



Infomerics Ratings

# Infomerics Valuation And Rating Pvt. Ltd.

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## INDUSTRY OUTLOOK

### MICRO, SMALL AND MEDIUM ENTERPRISES (MSME): ISSUES & CHALLENGES

30 October 2020

#### 1. Introduction

The Micro, Small and Medium Enterprises (MSME) have been considered as the backbone of the national economy. The Indian MSMEs are characterized typically by its informal nature with huge employment absorbing capacity, exportable to the rest of the world, substantial contribution to domestic GDP, operational flexibility with low investment requirement etc. There are many women-led enterprises in rural, urban and semi-urban areas with the scope for acting as a catalyst for economic growth across the geographic, social and cultural strata of the country.

A legacy issue with the MSME remains that most of the small business is not formally registered (for revised MSME definition and registered MSMEs, see subsequent Sections). The National Sample Survey 73rd Round (NSS 73rd Round) conducted in 2015-16 found 6.34 lakh unincorporated non-agriculture MSMEs in the country<sup>1</sup>.

MSME definition was further amended on 1st June 2020<sup>2</sup>, since announcement of Atmanirbhar package; the turnover limit for medium enterprises has been revised upward to INR 250 crore from INR 100 crore as announced earlier. The New definition is being brought after MSME Development Act 2008. Turnover limit has increased up to INR 250 crore and investment limit raised to INR 50 crore. (see, Table 2).

According to the PIB press release (1st June 2020) the Cabinet Committee on Economic Affairs (CCEA) has approved modalities and road map for implementing two package for MSMEs- INR 20,000 crore package for distressed MSMEs and INR 50,000 crore equity infusion through fund of funds, which would also enable them to get listed on stock exchange<sup>3</sup>.

On 12th May 2020, Prime Minister conveyed a message to the nation for a self-reliant India movement, comprising five pillars of 'Atmanirbhar Bharat'- Economy, infrastructure, System, Vibrant Demography and Demand; with an announcement of special economic package of INR 20 lakh crore (equivalent to 10 per cent of India's GDP). Subsequent to this announcement, on 13th May 2020, India's Finance Minister has announced a package of measures for NBFC, MSME, MFIs, HFCs along with other measures. There are important package and change of definition of MSME has been announced that are depicted as follows:

## MSME Package:

- **Collateral free automatic loans of Rs. 3,00,000 crore for standard MSMEs:** These loans to have a tenure of 4 years, 12 month moratorium on principal repayment and do not require any fresh collateral or guarantee fee. The banks and NBFC extending this credit are to be provided 100% credit guarantee cover by the government on interest and principal. These loans can be availed till 31 October 2020. These measures are estimated to benefit 45 lakh units.
- **Rs. 20,000 crores subordinate debt provision for stressed MSMEs:** 2 lakh MSME which are NPA or are stressed can avail of this facility. Rs. 4 000 crores to be provided to Credit Guarantee Fund Trust for Micro and Small Enterprises who will in turn provide partial credit guarantee support to banks. The debt given by the banks will be used to infuse equity in the unit by the promoter.
- **Rs. 50,000 crore equity infusion into MSMEs that have potential and viability through fund of funds:** Fund of funds with a corpus of Rs. 10,000 crore to be set up. Only Rs. 10,000 crore will be from the Budget presumably.

## Change in Definition of MSME

**Table 1: Old criteria: Based on investment in plant and machinery**

SI No.	Classification	Micro	Small	Medium
1	Manufacturing enterprise	Investment < Rs 25 lakh	Investment <Rