technology mission should be to:*

- a. *Act as one-stop solution for all technological needs of the MSMEs*
- b. *Promote national and collaborative developmental research to address prevalent and emerging challenges.*
- c. *Evaluate the present level of technology in various sectors and to forecast technology level to be achieved. To explore existing and emerging technologies suitable for MSMEs.*
- d. *Develop synergies with line departments at Central/ State level for last mile connectivity of the research findings.*
- e. *Explore importing of foreign technologies, customising them and providing to MSMEs through cluster approach.*
- f. *Evolve Science & Technology based sustainable models with industry and recommend appropriate policy inputs including providing technologies at affordable cost through cluster approach.*
- g. *Advocacy for Strong Apprenticeship Act and its implementation*
- h. *Assisting the MSMEs who are willing to enter into collaboration with companies/ institutions having latest technology for transfer of design, training, etc.*
- i. *Fund institutions/innovators to solve technology related problems of MSEs in rural areas.*

B. *To give focused attention, technology mission in the first instance, may give priority to selected sectors both in Manufacturing such as food & agro processing industry, apparel, leather and leather products, gems & jewellery, automobile components, toys, drugs and pharmaceuticals, etc., and Service sector like tourism, hospitality, health care, etc. For each of the industries selected, a sub mission should be set up.*

C. *The Mission should promote environment friendly technologies and address issues relating to pollution control by MSMEs, including common effluent treatment plants. Similarly, the technology mission should promote energy conservation by MSMEs. MSMEs need to improve the quality of their products both for the domestic market as well as for exports.*

- ii. *Need for more Industry specific Technology Centres: Ministry of MSME has a successful model of Technology Centres for providing short term and long term training programmes apart from providing tools, consultancy and common facility support to MSMEs. There is a need to set up more product specific TCs in the hitherto unserved fields of Solar, Battery technology, e-vehicle, AR/VR/AI, food processing, basic trades like carpentry, advanced welding, black smithy, etc.*

- iii. *FDI policy must focus on development of local MSME sector to facilitate capacity, capability and technology development of MSMEs. In respect of all large projects involving FDI, ancillary development should be made a condition.*
- iv. *Government has announced the offset policy for the Defence procurement. It is essential to set up a mechanism in the Defence Ministry to ensure that the offsets under Defence purchases are suitably focused to support MSMEs in upgrading their capacities, capabilities and technology by providing handholding support to them. Similar offset must also be ensured by other like Railways, Airlines, Surface Transport, etc.*
- v. *Incubation Schemes of Ministry of MSME, Biotechnology, NITI Aayog, DST, other departments /, state governments should be strengthened and synergised. Joint Working group on Incubation Schemes should be set up. The amount of assistance should include the cost of nurturing ideas, making prototypes and even marketing the test batch in the markets and then improving the product till it stabilises.*
- vi. *Attracting private sector R&D investment: The Government should constructively encourage more R&D investment and resources from global corporations and the domestic corporate sector. Government could consider establishing a dedicated public-private development fund for core technologies in infrastructure, energy, biotechnology, advanced genomics and other high-priority fields. Government should incentivize large enterprises in mentoring and guiding to MSMEs, as a part of their CSR activity, particularly in terms of using the latest technology and moving up the value chain.*
- vii. *To conduct workshops for MSMEs in partnership with institutions and programmes which help promote science, technology, and innovation and enable them to interact with experts who can help them better understand consumer demand and emerging trends.*
- viii. *Lack of access to emerging technologies has prevented Indian MSMEs from growing to their full potential. Opportunities can be provided for international partnership for industries and clusters where Indian MSMEs have an inherent competitive advantage. This will enable Indian MSMEs to stay updated with latest technologies. Also, involvement of large enterprises to act as mentors for MSMEs will help in the development of specific clusters besides integrating MSMEs in the value chains.*

## **5.6 Entrepreneurship and Skill development**

Capacity Building of MSMEs involves suitable interventions both at enterprise level and cluster level. For individual MSMEs, it ranges from financial literacy, business knowledge, technology support and access to markets. Entrepreneurship development is the process of improving the skills and knowledge of entrepreneurs, enhancing the capacity to develop, manage and organize a business venture while keeping in mind the risks associated with it.

### **5.6.1 Entrepreneurship and Skill Development Initiatives**

Ministry of MSME organises Entrepreneurship and Skill Development Programmes (ESDP) for the existing and potential entrepreneurs, to build their capacity to take up successful ventures. The objective is to motivate young persons representing different sections of the society including SC/ST/Women, physically handicapped, Ex-servicemen and BPL persons to consider

self-employment or entrepreneurship as one of the career options. The objective is to promote new enterprises, capacity building of existing MSMEs and inculcating entrepreneurial culture in the country. The programme includes the following:

- i. Industrial Motivation Campaigns (IMCs) - Industrial Motivation Campaigns are organized to identify and motivate traditional / non-traditional entrepreneurs having potential for setting up MSEs and to lead them towards self-employment. IMCs are also organised for Clusters SPVs/ Industry Associations/ Chambers for propagating schemes for promotion and development of MSMEs.
- ii. Entrepreneurship Awareness Programmes (EAPs) -Entrepreneurship Awareness Programmes are being organized to nurture the talent of youth by enlightening them on various aspects of industrial activity required for setting up MSEs. These EAPs are generally conducted in ITIs, Polytechnics and other technical institutions, where skill is available to motivate them towards self-employment.
- iii. Entrepreneurship-cum-Skill Development Programme (E-SDP) - Comprehensive training programmes are organized to upgrade skills of prospective entrepreneurs, existing workforce and also develop skills of new workers and technicians of MSEs by organising various technical cum skill development training programmes. The basic objective is to provide training for their skill upgradation and to equip them with better and improved technological skills of production.
- iv. Management Development Programmes (MDPs) -The objective of imparting training on management practice system is to improve the decision-making capabilities of existing & potential entrepreneurs resulting in higher productivity and profitability. These programmes are of short duration and the curriculum is designed based on the needs of the industry and are customized, if required by the clients.
- v. Vocational and Educational Training - The Regional Testing Centers, Field Testing Stations and Autonomous bodies like Tool Rooms and Technology Development Centers (TDCs) of the Ministry conduct long term, short term, trade/field-specific and industry-specific tailor-made courses as well as vocational training programmes.
- vi. Enterprise Development Centre (EDC) - DC MSME through its field offices i.e. Micro Small and Medium Enterprises Development Institutes (MSME-DIs) and Technology Centres (TCs) not only caters to the needs of aspiring entrepreneurs across the country but also imparts skill sets to the youth to equip themselves for the job market. However, due to presence of MSME-DIs and TCs only in the state capitals and few cities, their outreach is very limited. To enhance outreach and to further consolidate the enterprise facilitation process, the EDC has been conceptualized to provide impetus to the entrepreneurship development initiatives and business incubation of the DC MSME through hand holding support to new and budding entrepreneurs in the country.

#### 5.6.2 Skill Mapping for MSMEs

- i. Skill Mapping is the process of identifying the specific skills, knowledge, abilities, and behaviours required to operate effectively in a specific trade, profession, or job position. M/o MSME has compiled district-wise Skill Development requirements (skill maps) for

652 districts of the country. The District-wise skill development needs have been formulated based on industry clusters situated in the respective districts. Further, based on industry clusters, the type of skills required to produce products and subsequently, the need for training programmes to be conducted for skilling un-employed youth have been identified.

- ii. Skill Map of each district contains details on the number of training institutes and engineering colleges in each district, including the names of the technical institutions (ITIs, Polytechnics, and Engineering Colleges with the facilities), availability of various raw materials and types of existing industries in that district.
- iii. District Industrial Profiles of each of these districts enables entrepreneurs find the most suitable place to locate their business. The district-wise skill profiles have been prepared in consultation with stakeholders, such as the State Governments, Industry associations, and various universities and have been validated by Industry associations and universities.

### 5.6.3 SME Incubators

Innovative entrepreneurial ideas must be fostered and developed in a supportive environment before they become attractive for venture capital. Hence the need arises for incubation centres - to promote and support untapped creativity of individual innovators and to assist them to become technology-based entrepreneurs. The objective is to provide early stage funding to nurture innovative business ideas (new indigenous technology, processes, products, procedures, etc.) that could be commercialised in a year. Ministry provides financial assistance for setting up business incubators.

### 5.6.4 Challenges in Entrepreneurship and Skill Development

- i. The key constraints to capacity building of MSMEs mainly relate to scale and cost. Though there are numerous schemes operated by the Ministry by way of financial assistance, aid, etc., the main concern is upscaling these measures and reaching out to MSMEs in every corner of the country.
- ii. MSMEs lack capacity to integrate with the world market for competing at the global level and export/ supply to larger firms both internationally as well as domestically. The Global Value Chain (GVC) linkage offers this opportunity. The skill sets needed to compete with global players are different and these firms must be technologically and digitally advanced.
- iii. A weak industry-academia interface exists in the country, which hampers the ability of students to venture into entrepreneurship. To give impetus to the capacity building of entrepreneurs dedicated efforts are required especially in Tier II and III cities.
- iv. Education Institutions / University / institute need to be roped in to enhance the capacity of a MSME Entrepreneur during under-graduate/graduate level. Having Entrepreneur Development Cell, for capacity building of entrepreneurs, at educational institutions will go a long way in developing right set of skills right in the beginning. These cells can be used by SMEs to source ideas / technology / modernisation/ innovation, etc., to be globally competitive.
- v. There is a disconnect between the demand for and supply of skilled manpower through vocational and technical training, skill up-gradation, building of new skills, mapping of existing skills and their certification, etc. The initiatives taken for skill development are to be attuned with the future needs of skill development in the country.

## **5.7 Delivery Mechanism and Need for MSME Eco-system**

5.7.1 The current growth of MSMEs is non-uniform and there exists a significant gap in growth of enterprises across services and manufacturing sectors. It is, therefore, critical to see that adequate growth is met across services, manufacturing and agriculture segments to ensure holistic and stable overall economic growth. The Government initiatives for the promotion and development of MSMEs have been segmented not recognising holistic nature of business eco-system. The gaps need to be filled to take the MSMEs to the next level of competitiveness and scale. In this emerging context, MSMEs need a business eco-system that empowers them to compete effectively. There is a need to provide ecosystem support and turnkey facilitation to enterprises particularly for self-employed individuals and MSEs.

5.7.2 The eco-system is required for connecting the dots, filling the gaps- and providing missing interventions. It will seek to dovetail all programmes, schemes, initiatives and components pertaining to enterprises within the Ministry and across other Ministries. The programme seeks to support individuals and enterprises by way of human development, market access, credit access, technology and hand-holding facilitation. Further, this will also provide a platform of convergence for civil society and private sector initiatives.

5.7.3 The Enterprise Eco-System - Building on its knowledge and expertise of the MSMEs, the DC MSME is forging a holistic combination of the strengths of Technical Assistance and Financial Assistance. Under it, DC MSME will transform the existing scenario into an engaging and effective eco-system, promotion model, by focusing on the concept of UDYAM-JYOTI. The creation of seven verticals will strengthen the Enterprise Eco-System:

- i. Human Capital Development
- ii. Knowledge Dissemination
- iii. Access to Finance including Insurance
- iv. Access to Technology
- v. Access to Common Facility (Infrastructure)
- vi. Access to Markets
- vii. Policy, Governance and Ease of Doing Business

5.7.4 The Need for creation of a Non-profit Aggregator - At present, the schemes are working in isolation and cater to a limited number of target beneficiaries. This leaves certain gaps and uncovered areas from the sectoral angle. To cite an example, MSME Tool Rooms provide specialized and high-quality training, consultancy and tooling technology services in their respective fields but there are other fields also in which MSMEs need such support. Similarly, the schemes for credit, technology, cluster infrastructure, marketing, etc. also leave out gaps mostly because of institutional rigidities that take time to resolve. There are several schemes in respect of various facilitation requirements of MSMEs operated by other ministries of Government of India and State governments through non-profit as well as for-profit institutions.

### **5.7.5 Recommendations**

- i. *The Committee recommends setting up of a Non-profit SPV to support crowd sourcing of investments by various agencies particularly CSR and non-profits to pave the way for conducive business ecosystem for MSMEs. The SPV will also coordinate with NSDC, NSIC and other financial/promotional institutions apart from facilitating angel funds and*

*management support to Government in terms of mobilizing investments from multi-lateral institutions. The activities proposed to be taken up by Non-profit SPV for promotion and development of MSMEs are as under:*

- a. Government programmes in integrated mode to take up interventions for viability gap and pave the way for crowd sourcing of knowledge services/ capital.*
  - b. Consolidation and convergence of the activities of various technology service providers. Convergence of investments under all the MSME related Central/ State management.*
  - c. Function as designated agency for identified Government schemes/ projects in the MSME sector.*
  - d. To develop joint ventures and public-private partnership to pave the way for greater private sector participation and maximization of returns from existing investments in public infrastructures and institutions.*
- ii. National Council for MSMEs - The first step in this direction is to ensure Policy Convergence. The convergence has to begin at the national level and go down the federal structure. In order to facilitate coherent policy outlook and unity of monitoring, it is recommended that at the apex level a National Council for MSMEs should be set up under the Chairmanship of the Prime Minister with the Ministers for MSME, Commerce & Industry, Textiles, Food Processing, Agriculture, Rural Development, Railways and Surface Transport being members. The states should have a similar State Council for MSMEs.*

## **5.8 Financial Literacy**

5.8.1 An important element of enhancing the capability of MSMEs is to make them financially literate, so that they are better positioned to take advantage of the various benefits that the financial sector can offer them. For instance, being aware and choosing the most appropriate payment and deposit services, including digital ones is crucial for MSMEs. Similarly, it is important for them to understand the benefits, risks, costs and limitations related to digital services and platforms for funding the business (such as crowd funding, peer-to-peer lending and initial coin offerings). The importance of financial skills for MSMEs has been recognised by the G20/OECD High-Level Principles on SME financing developed in 2015, where Principle 7 recalls the importance to “Enhance SME financial skills and strategic vision”. The OECD/INFE have categorized various financial competencies for MSEs across four categories viz., choice and use of financial services; financial planning and business management; risk and insurance; and financial landscape. These have been further categorized across basic components of knowledge, attitude and behavior and across life stages of enterprises viz., basic (informal), starting up (formal), growing, and closing.

5.8.2 Policy makers seeking to improve the level of financial literacy among MSMEs could start with collecting evidence on the levels of financial literacy among MSMEs and identifying what financial competencies MSMEs and potential entrepreneurs need. This could then be used to drive a financial literacy program. National Centre for Financial Education (NCFE) is a non-profit company created under Section 8 of Companies Act 2013, to promote financial literacy in India. It is promoted by four major financial regulators RBI, SEBI, IRDA and PFRDA.

### 5.8.3 Multi stakeholder approach of RBI

In India, the RBI is implementing the National Strategy for Financial Education (NSFE) in collaboration with different stakeholders. Initiatives are underway to address demand side barriers and enhance financial literacy in a digital landscape. This is predominantly bank led, delivered through Financial Literacy Centres (FLC) set up by banks. Besides the traditional approaches, efforts are on to spread financial literacy through interactive and non-interactive kiosks in different locations with the financial messages administered from a central location. In addition, RBI is also looking at collaborations with NGOs on using digital means to spread financial literacy through IVRS, mobile apps, SMS as well as through Banking Correspondents.

5.8.4 In India, "Going Digital" has been one of the important objectives of financial literacy programs and disseminating financial literacy on new and emerging digital platforms like the Unified Payments Interface (UPI) has been a key priority area for RBI. 'RBI Kehta Hai' has been useful to increase awareness amongst customers. The various initiatives are also supplemented with mass media campaigns.

### 5.8.5 Content creation, dissemination and evaluation

Developed under the aegis of NCFE, CaBFLiP (capacity building for financial literacy programmes) booklet covers four modules viz., Money and Transactions, Planning and Managing Finances, Risk and Reward & Financial Landscape spread across 20 sub-competencies based on the OECD/INFE Core competencies on financial literacy for adults. This 240-page book is for the knowledge of the financial literacy trainers. To supplement physical training programmes, an e-learning portal is also being developed for trainers on the CaBFLiP content. Many audio visuals have also been prepared for wider dissemination based on simple messages such as KYC guidelines, electronic banking, banking ombudsman, etc.

### 5.8.6 Recommendation

*The Committee recognizes the need for the creation of similar content for the benefit of entrepreneurs, which can be prepared based on OECD/INFE Core competencies framework on financial literacy for MSMEs after adopting it to Indian Context. For example, NCFE has prepared two Audio Visuals on Certified Credit Counsellor and Udyami Mitra Portal for wider dissemination to the entrepreneurs. For dissemination of the content, various delivery channels such as mass media, RSETIs, FLCs, target group specific meetings conducted by various industrial bodies such as town hall meetings with entrepreneurs and specific MSME clusters can be explored. Finally, it is also important to carry out periodic surveys among the owners/managers of MSMEs across the country to assess the levels of financial literacy and the impact of literacy programmes. Availability of credit, infrastructural issues, bank facilities, and many more indicators can also be measured across the regions and targeted policies can be formulated accordingly.*

## 6 GOVERNMENT SCHEMES AND OUTREACH

The evolution of an enterprise from micro to small and medium is a continuous process in entrepreneurial domain. This is possible by harnessing the resources and support that is prevalent and created by the Government through various ministries. Ministry of MSME, through its various schemes help and facilitate the promotion and development of entrepreneurs' especially small businesses in attaining a level playing field in the market. Various other Ministries also extend support in the areas of skill development, market development assistance, technology support, credit flow, public procurement policies, etc.

### 6.1 Supportive Role of the Government

6.1.1 At the Centre level, MSMED Act, 2006 has been enacted to provide for facilitating the promotion, development and enhancing the competitiveness of MSMEs. Chapter V, Section 9 of the Act empowers GoI to issue guidelines for enhancement of competitiveness through programs on: technology upgradation and skilling, marketing assistance, infrastructure facilities, cluster development, backward and forward linkages.

6.1.2 Over the years, Ministry of MSME has launched several schemes to address different needs of the MSME ecosystem. Although, Ministry of MSME is the nodal ministry for MSMEs in the country, yet on the ground several sectoral Ministries have a presence and contribute in this direction. For instance, Ministry of Textiles through its Development Commissioner (Handlooms) focuses on awareness creation, skill development, design and technology, market intelligence, etc., for the handloom sector. Ministry of Ayush ensures the development and propagation of AYUSH systems of medicine by assisting in creation of AYUSH clusters through Special Purpose Vehicles. Major schemes being run by these Ministries are provided in the Table XII below.

Table XII : Major schemes of the Government	
Ministry	Scheme
Ministry of MSME	<ul style="list-style-type: none"> <li>- A Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship(ASPIRE)</li> <li>- Scheme of Fund for Regeneration of Traditional Industries (SFURTI)</li> <li>- Credit Linked Capital Subsidy Technology Upgradation Scheme (CLCS-TUS)</li> <li>- Market Development Assistance to Khadi artisans (MDA)</li> <li>- Technology Development Centers are providing skilling on cutting edge technology to youths and MSME</li> <li>- Micro and Small Enterprise Cluster Development Programme (MSE-CDP)</li> <li>- National SCST Hub</li> <li>- Coir Udyami Yojana</li> </ul>
Ministry of Food Processing Industries	<ul style="list-style-type: none"> <li>- Marketing Research and Information Network</li> <li>- Development/Strengthening of Agricultural Marketing Infrastructure</li> </ul>

	<ul style="list-style-type: none"> <li>- Grading and Standardization</li> <li>- Agro processing Cluster</li> <li>- Mega Food Parks</li> <li>- Publicity and Marketing</li> </ul>
Ministry of Commerce	<ul style="list-style-type: none"> <li>- Startup India</li> <li>- Trade Infrastructure for Export Scheme</li> <li>- Modified Industrial Infrastructure Upgradation Scheme</li> </ul>
Ministry of Textile	<ul style="list-style-type: none"> <li>- Capacity Building in Textile Sector</li> <li>- Powerloom Cluster development</li> <li>- Integrated Textile Parks</li> <li>- Ambedkar Hastashilp Vikas Yojna</li> </ul>
Ministry of AYUSH	<ul style="list-style-type: none"> <li>- Assistance to organisations (government / non-government non-profit) engaged in Ayush education / drug development and research / clinical research, etc. for upgradation to Centres of Excellence</li> <li>- Scheme for Development of Ayush Clusters</li> </ul>
Ministry of Chemicals and Fertilizers, Department of Pharmaceuticals	<ul style="list-style-type: none"> <li>- Cluster Development Programme for Pharma Sector (CDP-PS)</li> <li>- Pharmaceutical Promotion and Development Scheme</li> </ul>
Ministry of Communication and Information Technology	<ul style="list-style-type: none"> <li>- Technology Incubation and Development of Entrepreneurs</li> <li>- Software Technology Parks</li> </ul>
Ministry of Skill Development and Entrepreneurship Schemes	<ul style="list-style-type: none"> <li>- Udaan Training Programme for Unemployed Youth of J&amp;K</li> <li>- National Skill Certification and Monetary Reward (STAR scheme)</li> <li>- Pradhan Mantri Kaushal Vikas Yojana</li> </ul>

6.1.3 Apart from these initiatives, Pradhan Mantri MUDRA Yojana, Make in India, Startup India, ease of doing business and GST are some of the other major initiatives facilitating growth of the sector. A major decision regarding change in classification of MSMEs from 'investment in plant and machinery/equipment' to 'annual turnover' has been proposed. Taking turnover as a criterion can be pegged with reliable figures available e.g. in GST Network and other methods of ascertaining will help in having a non- discretionary, transparent and objective mechanism that will eliminate the need for inspections, make the classification system progressive and evolutionary and improve the ease of doing business. This is one of the many reform steps taken by the Ministry aligned to Maximum Governance, Minimum Government. The consequent amendment to the MSMED Act, 2006 for changing the basis of classification needs to be expedited.

6.1.4 In addition, there are State-level interventions in the MSME sector. At the state level, MSME Policy of respective states serves as a guiding principle to schemes and initiatives. Different States provide different fiscal incentives to promote growth of sectors aligned to the State. In addition to fiscal incentives, few States like Haryana and Madhya Pradesh have designed schemes and initiatives aligned to specific needs of the State. Mini-Cluster scheme in

Haryana, setting up of Business Facilitation Centres in Madhya Pradesh are few examples in this regard. The details of Schemes implemented by various Ministries is given in Annex II.

## 6.2 Need for Reforms

6.2.1 Government initiatives have, however, been segmented and piecemeal in their approach not catering to the complete requirement of business ecosystem in which enterprises operate. These are due to delivery constraints because of limited resources - both man power and financial resources and coverage constraints. For example, in Ministry of MSME itself, out of around thousand potential clusters spread across the country, interventions have been made in only 115 clusters under the MSE-CDP scheme, 594 SPVs are in operation under the LEAN Manufacturing Scheme while 20,000 units have got registered and certificates have been issued to 86 units under the ZED Scheme.

6.2.2 The exponential growth in number of B2B startups in India, catering to the needs of digital transformation and financing needs of MSMEs is testimony to the huge unmet need on the demand side. Reforms on the supply side need to augment the delivery capacity of Government agencies and be more responsive and tailored to the demands of MSMEs. Further, there is immense scope to leverage private sector in the growth of MSMEs by designing programmes that will be a win-win situation for MSMEs, Private Sector as well as Central and State Governments.

## 6.3 Mapping Elements of an Enabling Ecosystem for MSMEs with various Government Initiatives

6.3.1 The experience on the ground and available indicators have led to creation of seven pillars that contribute towards an enabling ecosystem for an enterprise to be born, germinate, blossom and sustain. (also discussed in Chapter 5)

<b>Table XIII : Seven components of the MSME ecosystem</b>	
<b>Pillar</b>	<b>Description</b>
Human Capital Development	Enabling entrepreneurship and skill development to build human capital for the sector
Knowledge Dissemination	Enabling one-stop information sources to resolve information asymmetry
Access to Finance including Insurance	Enabling timely access to credit and insurance products
Access to Technology	Enabling development of emerging technology ecosystem
Common Facility Infrastructure	Enabling incubation, plug and play facilities in major clusters
Facilitating Access to Markets	Enabling improved access to markets including digital marketing enablement
Policy Governance and Ease of Doing Business	Enabling responsive policy formulation

6.3.2 These seven pillars are presented below, the illustration depicts the seven components of the ecosystem in a floral pattern where MSME competitiveness and sustainability is at the centre. As a first step, all existing MSME Schemes have been aligned to the seven pillars of the ecosystem as mentioned above. The Table below illustrates that even after the realignment, there are gaps that remain to be addressed. The intensity of these gaps varies across different regions of the country. The situation does not change much when a similar mapping is done for the schemes of other Ministries.



Table XIV : Mapping elements of MSME Ecosystem to various Schemes							
Schemes	Human Capital	Knowledge	Finance	Technology	Infra	Markets	Policy
EDC	✓	✓	✓	✓		✓	✓
NMCP(CLCS-TUS)	✓	✓	✓	✓	✓		
CLCSS		✓	✓	✓			
CGTMSE		✓	✓				
Interest Subvention			✓				✓
SFURTI	✓	✓		✓	✓	✓	
MDA		✓				✓	
ICS		✓				✓	
PMEGP	✓	✓	✓				
MAS		✓				✓	
CDP		✓		✓	✓		
Coir Vikas Yojana	✓	✓			✓	✓	
ASPIRE	✓	✓					
Solar Charkha	✓	✓		✓			
ISEC			✓				
Coir Udyami Yojana	✓		✓				
National SC/ST Hub		✓	✓	✓		✓	✓

### 6.3.3 Recommendations

- i. *The Committee recommends that the Ministry of MSME should be the Nodal Ministry for all interventions pertaining to the MSME Sector, rather than multiple schemes being run by different Ministries for promotion of MSMEs in their respective domain.*
- ii. *There is a potential to develop an ecosystem of sustainable, natural resource dependent and community based micro-enterprises for livelihood security in rural and backward areas. This can happen by leveraging natural assets that have been created on a large-scale under various schemes of the Government like MGNREGA, NRLM, National Afforestation Programme besides various sectoral interventions by different Ministries. However, these exist in isolation without synergistic operations or fall short because of small but critical gaps for effective implementation. The requirement on the ground is to optimize the use of existing schematic natural and infrastructural resources for the benefit of MSMEs.*
- iii. *It is critical that a mechanism is devised to converge and integrate various initiatives horizontally and vertically. The first step in this direction is identification of demand. Access and use of data available with various agencies like banks and other financial institutions besides other high touch data and data with authorities like GST, GeM should be pooled, subjected to data analytics to identify real demand and gaps in supply on the ground. Based on such an analysis, scheme delivery and policy initiatives need to be dynamically fine-tuned with minimum lag.*
- iv. *The business of supporting MSMEs should be done in a business-like manner without sectoral and jurisdictional limitations. Perhaps a corporate entity could be thought of as a delivery and implementation vehicle in this regard. This could be a not-for-profit entity whose structure could be devised so that it remains lean and sustainable.*
- v. *Several initiatives need to be taken to support MSMEs in all stages of their life cycle. One of the major steps is to refurbish the system of DICs and create EDCs at the grass root level. These EDCs will act as one stop-shop for information and facilitation including business development services required by aspiring and existing entrepreneurs. This will include assisting them for obtaining various Central and State Government Registrations like UAM, GST Registration, MSME Databank, labour licenses, etc. An online resource, India Enterprise Portal could be envisioned to be a knowledge aggregator for the sector. It would act as an information repository as well serve the need for knowledge dissemination. Consultations with these forums will enable MSME centric decision making.*
- vi. *PMEGP needs to be restructured to better meet aspirations of young India. The scheme may have one component reflecting the present support for new units only which may be, for say, 25% of the funds under the scheme with subsidy of upto 15%. The balance 75% must be used for upscaling services for business counselling, help in developing and drafting business proposals and exposure trips for budding and first generation entrepreneurs.*

## 7 ACCESS TO FINANCE

### 7.1 Institutional arrangement for financing MSMEs

Access to timely and adequate credit by MSMEs at a reasonable cost is essential for growth of the sector. The institutions lending to MSMEs in India regulated by Reserve Bank include Scheduled Commercial Banks (Public Sector Banks, Private Sector Banks including Small Finance Banks, Foreign Banks, Co-operative Banks and Regional Rural Banks) and Non-Banking Financial Companies including NBFC- MFIs. In addition to this, Securities and Exchange Board of India (SEBI) regulates the institutions engaged in providing or mediating capital to MSMEs such as SME Exchanges, Angel Investors, Venture Capital and Private Equity. Apex institutions such as SIDBI and MUDRA provide sectoral support and come within the purview of the Central Government.

### 7.2 Status of MSME Financing

#### 7.2.1 MSME Credit Demand and Gap Estimates

In India, the total addressable demand for external credit is estimated to be ₹37 trillion<sup>6</sup> while the overall supply of finance from formal sources is estimated to be ₹14.5 trillion. Therefore, the overall credit gap in the MSME sector is estimated to be ₹20 – 25 trillion.

#### 7.2.2 Credit Flow to MSME sector by SCBs and NBFCs

At an aggregate level, the banking sector has credit outstanding to MSMEs of approximately ₹17.4 trillion as on March 31, 2019. SCBs account for 90% of the share of this, although NBFCs have grown at a healthy rate in recent years.

Table XV - Credit Flow to MSME sector <span style="float: right;">(Amount in ₹ Billion)</span>					
Year ended	Public Sector Banks	Private Sector Banks	Foreign Banks	Scheduled Commercial Banks	Non-Banking Finance Company
	Amt. O/s	Amt. O/s	Amt. O/s	Amt. O/s	Amt. O/s
March 2014	7583.78	2471.22	344.30	10399.30	85.76
March 2015	8526.89 (12.44%)	2815.48 (13.93%)	367.87 (6.85%)	11710.26 (12.61%)	286.48 (234.05%)
March 2016	8205.48 (-3.77%)	3590.85 (27.54%)	363.73 (-1.13%)	12160.07 (3.84%)	880.13 (207.22%)
March 2017	8289.33 (1.02%)	4309.62 (20.02%)	365.02 (0.35%)	12963.98 (6.61%)	1113.10 (26.47%)
March 2018	8645.98 (4.30%)	4107.60 (-4.69%)	488.81 (33.91%)	13242.39 (2.15%)	1441.40 (29.49%)
March 2019*	9367.24 (8.34%)	5717.04 (39.18%)	691.37 (41.44%)	15775.66 (19.13%)	1622.17 (12.54%)

Source: As reported by Scheduled Commercial Banks to RBI

Note: Figures in parenthesis indicate Y-o-Y % growth/decline

\* Data for March 2019 is provisional

<sup>6</sup> IFC Report (2018)

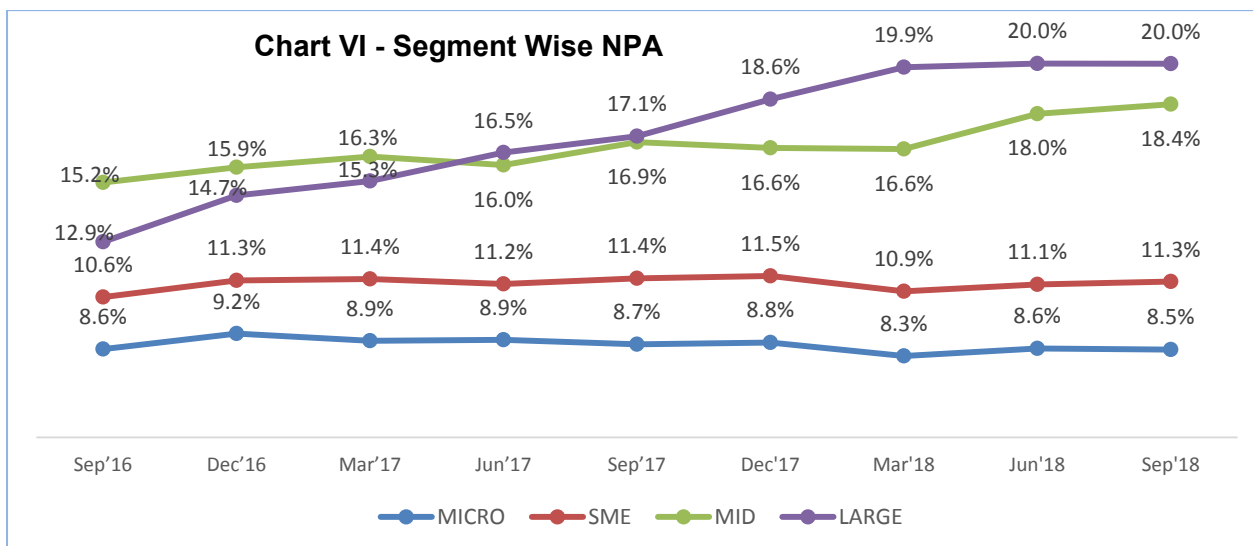
### 7.2.3 Credit Exposure and NPAs by Segment

Since MSMEs represent such a heterogeneous set of firms, it is relevant to study credit dynamics by segment.

<b>Table XVI : Overall Credit Exposure</b>					<i>(in ₹ lakh crore)</i>
	Micro <₹1 Cr	SME ₹ 1 Cr- 25 Cr	MID ₹25 Cr-100 Cr	Large >₹ 100 Cr	Overall
Sep'16	3.0	7.5	4.8	34.1	49.4
Dec'16	2.9	7.5	4.9	34.3	49.6
Mar'17	3.1	7.8	4.9	34.1	50.0
Jun'17	3.3	8.1	5.0	34.4	50.8
Sep'17	3.5	8.5	5.2	34.7	51.8
Dec'17	3.7	8.9	5.4	36.4	54.5
Mar'18	4.0	9.6	5.5	37.8	57.0
Jun'18	4.2	10.0	5.5	38.3	58.1
Sep'18	4.3	10.0	5.5	38.9	58.7
Y-o-Y growth (From Sep'17- Sep'18)	22.3%	18.4%	7.2%	12.0%	13.5%

Source: TransUnion CIBIL

From the above, it can be inferred that Micro (*credit exposure less than ₹1 crore*) and SME (*credit exposure between ₹1 crore-25 crore*) segments aggregated ₹14.3 lakh crore as on September 2018. Micro and SME accounted for 24.3% of commercial credit outstanding with Y-o-Y (Sep 17-Sep18) growth of 22.3% and 18.4% respectively. Chart VI showing the trend of NPA in the above mentioned segments during the same period is given below:



Source: TransUnion CIBIL

The key trends emerging from the above data, are as follows:

- i. The micro segment (<₹1 crore) is the fastest growing segment and accounts for ₹4.3 lakh crore out of the total of ₹14.3 lakh crore outstanding MSME credit). This segment grew at 22% y-o-y in 2018. This segment also exhibits the lowest NPAs, although in absolute terms still high at 8.5%.
- ii. As per RBI data, the share of NBFCs in outstanding credit to MSME was 9.3% in March 2019. This trend is expected to accelerate with the emergence of FinTech (typically registered as NBFCs) focused on this segment.
- iii. Share of NBFCs in outstanding credit to Medium enterprises has also become significant. As of March 2018, credit from NBFCs was 17% of the total credit extended by SCBs and NBFCs to Medium enterprises, as per RBI data.

#### 7.2.4 Data on Formal Credit to MSMEs

The data on MSME credit is captured by RBI from banks and NBFCs. Credit Information Companies (CICs) are also receiving similar data from banks and NBFCs. The data set with regard to formal credit to MSME differ in some respect which is explained in Box X.

### **Box X : Data on Formal Credit to MSMEs**

Traditionally the RBI has been the primary source of data of formal credit to MSMEs. In recent years, however, Credit Information Companies (CICs) are also providing similar data. It is observed that the data reported by RBI and TransUnion CIBIL differ. Sometime it creates confusion among the users about the current status of access to formal finance to this sector. This apparent divergence, however, is primarily due to the difference in methodology adopted by CIBIL. In order to estimate the total credit supply in MSME sector, CIBIL considers two major components: (i) commercial entities with aggregate exposure up to ₹25 crores; and (ii) individuals in retail borrowing for commercial end use (indicatively this comprises business loans, commercial vehicle, construction equipment loans, loan against property and other retail loans (non-consumption) taken by self-employed individuals and professionals).

As per data collated by RBI, as on March 2018, outstanding MSME credit to enterprises stood at ₹14.68 lakh crore. This includes ₹13.24 lakh crore from banks and ₹1.44 lakh crore from the NBFCs. At the same time point, CIBIL has reported MSMEs outstanding credit data of ₹13.69 lakh crore. RBI's data is slightly higher since CIBIL considers data upto ₹25 crore only. So far as the MSME credit to enterprises is concerned, the data between RBI and CIBIL is fairly congruous. But, additionally CIBIL classifies outstanding credit to individuals, on the basis of end use of funds declared by retail borrowers, also as loans under MSMEs. As on March 2018, this amount stood at ₹9.04 lakh crore. However, these are retail borrowings, and cannot be classified as MSME loans as per the notifications of Ministry of MSME. Further, banks report the data to CIBIL on monthly basis which are not necessarily audited, whereas RBI publications disseminates audited figure.

RBI collects MSMEs credit data from scheduled commercial banks (SCBs) through 3 different returns serving different objectives. First, the sectoral credit data of Monetary Policy Department (MPD) is monthly data and it does not capture data from all the SCBs. These data are provisional in nature and relate to select 41 scheduled commercial banks. From September 2017, the data account for about 90 per cent of total non-food credit extended by all SCBs. MPD data provides a quick and initial trends of financing to various sectors, including MSMEs. Second, borrower category-wise data captured at the account level in the Basic Statistical Return (BSR) system also provides MSMEs credit data. But the BSR compilation process was last modified in the year 2008 and banks continue to generate the BSR report based on the same logic. Third data source of MSMEs credit relates to the priority sector data collected by FIDD from all SCBs. PSL classification is not only based on the activity but also captures details like investment in SIDBI, Mudra, etc. Overdraft given in A/c under Jan Dhan Yojana is also classified as Micro. Priority sector classification is complex which captures credit, investment and certain deposit data and also PSLC, IBC, pass through certificate, various aggregate limits for banking system while classifying the accounts. Therefore, MSMEs credit data as captured under priority sector is considered consistent in terms of its concepts, definition, coverage and it captures the changing financing dynamics of the sector over time.

## **7.3 Barriers to MSME Lending**

7.3.1 Despite an ongoing policy focus, growth of MSME credit has been weak. Years of mandated lending have not produced enough progress and new approaches are needed. Some of the issues are examined later in detail.

7.3.2 At an overall level, India's banking system is still small relative to the needs of the real sector. Against this backdrop, MSMEs find it challenging to access adequate credit.

7.3.3 First, the risk in lending to MSME sector are high as is evident from the NPA data in Chart VI. The risks in turn can be traced to inability to pay and unwillingness to pay. The former can in turn be traced to business risk factors such as delayed buyer payments embedded in supply chains or supplying to Government entities and also other business risks, including changes in consumer demand or extraneous events that create a slow-down in the market. MSMEs often have little to no equity buffers. Neither risk mitigation mechanisms are available to the MSMEs nor to their lenders, does this inevitably translate into significant credit losses. Even expected losses on these loans are not rationally priced.

7.3.4 The second barrier is cost-to-serve. Assessing the creditworthiness of an MSME can be difficult due to information asymmetry, particularly with respect to financial performance of the business. In the absence of collateral, under-writing the customer often entails a “high-touch” approach which translates into higher operating cost. This can be addressed by bringing greater innovation in how small business loans are evaluated, underwritten, and managed. Electronic KYC, paperless (digital) applications, rapid loan underwriting and a greater emphasis on customer service can redefine the lending to MSME sector.

7.3.5 The third reason is lender coverage. While many urban areas have sufficient lender coverage, there is very poor credit depth in large parts of the country. This remoteness translates into weaker access to formal credit.

7.3.6 It is evident that a long-term strategy to increase debt to MSMEs must take into consideration the cost-to-serve and risk related issues so that it is not at odds with stability of the banking sector. It also needs to leverage upon developments such as the availability of GST data and emergence of new kinds of lenders to evolve newer methods of MSME lending.

## 7.4 Credit Appraisal

7.4.1 In order to meet day to day operation and to acquire productive assets, MSMEs require working capital and term loans. While extending such loans, the primary responsibility of the lending institutions is to assess credit risk of the borrower for which banks need sound credit appraisal system. This risk is assessed based on Score Card Models with minimum cut off scores for small loans & on detailed Credit Risk Assessment (CRA) Models for large loans. These models are developed and accepted on the basis of risk appetite of individual banks. The traditional credit appraisal system results in high Turnaround Time (TAT). As per MSME Pulse Report by SIDBI-TransUnion CIBIL, TAT for MSME proposals is as under:

<b>Table XVII : Turnaround Time for lending to MSME</b> <i>(in days)</i>			
Lenders	2016	2017	2018
NBFCs	24	19	18
PSBs	41	35	31
Private Sector Banks	32	29	29

#### 7.4.2 PSBLoansIn59Minutes

PSBLoansIn59Minutes is an online marketplace, which enables in-principle approval for MSME loans up to ₹1 crore in 59 minutes from Public Sector Banks. On this platform, MSME borrower is not required to submit any physical document for in-principle approval. The solution uses algorithms to analyse data points from various sources such as IT returns, GST data, Bank Statements, etc. After receiving the in-principle approval letter, the beneficiary is expected to contact the concerned branch to get the in-principle approval into regular sanction to obtain disbursement of the loan. However, feedback received from entrepreneurs indicated that obtaining regular sanctions from the banks post in-principle approval has not been smooth. Inordinate delays in sanctions or high rejection rate have been noticed in such cases. The data is given in Table XVIII.

Table XVIII :PSBLoansIn59Minutes data			
Particulars	As on November 2, 2018	As on June 7, 2019	% increase
New Loans			
Preliminary approvals (No.)	4,964	62,680	1163
Final sanctions (No.)	748	45,265	5951
Amount sanctioned (₹ crore)	209	12,663	5959
Renewals			
Preliminary approvals (No.)	67,077	1,02,731	53
Final sanctions (No.)	1,239	82,619	6568
Amount sanctioned (₹ crore)	428	27,493	6324
Total			
Preliminary approvals (No.)	72,041	1,65,411	130
Final sanctions (No.)	1,987	1,27,884	6336
Amount sanctioned (₹ crore)	637	40,156	6204

#### 7.4.3 Recommendations:

- Uniformity in and simplification of various loan application formats and assessment process in line with learnings from supply chain financing, escrowing of cash flows is needed for quicker decision making and reducing turnaround time. Further, there is need to develop new MSME products as per prevailing market dynamics. Creating Centralised Centres of Excellence with specialized staff can help expedite processing of loan proposals. A working group involving SIDBI and IBA may work on this with SIDBI taking the lead. As there is considerable expertise on the subject available with RBI, it may provide specialised technical assistance and expertise to this group.*
- The working group of SIDBI and IBA may also consider ways to reduce Turn Around Time (TAT) especially in the pre LOS (Loan Origination System) or centralised sanction stage.*
- Banks should use surrogates like personal guarantee, bank statement, GST data, standardized score cards to evaluate credit worthiness of MSME borrowers. For PSBs,*

*these can be part of Enhanced Access and Service Excellence (EASE) programme of Ministry of Finance so that progress can be monitored.*

- iv. Government should specifically encourage MSMEs to obtain Zero Defect Zero Effect (ZED) Certification from QCI, and the banks could pass on some benefit due to lower risks for such units by way of interest / processing fee concessions.*
- v. Presently, banks assess working capital and term loan requirement of MSME units based on various methods viz., Cash Budget Method, Nayak Committee or minimum 20% of Turnover Method, Traditional or Operating Cycle Method. Out of these methods, assessment based on projected turnover based method prescribed by Nayak Committee, is generally used by banks. The movement from Balance Sheet or turnover based Working Capital financing to cash flow based, or supply chain/ cluster based financing needs to be accelerated to reduce TAT. This is within the remit of individual banks and requires no regulatory intervention.*
- vi. The PSBLoansIn59Minutes portal currently caters primarily to existing entrepreneur on account of its reliance on GST, income tax data, etc. Facility for new entrepreneurs presently under development needs to be expeditiously deployed. Limit of the loans should be enhanced to ₹5 crore. Further, Loans sanctioned under Standup India and MUDRA should be included in portal. Banks need to ensure that all applications accorded in principal approval are disposed of within a period of 7-10 days. Algorithms leading to initial in-principle sanction but final rejections by the banks' need to be reviewed in a time bound manner. CGTMSE guarantee fee for those not offering any collateral may be made part of in-principle sanction. Portal could be linked with land record, CERSAI, CGTMSE.*

## **7.5 Cash Flow-based Lending**

Cash Flow-based lending (CFL) envisages a shift in bank's appraisal system from traditional balance sheet based funding to a more objective appraisal system of leveraging cash flows of the unit. In CFL, loan requirement is based on actual revenue generation and capacity to repay. Furthermore, the repayment schedule is based on the timing of the MSME's cash inflows. The advantages of CFL are loan amount and repayment are based on the MSME's actual cash generation, reduction in credit risk, reduced monitoring costs for banks, reduction in TAT and ability to serve entities that don't have adequate collaterals. The different ways of CFL are as under:

- i. Turnover ascertained by the bank based on GST data
- ii. Trip Finance for logistics companies (invoice based lending to truckers based on each trip)
- iii. Lending to hospitality industry through aggregator models
- iv. E-Commerce transactions (to provide financial assistance to registered sellers engaged in selling products through online portal of e-trailer platforms)
- v. Turnover ascertained from digital sales on POS machine
- vi. Supply Chain Finance (dealer financing and vendor financing)

- vii. Startups and new age service enterprises do not have inventory but need working capital to pay daily / monthly expenses before revenues start coming in. They may need some working capital which may have to be part of the term loan itself

### 7.5.1 Recommendations

- i. Banks should develop customised products to assess the financing requirements based on expected cash flows moving away from traditional forms of assessment.
- ii. Banks need to build their ability to capture cash flows of MSME borrowers on a regular basis, for which tie-ups with Industry Majors / Aggregators / Online platforms will have to be done by the Banks. When Account Aggregators (AA) get operationalized, lenders will have access to more information on borrowers' transactions at a single point which would further facilitate cash flow based lending.
- iii. Banks should monitor on ongoing basis data input from partners for early warning indicators. For instance, in case of e-commerce sellers, any change in seller rating, velocity of sales, etc.

The digital architecture for Cash Flow lending is given in Chapter 8.

### 7.6 Trade Receivables Discounting System (TReDS)

RBI introduced TReDS in 2014 in order to solve the problem of delayed payments to MSMEs, TReDS is an electronic platform where receivables of MSMEs drawn against buyers (large corporates, PSUs, Government Departments, etc.) are financed through multiple financiers at competitive rates through an auction mechanism. Presently, three entities viz., Receivables Exchange of India Ltd. (RXIL), A. TReDS, and Mynd Solutions licensed by RBI are operating the platform for more than two years. The summary of traction gained on the TReDS platform as on March 31, 2019 is given in Table XIX below:

Table XIX: Traction gained on TReDS platforms					
Participants registered				Invoices financed	
MSME Sellers	Buyers	Banks	NBFC Factors	No. of Invoices	Amount
					(₹ in Billion)
3708	604	71	5	251988	66.69

Source: Data submitted by TReDS entities to RBI

#### 7.6.1 Initiatives by Government and RBI to promote TReDS

In 2016, RBI classified banks' exposure through this platform under Priority Sector Lending (PSL). In 2017, Gol made it mandatory for PSUs to register on the TReDS platform. In November 2018, Gol announced that Companies whose turnover exceeds ₹500 crore will have to register on the TReDS platform. Despite all the initiatives taken by the Government and RBI, the usage of this facility remains rather low, as the number of large corporates, PSUs and Government Departments on-boarded on the platform is still low.

## 7.6.2 Recommendations

*In order to enable TReDS gain necessary traction and relax procedural hurdles the Committee recommends the following measures:*

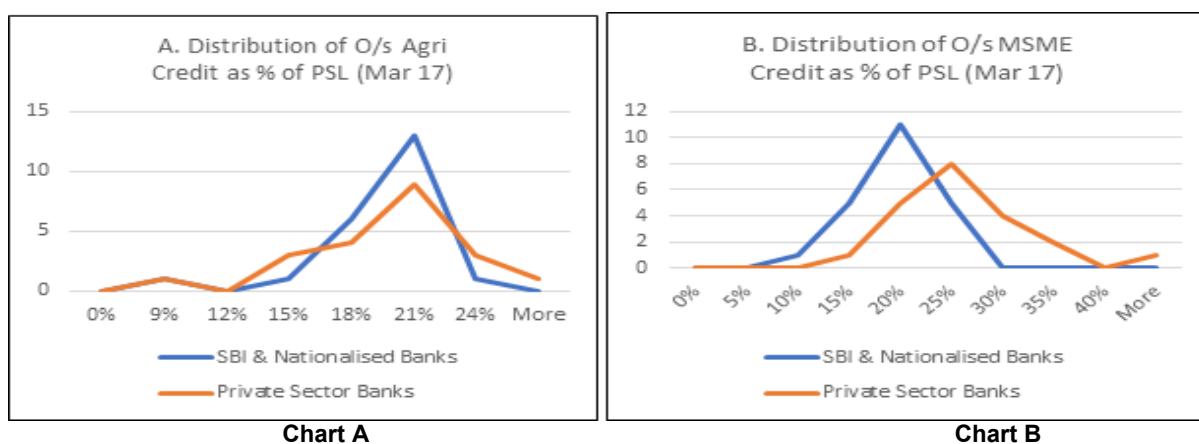
- i. Create a second TReDS window for reverse factoring so that supplier financing can be provided easily. The details regarding this are mentioned in Chapter 8.*
- ii. The scope of Centralised KYC network may be expanded for capturing enterprises level document also. This would reduce the delay in on-boarding of MSMEs and Corporates.*
- iii. Creation of pooled API of all the three TReDS platform providers would enable the financiers to understand the past repayment history of buyers thus enabling them to take more informed decision. Further, it will also rule out possibility of dual financing. NPCI which is acting as settlement entity for TReDS may consider creating such API.*
- iv. MSMEs also supply to Corporates having lower rating. Such MSMEs find it difficult to discount invoices on the platform. Widening the scope of financiers by permitting NBFCs other than NBFC factors would possibly lead to discounting of such invoices. A minimum rating may be required for these NBFCs. For the purpose, necessary amendments in the Factoring Act may be considered by Gol.*
- v. GeM is now collaborating with TReDS platforms for enabling discounting of bills for orders accepted through GeM. PSEs are required to settle invoices for goods supplied within 10 days of issue of certificate of acceptance. As PSEs do not maintain a pool account with GeM, there were instances of PSEs being unable to pay within 10 days. The Committee has been informed that GeM and TReDS platforms have worked out an arrangement whereby such invoices, which already have a certificate of acceptance, will be put up for discounting on that TReDS platform where the PSE and MSME supplier are both registered. This enables the bill to be discounted. The PSE gets time to make the payment and the supplier gets the money. Final IT integration for seamless transition is currently underway between GeM and the three TReDS platforms. The integration of GeM and TReDS needs to be completed within a time bound manner.*
- vi. Registration of invoice and satisfaction of charge upon it with CERSAI generally takes around 30 days which creates possibility of dual financing. Hence, it is recommended that the time period of 30 days should be reduced.*
- vii. Presently, Factoring Act permits only financiers to register charge with CERSAI. If TReDS entities are permitted to act as an agent for Financiers for filing of Registration of Charge with CERSAI and its Satisfaction it will lead to operational efficiency. Therefore, Factoring Act may be amended to permit TReDS entities to register charge with CERSAI.*
- viii. Credit Guarantee Fund Scheme for Factoring of NCGTC may be extended to invoices to be discounted in TReDS platform through second window as such guarantee may result in even bills drawn on smaller /lower rated buyers being accepted for discounting by factors and banks initially, and once transaction histories are built, they may dispense with guarantee subsequently. This would also in a way lead to better price discovery of the risks for the sellers.*

## 7.7 Lending to MSMEs under Priority Sector lending

7.7.1 Banks and NBFCs form the predominant source of formal credit to MSMEs with all such loans by banks qualifying for PSL classification. There is currently little differentiation in business strategies followed by banks in MSME lending. A contributing factor for this could be the rigid nature of the PSL targets (40% of their ANBC). Under PSL guidelines, 7.5% of ANBC of the bank must go to Micro enterprises.

7.7.2 Within the banking sector, one concern is that origination approaches often tend to be homogenous and creating correlated credit behavior and outcomes. The following charts indicate that whether it be the case of agricultural credit (Chart A) which has a target of 18% of overall PSL, or the case of MSME credit (Chart B) which does not have a target, an overwhelming 88% and 84% of banks studied did not go beyond 21% (of PSL) for agricultural credit and 25% (of PSL) for MSME credit respectively within the overall PSL target of 40% of ANBC. There appears to be very uniform origination strategies across banks and it appears that none of the banks are pursuing MSME lending as a core business strategy.

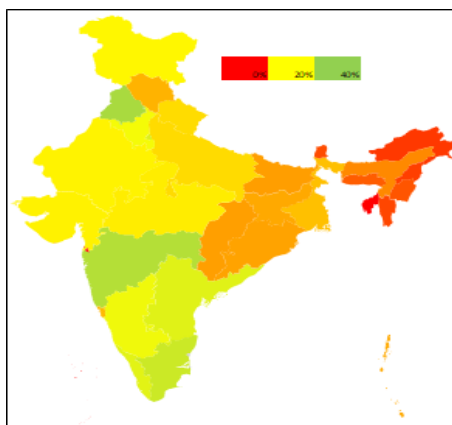
**Chart VII: Distribution of O/s Agriculture Credit and MSME Credit as a % of PSL (Mar 2017)<sup>7</sup>**



7.7.3 Globally, there are examples of SME-focused banks such as Equity Bank in Kenya that have been able to innovate significantly because of their customer focus. It would be useful to have such banks in the Indian landscape as well. One challenge is that current PSL guidelines require all banks to lend to all segments (agriculture, MSME and weaker sections) making it hard to specialise. PSL outreach has been sectorally and geographically skewed. Regional disparities in PSL credit become sharper when the PSL Credit to State GDP is considered.

<sup>7</sup> Data Source: Distribution of Outstanding Advances of Scheduled Commercial Banks to Priority Sector, Statistical Tables Relating to Banks in India, RBI

**Chart VIII Variations in PSL Credit to NSDP, 2016-17 (at Current Prices)**



These disparities become starker when district level disparities are studied. The existence of such disparities points to considerable gaps in design and delivery that prevent institutional credit from reaching a broader swathe of geographies and may in fact be a factor in holding growth back.

#### 7.7.4 A proposal to re-design PSL to address regional imbalances in credit

- i. PSL is integral to the rural and agricultural economy. It is worth continuously evaluating how best to achieve the goals of PSL while at the same time minimizing market distortions and allowing banks to pursue the most efficient strategies available to them. It may be useful to think of ways to encourage banks to do more lending, either direct or through partnerships in order to reach the most deserving. The true test of whether 'priority' sectors are being served, is to answer the question of whether PSL is indeed reaching those sectors and regions that are the least served, such as the eastern and north-eastern parts of the country, low-income households and MSMEs.
- ii. Existing PSL policy design has prevented banks from pursuing unique business strategies and has instead led to a natural evolution towards identical business strategies that create institutions with similar problems and hence, cyclicity. Banking policy, including PSL policy, can focus on providing flexibility to banks to choose their specific sectors on which to build their specialised business models. This can be operationalised by giving flexibility and encouragement to banks to meet their PSL targets by employing a combination of strategies. A beginning has been made in this direction with the introduction of PSLCs whereby banks can achieve a surplus in their area of specialization and sell PSLCs and buy PSLCs in other areas to achieve their targets.
- iii. The Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households and Small Businesses (2013) had recommended the Adjusted PSL (APSL) mechanism. Under this mechanism, while there is no change in the underlying sectors eligible for PSL, there is additional weightage given to lending to the more underserved sectors and districts. The target for banks is to reach an APSL of 50% by lending to any combination of PSL sectors (agriculture, small business, weaker sections, etc.) and districts they choose. Overall, the implication of the APSL mechanism is that it will be the strategies of individual banks that will determine the fraction of ANBC they will need to lend as PSL – the only stipulation being that each bank will need to achieve a target APSL of 50%. The APSL mechanism is designed with the intent of promoting increased specialisation amongst banks by incentivizing lending to the more difficult regions and sectors thereby enabling banks to follow distinct strategies in reaching the APSL target.

### **7.7.5 Recommendations**

- i. *The Committee recommends that the APSL mechanism be tried out starting with MSMEs in Phase 1 and evaluating the results of the same. As a default, all banks must continue to achieve 40% of NBC as PSL lending in the case of Universal Banks and 75% in the case of Small Finance Banks. For banks that wish to specialize in MSME lending, the requirements to do agricultural lending under PSL can be waived provided they achieve 50% of NBC as SME-PSL lending in the case of Universal Banks and 80% in the case of Small Finance Banks. Additionally, weightages may be constructed for MSME lending in the Aspirational Districts to incentivize flow of credit to these underserved districts. Under such a construct one rupee of MSME lending in an Aspirational District would count more (say ₹1.25) towards PSL achievement than one rupee of lending in another district.*
- ii. *Current PSL guidelines state that investments by banks in securitised assets, representing loans to various categories of priority sector, are eligible for classification under respective categories of priority sector depending on the underlying assets provided - the all-inclusive interest charged to the ultimate borrower by the originating entity does not exceed the Base Rate of the investing bank plus 8% per annum. Such price caps are not applicable to banks when they originate directly through branches. In order to encourage smaller NBFCs to extend MSME lending to underserved areas and micro-segments where the cost of intermediation are higher and to encourage partnerships between Banks and NBFCs, the Committee recommends modifying this cap to the Base Rate of the investing bank plus 12% per annum for now and periodically reviewing the need for such a cap.*

Allowing a specific bank to focus only on one or more sectors or regions of its choosing could ensure that the banking system as a whole delivers on the overall priority sector lending goals albeit with greater efficiency. Since the remit of this Committee was only MSMEs, APSL is recommended in this context. Further, it is recommended that RBI may similarly examine merits of allowing banks to specialize in agriculture lending and other sectors deemed critical to the development of the country.

### **7.8 Co-origination of Loans**

RBI issued guidelines on Co-origination of loans by Banks and Non-Banking Financial Companies Non-Deposit taking Systematically Important (NBFC-ND-SIs) having total assets size of ₹500 crore or more as per the last audited balance sheet, for providing credit to priority sector. Increasingly, RBI is encouraging Bank-NBFC partnerships that combine the balance sheet advantages of banks with the informational and cost advantages of NBFCs.

#### **7.8.1 The advantages of the Co-origination model**

The low-cost structure of NBFCs enable them to reach out to the informal sector and rural unbanked areas to study the demographics and assess the financial needs of the population. Banks will be able to increase business without increasing pressure on the branches, while keeping operating costs low.

- i. Historical data shows that NBFCs with better recovery mechanisms usually have lower level of NPAs for activities, where the bank has traditionally struggled with high NPAs.
- ii. NBFCs are technologically equipped to reduce the turnaround time for sourcing, assessing, sanctioning and recovering loans.
- iii. The borrower will benefit from lower interest costs through administration of blended rate of interest.
- iv. Increase in banks' lending to priority sector and achievement of priority sector targets.
- v. NBFCs will be able to overcome the constraints being faced presently in mobilising funds when banks step in with their low-cost funds and higher risk appetite.

Despite the fact that RBI had announced the scheme in September, 2018, it has not yet taken off for a number of reasons viz., putting in place a Board approved policy for co-origination, selection of NBFCs, development of products suitable for this scheme, and development of requisite IT infrastructure for smooth implementation. It is expected that once these enablers are in place, flow of credit to MSMEs through this scheme can increase manifold.

### **7.8.2 Recommendations**

*The Committee recommends the following for strengthening the co-origination model:*

- i. *The applicability of the Co-origination guidelines may be expanded to include Non-Systemically Important ND-NBFCs with a minimum credit rating. This will also encourage participation by new generation lenders that use alternative data for underwriting.*
- ii. *RBI to align IRAC norms for Banks and NBFCs.*
- iii. *NBFCs are not permitted to enforce action under the SARFAESI Act for loans below ₹1 crore. Since NBFCs will be servicing the loans on behalf of banks, they may be permitted to initiate all recovery measures including SARFAESI for the total loan amount for loans below ₹1 crore.*

## **7.9 Credit Guarantee Schemes**

7.9.1 Credit Guarantees in India for MSMEs were introduced through the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in the early 2000s. Over time, other Credit Guarantee Schemes have been introduced such as Credit Guarantee Fund Trust for Low Income Units by NHB, Credit Guarantee Fund for Micro Units (CGFMU), Credit Guarantees for Skilling Loans, Education Loans, loans extended under Standup India, factoring, loans extended to Scheduled Castes, etc. In addition, there are some Credit Guarantee Schemes being operated by the Private Sector on a smaller scale.

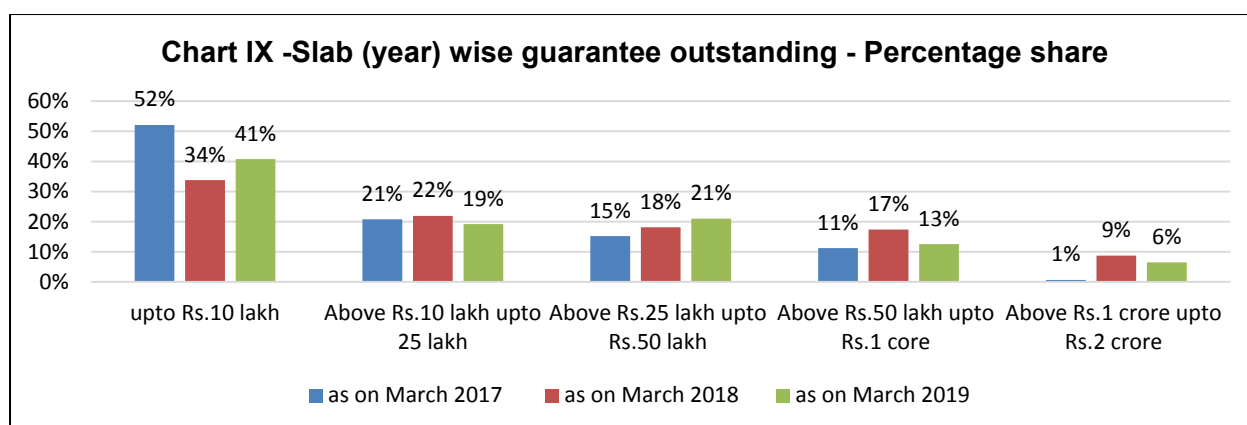
7.9.2 Government of India has set up the National Credit Guarantee Trustee Company (NCGTC) as a single entity to house and administer different Credit Guarantee Funds. Currently, NCGTC, administer Credit Guarantees for Micro Units, Standup India loans, Factoring, Skilling Loans, Education Loans and a proposed scheme to guarantee Venture Debt to Startup.

7.9.3 A plethora of Credit Guarantee Schemes are therefore currently in operation. Many of these directly concern MSMEs. Most of these schemes offer individual guarantee where a contract is signed with the borrower. However, the CGFMU offers a portfolio guarantee which involves a contract signed with the lender and covers loans upto ₹10 lakh for which collateral is otherwise not required. CGTMSE, on the other hand also offers partial credit guarantee

coverage i.e. a loan could be partially secured by collateral and the un-collateralised portion could be covered under an individual credit guarantee. An analysis of various Credit Guarantee Schemes suggest considerable deployment of public funds with overlapping guarantees and gross underutilization/over-leverage of the corpus in some funds.

7.9.4 While both CGTMSE and NCGTC offer the credit guarantee product, the guarantee structure and features are different. Structurally, the primary difference is that the CGTMSE is a loan level guarantee scheme while CGFMU for MUDRA loans, run by NCGTC, is a portfolio level guarantee scheme. This means that pay-outs happen under CGTMSE when individual loans, covered under the scheme, start to default. In contrast, pay-outs happen in CGFMU only when the threshold NPA level of the portfolio is breached. As on March 31, 2018 the corpus of CGTMSE was ₹6200 crore and that of CGFMU was ₹3200 crore.

7.9.5 Chart IX below shows the distribution of CGTMSE guarantees across various slabs of loan values. It will be noted that the largest proportion of guarantees goes to loans upto ₹10 lakh which are mandated to be unsecured. This creates an overlap between CGTMSE and MUDRA.



Source: As per data received from CGTMSE

### 7.9.6 Recommendations

*The Committee recommends the following in respect of Credit Guarantee Schemes:*

- i. All Credit Guarantee Schemes should be subject to the regulation and supervision of RBI. These guidelines could draw upon the well acknowledged principle for design, implementation and evaluation of Public Credit Guarantee Schemes for SMEs which has been evolved by the World Bank Group.*
- ii. All new Credit Guarantee Funds set up by the Government should be run by NCGTC, where expertise on risk management, fund management and compliance can be built up. Modalities for pooling of under-utilized corpus funds across guarantee schemes should be worked out.*
- iii. NCGTC has been set up as a Government Company while CGTMSE is predominantly owned by Government with SIDBI holding a minority share. It is necessary that the top management of both these institutions are professionalised and sourced from a wider*

*pool. It would also be appropriate that SIDBI disengages itself from day to day management and Boards of both NCGTC and CGTMSE.*

- iv. The Committee has recommended that the limit for collateral free lending should be increased to ₹20 lakh for lending to MSMEs and SHGs. It is accordingly recommended that the portfolio guarantee extended under the CGFMU be extended to ₹20 lakh for borrowers under PMMY as well as SHGs. The corpus of CGFMU may be augmented accordingly to ₹10,000 crore by 2024.*
- v. The CGFMU needs to revisit its procedure and guidelines so that these are better linked to Bank systems, e.g., using PAN as an identifier, increase cover to the extent of 75% as against 50% at present, etc. It also needs to reduce deductibles and first loss provisioning to make the scheme more attractive for lenders. Subsequent to these changes no other Credit Guarantee Scheme including CGTMSE should issue individual credit guarantee cover to MSMEs for loans below ₹20 lakh.*
- vi. The Standup India Guarantee Scheme overlaps with the CGTMSE with similar cover. This Credit Guarantee Scheme needs to be folded up with the corpus being redeployed either in CGTMSE or in the CGFMU. Guarantees for Standup India loans would continue to be extended through CGTMSE.*
- vii. CGTMSE may consider introducing ex-ante Credit Guarantees for loans above ₹2 crore. This would enable potential borrowers to be initially appraised by CGTMSE and secure a credit guarantee from it. Based on this credit guarantee, the borrower could now approach different banks to get best interest rates as a borrower who is fully secured.*
- viii. Currently, CGTMSE pricing is set at the level of the MLI with premium being charged on the basis of NPA percentage and Claim Payout ratio of the bank as a whole which lead to adverse effects on the Firms/ Companies which are actually performing well. In addition to Bank-level criteria, the Committee recommends that premium must also be sensitive to borrower-level characteristic such as formalisation and credit history. These schemes should reward both good borrowers and good MLIs.*
- ix. MUDRA and NCGTC must focus on catalyzing the markets – where it may otherwise be risk averse to participate. They must evolve into financial Institutions which can provide for the MSME sector, risk management support through participation in a whole suite of structured finance products. These institutions can provide a whole suite of specialised products and investment approaches such as the following to boost risk-taking by MLIs in previously underserved regions and sectors. By adopting such a strategy, MUDRA and SIDBI can serve MLIs by catalysing a new base of capital markets investors. These products could include credit enhancements of various types, including investments in junior tranches of securitisation transactions.*
- x. Additionally, there can be different refinance rates and guarantee fees for MLIs (whether banks or NBFCs) serving MSMEs that are in the Aspirational Districts.*

- xi. *The Committee recommends that enterprises that are emerging from various SHG initiatives under SRLM and NRLM programmes be included within the purview of MUDRA's guarantee programme and the corpus for the same may be accordingly increased.*

### **7.10 Portability of MSME loans**

7.10.1 Loan portability is a feature offered on loans which enables the borrower to switch, from existing lender to a new lender who offers favorable terms of credit. During interactions with MSME borrowers, the Committee was apprised of the difficulties in this regard. The need for loan portability could arise from various factors including inadequate credit limits, service deficiencies, potential for lower rates and need for value-added services such as trade finance and forex.

7.10.2 Small enterprises that grow into Medium enterprises often outpace their lender's willingness or ability to extend credit to them. A mechanism may be created allowing borrowers to shift their loan book to a new lender after a year's moratorium. Housing loans have become portable in this way and have improved the competitiveness of the sector. The same effect will take place for business loans as well. Providing a facility to shift MSME loan accounts from one lender to another in a hassle-free manner can help both as follows:

- i. Promote competition amongst lenders to retain customers
- ii. Improve service quality
- iii. Drive innovation through customised solutions for different sectors
- iv. Reduce costs for the borrowers

#### **7.10.3 Recommendation**

*In order to provide loan portability in a seamless manner to MSMEs, the Committee recommends that RBI should come out with measures on portability of MSME loans with a lock in period of one year*

### **7.11 Regulatory Retail**

As per the extant RBI regulations on Prudential Guidelines on Capital Adequacy and Market Discipline New Capital Adequacy Framework (NCAF) dated July 1, 2015, regulatory retail is capped at ₹5 crore exposure. Loans upto ₹5 crore including all MSME loans within this ceiling attract risk weight of 75% and have no requirement of mandatory credit rating. Beyond ₹5 crore exposure, risk weights increase to 100% and more.

#### **7.11.1 Recommendation**

*The limit of ₹5 crore was introduced along with the adoption of Basel II in India. Basel II allows for regulatory retail (or SME exposure) upto Euro 1 million. In today's terms, Euro 1 million easily translates to ₹7.5 crore, if not more. The Committee recommends RBI to revise the limit to ₹7.5 crore.*

## **7.12 Collateral free limit**

As per RBI's instructions issued in 2010, banks are mandated not to insist on collateral on loans upto ₹10 lakh. This circular underpinned the design of the MUDRA scheme and is also drawn upon for SHG lending. On a pure inflation adjusted basis, ₹10 lakh of 2010 is nearly ₹20 lakh now.

### **7.12.1 Recommendations**

- i. Increase the limit for non-collateralised loans to ₹20 lakh, this would address a significant proportion of MSEs' needs.*
- ii. Revision in loan limit sanctioned under MUDRA to ₹20 lakh from ₹10 lakh.*
- iii. Portfolio guarantee through NCGTC for all such collateral free MSME loans may be increased i.e. proportion of guarantee coverage should be increased to 66.6-75% from 50 %. A commensurate enhancement in corpus may also be done.*
- iv. CGTSME would no longer provide individual covers upto ₹20 lakh, except for such units which are at say ₹20 lakh exposure and are now looking at further growth and therefore a transition to an individual guarantee.*

## **7.13 Restructuring of NPA accounts**

7.13.1 RBI's one-time restructuring scheme announced on January 1, 2019 is available for stressed accounts which are still standard. This does not cover MSME accounts which have become NPA. For such accounts, banks have to make 15% provision, the day the account becomes NPA. There is thereafter a hesitation on the part of the banker to restructure the account even though further provisioning is not immediately required for another year.

7.13.2 There are two reasons for this. The first reason is the banker's apprehension. The classification of any account as NPA triggers off an internal staff accountability exercise as per extant guidelines. There is a concomitant fear of investigative agencies. The second reason is that for such MSME NPA accounts there is no visibility of future viability. Cash flows remain uncertain because of delayed receivables and the borrower has already used up available resources to keep operations going leaving nothing for fresh equity. The Committee analyzed the reasons for delay in loan / Interest servicing by MSMEs as given in Box XI.

### **7.13.3 Recommendation**

*An MSME account could be considered for upgrade to "standard" after six months of satisfactory operations, instead of one year at present. In addition to stable performance for six months, the MSME must also have demonstrable additional equity in the business and/or new sources of cash-flows.*

### Box XI - MSME- Reasons for delay in Loan and Interest servicing

#### Key Objective

Identifying the primary reasons for delay in loan and interest servicing by MSME

#### Approach

- An analysis has been undertaken on NPA and non NPA borrowers for gaining deeper insights
- This includes inputs based on internal data, external sources (credit bureau) and market intelligence

#### Primary reasons for MSMSE turning NPA

- Delays in debtor collection leading to stress
- Overtrading and extending credits to customers without credit and reference checks
- Diversification into new or unrelated business in anticipation of higher returns
- Using short term working capital instruments for capital expansion leading to mismatch between receivables and payables
- Low awareness of financial management, credit discipline and banking practice
- Management / promoter related issues - succession plan, disputes in partners and intention issues
- Lack of resources, additional finance once the accounts starts showing signs of stress
- Sudden changes in external environment like pricing, business model ,regulator and government policy

#### Observations for Non NPA borrowers

- Overall 30-35 % borrowers in this category have debtor days > 90 days
- High rotation with lending bank, end use of funds in line of business, timely submission of regulatory requirements, management involvement, competency in areas of business and compliance conscience
- Average utilization of 60-70% on portfolio basis, hence additional fund available with them to meet any contingency on account of delay in receivables.
- Transunion CIBIL MSME Rank (CMR) score provides rank to the MSME. CMR takes into account liquidity risk, repayment track (DPD, NPA,etc.) and firmographic behavior (vintage, recency to credit). Date analysis reflects :
  - 21% of the MSME accounts are Delinquent but in Non NPA buckets
  - A significant proportion of MSMEs are delinquent but not NPA still majority of them have better CMR
  - Actual percentage of MSMEs which turned into NPA in next 12 months is similar for MSMEs in a specific rank irrespective of delinquency or not.

#### Probability of borrower turning NPA given its CMR status

	CMR-1	CMR-2	CMR-3	CMR-4	CMR-5	CMR-6	CMR-7	CMR-8	CMR-9	CMR-10
Bad Rate - ALL	1.6%	1.9%	3.4%	7.2%	10.0%	13.5%	22.8%	46.2%	75.9%	96.7%
Bad Rate - Delq Not NPA	-	-	5.1%	8.0%	11.3%	15.5%	24.2%	54.2%	83.4%	-

Source: CIBIL Transunion

An internal study conducted on 100+ NPA cases suggests the following prominent reasons for an account going bad

Reasons for stress	% of total cases studied
Increase in receivable period/Increase in both inventory and receivable period/Liquidity	41%
Loss in business/Change in regulations/Competitive factors	29%
Change of promoter/ succession plan/ change in business model	10%
Intention issues/ Withdrawal of capital	10%
Others/Miscellaneous	10%

#### Suggestions:

1. Providing access to MSME to check the credit rating/CMR of their buyers based on their consent through their primary bank
2. Incorporation of CMR in credit rating mechanism, CMR being a strong indicator of liquidity risk, repayment track, specific behavior pertaining to vintage and recency to credit
3. Development of surveillance mechanism with bureau indicating deterioration in CMR
4. Rehabilitation/rectification action by lending institution for borrowers wherein significant increase in receivable/inventory cycle is observed during regular account monitoring
5. Training and capability building :
  - Professional training through public/private partnership model in areas of business management, financial discipline, industry outlook through case study approach , subsidy to be provided by government for such learning courses for increased participation
  - Financing expansion, diversification and setting up of new venture
6. MSME portal which would provide literature on micro market based- industry trends, best practices, reasons of failure and key indicators

## 7.14 Role of MUDRA

MUDRA provides refinance to MLIs against their portfolio of eligible PMMY loans and operates the MIS which supports reporting and analysis of PMMY loans. Over 200 lending institutions including Banks, MFIs, NBFCs and SFBs are MLIs. MUDRA is well capitalised with Net Owned Funds (NOF) in excess of ₹2000 crore and it is an AAA rated entity. MUDRA primarily relies upon Priority Sector Shortfall (PSS) funds allocated to it by RBI for extending refinance. It has also invested some amount in Pass Through Certificates (PTCs). Table XX indicates the PSS approved, refinance extended and investments made in PTCs year on year.

Table XX: PSS approved, refinance extended and investments made in PTCs year on year								
(₹ in crore)								
Particulars	2015-16		2016-17		2017-18		2018-19	
PSS approved by RBI	10,000		#NIL		10,000		10,000	
<b>Disbursements</b>	PSS	Non PSS	PSS	Non PSS	PSS	Non PSS	PSS	Non PSS
Banks	2432	0	1866	0	4405	0	5479	0
MFIs	616	0	787	0	361	8	314	0
NBFCs	0	0	0	399	478	527	700	8
RRBs	239	0	182	0	516	0	50	0
SFBs	0	0	0	0	500	0	270	50
Investment in PTCs	0	50	0	271	0	704	0	309
Total	3287	50	2855	670	6261	1239	6763	367

Source: MUDRA and RBI

#PSS allocated by RBI in 2015-16 was carried forward to 2016-17

### 7.14.1 Refinance and Securitization

MUDRA essentially offers a single refinance product. As most of the refinance is funded by PSS, interest rate caps apply on the pool of loans taken up for refinance. In addition, it specifies eligibility criteria for an MLI to be eligible for availing refinance.

In many ways, this mirrors the approach followed by SIDBI for a long time, with the difference being that MUDRA is restricted to refinancing portfolios of PMMY loans only. MUDRA's resources for refinance are heavily dependent on the inability of banks to meet PSL targets and sub-targets. While PSS backed refinance does help in reducing interest rates to the final borrower, there is a real danger of refinancing becoming a liquidity management tool instead of ensuring incremental credit flow to Micro enterprises. Approximately 10% of MUDRA's business is through PTCs. As this business cannot be financed out of PSS, MUDRA does so out of its own funds or funds borrowed by it outside PSS. There is significant room for growth in this.

### 7.14.2 Recommendation

*In order to play a more catalytic role, MUDRA would require enhancement of in-house (or outsourced) capabilities, including underwriting, risk management, fund raising based on its own AAA rating and sharper focus on emerging trends in the market. A reimagining of MUDRA is necessary including assessing the rationale for continuing it as a subsidiary of SIDBI.*

Detailed recommendations with respect to enhancing the guarantee role of MUDRA has been covered in para 7.9.

### 7.15 Financing Rural Enterprises and SHGs

There has been a significant shift in progress in rural livelihoods, from farm-based to off-farm and non-farm based activities<sup>8</sup>. The Rural Non-Farm Sector (RNFS) contributes over 65% to the rural Net Domestic Product (NDP). While the total number of MSMEs are comparable across rural and urban areas, rural India accounts for a significant share of manufacturing MSMEs. Table XXI below highlights its dwindling share in rural employment, even while contributing more than half of manufacturing NDP.

Table XXI: Share of Rural Areas in Total NDP and Workforce across Different Sectors (%)								
Year	Agriculture		Manufacturing		Construction		Services	
	NDP	Emp	NDP	Emp	NDP	Emp	NDP	Emp
1999 - 2000	93.2	96.6	41.6	51.5	43.3	57.6	27.1	40.7
2011 -12	95.1	95.9	51.3	47.4	48.7	74.6	25.9	39.6

*Emp – Employment*

*Source: EPW, Chand et al.*

#### 7.15.1 Technical Assistance

MSMEs in rural areas suffer disadvantages in the form of higher cost of logistics, limited market access, lack of knowledge, uneven connectivity, limited access to finance, a labour market lacking in skills and poor infrastructure. Together, these add up to lower productivity and shorter life spans for such enterprises.

Institutional support structures for MSMEs have conventionally been predicated upon industry-focused manufacturing and machine-based value addition. The unintended consequence of this has been the relative neglect of service enterprises and of rural enterprises especially those which are in any way linked to farming or allied activities. Handholding support and business development services for most rural enterprises is anchored primarily in the Agriculture/Animal

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<sup>8</sup> The rural non-farm sector (RNFS) encompasses all non-agricultural activities: mining and quarrying, household and non-household manufacturing, processing, repair, construction, trade and commerce, transport and other services in villages and rural towns undertaken by enterprises varying in size from household own-account enterprises to factories.

Husbandry Department of Government, which has been better at technical solutions and not as much on business aspects.

### **7.15.2 Recommendations**

- i. EDCs should have a specific focus on rural enterprises and capacity-building. Setting up of EDCs within DICs supported through a Central Sector Scheme with one of their specific mandates being handholding rural enterprises as well as enterprises set up by SHGs or their members.*
- ii. EDCs should be equipped to assist rural enterprises in respect of GST, IT, MSME Portal registration, PAN application, loan document preparation, etc. Partnership with Common Service Centre (CSC) – Village Level Entrepreneur (VLE) for the purpose may be explored.*
- iii. DICs and EDCs should have a dedicated effort to on-board rural MSMEs on large e-commerce platforms that can create better visibility and access to markets for these sellers.*

### **7.16 Access to digital payments and commerce platforms for rural MSMEs**

Some of the traditional limitations of rural MSMEs on account of remoteness and poor infrastructure access can be overcome through access to digital platforms. These include platforms for buying/selling as well as for payments. As has been noted by the Committee in other sections, building “digital trails” is increasingly becoming an important pre-requisite for access to credit. Therefore, there must be special focus on this issue. Rather than creating standalone platforms (that may have limited size) for this segment, the effort of EDCs should be on ways to on-board rural MSMEs to existing e-commerce platforms that have sufficient scale and liquidity.

#### **7.16.1 Recommendations**

- i. The Committee recommends an urgent focus to implement broadband connectivity in all parts of the country which will benefit rural MSMEs.*
- ii. Access to digital payments requires more demand-side incentives. As has been suggested by the High Level Committee on Deepening Digital Payments (Chairman: Nandan Nilekani), the acceptance network in rural areas need significant improvement. This Committee supports the recommendation to set up an Acceptance Development Fund to support merchants in rural areas.*

### **7.17 Issues related to SHGs**

7.17.1 SHGs perform an important role in financial intermediation especially for women in rural areas. The social capital crystallised through SHGs has contributed greatly to a quiet transformation in rural India. Estimates by NABARD indicate that there were over 87 lakh SHGs in the country as of March 2018 (This includes SHGs under two schemes of GoI – Deendayal Antodaya Yojana National Rural Livelihoods Mission or DAY-NRLM and National Urban Livelihood Mission or NULM). Of these 87 lakh SHGs, about 50 lakh SHGs were availing credit from financial institutions. Financial intermediation by SHGs has made livelihood creation possible at both individual and group level. However, the potential offered by this initiative remains under utilised, on both parameters - financing and livelihoods.

7.17.2 While the SHG itself may be linked to a bank, the financial transactions especially their track record in taking a loan and repaying is not transmitted to or utilised optimally by the formal financing system. Book keeping by an SHG has no organic link even with its financing bank. Details of individual members such as photographs, Aadhaar, bank account or mobile numbers are *universally* not available to either the SHG or the bank. In course of time, it becomes a challenge for an enterprising member of SHG with an excellent track record of savings and repayment, to establish her credentials with a bank when she approaches it for a loan in her own right.

7.17.3 RBI has mandated member level credit information reporting by banks. However, many implementation issues persist. The key issue is that banks lend to the SHG and the SHG takes care of internal lending. The internal lending records, including demographic and KYC information are usually maintained manually. Digitization of SHG records has been flagged as an important theme and NABARD has been leading this effort through an initiative called “e-Shakti” funded by the Financial Inclusion Fund (FIF) of the RBI. This effort may need some new thinking.

7.17.4 Specifically, there are two suggestions: a) an SHG registry be created that should be able to issue an identity to the group and its members, and allows all their data to be captured, and shared with the consent of the data principal and b) Since most of the transactions at SHGs follow a known pattern, it is recommended that standardized transaction API be defined for the SHGs. The Ministry of Rural Development through the NRLM program can take a lead in developing, publishing and maintaining these APIs. Credit reporting of individual members of SHGs to credit bureau needs to be accelerated. Banks have reported various implementation issues here.

#### **7.17.5 Recommendations**

- i. Loans to SHGs may be made collateral free upto ₹20 lakh, as against ₹10 lakh at present, in line with the recommendation for micro enterprises.*
- ii. DFS may act as Settlor for a Credit Guarantee Fund to be operated by NCGTC for extending Credit Guarantees to digitalised SHGs as well as producer collectives or Farmer Producer Organisations (FPOs) which are registered entities. This Credit Guarantee may be configured to provide upto 75% guarantee cover to these SHGs, FPOs, etc. for loans between ₹20 lakh and ₹1 crore on the lines of CGTMSE, Education Loans, Skilling loans, etc. This will mean that loans upto ₹1 crore would be effectively collateral free.*
- iii. The transition of Farmer Producer Organisations (FPOs) to Farmer Producer Companies (FPCs) should be actively focused upon.*

#### **7.18 Credit Rating**

A credit rating, in theory, alleviates the information asymmetry between the MSME borrower and the lender. It also allows for risk-based pricing. In order to encourage the development of this market, Ministry of MSME had a scheme to subsidise cost of ratings for MSMEs which has since been discontinued. Most credit rating agencies have developed modified rating tools taking into account the specifics of the MSME sector. However, adoption of ratings continues to be low following the discontinuation of the ratings subsidy.

7.18.1 The current regulatory provisions relating to capital adequacy requirements are as follows: Exposures that meet the criteria of regulatory retail carry a Risk Weight of 75%. Unrated exposures carry Risk Weight of 100%, except borrowers with total exposure of above ₹100 crore, for whom ratings is mandatory.

7.18.2 While most of the small MSME borrowers would fall within the definition of regulatory retail, most other MSME borrowers are reluctant to get themselves rated for the following reasons:

- i. Cost of getting a rating is perceived as being high, particularly as the correlations between having a rating and getting a loan or better pricing is still low.
- ii. Most MSME borrowers due to their weak capital structures and lack of any fall back mechanisms get poor ratings. 66% of MSME were rated MSME 4 and below (in an 8 point rating scale) in 2017-18 by Acuite Ratings & Research Ltd.<sup>9</sup>.
- iii. For units enjoying limits up to ₹100 crore, there is a risk of capital requirement going up in case they fail to get a satisfactory rating as risk weight for ratings below investment grade (BBB-) is 150%, whereas unrated exposure would have carried risk weight of 100%.

There is a need to make MSME rating products more relevant and predictive of credit performance. Rating agencies may be encouraged to build more 360 degree scoring models that take into account newer sources of data including utility bill payments, GST, entrepreneur psychometrics and personal credit history of the entrepreneur. Implementation of a universal enterprise ID will facilitate this market. To promote the growth of Cash Flow-based Lending, rating agencies may need to develop newer offerings.

Banks in their credit appraisal process must specify the work-flow (including TAT) in the event that the MSME has a credit rating available to it. This work-flow should be internally disseminated widely across all relevant branches. Internal credit rating tool/criteria developed by the Banks and NBFCs should be transparent.

## **7.19 Equity and Venture Capital Funding for MSMEs**

MSMEs in India largely rely on informal sources for equity, i.e. own saved funds and funding from family & friends. Debt has been preferred mode of borrowing for entrepreneurial activity in India through products such as Loan Against Property (LAP) and Jewel Loans, while equity as source of finance is being utilised by very few enterprises. Formal sources of equity or equity-like capital for MSMEs are Angel Investors (pre-seed and seed-stage) and Venture Capital Investors (early stage but where revenues are available). Venture Debt is a relatively new instrument in the Indian market that provides high-risk debt to early stage enterprises.

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<sup>9</sup> Acuite Ratings & Research Ltd.

### 7.19.1 Challenges in Equity Financing of MSMEs

MSMEs have limited access to external equity primarily because only a handful of players provide early-stage equity capital. Even if the equity were made available, the uptake would remain low due to:

- Legal structure of enterprises prevents infusion of external equity
- Smaller investment sizes per enterprise tend to increase transaction and management costs for equity investors, making this segment relatively less attractive
- Information asymmetry between promoters, investors and other stakeholders
- Entrepreneur's concern regarding control and management
- Low probability of non-linear returns

### 7.19.2 Funding for Startups

Startups in India, both tech and non-tech, face dearth of funding beyond Series B stage. A board that allows equities exchange of these SMEs can effectively help address this problem. It will also give the wider public to participate in the dynamic Indian startup ecosystem. The Innovators Growth Platform (IGP) proposed by SEBI is a welcome development. Some modifications are required for the success of IGP. SEBI must relax the norms defining the Accredited Investors (AIs) who could participate. Currently it recommended these AIs as individuals with a total gross income of ₹50 lakh per annum and minimum liquid net worth of ₹5 crore, or a corporate body with a net worth of ₹25 crore. But these should be akin to the Angel Investor requirements for Angel Funds - an individual investor who has net tangible assets of at least ₹2 crore excluding value of his principal residence or a body corporate with a net worth of at least ₹10 crore. To create enough liquidity, participation of HNIs, Mutual Funds, FIIs, etc. must be encouraged. Most technology startups or high-growth startups are often loss making hence there should be no profitability requirement to list. SEBI should facilitate dual class share structure which is very popular with tech startups across the world. Further, standards for internal governance of MSMEs may be developed that can help MSMEs identify current gaps and areas of improvement.

### 7.19.3 Listing on SME Exchange

While listing on an exchange provides a lot of benefits to SMEs and their stakeholders but SMEs often shy away from listing due to increased disclosure requirements and compliance burden. Most SMEs in India are not aware of long-term growth benefits of listing on the SME exchanges. It is important to clearly communicate to the promoters of SMEs how listing can help not only in personal wealth creation and liquidity for promoters but also help their businesses to grow faster and more sustainably over the long term.

7.19.4 The National Equities Exchange and Quotation of China and Venture Capital Programme of Israel is discussed in Box XII and XIII respectively.

### 7.19.5 Recommendations

- i. *SIDBI, as a nodal agency, should ideally play role of a facilitator to create platform wherein various Venture Capital Funds can participate and in turn create multiplier effect for providing Equity Support to MSMEs. For this it has to help popularize/ spread awareness of new ways of investing (modified term sheets for instance).*
- ii. *A Government sponsored Fund of Funds (FoF) of ₹10,000 crore to support VC/PE firms investing in the MSME sector that will support crowd funding from venture capital and private equity firms, which focus on investing in the MSME segment on modified term sheets developed by SIDBI. This would encourage innovation in term-sheets and product structures.*
- iii. *A Distressed Asset Fund of ₹5000 crore be structured to assist units in clusters where a change in the external environment e.g. a ban on plastics or 'dumping', has led to a large number of MSMEs becoming NPA. This fund could then operate on the lines of the Textile Upgradation Fund Scheme (TUFS) which has been in existence over many years. This would be of significant size which makes equity investments that help unlock debt or help revive sick units. It is a variation of VCF, meant for equity investment of ₹1 lakh to ₹10 lakh in proprietary or partnership MSMEs which will not or cannot list on stock exchanges. Covenants such as formalization and digitization of cash flows can be built in. The structure would recognize that exits will not be big bang but through a percentage of revenues or profits over a period of say 3-5 years. Such a Fund could work in tandem with RBI mandated restructuring schemes or bank led NPA revival solutions for MSMEs. The onus of creating this fund would lie with the Government.*
- iv. *Introduce voluntary certification for MSMEs that comply with prescribed internal governance standards.*

#### **Box XII - New Financial Institutions – The New Third Board – Comparison with China**

The National Equities Exchange and Quotation (NEEQ) or the New Third Board is a national over-the-counter (OTC) market. NEEQ is targeted at innovation oriented, entrepreneurial, and growing medium, small and micro-sized businesses. NEEQ started out by only allowing few high-tech enterprises in Beijing's Zhongguancun Science Park to list and then later expanded to the entire country in a phased manner.

NEEQ uses filing system as opposed to approval system used on China's main boards. So, NEEQ itself approves listings based on application materials submitted by the sponsors of the applicant companies.

The relatively low listing requirements and shorter listing timeline have greatly expedited financing for small, high-growth internet enterprises. Listing on the NEEQ requires a company to have a valid existence for only two years, whereas the main exchanges in China require three years. Unlike the other boards that have minimum pre-IPO profit requirements, the NEEQ only requires a company to have 'sustainable profitability' and does not elaborate on what these requirements are. NEEQ only allows qualified investors to participate and caps the number of shareholders at 200 to protect the retail investor from high-risk securities.

Since, NEEQ's inception over 11,000 companies have listed on this exchange and two-thirds of these are tech companies. Since, 2015 over USD 61 Billion has been raised on NEEQ and it has a total market capitalization of over USD 500 Billion. This board has emerged as an attractive and important financing channel for SMEs. It has also become a major exit channel for VC-backed companies.

	SME Exchange	NEEQ
Track Record	At least 3 Years old	At least 2 years old
Profitability Requirement	Positive Earnings before Depreciation & taxes for at least 2 financial years	None
Market Making	Mandatory	Mandatory
Approved Authority	NSE Emerge	NEEQ
Net Asset Requirement	Positive Net worth for 2 financial years	None
Number of subscribers	>50	<200
IPO Application Size	INR 100,000	N/A

#### A comparison of India's SME Exchanges & NEEQ

Despite these incentives and facilities, China is still losing its large tech startups especially when the time comes for their IPOs. This is primarily because of inherent drawbacks in their main boards. Companies like JD.com, Alibaba, Tencent chose NASDAQ, NYSE, and Hong Kong exchange because they allow dual share class structure which Chinese boards don't. And, NEEQ has been having issues with creating enough liquidity in the market. Now, with Shanghai's Science & Technology board the Chinese authorities are aiming to solve both these issues. This new exchange is expected to begin operations in June of this year.

#### Box XIII - Israel Venture Capital Programmes

The Government of Israel in early 1990s launched two major programmes aimed at promoting the venture capital industry in the country. First programme was called Inbal where a government insurance company provided a 70% guarantee to 4 selected VC funds. The second program was called Yozma, where the government launched a US\$ 100 million government owned VC firm that invested 80% of its capital in 10 private VC funds and also directly invested the other 20% in MSMEs. Each private 'Yozma Fund' had to partner with one foreign VC institution together with a well-established Israeli financial institution. However, the private VC firm itself had to be a completely new organization not owned by any existing financial institution. On fulfilling these conditions, the Government would invest (through Yozma) 40% (up to 8M\$) of the total funds raised. Thus the \$100M of Government funds would draw at least \$150M of private sector funds (domestic and foreign). Each Yozma fund had a call option on Government shares, at cost (plus interest) for a period of five years. Thus, Yozma did not simply provide supply, risk sharing incentives to investors, but it also provided an upside incentive. The incentives to the 'upside' also stimulated entry of professional VC firms and managers.

The 10 Yozma funds were successful in attracting capital aggregating US\$ 263 mn. These funds invested in a total of 164 startup companies and later exited 56% of their investments.

## 7.20 Mitigating Risk and Impact of Calamities

7.20.1 The principal causes identified for stressed MSME borrower's accounts include delays in payment by the borrower, diversion of fund/fraud, death or major illness of the borrower, calamities and catastrophe. The recommendations of this Committee made elsewhere in the Report seek to address problems related to delayed payment and mitigation of risk because of catastrophe/calamity, death of the borrower. As per the analysis conducted by the Committee stress in 30-35% of the accounts is due to payment delays and such catastrophe/calamities.

7.20.2 Like any business venture, MSMEs face commercial risks in doing business. It is however certain non-commercial risks that pose existential threats to MSMEs. MSME owners cannot be expected to be effective at managing external risks effectively and usually lack the resilience to bounce back after a catastrophic event.

7.20.3 These non-commercial risks take different hues. First, MSEs are overwhelmingly run as proprietorships. Death or illness of the sole owner inevitably results in closure of the unit, loss of jobs and misery for families. It is noted that SME risk profiles strongly co-mingle personal and business risk. Second, natural calamities such as floods wash away businesses and homes, leaving no capital to restart or borrow and a backlog of loans to be repaid. Third, a blanket ban on certain activities, for instance on plastic bags or on chemical units, by courts, tribunals, new legislation or by Government, leave these businesses helpless. Often these bans serve a larger societal or environmental purpose but end up causing collateral damage as there is little by way of advance notice or even clear direction of policy. Death and calamity will occur. From an MSME perspective, the intent must be to mitigate the impact.

#### **7.20.4 Recommendations**

The Committee therefore recommends the following:

- i. *Group policies for death and accident cover for MSME entrepreneurs need to be developed with insurance cover significantly higher than the cover currently offered by PMSBY and PMJJBY schemes. As Group policies, these would involve significant reduction in premium payable. Coverage could be offered in slabs so that there are different sub-products for say a Micro entrepreneur vs a Medium entrepreneur. A portion of the sum assured could be assigned towards settling workers' dues at the unit. The insurance cover would require no subsidy support from Government and could be configured as an incentive for MSMEs which have been formalised, for instance, through GST enrolment or MSME registration or under the Shops and Establishments Act.*
- ii. *Active efforts, in campaign mode, are needed to extend coverage under PMSBY and PMJJBY to all MSME employees*
- iii. *Workers at urban and rural formalised MSEs need to be specifically covered under PMJAY/ Ayushman Bharat scheme. Thereafter, MSME-DIs and DICs may be involved in an intensive campaign to assist enrolment of workers of MSEs and their families under the PMJAY/ Ayushman Bharat scheme so that health cover of ₹5 lakh becomes available to them. For MSE entrepreneurs, a group health scheme on similar lines based on full contribution by the entrepreneur may be designed in consultation with insurance companies.*
- iv. *Calamities such as earthquakes, cyclones and floods have been occurring ever so often. Disaster relief efforts by Government have tended to focus on rescue, temporary rehabilitation and ex gratia payments. Ex gratia payments cover death and loss of homestead but rarely cover loss of business enterprises. In a relative sense, MSMEs are prone to both business (cycle) risks and natural calamity related risks, the latter being associated more with agriculture. Agriculture failure gets attention and relief, while the same does not happen for MSMEs. Once relief work is discontinued and some shelter has been built, MSME owners struggle with reviving their business. Currently, on declaration of a natural calamity, banks offer a rescheduling of existing loans. This has involved conversion*

*of outstanding limits to Working Capital Term Loans, moratorium on repayments of old loans, some amount as fresh loan, etc. While this provides some immediate succour, the overall leverage increases. In most cases, sooner or later, the old and new debt together becomes difficult to sustain. The leverage does not reduce as net earnings are being used to service the increased debt and no capital accumulation is taking place. This gap can be met in two possible ways. The first would be to make changes in the Relief Manual so that a fixed amount could be given as ex gratia for MSEs in lieu of equity to enable them to restart their enterprise. The other alternative could be to set up a micro equity window, with Gol funding, operated by SIDBI for providing patient capital to formalised, calamity affected MSEs.*

- v. Blanket bans lead to large scale shut down of units. These bans are not simply cyclical and often result in significant structural changes in the industry segment concerned. Loans taken by such units have to be written off, entrepreneurs are tagged as defaulters and jobs are lost. This needs to be distinguished from business failure at an individual level as this is an exogenous event. Rather than attempting to compensate entrepreneurs for the event, changes to the MSMED Act, 2006 could be envisaged whereby a transition time of, say one year, is provided under the law to affected units for an orderly closure of their unit.*
- vi. Design of insurance products that address the special needs of MSMEs after a catastrophic event should be encouraged. This would include solutions for maintenance of income in case of business interruption, cost of re-education, partner insurance, key man insurance and capital for accessing loans. This insurance solution should be made available at an affordable price.*
- vii. TReDS platform mitigates risk arising out of non-payment of receivables of MSMEs who supply to a large buyer or are a part of a formal supply chain. Yet, there are many buyers who are not on TReDS. MSME sellers often take a blind call on the credentials of such buyers and their ability to pay in time. Trade Credit Insurance is an insurance product that secures the payment of such receivables and helps MSMEs sell to new buyers who may often be in distant geographies. There is a need to widely publicise this insurance product to MSMEs.*

## 8 NEW TECHNOLOGICAL INTERVENTIONS FOR MSME LENDING

MSMEs lack access to formal credit as banks face challenges in credit risk assessment of MSMEs on account of lack of financial information, historical cash flow, etc. Due to the lack of credible information on the functioning and performance of the MSME units, MSMEs have been found to be deprived of institutional credit. One of the reasons for non-availability of information has been non-existence of any Unique Identification Number to correlate various information related to an MSME. The absence of standardized rating mechanism leads to lender specific assessment models, delaying the credit risk assessment. Lack of appropriate data leads to lender doing detailed analysis and hence delaying the credit decision. Further, in the absence of information on credit score/ rating of prospective buyers, MSMEs end up with delayed debtor collection, leading to stress in business.

Keeping in mind the stages of growth of MSME and after studying the challenges for access to credit, the Committee recommends areas which require technological interventions requiring modifications to the Financial Architecture, along with a Regulatory Action Plan and Digital Public Infrastructure Action Plan.

### 8.1 Financial Architecture for MSME Lending

The Committee considered various elements of the financial architecture from the perspective of improving lending to MSMEs. The following elements were found to require significant changes.

#### 8.1.1 Data for Non-Corporate entity

A unique identifier is required to obtain reliable data about the entity for the purpose of lending. However, for non-corporate entities, such as proprietorship and partnership firms, there is no mechanism to fetch or verify key details pertaining to proprietors and partners, registration date, address, financial statements & partnership deeds. Moreover, in the case of proprietorship firms, multiple firms owned by a proprietor have same PAN.

#### 8.1.2 Recommendations

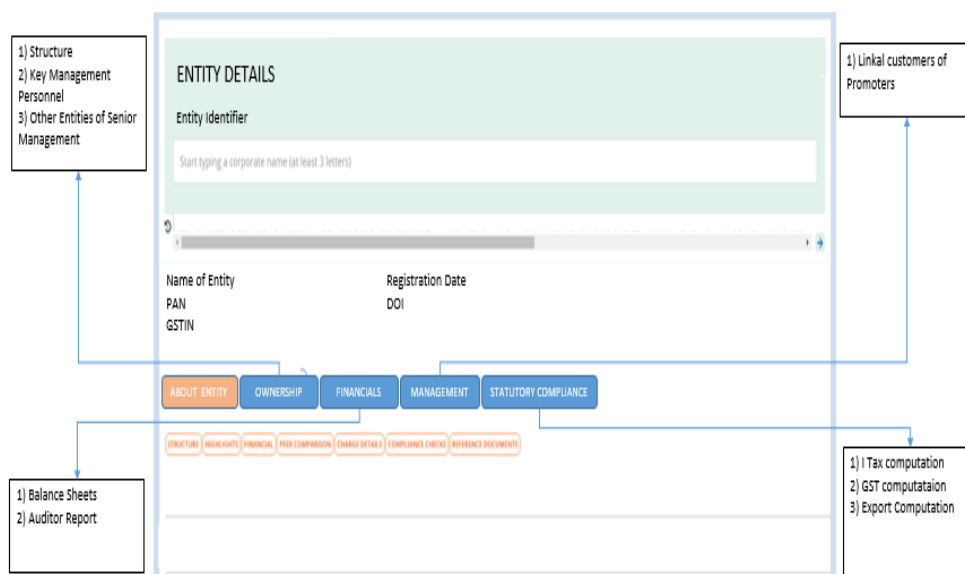
*In light of these impediments to lending, the Committee recommends the following:*

- i. The creation of a unique identifier such as Unique Enterprise ID (UEI), on lines of Corporate data collected by Ministry of Corporate Affairs, wherein all details pertaining to any MSME firm can be integrated. The Committee has recommended a methodology for creating this Id later in this section.*
- ii. The Committee has recommended that the PAN be used as the UEI, and that CBDT be responsible for the implementation of this recommendation.*
- iii. The UEI should be used for creation of comprehensive reports pulled from different data sources that cover:*
  - a. Financial information (Ownership structure, Complete Financials, Auditor Comments)*

- b. *Non- Financial Information (Registration details; Management details; related entity of the proprietor, partners; status of statutory compliance viz., TDS, GST, Export-Import regulation, etc.)*

*Each of the individual owners of the repositories with this information must be responsible for including the UEI in their database and making available an API for this access. The Department of Revenue (DOR) can be the coordinating agency, responsible for successful completion of this task.*

- iv. *This report, and details related to the UEI could be available through an API.*



### 8.1.3 Rating of MSME

Lenders analyze credit worthiness of the borrower based on a mix of financial and non-financial parameters. Current system of credit appraisal is based on acceptability of the risk associated with a customer. This risk is assessed based on Score Card Models with minimum cut off scores for small loans and on detailed Credit Risk Assessment (CRA) Models for large loans. These models are developed and accepted to meet the risk appetite of individual banks.

### 8.1.4 Recommendations

*The Committee recommends that the RBI facilitate the creation of additional information sources from where a financial institution may download a report which includes a score for the entity based on additional factors including business risk, industry risk, management risk, and financial risk. Additional parameters used in this score could include: Business Vintage, GST compliance, Direct Tax compliance, PF and ESI compliance, Export compliance, Promoter Net Worth. Such reports could also provide additional information including peer comparisons and industry analysis.*

### 8.1.5 Credit Score of Buyers for MSMEs

It is a common practice for MSMEs to provide trade credit to their buyers. Many a times due to delay in payment / non-realization of payment from buyers leads to deterioration in asset quality of MSMEs.

### **8.1.6 Recommendation**

*The Committee recommends that the RBI may enable the MSME to check the credit rating / Credit Monitoring Report (CMR) for their buyers, based on consent, through their primary banker. CMR being a strong indicator of liquidity risk, repayment track, specific behavior pertaining to vintage and regency to credit, the Committee recommends the incorporation of CMR in the credit rating mechanism.*

### **8.1.7 Disbursement Architecture and KYC Norms**

In addition to the previously discussed impediments, there are additional steps where physical visits are required. These are required for:

- i. KYC checks, and document collection;
- ii. Physical loan acceptance for partnership firms and companies due to requirements related to board resolutions, checking of borrowing clauses, etc;
- iii. State wise varying requirements, and potentially cumbersome processes for stamp duty payments.

### **8.1.8 Recommendations**

*In view of digitizing account opening / lending processes with certain risk mitigating measures to prevent misuse, the Committee recommends that Regulated Entities (RE) be permitted to adopt KYC procedures directed towards customer convenience, real time risk mitigation and the availability of documents with specific customer segments as mentioned below.*

- i. *It is suggested that online repositories like Ministry of Corporate Affairs website for corporates/LLPs, GST, Shop and Establishment be encouraged to open APIs for verification of documents issued by them. Further, various document issuing Departments of the Central and State Governments should also promote online repositories for this purpose. REs may validate document information real time through API based verification with the respective Government databases maintained by the issuing Department. Such API verification should be treated at par with physical verification of the documents submitted by customers which in turn would also mitigate the risk of fake / forged documents being submitted.*
- ii. *Lenders may use API services (self or through FinTech providers) and maintain appropriate logs to evidence verification of such documents. Currently, for example GSTIN / PAN can be used to fetch the name of entity, registered address, e-mail id, and entity type through an API with GST database. The following APIs are currently available. Entity Proof for KYC -MCA (Fetch Corporate & Director details from MCA database), GST, NSDL (PAN), Service Tax, VAT, TIN, Shops & Establishment, IEC, Professional tax, ICAI, ICWAI, ICSI, FSSAI*
- iii. *The Committee further recommends that physical verification be replaced with electronic verification wherever possible. This includes:*
  - a. *Promotion of digital signatures by partners & directors for acceptance and documentation;*

- b. *Creation of a platform to upload digital documents for online stamping which incorporates compliance with state-wise stamp duty payments;*
- c. *Integration with online mortgage repository for ensuring end to end digital journey in secured cases;*
- d. *Digital KYC which enables digital site visit with geo-location tagging, video KYC for ease & seamless on-boarding.*

#### **Box XIV- Video Based KYC**

Presently the KYC process is manual and necessitates a physical presence, thus increasing costs and timelines in completing the required KYC processes. As an alternative to enabling e-KYC, the Committee recommends video KYC to be adopted as a part of digital financial architecture as a suitable alternative to performing a digital Aadhaar-based KYC process towards enabling non – physical customer onboarding

- i. Valid documentation as per extant requirements is identified and verified by an employee of the entity;
- ii. PAN number from document is validated against the NSDL database
- iii. Face match is done between OVD (Official Valid Document) provided and the customer image taken as a part of the process, hence validating the document holder is indeed the applicant.
- iv. Face match is validated by the employee
- v. Customer, through the mobile app/website, provides confirmation on proceeding with the transaction after verification through an OTP based verification process.

The proposed process is as follows: -

- i. The customer signs up for the facility through the entity's mobile app or website.
- ii. The customer schedules an appointment with respect to preferred date and time on the application as a part of the sign up process.
- iii. Customer shares images of his/hers original POI (Proof of Identity)/POA (Proof of Address) which are OVD (Official Valid Documents) during the sign up process.
- iv. Based on the underwriting outcome, an offer is generated, forwarded to and accepted by the customer. The customer, through an OTP based click-wrap accepts the offer on the app / website.
- v. The entity then reaches out to the customer as per the preferred date and time for initiating the digital verification process. The customer will also be provided an option of a physical visit in case they are not comfortable with the digital process.
- vi. Outline of the Digital Verification Process
- vii. On successful connect with the customer:
  - a. Video call is initiated using Google Duo (Android user) / Facetime (iOS user)
  - b. The entity's authorized person will identify him/herself with his/her valid identity card.
  - c. Customer is requested to display his/her original POI, and read out his/her name as it appears on the POI document. The authorized person then verifies the name with the name appearing in the earlier shared image.
  - d. The authorized person verifies whether the photo on the identity proof is matching against the customer/ person on the call.
  - e. The customer is then requested to display his/her original POA. The authorized person verifies the name with the name appearing in the earlier shared image. Address availability is also verified on the document displayed.
  - f. On successful verification of documents, the authorized person then confirms the Video KYC to be complete on the said date.
- viii. The authorized person then uploads the recorded KYC video.
- ix. The checker from entity's team verifies the upload of the following:
  - a. Image of POI document
  - b. Image of POA document
  - c. Video of KYC verification
- x. On successful verification, the customer is informed of the verification and if they would like to continue confirms that they would like to proceed with the facility.

### **8.1.9 Approach to Universal Enterprise ID**

In 2009, Government of India established Unique Identification Authority of India (UIDAI) with a mandate to issue unique identity (Aadhaar) to every resident in the country. Aadhaar allows various systems to use the Aadhaar digital identity and online authentication and in the process improves delivery of services and benefits in a presence-less and paperless fashion. With more than 1.2 Billion people having Aadhaar as of today, Aadhaar has become the National Resident Registry allowing authentication and basic KYC to be done electronically and in a trustworthy manner.

However, in the case of organizations or enterprises such as companies registered under the Companies Act, Cooperative Societies, Sole Proprietorship, Trusts, etc., only a registrar specific ID is issued by the concerned registering authority. There is no common identifier through which an entity/enterprise can be recognized, referenced, and electronically verified. Enterprises face problems when they approach other authorities for any permissions or approach banks or clearances as it requires cross checking and verification of credentials from the different departments and authorities.

In view of the above it is important to provide all enterprises a unique identifier (ID) across the country (Corporations, Limited Companies, Proprietorships, Registered Societies, Trusts, etc.) and enable electronic verification, electronic KYC, and allow various credentialing and other services to be enabled on top of this unique enterprise ID and ease the cost of doing business.

### **8.1.10 Key Objectives**

- i. Provide a unique ID for all enterprises across all registrars (companies, societies, trust, etc.) via a common digital ID platform.
- ii. Link Unique ID with key individuals behind these enterprises within the ID system to allow deduplication, fraud detection, and electronic verification.
- iii. Enable Enterprise ID authentication and e-KYC services (both API based and offline as in Aadhaar) for enterprises to make ID verification and KYC paperless and instant for enterprises. Office bearers who are linked to this enterprise should be able to electronically verify and allow paperless KYC and verification while applying for various services (e.g. issuing import license, applying for a loan, getting building permits, etc.) thus reducing paperwork, cost, and delays.
- iv. Encourage various systems to issue credentials (certificates, permits, licenses, etc.) on this unique enterprise ID in electronic format that is downloadable and usable in a paperless fashion.

### **8.1.11 Analysis of Current Systems**

After detailed analysis of existing systems, it is clear that there are primarily two options for India to achieve this.

- i. Build a completely new enterprise ID issuance system from scratch and get various existing systems to adopt it.

- ii. Or use PAN (with minor enhancements) as the Unique Enterprise ID that is already used widely with any necessary changes to achieve the objectives.

Following table compares current systems against a completely new ID system:

System feature	New ID	PAN	GSTN
Support for all types of enterprises to obtain the identifier	Yes (to be built)	Yes	No
System and technology already in place	No	Yes	Yes
Allows linking of PAN (Aadhaar linked) of key people	Yes (to be built)	Yes <sup>#</sup>	Yes
Large set of enterprises and systems already use this ID within their systems.	No	Yes	Yes
Easy to seed this in various systems including Government and financial systems	No	Yes	Partial <sup>#</sup>
Tax systems already capture this ID and no changes are required	No	Yes	Yes
Registrar specific systems already captures this and require minimal change	No	Partial <sup>#</sup>	No
Require minimal/no law changes to introduce the ID	No. New Law required.	Yes <sup>#</sup>	Partial
Require no additional institutional creation or setup to introduce the ID	No	Yes	Yes
Proprietor ID separation from enterprise in the case of proprietorships	Yes (to be built)	Needs change <sup>#</sup>	Yes
Separate ID for physical establishments within the enterprise rather than the enterprise	Yes (to be built)	No	Yes
Common way to manage pending credits/loans, etc.	No	Yes <sup>#</sup>	No

<sup>#</sup> - Some caveats apply

### 8.1.12 Recommendations

*The Committee recommends the following approach:*

*i. Considering that PAN system has already started linking Aadhaar to PAN of individuals, with minimal improvements in the system and necessary law changes to mandate PAN for all types of enterprises, PAN system should serve as the Universal Enterprise ID and can easily meet all the objectives laid out earlier in the document. With large number of PAN issuance, introduction of e-PAN, PAN authentication and e-KYC APIs, institutional structure, law, etc. PAN, undoubtedly, is the recommended choice.*

*ii. In addition, many systems such as banking, GST, RBI's proposed Public Credit Registry (PCR), etc. use PAN as the key identifier and has seeded PAN within them making overall adoption of PAN, as the Enterprise ID, much simpler. Global approaches of Unique Business*

*Identifiers (UBI)<sup>10</sup> already suggest existing tax identification ID(s) to be a viable option as business ID.*

*iii. Another strong indicator is the 63.3 million of MSME (basis NSS 73<sup>rd</sup> Round Survey 2015-16) spread in areas of Manufacturing (31%), Trade (36%) & Other Services (33%). With the introduction of GST, most of this segment now already have PAN and GSTN-ID.*

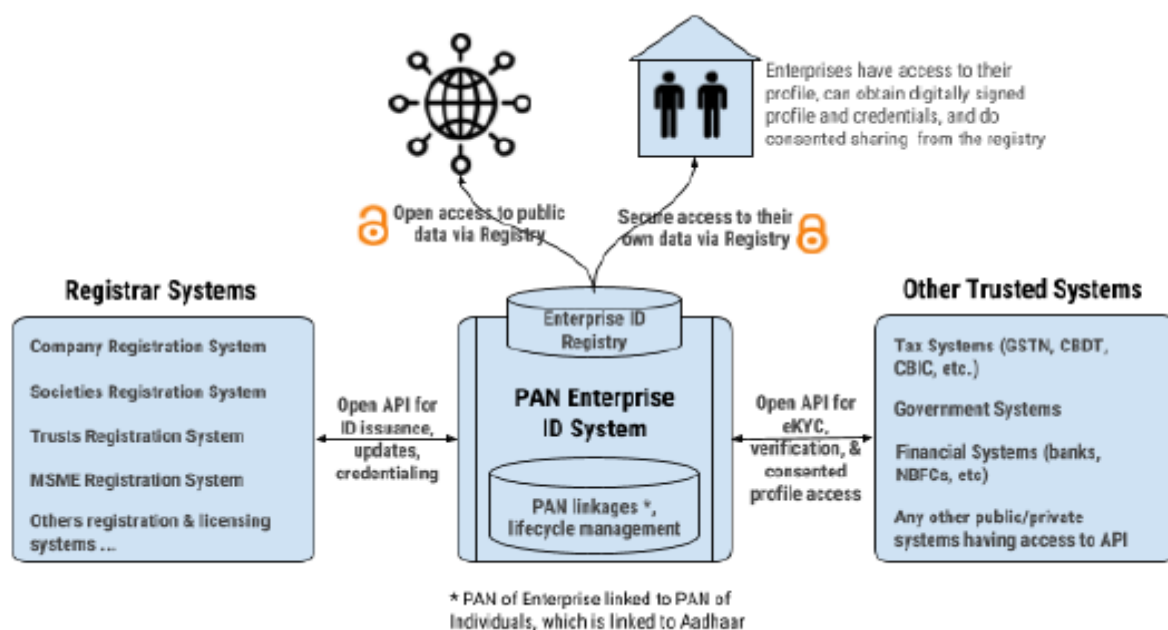
#### **8.1.13 Five-Step Implementation Plan for Universal Enterprise ID**

- i. Enable PAN as the national unique enterprise ID and allow seamless usage of PAN ID system across all ministries for common usage.
- ii. Make necessary law/regulation changes to separate PAN for individuals vs PAN for enterprises including proprietorships (there is no need to change tax rules, measures may be taken to issue a separate e-PAN for proprietorship which is linked to PAN of the proprietor who will still be liable for all tax). Make it easy (electronic and convenient) for all types of entities to obtain PAN. Explore making necessary legal changes for mandating PAN for all "entities" (companies, trusts, societies, etc.).
- iii. Link PAN of key people to enterprise PAN which, in turn, can be linked to their individual Aadhaar.
- iv. In addition, work towards seamless integration with various registrar systems for single step issuance of PAN at the time of registration of company/MSME/society/etc. For example, while registering a society, new enterprise ID should automatically be assigned without having to apply multiple times.
- v. Enable PAN based e-verification and e-KYC via open APIs. This is critical for ensuring move towards an electronic and paperless way to verify PAN and corresponding base KYC profile, thus reducing the cost of doing business and enhancing the ease. In addition, encourage various license/certificate issuing systems to issue electronic credentials (various certifications, licenses, attestations, etc.) based on PAN and allow enterprises to have access to their full registry profile.

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<sup>10</sup> Report on UBI from World Bank - <http://documents.worldbank.org/curated/en/471531468196759403/pdf/103570-REVISED-Implementing-a-unique-business-identifier-in-government.pdf>

The following diagram shows the high level architecture of the system.



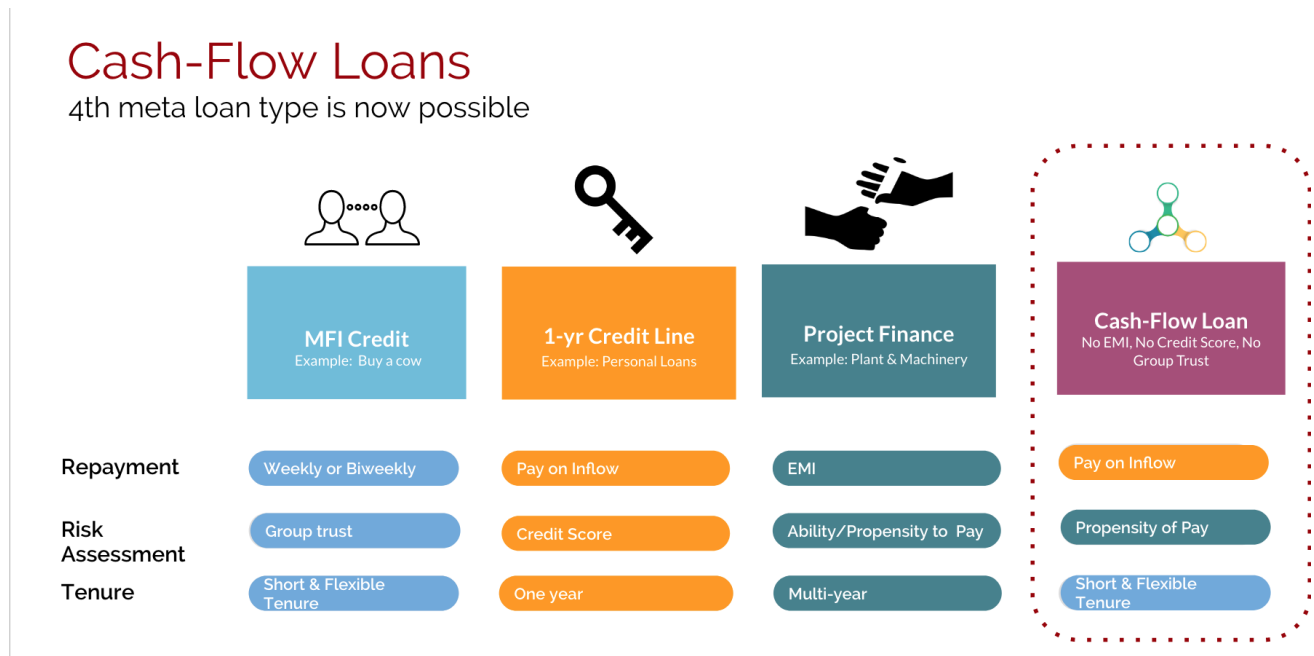
Creating a completely new system is highly risky for this project and fraught with the possibility of failure. *The Committee recommends that PAN, with appropriate changes prescribed in this document, be used as the Universal Enterprise Identifier. This will enable rapid adoption of this scheme by existing systems with nil or minimal changes.*

It must be further clarified that while a single Identity is being mooted for enterprises, the information related to these enterprises will remain within various registrar and trusted systems. These systems will have to provide APIs for obtaining additional information about these entities which is maintained by them.

## 8.2 Regulatory Action Plan for Cash-Flow Lending

Introduction of Cash-Flow Lending is essential to ease the credit gap faced by MSMEs. There are structural barriers for cash-flow lending to MSMEs. Customer Acquisition Costs (CAC) for lenders are high since qualified lenders and borrowers are not connected to each other. Loan Operating Costs (LOC) for processing the loan application, disbursement and chasing repayments are also very high. Some of these costs are fixed and hence, smaller business loans, particularly those under ₹10 lakhs are considerably less profitable than large business loans and are therefore less appealing to banks.

Furthermore, assessing the creditworthiness of an MSME can be difficult due to information asymmetry. Little, if any, public information exists about the performance of most small businesses. MFIs, Small Finance Banks and Cooperative Banks have traditionally placed greater emphasis on relationships with borrowers in their underwriting processes.



Due to these structural issues, the smaller firms feel major credit constraints. The smaller firms are perceived to be riskier and often have fewer assets with which to collateralize the loan compared to large enterprises.

These structural barriers can be addressed by bringing greater innovation in how small business loans are evaluated, underwritten, and managed. Paperless (digital) applications, rapid loan underwriting, and a greater emphasis on customer service can redefine the MSME lending sector.

### 8.2.1 Loan Service Providers

Customer Acquisition Costs (CAC) can be brought down by tapping into existing online and offline business networks. This requires a new type of lightly regulated Loan Service Provider (LSP) to be introduced into the value-chain. LSPs are borrower facing agents like Registered Investment Advisers (RIA) in Mutual Fund industry and supplement the Lender facing agents - the Direct Selling Agents (DSAs) - that already exist. LSPs will have the potential to drive the growth of multi-lender marketplaces, invoice and payables financing, inventory financing, and small-project financing. The LSPs partner with Lenders in one of two ways: (a) Arm's Length activities such as referrals of small loans; or, (b) More substantial integrations of new applications or underwriting models into an existing bank's operating and compliance systems. Their captive customer bases and deep data on customer activities reduces the Customer Acquisition Costs (CAC) for Lenders.

It should be noted that these LSPs are not lenders. This approach of regarding LSPs as borrower agent sidesteps the problems that blended online platforms have posed for regulators in the West. There is a precedence of the utility of this model in the Mutual Fund industry where both RIAs and distributors exist. This regulatory approach of having a new lightly regulated intermediary (like PhonePe, BharatPay and GooglePay) has been used with great success by RBI in regulating the new UPI ecosystem and, thus, can easily be replicated here.

As agents of the MSMEs, the LSPs would be required to assist them with accurate and timely information about the loans, provide help with complicated offers, expose hidden costs, etc. Many small businesses or sole proprietorships don't have lawyers or advisors available to decipher complicated offers with hidden costs. The RBI may notify a MSME Borrower's Bill of Rights that the industry can honor.

### **8.2.2 Regulatory Guidance**

To ensure better compliance, and reduce doubts, the Regulator should issue clear, succinct guidance that states the reasons and principles behind each regulation. The effectiveness and impact of the regulation should be assessed, where possible. This will help the industry and the regulator in monitoring and responding rapidly to the implementation by the industry.

### **8.2.3 Recommendations**

*The Committee has following Recommendations that define the Regulatory Action Plan (RAP) for the RBI:*

*A. Create a new category of Loan Service Providers. With a view to enabling more customers to access credit, the regulator must create a new category - Loan Service Providers (LSPs) – who will be an agent of the Borrowers. The LSPs offering individualized advice should act in borrowers' best interest, respecting fiduciary duties of disclosure, loyalty, and prudence. Similarly, Lender agents like DSAs and brokers should be required to disclose conflicts that compromise their impartiality, such as incentives from lenders to market higher-priced loans over others, and clearly break out the fees they add to loans. Creating a clear, straightforward, lightly regulated charter of LSPs and DSAs would encourage additional innovation in the MSME lending space.*

*Further, the Committee recommends that the RBI facilitate the creation of a Self-Regulatory Organization, on the lines of AMFI and RIAs, to organize and provide light touch regulation for this category of players.*

*B. Mandating Disclosure of Originations, Annual Percentage Rate (APRs), Default Rates, and Borrower Satisfaction across the MSME Lending market. The regulator must collect specific data, through the proposed PCR, from market players on their small business loan transactions, such as average APRs and default rates. This data, which should be released quarterly by RBI, will shed light on current practices and on the state of access to credit, deterring bad actors and reducing the risk of cumbersome regulation stifling important innovations.*

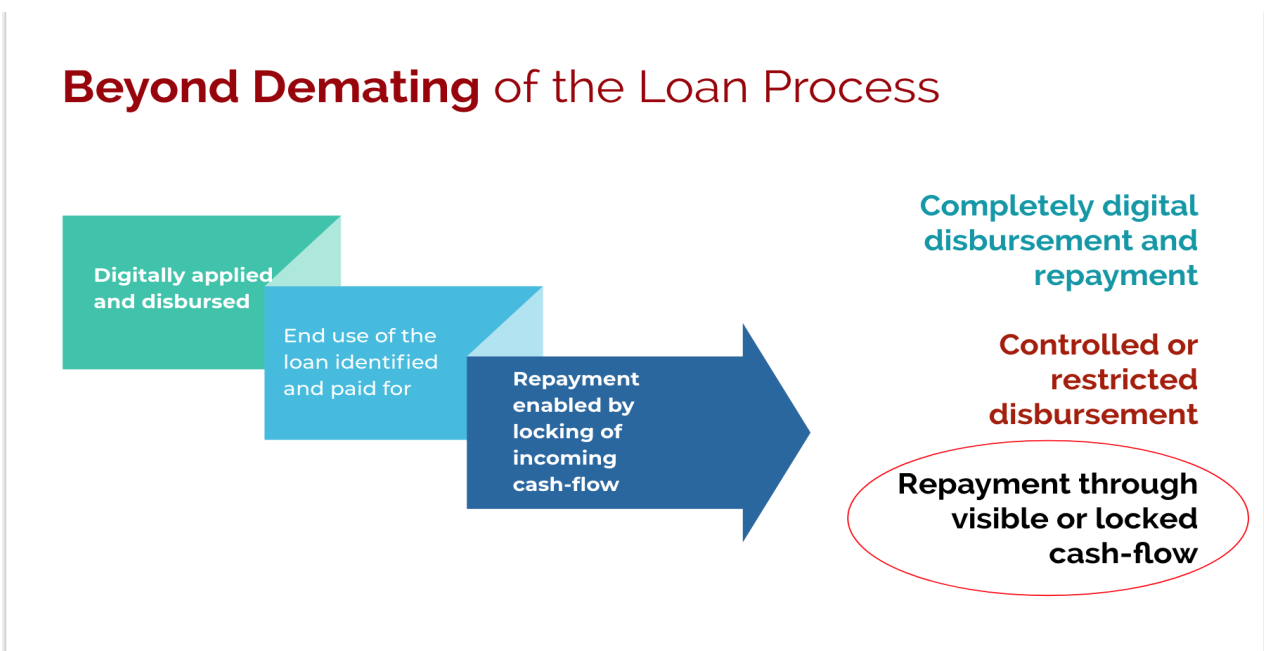
*C. MSME Lending Innovation Sandbox should be created. The RBI has already announced a draft framework for a Regulatory Sandbox. The Committee recommends that this be extended to bring in a focus on MSME lending with a view to simplifying the compliance process without compromising on the regulatory objectives. Sandbox participants should seek out innovative*

ways of executing the regulatory tasks such as data collection, compliance and reporting, and disclosure that takes advantage of technology, keep processes simple and leave room for continuous improvement and innovation in the way the regulations are implemented.

The Committee believes that these recommendations will catalyze sustainable growth of MSMEs lending while ensuring that small business borrowers are protected when seeking credit, whether online or offline.

### 8.3 Digital Public Infrastructure Action Plan for Cash-Flow Lending

Reducing Loan Operating Costs (LOC) for processing the loan application, disbursement and chasing repayments requires the creation of shared Digital Public Infrastructure like India Stack. A lot of this infrastructure is in place. However, a concerted time-bound effort is required to bring forth the full power of this approach.



Unlike other forms of lending (project finance, credit lines, MFI microcredit), cash-flow lending is possible only in a digital lending and payments value chain. For instance, cash-flow lending, at the very minimum, needs visibility to past and future cash-flows. The Account Aggregator (AA) system provides this information on a consented basis. Beyond visibility, this form of lending benefits from automated controls on cash-flows. For instance, the lender can be assured repayment through a lien on future cash flows. This is now possible due to a set of interlocking Digital Public Infrastructure, as E-Liens.

The Digital Public Infrastructure reduces Loan Operating Costs significantly. Furthermore, it addresses information asymmetry that improves credit access and quality in the ecosystem. Cash-flow lending, due to its complete dependence on digital lending value-chain, is the test case for any Regulatory or Digital Public Infrastructure improvements.

### **8.3.1 Recommendations**

*In light of this, the Committee has the following recommendations that define the Digital Public Infrastructure Action Plan (DPI-AP) to be implemented by the RBI, and the agencies identified in the Financial Architecture for MSME lending:*

*A. Accelerate industry deployment of E-Liens so that future incoming cash-flows can be locked down for better loan repayment rates. Specifically, following needs to be done:*

- i. GST Council should require Buyers to pay only to the payment address mentioned in the GST Invoice.*
- ii. Issuance of a new standard for utilization of Transaction ID field such that invoice number and date are included. RBI should encourage unbundled payments against each invoice. This unbundling would allow for automatic reconciliations to happen and for E-Lien triggers to be generated. This shift is necessary to support lending in the MSME sector against future cash-flows.*
- iii. Upgradation of UPI e-mandate markup language to include event-triggers (in addition to time triggers) and its standardization across merchant credit card accounts, CASA accounts and UPI for E-Lien creation. The new E-Lien system allows for these future cash-flows to be locked to repay a loan. Today, this happens with post-dated cheques and e-NACH. There are time-based triggers. When this is expanded to include event-based triggers (e.g. when Buyer ABC pays me, send 80% of the received amount to the Lender), cash-flow lending can be unleashed at full-scale. The system of describing the time or event-based triggers has to be a national standard so that lenders can make this work for incoming cash-flow into any bank account, credit card merchant account or UPI account. The quickest way to get to this national standard is to upgrade the already issued UPI 2.0 e-Mandate markup language.*
- iv. Instructions issued to report all E-Liens to PCR or CERSAI with provision for real-time lookups.*

*B. Create a second TReDS window for reverse factoring so that supplier financing can be provided easily. Specifically, two things need to be done:*

- i. Issuance of the workflow for new TReDS window for reverse factoring.*
- ii. Instructions to current TReDS licensees to activate the second window in a time-bound fashion.*

*C. Introduce Enterprise ID using PAN on a mission mode basis to ensure the availability of credit to MSMEs. The design is already in place, and the Committee has detailed a five step implementation plan for implementing a Universal Enterprise Id in this chapter, which may be considered for an implementation project.*

*D. Connect GSTN to Account Aggregators (AA) and Upgrade E-Way Bill system to include Proof-of-Delivery (POD).*

*Making GST invoices available to lender is essential for cash-flow lending to take off. For this, GSTN system needs to be connected to the AA system. Dematerializing of POD is essential for inventory financing for MSMEs to grow. The design is already in place. Only an implementation project needs to be created.*

*E. Upgrade Self-Help Group (SHG) access to credit by grandfathering SHG member history into the credit system and by introduction of mobile/tablet-based book-keeping, SHGs will see an expansion of cash-flow lending. Many SHGs grow into nano and micro enterprises. By grandfathering SHG member history into the credit system one can improve the odds of new entrepreneurs getting financing. Some of these nano and micro enterprises also obtain their first project finance at this stage. The details are also discussed in Chapter 7.*

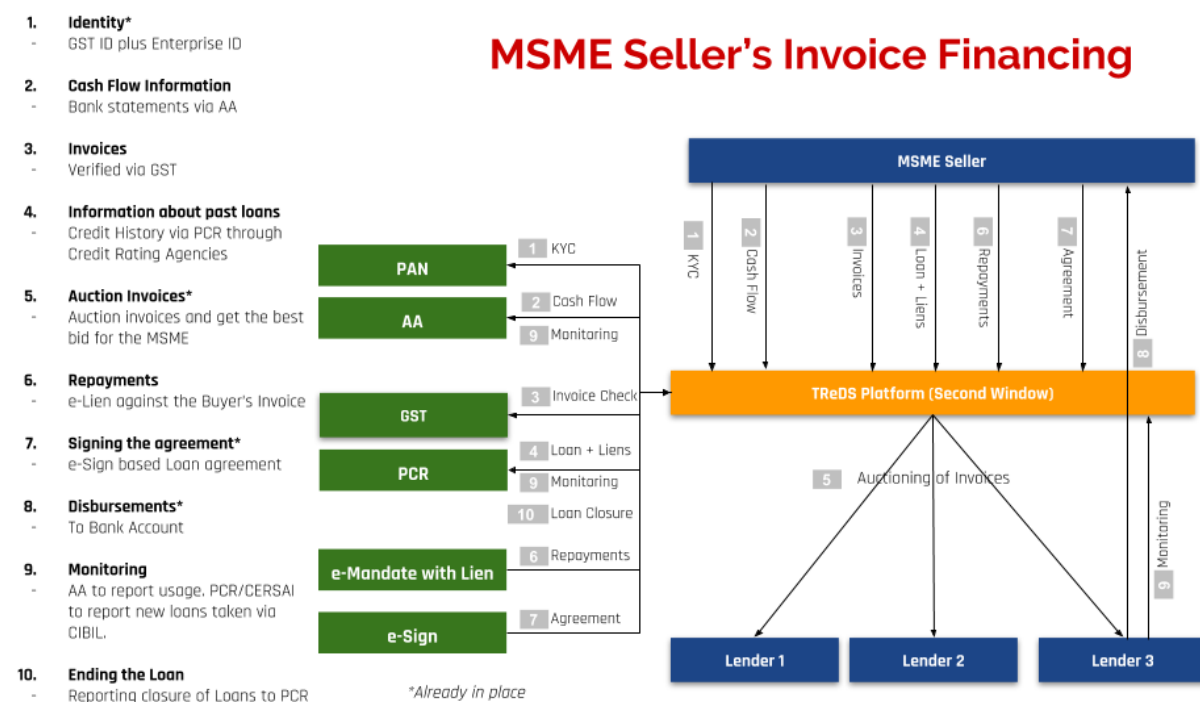
## 8.4 Expanding Receivable Financing

Financial Sector Reforms (FSR) Committee in 2008 in their report “Hundred Small Steps” recommended the setting up of electronic bill factoring exchange. As a result, TReDS came up in 2014, where credit exposure is taken by large Purchaser / Corporates against the invoices drawn by its MSME suppliers. Some of the issues related to the current TReDS have been discussed in Chapter 7. It is now time to rapidly expand this system to enable additional forms of financing.

### 8.4.1 The TReDS ‘Second Window’

The second window is possible because of a combination of liberated data and agreement between MSME Seller and TReDS platform Lenders, for obtaining cash-flow lending for its invoices. This window abstracts the need for Buyer’s ‘acceptance of invoice’ on the TReDS platform, resulting in a reduction of steps, and a lowering of operational costs.

Various India Stack Open APIs integration into TReDS Platform will facilitate MSME on-boarding, invoice verification via GST, MSME bank transactional cash flow data, GST data, past loans and credit history, repayments tied to electronic Liens on cash inflows and more.



The various APIs and technology elements are discussed below –

- i. ePAN & Enterprise ID – ePAN will establish the identity of businesses, while Enterprise ID API will address the need to obtain KYC verification for on-boarding MSMEs into TReDS platform.
- ii. e-Sign – Contractual on-boarding MSME's at scale can be achieved through e-contracts via e-Sign.
- iii. Account Aggregator – AA will consolidate all consented transactional data, including cash-flow statements across MSME's banks and past GST data.
- iv. GST – GST will allow through its API, the ability to verify MSME Invoices on TReDS platform. It will also support 'matched invoice' validation of MSME Seller and Buyer.
- v. Public Credit Registry – As a public utility, the upcoming PCR will allow Lender's secure past credit history on MSME's loan exposure, repayments and outstandings. In addition, PCR will also electronically affix liens on MSME's incoming cash-flows against MSME lending through TReDS platform.
- vi. The proposed e-mandate with Lien allows a bank account owner to specify that a specific payment instruction is to be executed when there is an incoming payment transaction which meets certain parameters – for instance, from a source and against a specific invoice.

#### 8.4.2 Implication of TReDS 'Second Window' –

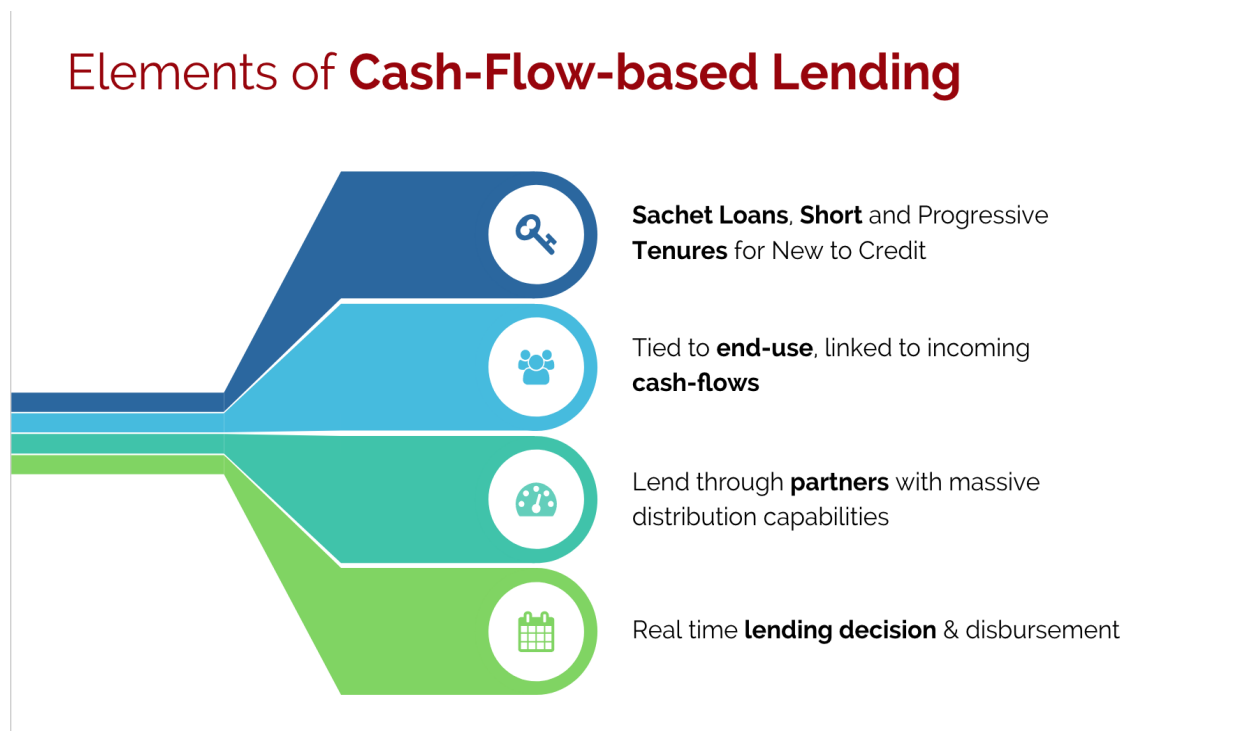
**Buyer less** – The concept of 'GST Trusted Invoice' into TReDS, obviates the need for Buyer in the TReDS lending transaction. The veracity of the Invoice is ascertained from GST submissions for Input Tax Credit, and payments are enforced through a lien on the Buyer's Bank account, hence this process just needs the MSME Seller and Lenders involved in a transaction. The invoice is required to have a pay-by-date for this purpose.

##### **Box XV - TReDS Second Window - Steps for an MSME Seller to raise financing from a Platform**

- i. MSME registers itself with the TReDS platform with the help of an Enterprise ID. Enterprise ID can be PAN.
- ii. MSME gives consent to the platform to fetch its Cash Flow data via Account Aggregator and its Credit History from Credit Rating Agencies via PCR [Public Credit Registry]
- iii. MSME presents the GST Invoice(s) to the platform to get financed.
- iv. TReDS platform will verify the Invoice with the GST system.
- v. TReDS platform will auction the verified Invoice to multiple lenders and present the resulting options to the MSME.
- vi. MSME chooses a lender.
- vii. MSME signs an e-Lien against that Invoice(s), promising to auto-pay the invoice receivables to the lender.
- viii. MSME e-signs the loan agreement, facilitated by the TReDS platform.
- ix. Lender updates PCR with the details of the Loan and the e-Lien.
- x. Lender disburses the loan amount to the MSME's bank account.
- xi. Lender continuously monitors the MSME's financial situation during the period of the loan via access to cash flow data from AA and loan track record from PCR.
- xii. MSME receives money from its buyer on the bank account under e-Lien. The bank auto-settles the money to the Lender per the terms of the e-Lien.
- xiii. Lender updates the PCR based on the repayments received
- xiv. Lender updates the PCR if and when the loan has been closed.

Detailed workflow diagrams can be found in the Annex III.

8.4.3 Cash-flow loans don't need borrower assessments or project assessments. They are tied to future cash-flow instead. They tend to be short-tenure since predicting short-term cash-flow is easy. The repayment schedules are flexible so that the borrower can pay when the cash-flow materializes.



Thus cash-flow loans are different from MFI credit, 1-year credit lines and project finance in that they don't use credit scores, EMIs or group trust. But they borrow specific techniques pioneered earlier. For instance, they use the idea of short and flexible tenures from micro-credit. They also use the idea of pay-on-inflow from 1-year credit lines. Small project financing has to deal with propensity to pay issues and the techniques developed there apply to cash-flow loans as well.

Due to the availability of Digital Public Infrastructure like GST and India Stack, cash-flow lending is ready for takeoff. This type of lending will help close the credit gap to MSMEs powering their growth. This growth will create jobs on the ground.

## 8.5 Conclusion

A combination of Digital Public Infrastructure, progressive regulation and new market forces has the potential to energize the MSME Lending Sector. Emergence of a digital lending value chain will provide fast turnaround and easy accessibility for MSME borrowers and use new data and credit scoring algorithms to provide new types of risk-adjusted lending products. This infrastructure can operate at a scale, break access barriers, and provide MSMEs with the ability to access finance and scale to reach their potential.

## **9 SUMMARY OF RECOMMENDATIONS**

### **9.1 Definition of Micro, Small and Medium Enterprises (MSMEs)**

- i. The MSMED Act, 2006 may be reimagined as a comprehensive and holistic MSME Code having a provision for sunset on plethora of complex laws scattered all over the legislative framework. Under this new law, the territorial jurisdiction based and arbitrary inspection system may be substituted with a policy based and transparent inspection system. This may also include sunset clauses on inspections.

**[Action: Ministry of MSME, Para: 4.1.3]**

- ii. The Committee deliberated upon the proposed turnover based definition of MSMEs with various Ministries, Associations and other Stakeholders. The Committee also debated the merits of an employment-based definition and recognized while this was an additional feature preferred in some countries, this definition would pose challenges in implementation. The proposed definition has been considered progressive and suitable because of introduction of Goods and Services Tax (GST). Under the new tax regime, turnover details of enterprises are being captured by Goods and Services Tax Network (GSTN) and turnover declared by GST registered MSME units can be easily verified through GSTN. Hence, turnover based definition would be transparent, progressive and easier to implement. It would also help in removing the bias towards manufacturing enterprises in the existing definition and improve the ease of doing business. The Committee also felt that in view of the need to adjust the definition criteria from time to time in the context of changing economic scenario, the Parliament may consider delegating the power of classifying MSMEs to the Executive.

**[Action: Ministry of MSME, Para: 4.2.3]**

### **9.2 Role of Small Industries Development Bank of India (SIDBI)**

- i. The Committee recommends a more focused engagement of SIDBI with State Governments for MSME development and promotion. This could take various forms as indicated below:
  - a. Use of Priority Sector Shortfall (PSS) funds to create a low cost lending window for State Governments for infrastructure projects in clusters, civil works for rehabilitation of existing industrial estates and setting up of new industrial estates. This would require RBI approval and could be structured on the lines of the Rural Infrastructure Development Fund (RIDF).
  - b. Helping State Governments in designing or operating schemes for equity support, interest subvention, resolution of stressed MSMEs, learning events for MSME entrepreneurs including field visits to well performing clusters, etc.
  - c. Collaborating with State Governments to get MSME units from the State onto digital platforms such as PSBLoansIn59Minutes, Stock Exchange listing, e-commerce platforms, etc.
- ii. SIDBI should help deepen credit markets for MSMEs in underserved districts and regions by handholding private lenders such as NBFCs and MFIs for increasing their presence and reach, working with local level bankers, differential pricing for refinance, awareness programmes, etc. The other areas where SIDBI can contribute viz., developing and deploying

additional instruments for debt and equity which help crystallize new sources of funding for MSMEs and MSME lenders such as first loss guarantees, Pass Through Certificates (PTCs), etc. For this it needs partnership arrangements and may, if required, raise funds directly from the market based on its AAA rating.

- iii. SIDBI should gradually take on a role of a market maker for SME debt on select platforms.
- iv. SIDBI should review investments in SFCs, TCOs and other such subsidiaries/ associate companies where the responsibility of incubation is over.
- v. SIDBI should continue to roll out of knowledge products, including in vernacular languages.

**[Action: SIDBI, RBI, Para: 4.13.4]**

### **9.3 PSBLoansIn59Minutes**

The PSBLoansIn59Minutes portal currently caters primarily to existing entrepreneur on account of its reliance on GST, income tax data, etc. Facility for new entrepreneurs presently under development needs to be expeditiously deployed. Limit of the loans should be enhanced to ₹5 crore. Further, Loans sanctioned under Standup India and MUDRA should be included in portal. Banks need to ensure that all applications accorded in principal approval are disposed of within a period of 7-10 days. Algorithms leading to initial in-principle sanction but final rejections by the banks' need to be reviewed in a time bound manner. CGTMSE guarantee fee for those not offering any collateral may be made part of in-principle sanction. Portal could be linked with land record, CERSAI, CGTMSE. **[Action: SIDBI, Para 7.4.3]**

### **9.4 Equity and Venture Capital Funding for MSMEs**

- i. SIDBI, as a nodal agency, should ideally play role of a facilitator to create platform wherein various Venture Capital Funds can participate and in turn create multiplier effect for providing Equity Support to MSMEs. For this it has to help popularize/ spread awareness of new ways of investing (modified term sheets for instance). **[Action: SIDBI]**
- ii. A Government sponsored Fund of Funds (FoF) of ₹10,000 crore to support VC/PE firms investing in the MSME sector that will support crowd funding from venture capital and private equity firms, which focus on investing in the MSME segment on modified term sheets developed by SIDBI. This would encourage innovation in term-sheets and product structures. **[Action: Ministry of MSME, SIDBI]**
- iii. A Distressed Asset Fund of ₹5000 crore, be structured to assist units in clusters where a change in the external environment e.g., a ban on plastics or 'dumping' has led to a large number of MSMEs becoming NPA. This fund could then operate on the lines of the Textile Upgradation Fund Scheme (TUFS) which has been in existence over many years. This would be of significant size which makes equity investments that help unlock debt or help revive sick units. It is a variation of VCF, meant for equity investment of ₹1 lakh to ₹10 lakh in proprietary or partnership MSMEs which will not or cannot list on stock exchanges. Covenants such as formalization and digitization of cash flows can be built in. The structure would recognize that exits will not be big bang but through a percentage of revenues or profits over a period of say 3-5 years. Such a Fund could work in tandem with RBI mandated restructuring schemes or bank led NPA revival solutions for MSMEs. The onus of creating this fund would lie with the Government. **[Action: DFS]**

- iv. Introduce voluntary certification for MSMEs that comply with prescribed internal governance standards **[Action: SIDBI & Credit Rating Agencies]**

**[Para 7.19.5]**

### **9.5 Issues of Delayed Payments**

- i. An amendment may be made to the MSMED Act, 2006 requiring all MSMEs to mandatorily upload all their invoices above an amount to be specified by Government, from time to time on Information Utilities (IU) set up under IBC. To begin with, this could be for invoices above ₹1 crore.
- ii. To take care of the situation where the MSME is unable or unwilling to complain, a designated authority under the DC MSME may be identified. This authority will be able to request/ obtain information on unpaid bills, of say, all corporates including PSUs above ₹1000 crore turnover to begin with, on the first working day of each month. For the IU to respond to this request, the Authority set up under the DC MSME will have to be notified under IBBI IU Regulation No. 23. With access to this information, the Designated Authority will write to/ email each of the corporates concerned, bringing to their notice, MSME supplier bills which have remained unpaid beyond the due date.
- iii. It is likely that on receipt of this communication, the corporate will take steps to clear dues. If it does not do so before the first working day of the next month, when the next statement will be generated, then the Authority may send a communication to both the buyer and the seller that payment has not happened as evidenced by the IU in spite of a communication been sent to the corporate buyer. This communication could then be disclosed on the Authority's website for information of lenders, rating agency and other MSMEs as a means of naming and shaming. The MSME will now also have a stronger basis to initiate action, should it choose to finally do so.

**[Action: Ministry of MSME, IBBI Para 4.3.7]**

### **9.6 Micro and Small Enterprises Facilitation Council (MSEFC)**

- i. The scope of Facilitation Council is limited to redress cases of MSEs. Presently, Medium enterprises supplying to large corporates are deprived of redressal forum. Hence, the ambit of facilitation council may be extended to Medium enterprises also.
- ii. As per Section 80 of Arbitration and Conciliation Act 1996 unless otherwise agreed by the parties, the Conciliator shall not act as an arbitrator in any arbitral proceedings in respect of a dispute that is subject of the conciliation proceedings". However, sub-section 18(4) of MSMED Act, 2006 states that Council can act as an arbitrator or conciliator in a standing dispute where supplier located within its jurisdiction and a buyer located anywhere in India. As MSMED Act, 2006 is silent on this aspect, specific provision is required by a suitable amendment to the aforesaid Act.
- iii. There has to be specific mention in MSMED Act, 2006 for cases already taken up by NCLT. Suitable amendment needs to be done in MSMED Act as NCLT came into effect in the year 2016 much later than MSMED Act, 2006. Although section 14(1) of IBC 2016 clearly states that "subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of

law, tribunal, arbitration panel or other authority. There is no clarity about process to be adopted after moratorium period is over.

- iv. Some supplier units filed cases before High Court about matter not decided within 90 days as stipulated in the sub-Section 18(5) of the MSMED Act, 2006. Completing the proceedings (Conciliation & Arbitration) within 90 days is difficult. Hence, MSMED Act 2006 may be amendment by way of inserting “shall be decided ‘preferably’ within 90 days” or within 180 days instead of “shall be decided within 90 days.
- v. During meetings with State Government officials and MSME Associations, the Committee was informed that MSE borrowers lack awareness about Samadhaan Portal. Therefore, there is a need to publicize the portal amongst the MSME entrepreneurs.
- vi. Further, it is observed that majority of the States have only one Facilitation Council which is not adequate to cater to delayed payment cases arising in the entire State. Hence, there is a need to increase the number of MSEFCs particularly in larger States such as Madhya Pradesh, Uttar Pradesh, etc., and in areas of large concentration and volume, so as to meet the time specified for resolving cases. **[Action: Ministry of MSME Para 4.3.3]**

## **9.7 Public Procurement Policy**

The Committee was informed that certain Government Departments have been placing orders for supply of equipment and materials which are well in excess of their anticipated or available annual budget. Execution of such orders is made in good faith and thereafter payments are delayed, at times, for months on end. The Committee recommends that the General Financial Rules (GFR) and Departmental Procurement Codes/ Manuals, as the case may be, be amended to prohibit placing of purchase orders in excess of the annual budget approved by the Legislature/ Government. **[Action: Department of Expenditure, Para 4.4.4]**

## **9.8 Government e-Marketplace**

- i. More MSEs need to be encouraged to register on the portal. For this a focused campaign for enrolment of MSEs should be initiated involving MSME support institutions, States’ Directorate of Industries and DICs. **[Action: Ministry of MSME]**
- ii. The Committee recommends that for the purpose of scaling up portal, the Government may make it mandatory for PSUs / Government Departments to meet their MSME procurement targets through GeM portal only. **[Action: Ministry of MSME]**
- iii. Government may consider making GeM as a full-fledged market place also and permit MSME sellers on-boarded on the portal to procure raw-material as well. **[Action: GeM]**
- iv. GeM is now collaborating with TReDS platforms for enabling discounting of bills for orders accepted through GeM. PSEs are required to settle invoices for goods supplied within 10 days of issue of certificate of acceptance. As PSEs do not maintain a pool account with GeM, there were instances of PSEs being unable to pay within 10 days. The Committee has been informed that GeM and TReDS platforms have worked out an arrangement whereby such invoices, which already have a certificate of acceptance, will be put up for discounting on that TReDS platform where the PSE and MSME supplier are both registered. This enables the bill to be discounted. The PSE gets time to make the payment and the supplier gets the money. Final IT integration for seamless transition is currently underway between GeM and the three TReDS platforms. The integration of GeM and TReDS needs to be completed within a time bound manner. **[Action: GeM]**  
**[Para 4.4.4]**

## **9.9 Delivery mechanism and MSME eco-system**

- i. The Committee recommends setting up of a Non-profit SPV to support crowd sourcing of investments by various agencies particularly CSR and non-profits to pave the way for conducive business ecosystem for MSMEs. The SPV will also coordinate with NSDC, NSIC and other financial/promotional institutions apart from facilitating impact/angel funds and management support to Government in terms of mobilizing investments from multi-lateral institutions.
- ii. The Committee recommends policy convergence at the national level that also goes down the federal structure. In order to facilitate coherent policy outlook and unity of monitoring, it is recommended that at the apex level a National Council for MSMEs should be set up under the Chairmanship of the Prime Minister with the Ministers for MSME, Commerce & Industry, Textiles, Food Processing, Agriculture, Rural Development, Railways and Surface Transport being members. The states should have a similar State Council for MSMEs.

**[Action: Ministry of MSME Para 5.7.5]**

## **9.10 National Board for MSMEs**

National Board may continue to function as the body for reviewing and steering the overall implementation of various policies / schemes of MSMEs impacting all aspects of the MSME ecosystem, involving all stakeholders, particularly in terms of bringing MSMEs out of informal category, improving infrastructure, skill and capacity building, technical and financial know-how, etc. The functioning and scope of the Board may be reviewed to strengthen its role. **[Action: Ministry of MSME, Para 4.9.3]**

## **9.11 Khadi and Village Industries Commission (KVIC)**

The Committee recommends KVIC should be corporatized with focus on promotional work. The marketing function may be hived off and also corporatized to enable private participation and enabling use of Khadi in the private sector. **[Action: Ministry of MSME, Para 4.12.1]**

## **9.12 State Financial Corporation (SFC)**

The Committee recommends that State Governments should re-examine the role of SFCs. Financial resources will need to be programmed accordingly, within the context of the State. For instance, should funds be used to support the SFC or should they be used to incentivize private sector to move to areas where more competition amongst lenders is needed. The Committee also recommends a review of the SFC Act for enhancing the role of States so that more operational freedom is given to SFCs. **[Action: State Governments, DFS Para 4.11.4]**

## **9.13 District Industries Centers (DICs)**

- i. A new Central Scheme to be initiated for supporting setting up of Enterprise Development Centres (EDCs) in DICs. These EDCs while being principally funded by GoI must have the operational flexibility to partner with the private sector, particularly in the areas of skilling and technology development. Contribution of companies to capacity building via EDCs must be eligible for Corporate Social Responsibility (CSR) spending.

- ii. Planning for Training Programs - The need of training for entrepreneurs in various fields may be assessed and included in the action plans of DICs. The training should be based on contemporary requirements and should be relevant to the needs of the entrepreneurs. As much as possible, training must be imparted by corporates engaged in the relevant field and practitioner rather than be limited to staff of DIC only.
- iii. Empowering DICs - DICs should be given more powers for providing tangible services such as arranging terms, and other inputs including technologies for the development of industries and artisans.
- iv. Data Collection and Statistical Analysis - The data banks created by the DICs should be strengthened and trained persons to be deployed to keep the data up-to-date. Proper collection of statistics on the requirements of entrepreneurs should be undertaken by DICs.
- v. EDCs should have a specific focus on rural enterprises and capacity-building. Setting up of EDCs within DICs supported through a Central Sector Scheme with one of their specific mandates being handholding rural enterprises as well as enterprises set up by SHGs or their members.
- vi. EDCs should be equipped to assist enterprises in respect of GST, IT, MSME Portal registration, PAN application, loan document preparation, etc. Partnership with Common Service Centre (CSC) – Village Level Entrepreneur (VLE) for the purpose may be explored.
- vii. DICs and EDCs should have a dedicated effort to on-board rural MSMEs on large e-commerce platforms that can create better visibility and access to markets for these sellers.
- viii. DICs need to be professionalized and corporatized into not for profit entities. This would enable DICs to engage in partnerships with private sector for delivering extension services to MSMEs

**[Action: DC MSME, Para 4.9.3, 7.15.2]**

#### **9.14 Cluster Development 2.0**

The Committee recommends following to strengthen cluster development programme in India:

- i. Cluster prioritization and selection criteria.
- ii. Widening the definition of cluster constituents and optimal size of a cluster for holistic cluster development.
- iii. Synergy and coordination within large number of support schemes.
- iv. Improving the scheme (design, implementation and monitoring process) so that it meets the priority needs of the sector and are outcome based and impact oriented
- v. Enhancing the funding contribution from private sector.
- vi. Strengthening the cluster eco system and intensively involve local intermediaries such as business membership organizations in developing linkages with other stakeholders such as training, educational and research institutions.
- vii. To ensure continuous flow of data and information on clusters and avoid duplication of efforts by different agencies and institutions

**[Action: DC MSME, Para 5.3.6]**

### **9.15 Marketing Support for MSMEs**

The Committee recommends the following for improving marketing support to MSMEs:

- i. Facilitate the marketing side of innovation and assist MSMEs to on-board 'B2B' and 'B2C' e-commerce market places.
- ii. Utilize existing Technology Centers (TCs) across the country for providing access to information on Indian and external markets for innovative products and on how MSMEs can benefit from new technological inputs.
- iii. Incentivizing large enterprises for providing assistance and guidance to MSMEs, particularly in terms of using the latest technology and bringing them up the value chain
- iv. Strengthening of schemes like 'Consortia Formation', 'Brand Building', 'E-marketing through specialized MSME portals', and holding of more domestic and international exhibitions in order to provide increased marketing support to MSMEs
- v. Strengthening up of MSME export promotion council

**[Action: DC MSME, Para 5.4.6]**

### **9.16 Access to Technology**

The Committee recommends following for encouraging Technology adoption for the MSME Sector:

- i. Technology Mission: Technology Missions related to water, literacy, immunization, oil seeds, telecom, jute, cotton and dairy had been set up by the Government. A Technology Mission should be launched by the Ministry of MSME, for converging the efforts of various stakeholders for the technology upgradation of the MSMEs across the country.
- ii. Need for more Industry specific Technology Centres (TCs): Ministry of MSME has successful model of Technology Centres for providing short term and long term training programmes apart from providing tools, consultancy and common facility support to MSMEs. There is a need to set up more product specific TCs in hitherto unserved fields of Solar, Battery technology, e vehicle, AR/VE/AI, food processing, basic trades like carpentry, advanced welding, black smithy, etc.
- iii. FDI policy must focus on development of local MSME sector to bring up capacity, capability and technology development of the MSMEs. In respect of all large projects involving FDI, ancillary development should be made a condition.
- iv. Incubation schemes of Ministry of MSME, Biotechnology, NITI Aayog, DST, other departments, state governments should be strengthened and synergised. Joint Working group on Incubation Schemes should be set up. The amount of assistance should include the cost of nurturing ideas, making prototypes and even marketing the test batch in the markets and then improving the product till it stabilises.
- v. The Government should constructively encourage more R&D investment and resources from global corporations and the domestic corporate sector. Government could consider establishing a dedicated public-private development fund for core technologies in infrastructure, energy, biotechnology, advanced genomics and other high-priority fields. Government should incentivize large enterprises in mentoring and guiding to MSMEs, as a part of their CSR activity, particularly in terms of using the latest technology and moving up the value chain.

**[Action: DC MSME, Para 5.5.6]**

### 9.17 Financial Literacy

The Committee recognizes the need for the creation of content for the benefit of entrepreneurs, which can be prepared based on OECD/INFE Core Competencies Framework on Financial Literacy for MSMEs after adopting it to Indian Context. For example, NCFE has prepared audio visuals on Certified Credit Counsellor and Udyami Mitra Portal for wider dissemination to the entrepreneurs. For dissemination of the content, various delivery channels such as mass media, RSETIs, FLCs, target group specific meetings conducted by various industrial bodies such as town hall meetings with entrepreneurs and specific MSME clusters can be explored. Finally, it is also important to carry out periodic surveys among the owners/managers of MSMEs across the country to assess the levels of financial literacy and the impact of literacy programs. Availability of credit, infrastructural issues, bank facilities, and many more indicators can also be measured across the regions and targeted policies can be formulated accordingly.

**[Action: NCFE, Para 5.8.6]**

### 9.18 Convergence of Government Schemes

- i. The Committee recommends that the Ministry of MSME should be the Nodal Ministry for all interventions pertaining to the MSME Sector, rather than multiple schemes being run by different Ministries for promotion of MSMEs in their respective domain.
- ii. PMEGP needs to be restructured to better meet aspirations of young India. The scheme may have one component reflecting the present support for new units only which may be, for say, 25% of the funds under the scheme with subsidy of upto 15%. The balance 75% must be used for upscaling services for business counselling, help in developing and drafting business proposals and exposure trips for budding and first generation entrepreneurs.

**[Action: Ministry of MSME, Para 6.3.3]**

### 9.19 Registration of Startups

The Committee deliberated on all the aspects relating to Startups in India. The major reason for migration of startups to other countries is because of better enabling environment such as tax concessions, well developed infrastructure, ease of doing business, exit policy, etc. Hence, the Committee is of the view that financial incentives and excellent infrastructure facilities must be deployed to retain successful Indian startups and to lure the best talent from across the world to start businesses in India. Telangana has adopted an innovative model for startup which may be assessed for possible replication in other States. **[Action: DPIIT, Para 4.7.7]**

### 9.20 Exit Policy for MSMEs

- i. The IBC provides for a differentiated regime for insolvency/ bankruptcy of firms, proprietary firms and individuals. Delegated legislation/ rules in this regard are currently under discussion. The finalization of these rules can boost lender confidence because lenders will have more certainty and predictability regarding the recovery of defaulted loans. This can increase the amount of credit available to MSME in Indian economy and in turn reduce the credit gap. Having an efficient, expeditious insolvency system in place that helps MSME or swiftly reallocates their productive assets to more efficient activities is paramount. **[Action: MoCA]**

- ii. Due to the lack of sophistication on the part of MSMEs, Insolvency code/ delegated legislation should provision for out-of-court assistance to MSMEs such as mediation, debt counselling, financial education, or the appointment of a trustee. **[Action: DFS]**  
**[Para 4.13.3]**

## 9.21 Credit Guarantee Schemes

- i. All Credit Guarantee Schemes should be subject to the regulation and oversight / supervision of RBI. These guidelines could draw upon the well acknowledged principle for design, implementation and evaluation of Public Credit Guarantee Schemes for SMEs which has been evolved by the World Bank Group. **[Action: RBI]**
- ii. All new Credit Guarantee Funds set up by the Government should be run by NCGTC, where expertise on risk management, fund management and compliance can be built up. Modalities for pooling of under-utilized corpus funds across guarantee schemes should be worked out. **[Action: DFS]**
- iii. NCGTC has been set up as a Government Company while CGTMSE is predominantly owned by the Government with SIDBI holding a minority share. It is necessary that the top management of both these institutions are professionalised and sourced from a wider pool. It would also be appropriate that SIDBI disengages itself from day to day management and Boards of both NCGTC and CGTMSE. **[Action: DFS]**
- iv. The Committee has recommended that the limit for collateral free lending should be increased to ₹20 lakh for lending to MSMEs and SHGs. It is accordingly recommended that the portfolio guarantee extended under the CGFMU be extended to ₹20 lakh for borrowers under the PMMY as well as SHGs. The corpus of CGFMU may be augmented accordingly to ₹10,000 crore by 2024. **[Action: DFS]**
- v. The CGFMU needs to revisit its procedure and guidelines so that these are better linked to Bank systems e.g. using PAN as an identifier, increase cover to the extent of 75% as against 50% at present, etc. It also needs to reduce deductibles and first loss provisioning to make the scheme more attractive for lenders. Subsequent to these changes no other Credit Guarantee Scheme including CGTMSE shall issue individual credit guarantee cover to MSMEs for loans below ₹20 lakh. **[Action: DFS]**
- vi. The Standup India Guarantee Scheme overlaps with the CGTMSE with similar cover. This Credit Guarantee Scheme needs to be folded up with the corpus being redeployed either in CGTMSE or in the CGFMU. Guarantees for Standup India loans would continue to be extended through CGTMSE. **[Action: DFS]**
- vii. CGTMSE may consider introducing ex-ante Credit Guarantees for loans above ₹2 crore. This would enable potential borrowers to be initially appraised by CGTMSE and secure a credit guarantee from it. Based on this credit guarantee, the borrower could now approach different banks to get best interest rates as a borrower who is fully secured. **[Action: CGTMSE]**

- viii. Currently, CGTMSE pricing is set at the level of the MLI with premium is being charged on the basis of NPA percentage and Claim Payout ratio of the Bank as a whole which leads to adverse effects on the Firms/ Companies which are actually performing well. In addition to Bank-level criteria, the Committee recommend that premium must also be sensitive to borrower-level characteristic such as formalisation and credit history. These schemes should reward both good borrowers and good MLIs. **[Action: CGTMSE]**
- ix. MUDRA and NCGTC must focus on catalyzing the markets – where it may otherwise be risk averse to participate. They must evolve into financial institutions which can provide for the MSME sector, risk management support through participation in a whole suite of structured financial products. These institutions can provide a whole suite of specialised products and investment approaches to boost risk-taking by MLIs in previously underserved regions and sectors. By adopting such a strategy, MUDRA and SIDBI can serve MLIs by catalysing a new base of capital markets investors. These products could include credit enhancements of various types, including investments in junior tranches of securitisation transactions. **[Action: DFS & RBI]:**
- x. Additionally, there can be different refinance rates and guarantee fees for MLIs (whether banks or NBFCs) serving MSMEs that are in the Aspirational Districts. **[Action: MUDRA, CGTMSE & NCGTC]**
- xi. The Committee recommends that enterprises that are emerging from various SHG initiatives under SRLM and NRLM programmes be included within the purview of MUDRA's guarantee programme and the corpus for the same may be accordingly increased.**[Action: DFS]**  
**[Para 7.9.6]**

## 9.22 Trade Receivables Discounting System (TReDS)

- i. Create a second TReDS window for reverse factoring so that supplier financing can be provided easily. Specifically, two things need to be done:
  - a. Issuance of the workflow for new TReDS window for reverse factoring.
  - b. Instructions to current TReDS licensees to activate the second window in a time-bound fashion. **[Action: RBI]**
- ii. The scope of Centralised KYC network may be expanded for capturing enterprise level document also. This would reduce the delay in on-boarding of MSMEs and Corporates. **[Action: CERSAI]**
- iii. Registration of invoice and satisfaction of charge upon it with CERSAI generally takes around 30 days which creates possibility of dual financing. Hence, it is recommended that the time period of 30 days should be reduced. **[Action: CERSAI]**
- iv. Creation of pooled API of all TReDS platforms would enable the financiers to understand the past repayment history of buyers thus enabling them to take more informed decision. Further, it will also rule out possibility of dual financing. NPCI which acts as settlement entity for TReDS may consider creating such API. **[Action: NPCI]**
- v. MSMEs also supply to Corporates having lower rating. Such MSMEs find it difficult to discount invoices on the platform. Widening the scope of financiers by permitting NBFCs other than NBFC factors would possibly lead to discounting of such invoices. A minimum rating may be required for these NBFCs. **[Action: DFS ]**

- vi. Presently, Factoring Act, 2011 permits only financiers to register charge with CERSAI. If TReDS entities are permitted to act as an agent for Financiers for filing of Registration of Charge with CERSAI and its satisfaction this will lead to operational efficiency. Therefore, Factoring Act, 2011 may be amended to permit TReDS entities to register charge with CERSAI. **[Action: DFS]**
- vii. Credit Guarantee Fund Scheme for Factoring of NCGTC may be extended to invoices to be discounted on TReDS platform through second window as such guarantee may result in even bills drawn on smaller /lower rated buyers being accepted for discounting by factors and banks initially, and once transaction histories are built, they may dispense with guarantee subsequently. This would also in a way lead to better price discovery of the risks for the sellers. **[Action: DFS (NCGTC)]**

**[Para 7.6.2, 8.3.1]**

### **9.23 Collateral free limit**

- i. Increase the limit for non-collateralised loans to ₹20 lakh, this would address a significant proportion of MSEs needs. **[Action: RBI]**
- ii. Revision in loan limit sanctioned under MUDRA to ₹20 lakh from ₹10 lakh. **[Action: DFS]**
- iii. Portfolio guarantee through NCGTC for all such collateral free MSME loans may be increased i.e. proportion of guarantee coverage should be increased to 66.6-75% from 50 %. A commensurate enhancement in corpus may also be done. **[Action: DFS]**
- iv. CGTSME would no longer provide individual covers upto ₹20 lakh, except for such units which are at say ₹20 lakh exposure and are now looking at further growth and therefore a transition to an individual guarantee. **[Action: DFS]**

**[Para 7.12.1]**

### **9.24 Lending to MSMEs under PSL**

- i. The Committee recommends that the APSL mechanism be tried out starting with MSMEs in Phase 1 and evaluating the results of the same. As a default, all banks must continue to achieve 40% of NBC as PSL lending in the case of Universal Banks and 75% in the case of Small Finance Banks. For banks that wish to specialize in MSME lending, the requirements to do agricultural lending under PSL can be waived provided they achieve 50% of NBC as SME-PSL lending in the case of Universal Banks and 80% in the case of Small Finance Banks. Additionally, weightages may be constructed for MSME lending in the Aspirational Districts to incentivise flow of credit to these underserved districts. Under such a construct, one rupee of MSME lending in an Aspirational District would count more (say ₹ 1.25) towards PSL achievement than one rupee of lending in another district. **[Action: RBI]**
- ii. Current PSL guidelines state that investments by banks in securitised assets, representing loans to various categories of priority sector, are eligible for classification under respective categories of priority sector depending on the underlying assets provided - the all-inclusive interest charged to the ultimate borrower by the originating entity does not exceed the Base Rate of the investing bank plus 8% per annum. Such price caps are not applicable to banks when they originate directly through branches. In order to encourage smaller NBFCs to extend MSME lending to underserved areas and micro-segments where the cost of intermediation are higher and to encourage partnerships between Banks and NBFCs, the

Committee recommends modifying this cap to the Base Rate of the investing bank plus 12% per annum for now and periodically reviewing the need for such a cap. **[Action: RBI]**  
**[Para 7.7.5]**

## **9.25 Credit Appraisal**

- i. Uniformity in and simplification of various loan application formats and assessment process in line with learnings from supply chain financing, escrowing of cash flows is needed for quicker decision making and reducing turnaround time. Further, there is need to develop new MSME products as per prevailing market dynamics. Creating Centralised Centres of Excellence with specialized staff can help expedite processing of loan proposals. A working group involving SIDBI and IBA may work on this with SIDBI taking the lead. As there is considerable expertise on the subject available with RBI on the subject, RBI may provide specialised technical assistance and expertise to this group. **[Action: RBI, SIDBI, IBA]**
- ii. The working group of SIDBI and IBA may also consider ways to reduce Turn Around Time (TAT) especially in the pre LOS (Loan Origination System) or centralised sanction stage.
- iii. Banks should use surrogates like personal guarantee, bank statement, GST data, standardized score cards to evaluate credit worthiness of MSME borrowers. For PSBs, these can be part of Enhanced Access and Service Excellence (EASE) programme of Ministry of Finance so that progress is monitored. **[Action: Scheduled Commercial Banks, DFS]**
- iv. Government should specifically encourage MSMEs to obtain Zero Defect Zero Effect (ZED) Certification from QCI, and the banks could pass on some benefit due to lower risks for such units by way of interest/processing fee concessions. **[Action: Ministry of MSME & Scheduled Commercial Banks]**
- v. Presently, banks assess working capital and term loan requirement of MSME units based on various methods viz., Cash Budget Method, Nayak Committee or minimum 20% of Turnover Method, Traditional or Operating Cycle Method. Out of these methods, assessment based on projected turnover based method prescribed by Nayak Committee, is generally used by banks. The movement from Balance Sheet or turnover based Working Capital financing to cash flow based, or supply chain/ cluster based financing needs to be accelerated to reduce TAT. This is within the remit of individual banks and requires no regulatory intervention.  
**[Action: Scheduled Commercial Banks]**

**[Para 7.4.3]**

## **9.26 Cash Flow-based Lending**

- i. Banks should develop customised products to assess the financing requirements based on expected cash flows moving away from traditional forms of assessment.
- ii. Banks need to build their ability to capture cash flows of MSME borrowers on a regular basis, for which tie-ups with Industry Majors / Aggregators / Online platforms will have to be done by the Banks. When Account Aggregators (AA) get operationalized, lenders will have access to more information on borrowers' transactions at a single point which would further facilitate cash flow based lending.

- iii. Banks should monitor on ongoing basis data input from partners for early warning indicators, for instance, in case of e-commerce sellers, any change in seller rating, velocity of sales, etc. should be notified to lender.

**[Action: Scheduled Commercial Banks, Para 7.5.1]**

### **9.27 Co-origination of Loans**

- i. The applicability of the Co-origination guidelines may be expanded to include Non-Systemically Important ND-NBFCs with a minimum credit rating. This will also encourage participation by new generation lenders that use alternative data for underwriting. **[Action: RBI]**
- ii. RBI to align IRAC norms for Banks and NBFCs. **[Action: RBI]**
- iii. NBFCs are not permitted to enforce action under the SARFAESI Act for loans below ₹1 crore. Since NBFCs will be servicing the loans on behalf of banks, they may be permitted to initiate all recovery measures including SARFAESI for the total loan amount for loans below ₹1 crore. **[Action: DFS]**

**[Para 7.8.2]**

### **9.28 Portability of MSME loans**

In order to provide loan portability in a seamless manner to MSMEs, the Committee recommends that RBI should come out with measures on portability of MSME loans with a lock in period of one year. **[Action: RBI, Para 7.10.3]**

### **9.29 Regulatory Retail**

The limit of ₹5 crore was introduced along with the adoption of Basel II in India. Basel II allows for regulatory retail (or SME exposure) upto Euro 1 million. In today's terms, Euro 1 million easily translates to ₹7.5 crore, if not more. The Committee recommends RBI to revise the limit of regulatory retail to ₹7.5 crore. **[Action: RBI, Para 7.11.1]**

### **9.30 Restructuring of NPA accounts**

An MSME account could be considered for upgrade to "standard" after six months of satisfactory operation, instead of one year at present. In addition to stable performance for six months, the MSME must also have demonstrable additional equity in the business and/or new sources of cash-flow. **[Action: RBI, Para 7.13.3]**

### **9.31 Role of MUDRA**

In order to play a more catalytic role, MUDRA would require enhancement of in-house (or outsourced) capabilities, including underwriting, risk management, fund raising based on its own AAA rating and sharper focus on emerging trends in the market. A reimagining of MUDRA is necessary including assessing the rationale for continuing it as a subsidiary of SIDBI. **[Action: DFS, Para 7.14.2]**

### 9.32 Access to digital payments and commerce platforms for rural MSMEs

- i. The Committee recommends an urgent focus to implement broadband connectivity in all parts of the country which will disproportionately benefit rural MSMEs. **[Action: Department of Telecommunication]**
- ii. Access to digital payments requires more demand-side incentives. As has been suggested by the High Level Committee on Deepening Digital Payments (Chairman: Nandan Nilekani), the acceptance network in rural areas need significant improvement. This Committee supports the recommendation to set up an Acceptance Development Fund to support merchants in rural areas.

**[Para 7.16.1]**

### 9.33 Issues related to SHGs

- i. Loans to SHGs may be made collateral free upto ₹20 lakh, as against ₹10 lakh at present, in line with the recommendation for micro enterprises. **[Action: RBI]**
- ii. DFS may act as Settlor for a Credit Guarantee Fund to be operated by NCGTC for extending Credit Guarantees to digitalised SHGs as well as producer collectives or Farmer Producer Organisations (FPOs) which are registered entities, etc. This Credit Guarantee may be configured to provide upto 75% guarantee cover to these SHGs, FPOs, etc. for loans between ₹20 lakh and ₹1 crore on the lines of CGTMSE, Education Loans, Skilling loans, etc. This will mean that loans upto ₹1 crore would be effectively collateral free. **[Action: DFS]**
- iii. The transition of FPOs to Farmer Producer Companies (FPCs) should be actively focused upon. **[Action: MoRD, Ministry of Agriculture]**
- iv. The Committee recommends for upgrading Self-Help Group (SHG) access to credit by grandfathering SHG member history into the credit system and by introduction of mobile/tablet-based book-keeping, SHGs will see an expansion of cash-flow lending. Many SHGs grow into nano and micro enterprises. By grandfathering SHG member history into the credit system one can improve the odds of new entrepreneurs getting financing. **[Action: MoRD]**

**[Para 7.17.5, 8.3.1]**

### 9.34 Mitigating Risk and Impact of Calamities

- i. Group policies for death and accident cover for MSME entrepreneurs need to be developed with insurance cover significantly higher than the cover currently offered by PMSBY and PMJJBY schemes. As Group policies, these would involve significant reduction in premium payable. Coverage could be offered in slabs so that there are different sub-products for say a Micro entrepreneur vs a Medium entrepreneur. A portion of the sum assured could be assigned towards settling workers' dues at the unit. The insurance cover would require no subsidy support from the Government and could be configured as an incentive for MSMEs which have been formalised, for instance, through GST enrolment or MSME registration or under the Shops and Establishments Act. **[Action: DFS & DC MSME]**

- ii. Active efforts, in campaign mode, are needed to extend coverage under PMSBY and PMJJBY to all MSME employees. **[Action: DFS & DC MSME]**
- iii. Workers at urban and rural formalised MSEs need to be specifically covered under PMJAY-Ayushman Bharat scheme. Thereafter, MSME-DIs and DICs may be involved in an intensive campaign to assist enrolment of workers of MSEs and their families under the PMJAY/Ayushman Bharat scheme so that health cover of ₹5 lakh becomes available to them. For MSE entrepreneurs, a group health scheme on similar lines based on full contribution by the entrepreneur may be designed in consultation with insurance companies. **[Action: DFS & DC MSME]**
- iv. Calamities such as earthquakes, cyclones and floods have been occurring ever so often. Disaster relief efforts by Government have tended to focus on rescue, temporary rehabilitation and ex gratia payments. Ex gratia payments cover death and loss of homestead but rarely cover loss of business enterprises. In a relative sense, MSMEs are prone to both business (cycle) risks and natural calamity related risks, the latter being associated more with agriculture. Agriculture failure gets attention and relief, while the same does not happen for MSMEs. Once relief work is discontinued and some shelter has been built, MSME owners struggle with reviving their business. Currently, on declaration of a natural calamity, banks offer a rescheduling of existing loans. This has involved conversion of outstanding limits to Working Capital Term Loans, moratorium on repayments of old loans, some amount as fresh loan, etc. While this provides some immediate succour, the overall leverage increases. In most cases, sooner or later, the old and new debt together becomes difficult to sustain. The leverage does not reduce as net earnings are being used to service the increased debt and no capital accumulation is taking place. This gap can be met in two possible ways. The first would be to make changes in the Relief Manual so that a fixed amount could be given as ex gratia for MSEs in lieu of equity to enable them to restart their enterprise. The other alternative could be to set up a micro equity window, with GoI funding, operated by SIDBI for providing patient capital to formalised, calamity affected MSEs. **[Action: DFS]**
- v. Blanket bans lead to large scale shut down of units. These bans are not simply cyclical and often result in significant structural changes in the industry segment concerned. Loans taken by such units have to be written off, entrepreneurs are tagged as defaulters and jobs are lost. This needs to be distinguished from business failure at an individual level as this is an exogenous event. Rather than attempting to compensate entrepreneurs for the event, changes to the MSMED Act, 2006 could be envisaged whereby a transition time of, say one year, is provided under the law to affected units for an orderly closure of their unit. **[Action: Ministry of MSME]**
- vi. Design of insurance products that address the special needs of MSMEs after a catastrophic event should be encouraged. This would include solutions for maintenance of income in case of business interruption, cost of re-education, partner insurance, key man insurance and capital for accessing loans. This insurance solution should be made available at an affordable price. **[Action: IRDA]**
- vii. TReDS platform mitigates risk arising out of non-payment of receivables of MSMEs who supply to a large buyer or are a part of a formal supply chain. Yet, there are many buyers

who are not on TReDS. MSME sellers often take a blind call on the credentials of such buyers and their ability to pay in time. Trade Credit Insurance is an insurance product that secures the payment of such receivables and helps MSMEs sell to new buyers who may often be in distant geographies. There is a need to widely publicise this insurance product to MSMEs. **[Action: IRDA & Industry Associations]**

**[Para 7.20.4]**

## **New Technological Interventions for MSME Lending**

### **9.35 Financial Architecture for MSME Lending**

#### **A. Data for Non-Corporate entity**

- i. The creation of a unique identifier such as Unique Enterprise ID (UEI), on lines of Corporate data collected by Ministry of Corporate Affairs, wherein all details pertaining to any MSME firm can be integrated. The Committee recommends that the PAN be used as the UEI, and that CBDT may implement the following recommendations.
- ii. The UEI should be used for creation of comprehensive reports pulled from different data sources that cover
  - a. Financial information (Ownership structure, Complete Financials, Auditor Comments)
  - b. Non- Financial Information (Registration details; Management details; related entity of the proprietor, partners; status of statutory compliance viz., TDS, GST, Export-Import regulation, etc.)

Each of the individual owners of the repositories with this information must be responsible for including the UEI in their database and making available an API for this access. The Department of Revenue (DOR) can be the coordinating agency, for successful completion of this task. **[Para 8.1.2]**

#### **B: Rating of MSME**

The Committee recommends that RBI facilitate the creation of additional information sources from where a financial institution may download a report which includes a score for the entity based on additional factors including business risk, industry risk, management risk, and financial risk. Additional parameters used in this score could include: Business Vintage, GST compliance, Direct Tax compliance, PF and ESI compliance, Export compliance, Promoter Net Worth. Such reports could also provide additional information including peer comparisons and industry analysis. **[Para 8.1.4]**

#### **C: Credit Score of Buyers for MSMEs**

The Committee recommends that RBI may enable the MSME to check the credit rating / Credit Monitoring Report (CMR) for their buyers, based on consent, through their primary banker. CMR being a strong indicator of liquidity risk, repayment track, specific behavior pertaining to vintage and regency to credit, the Committee recommends the incorporation of CMR in the credit rating mechanism. **[Para 8.1.6]**

#### **D: Disbursement Architecture and KYC Norms**

- i. It is suggested that online repositories like Ministry of Corporate Affairs website for corporates/LLPs, GST, Shop and Establishment be encouraged to open APIs for verification of documents issued by them. Further, various document issuing Departments of the Central and State Governments should also promote online repositories for this purpose. REs may validate document information real time through API based verification with the respective

Government databases maintained by the issuing Department. Such API verification should be treated at par with physical verification of the documents submitted by customers which in turn would also mitigate the risk of fake / forged documents being submitted.

- ii. Lenders may use API services (self or through FinTech providers) and maintain appropriate logs to evidence verification of such documents. Currently, for example GSTIN / PAN can be used to fetch the name of entity, registered address, e-mail id, and entity type through an API with GST database. The following APIs are currently available. Entity Proof for KYC -MCA (Fetch Corporate & Director details from MCA database), GST, NSDL (PAN), Service Tax, VAT, TIN, Shops & Establishment, IEC, Professional tax, ICAI, ICWAI, ICSI, FSSAI.
- iii. The Committee further recommends that physical verification be replaced with electronic verification wherever possible. This includes:
  - a. Promotion of digital signatures by partners and directors for acceptance and documentation;
  - b. Creation of a platform to upload digital documents for online stamping which incorporates compliance with state-wise stamp duty payments;
  - c. Integration with online mortgage repository for ensuring end to end digital journey in secured cases;
  - d. Digital KYC which enables digital site visit with geo-location tagging, video KYC for ease & seamless on-boarding
- iv. Video Based KYC - Presently the KYC process is manual and necessitates a physical presence, thus increasing costs and timelines in completing the required KYC processes. As an alternative to enabling e-KYC, the Committee recommends video KYC to be adopted as a part of digital financial architecture as a suitable alternative to performing a digital Aadhaar-based KYC process towards enabling non – physical customer onboarding. **[Para 8.1.8]**

#### E: Approach to Universal Enterprise ID

The Committee strongly recommends that PAN, with appropriate changes prescribed in Chapter 8 be used as the Universal Enterprise Identifier. This will enable rapid adoption of this scheme and will allow many existing systems to adopt with no or minimal changes. **[Para 8.1.12]**

**[Action: Department of Revenue for PMLA changes, MeitY for digital signature and e-Governance changes, RBI for lending guidelines]**

### **9.36 Regulatory Action Plan for Cash-Flow Lending**

#### A. Create a new category of Loan Service Providers

With a view to enabling more customers to access credit, the regulator must create a new category - Loan Service Providers (LSPs) – who will be an agent of the borrowers. The LSPs offering individualized advice should act in borrowers' best interest, respecting fiduciary duties of disclosure, loyalty and prudence. Similarly, Lender agents like DSAs and brokers should be required to disclose conflicts that compromise their impartiality, such as incentives from lenders to market higher-priced loans over others, and clearly break out the fees they add to loans. Creating a clear, straightforward, lightly regulated charter of LSPs and DSAs would encourage additional innovation in the MSME lending space. Further, the Committee recommends that the RBI facilitate the creation of a Self-Regulatory Organization, on the lines of AMFI and RIAs, to organize and provide light touch regulation for this category of players.

B. Mandating Disclosure of Originations, Annual Percentage Rate (APRs), Default Rates, and Borrower Satisfaction across the MSME Lending market. The regulator must collect specific data, through the proposed PCR, from market players on their small business loan transactions, such as average APRs and default rates. This data, which should be released quarterly by RBI, will shed light on current practices and on the state of access to credit, deterring bad actors and reducing the risk of cumbersome regulation stifling important innovations.

#### C. MSME Lending Innovation Sandbox

RBI has already announced a draft framework for a Regulatory Sandbox. The Committee recommends that this be extended to bring in a focus on MSME lending with a view to simplifying the compliance process without compromising on the regulatory objectives. Sandbox participants should seek out innovative ways of executing the regulatory tasks such as data collection, compliance and reporting, and disclosure that takes advantage of technology, keep processes simple and leave room for continuous improvement and innovation in the way the regulations are implemented. **[Action: RBI Para 8.2]**

### 9.37 Digital Public Infrastructure Action Plan for Cash-Flow Lending

A. Accelerate industry deployment of E-Liens so that future incoming cash-flows can be locked down for better loan repayment rates. Specifically, following needs to be done:

- i. GST Council should require Buyers to pay only to the payment address mentioned in the GST Invoice.
- ii. Issuance of a new standard for utilization of Transaction ID field such that invoice number and date are included. RBI should encourage unbundled payments against each invoice. This unbundling would allow for automatic reconciliations to happen and for E-Lien triggers to be generated. This shift is necessary to support lending in the MSME sector against future cash-flows.
- iii. Upgradation of UPI e-mandate markup language to include event-triggers (in addition to time triggers) and its standardization across merchant credit card accounts, CASA accounts and UPI for E-Lien creation. The new E-Lien system allows for these future cash-flows to be locked to repay a loan. Today, this happens with post-dated cheques and e-NACH. There are time-based triggers. When this is expanded to include event-based triggers (e.g. when Buyer ABC pays, send 80% of the received amount to the Lender), cash-flow lending can be unleashed at full-scale. The system of describing the time or event-based triggers has to be a national standard so that lenders can make this work for incoming cash-flow into any bank account, credit card merchant account or UPI account. The quickest way to get to this national standard is to upgrade the already issued UPI 2.0 e-Mandate mark-up language.
- iv. Instructions issued to report all E-Liens to PCR or CERSAI with provision for real-time lookups.

B. TReDS Second Window (discussed above)

C. Introduction Enterprise ID using PAN (as mentioned above) on a mission mode basis to ensure the availability of credit to MSMEs.

D. Connect GSTN to Account Aggregators (AA) and Upgrade E-Way Bill system to include Proof-of-Delivery (POD). Making GST invoices available to lender is essential for cash-flow lending to take off. For this, GSTN system needs to be connected to the AA system. Dematerializing of POD is essential for inventory financing for MSMEs to grow. The design is already in place. Only an implementation project needs to be created. **[Action: Various Stakeholders, Para 8.3.1]**

### 1. Meetings held by the Committee

Sl. No	Date	Venue	External Participants Invited
1	January 12, 2019	RBI, Mumbai	Internal Meeting
2	February 5, 2019	RBI, Mumbai	<ul style="list-style-type: none"> <li>- Securities and Exchange Board of India</li> <li>- TransUnion CIBIL Limited</li> <li>- LetsVenture</li> </ul>
3	February 13, 2019	RBI, Delhi	<ul style="list-style-type: none"> <li>- Goods &amp; Services Tax Network</li> <li>- World Bank Group</li> </ul>
4	March 1, 2019	CAB, Pune	<ul style="list-style-type: none"> <li>- State Governments of Goa, Gujarat, Maharashtra, Madhya Pradesh,</li> <li>- ASSOCHAM</li> <li>- MSME Borrowers</li> </ul>
5	March 2, 2019	RBI, Chennai	<ul style="list-style-type: none"> <li>- State Governments of Andhra Pradesh, Karnataka, Kerala, Tamilnadu, Telangana</li> <li>- Tamilnadu Small and Tiny Industries Association (TANSTIA), Confederation of India Industries (CII)</li> <li>- MSME Borrowers</li> </ul>
6	March 8, 2019	RBI, Delhi	<ul style="list-style-type: none"> <li>- Small Industries Development Bank of India (SIDBI)</li> <li>- State Governments of New Delhi, Uttar Pradesh, Rajasthan, Haryana, Punjab, Uttarakhand, Himachal Pradesh, Jammu &amp; Kashmir</li> <li>- Federation of Indian Chambers of Commerce and Industry (FICCI), Federation of Indian Micro and Small &amp; Medium Enterprises (FISME)</li> <li>- MSME Borrowers</li> </ul>
7	March 15, 2019	RBI, Kolkata	<ul style="list-style-type: none"> <li>- State Governments of West Bengal, Odisha, Bihar, Jharkhand, Chattisgarh</li> <li>- Federation of Small &amp; Medium Industries, West Bengal (FOSMI), FICCI</li> <li>- MSME Borrowers</li> </ul>
8	March 16, 2019	RBI, Guwahati	<ul style="list-style-type: none"> <li>- State Governments of Nagaland, Sikkim, Assam, Arunachal Pradesh Manipur, Meghalaya, Mizoram, and Tripura.</li> <li>- Confederation of Indian Industry (CII), Federation of Industry of Commerce of North Eastern Region (FINER)</li> <li>- MSME Borrowers</li> </ul>
9	March 29, 2019	RBI, Delhi	<ul style="list-style-type: none"> <li>- NITI Aayog</li> <li>- Ministry of Rural Development</li> <li>- Department for Promotion of Industry and Internal Trade (DPIIT)</li> <li>- Ministry of Skill Development and Entrepreneurship</li> <li>- Madhya Pradesh Financial Corporation (MPFC)</li> <li>- Government e-Marketplace Portal</li> <li>- Capital Float</li> <li>- World Bank Group</li> </ul>
10	March 30, 2019	RBI, Delhi	<ul style="list-style-type: none"> <li>- A.TReDS</li> <li>- CRISIL</li> <li>- Acuité Ratings &amp; Research Ltd.</li> <li>- National E-Governance Services Limited (NeSL)</li> <li>- SBI Life Insurance Ltd.</li> </ul>
11	May 3, 2019	RBI, Delhi	<ul style="list-style-type: none"> <li>- Omidyar Network India</li> <li>- Department of Agricultural Co-operation &amp; Farmers' Welfare, Ministry of Agriculture &amp; Farmers' Welfare</li> </ul>

			<ul style="list-style-type: none"> <li>- Department of Animal Husbandry &amp; Dairying, Ministry Agriculture &amp; Farmers' Welfare</li> <li>- Ministry of Health &amp; Family Welfare</li> <li>- Ministry of Textiles</li> <li>- Department of Commerce, Ministry Commerce &amp; Industry</li> <li>- Ministry of Road Transport &amp; Highways</li> <li>- Ministry of Tourism</li> </ul>
12	May 10, 2019	Video Conference	Internal Meeting
13	May 20, 2019	Video Conference	Internal Meeting
14	May 27, 2019	Video Conference	Internal Meeting
15	June 8, 2019	RBI, Delhi	Internal Meeting

## 2. Area-wise Schemes of Various Ministries

Area-wise Schemes of Various Ministries								
Sl. No.	Name of the Ministry	Infrastructure	Capacity Building/Incubation Centres/Skill Training/Entrepreneurship	Market	Technology upgradation/Quality Management/R&D	Finance/Credit/Equity Support	Credit Guarantee / Insurance	International Market
1	MINISTRY OF MSME		Assistance to Training Institutions (ATI)	Marketing Assistance				International Co-operation
	DCMSME	Micro & Small Enterprises Cluster Development Programme (MSE-CDP)		MSME Market Development Assistance (MDA)	i. Credit Linked Capital Subsidy Scheme for Technology Upgradation ii. ISO 9000/ISO 14001 Certification Reimbursement ZED Scheme iii.	National Awards	Credit Guarantee Scheme	
	National Manufacturing Competitiveness Programme		Entrepreneurial and Managerial Development of SMEs through Incubators	Marketing Support / Assistance to MSMEs (Bar Code)  Marketing Assistance & Technology Upgradation	i. Quality Management Standards (QMS) and Quality Technology Tools (QTT) ii. Building Awareness on Intellectual Property Rights (IPR) iii. Lean Manufacturing Competitiveness for MSMEs iv. Design Clinic for Design Expertise to MSMEs Manufacturing Sector (DESIGN) v. Technology and Quality Upgradation Support to MSMEs			
	National Small Industries Corporation (NSIC) Schemes	Software Technology and Business Parks	Exhibition Hall, Hyderabad IT Incubator	Marketing Intelligence Services Lease		i. Bank Credit Facilitation ii. Bill Discounting		
	ARI Division Schemes	i. PMEGP ii. Coir Udyami Yojana iii. SFURTI	Aspire (Scheme for promotion of Innovation, Entrepreneurship and Agro- Industry)	Market Promotion Development Assistance (MPDA)			Janshree Bima Yojana for Khadi Artisans	
	Coir Vikas Yojana	Development of Production Infrastructure (DPI)	Skill Upgradation & Mahila Coir Yojana (MCY)	Domestic Market Promotion Scheme			Personal Accident Insurance Scheme for Coir Workers	Export Market Promotion
2	MINISTRY OF SKILL DEVELOPMENT AND ENTREPRENEURSHIP SCHEMES		i. Udaan Training Programme for Unemployed Youth of J&K ii. National Skill Certification & Monetary Reward (STAR scheme) iii. Pradhan Mantri Kaushal Vikas Yojana					
3	MINISTRY OF LABOUR AND EMPLOYMENT		i. Craftsmen Training (ITIs) ii. Skill Development Initiative					
4	MINISTRY OF HEAVY INDUSTRIES & PUBLIC ENTERPRISES	Capital Goods Scheme						
5	MINISTRY OF NEW AND RENEWABLE ENERGY				Development / Upgradation of Watermills (WM) and setting up Micro Hydel Projects (MHP) (up to 100 KW capacity)			
6	MINISTRY OF DEVELOPMENT OF NORTH EASTERN REGION		Capacity Building and Technical Assistance (CB&TA) scheme North –East Rural Livelihoods Project (NERLP)					
	North Eastern Development Finance Corporation Ltd (NEDFL)	NEDFi Opportunity Scheme for Small Enterprises (NoSSE) North East Entrepreneurs Development (NEED)	Initiative for Development of Entrepreneurs in Agriculture (IDEA) Women Enterprise Development (WED)		Equipment Finance	i. Corporate Finance ii. Micro Finance iii. NEDFi Equity Fund iv. Rupee Term Loan (RTL) v. Working Capital Term Loan (WCTL) vi. WCTL for Contract Finance		

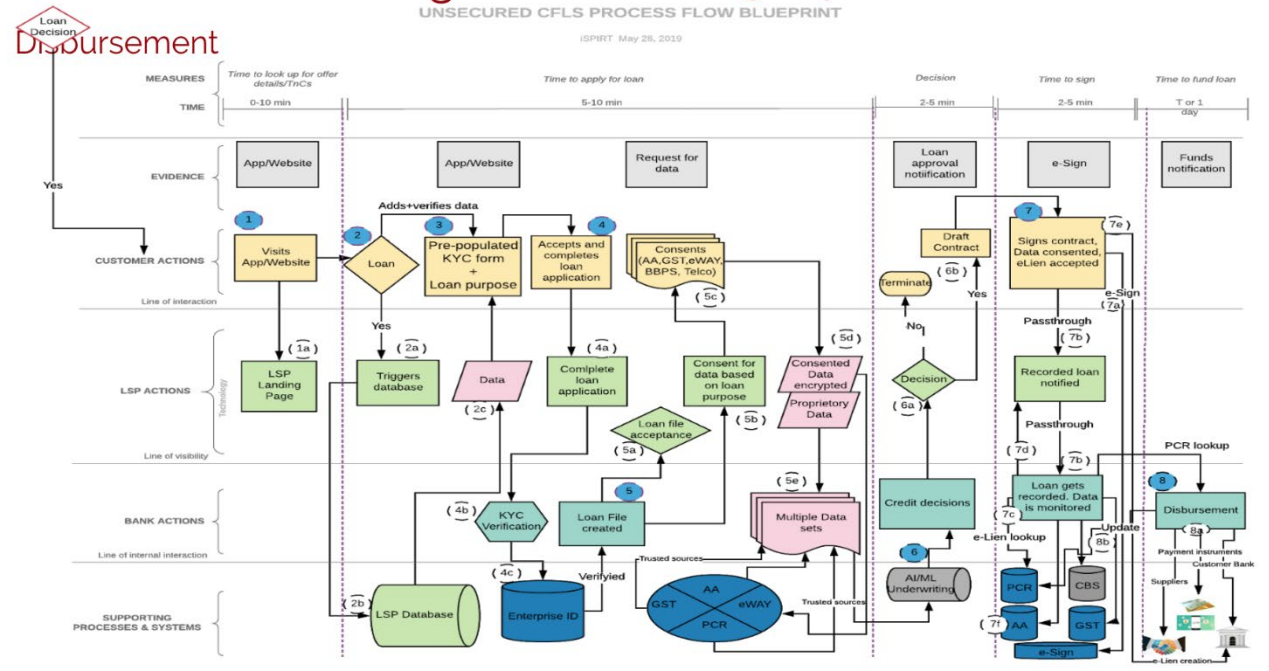
7	MINISTRY OF MINORITY AFFAIRS		i. "Nai Roshni"- For Leadership Development of Minority Women ii. "Seekho aur Kamao (Learn and Earn)" - For Skill Development of Minorities					
8	MINISTRY OF ENVIRONMENT, FOREST AND CLIMATE				i. Common Effluent Treatment Plants (CETPs) ii. Waste Minimisation & Clean Technology			
9	MINISTRY OF HUMAN RESOURCE DEVELOPMENT		National Scheme of Apprenticeship Training		Technology Development Mission			
10	MINISTRY OF HEALTH AND FAMILY WELFARE	Development of AYUSH Clusters		Promotion of Information, Education, and Communication (IEC) in AYUSH				Promotion of International Co-operation in AYUSH
11	NITI AAYOG SCHEMES		Self - Employment and Talent Utilisation (SETU)					
12	MINISTRY OF AGRICULTURE	Development/Strengthening of Agricultural Marketing Infrastructure, Grading & Standardisation	i. Promotion & Strengthening of Agricultural Mechanisation through Training, Testing & Demonstration ii. Capacity Building to Enhance Competitiveness of Indian Agriculture and Registration of Organic Products Abroad iii. Dairy Entrepreneurship Development			Small Farmers' Agriculture-Business Consortium- Agriculture-Business Development		
13	MINISTRY OF CHEMICALS AND FERTILISERS	Cluster Development Programme for Pharma Sector (CDP-PS)						
14	MINISTRY OF COMMERCE & INDUSTRY Exporter Credit Insurance						i. SME Exporters Policy ii. Small Exporters Policy (SEP)	
15	MINISTRY OF COMMERCE & INFORMATION TECHNOLOGY	Software Technology Parks of India (STPI)	Technology Incubation and Development of Entrepreneurs (TIDE) e-Governance- Capacity Building		i. R&D Funding ii. Multiplier Grants (MG) iii. Export Promotion of Capital Goods (EPCG)			
16	MINISTRY OF FINANCE					Pradhan Mantri MUDRA Yojana		
17	MINISTRY OF FOOD PROCESSING INDUSTRIES	Cold Chain		Mega Food Park				
18	MINISTRY OF HOUSING AND URBAN POVERTY ALLEVIATION		National Urban Livelihoods Mission					
19	MINISTRY OF RURAL DEVELOPMENT		i. National Rural Livelihood Mission (NRLM) ii. Aajeevika Skills Development Programme iii. MGNREGA Programme					
20	MINISTRY OF SCIENCE AND TECHNOLOGY National Science & Technology Entrepreneurship Development Board (NSTEDB)		i. Innovation and Entrepreneurship Development Centre (IEDC) ii. Entrepreneurship Development Cell (EDC) iii. Entrepreneurship Development Programme iv. Science & Technology Entrepreneurship Development (STED) v. Science & Technology Entrepreneurs / Entrepreneurship Park (STEP) vi. Technology Business Incubators (TBI)					
	Department of Bio-Technology (DBT)				Bio-Technology Industry Partnership Programme (BIPP)			
21	MINISTRY OF SOCIAL JUSTICE					Venture Capital Fund for SCs		

22	MINISTRY OF TEXTILES	i. Additional Grant for Apparel Manufacturing Units for Integrated Textile Park (SITP) ii. Comprehensive Handloom Cluster Development (CHCD) - Mega Handloom Cluster (12th Plan) iii. Related scheme Babasaheb Ambedkar Hastshilp Vikas Yojana			Catalytic Development Programme (CDP) in Project Mode Design and Technology Upgradation			
23	MINISTRY OF TOURISM		Capacity Building for Service Providers (Institutes)	Marketing Development Assistance (MDA) Publicity and Marketing				
24	MINISTRY OF TRIBAL					i. Adivasi Mahila Sashaktikaran Yojana ii. Tribal Forest Dwellers Empowerment iii. Micro Credit (MC) for SHGs		
25	MINISTRY OF WOMEN AND CHILD DEVELOPMENT		Gender Budgeting (GB) Support to Training and Employment Programme (STEP) for Women					

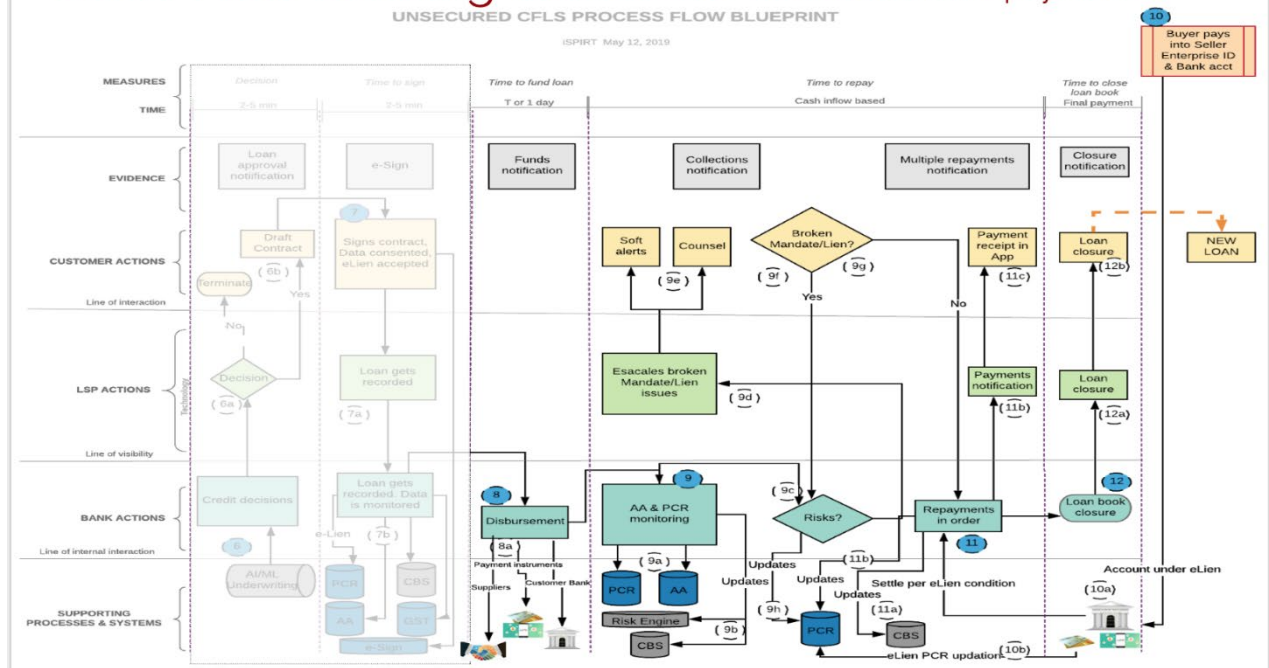
### 3. Cash-flow Lending Workflow

Cash-flow Lending is a pure digital lending value-chain that stitches together several market participants and leverages many Digital Public Infrastructure blocks. A Reference Workflow is presented here.

## Cash-Flow Lending Workflow: Eligibility, Decision, Contract, Disbursement



## Cash-Flow Lending Workflow: Disbursement, Repayments



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- II. The Nacional Financiera (NAFIN) Factoring Program in Mexico - Contract Financing
- III. Financial Incentives - Shenzhen's Success Story
- IV. Analysis of Delayed Payments
- V. Barriers for SMEs by stage of Procurement Process
- VI. International Learnings from Unique Business Identifier
- VII. Telangana Startup Model
- VIII. Enterprise Development Centres - Key Features
- IX. Alibaba Model & Amazon's Kala Haat
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- XII. New Financial Institutions – The New Third Board – Comparison with China
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- XX. PSS approved, Refinance extended and Investments made in PTCs (by MUDRA)
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- II. High level architecture for New Enterprise ID
- III. Cash Flow Loans
- IV. Beyond Demating of the Loan Process
- V. TReDS Platform Second Window
- VI. Elements of Cash-flow based Lending

## 8. Presentations made to the Committee

1	Shri Ramesh Abhishek, Secretary, Department for Promotion of Industry and Internal Trade (DPIIT)
2	Shri Amarjeet Sinha, Secretary, Ministry of Rural Development
3	Shri Yaduvendra Mathur, Additional Secretary, NITI Aayog
4	Dr. S. Eswara Reddy, Drugs Controller General of India (DCGI), Ministry of Health & Family Welfare
5	Ms. Sunita Sanghi, Senior Adviser Ministry of Skill Development and Entrepreneurship
6	Department of Agricultural Co-operation & Farmers' Welfare, Ministry of Agriculture & Farmers' Welfare
7	Department of Animal Husbandry & Dairying, Ministry Agriculture & Farmers' Welfare
8	Ministry of Textiles
9	Department of Commerce, Ministry Commerce & Industry
10	Ministry of Road Transport & Highways
11	Ministry of Tourism
12	Ms. Radha S. Chauhan, CEO, Government e-Marketplace (GeM) portal
13	Shri Prakash Kumar, CEO, Goods & Services Tax Network
14	Shri Mohammad Mustafa, Chairman and Managing Director, Small Industries Development Bank of India (SIDBI)
15	Shri Vijay Bharati, Director, Directorate of Micro, Small and Medium Enterprises, West Bengal Government
16	Ms. Smita Bharadwaj, Managing Director, Madhya Pradesh Financial Corporation (MPFC)
17	Shri Jayanta Jash Chief General Manager, Securities and Exchange Board of India
18	Shri Satish Pillai MD & CEO, TransUnion CIBIL Limited
19	Shri Kalyan Basu, MD & CEO, A.TREDS Ltd.
20	Shri Prasad Koparkar, Senior Director, CRISIL
21	Shri R Vasudevan, Senior Director, CRISIL
22	Shri Raman Uberoi, Senior Advisor, CRISIL
23	Shri Sankar Chakraborti, CEO, Acuité Ratings & Research Ltd.
24	Shri S. Raman, MD & CEO, National E-Governance Services Ltd. (NESL)
25	Shri Pushan Mahapatra, MD & CEO, SBI General Insurance Company Ltd.
26	Shri Sashank Rishyasringa, Co-founder & Managing Director, Capital Float
27	Shri Ankit Satsangi, Chief Risk Officer, Capital Float
28	Ms. Shanti Mohan Co-Founder, Lets' Venture
29	Ms. Roopa Kudva, Managing Director, Omidyar Network India
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	Ms. Ruchita Manghnani
	Mr. Andrew McCarthy
31	ICICI Bank Team
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	Shri Nikhil Jain, Assistant General Manager
	Shri Puneet Mehta, Assistant General Manager

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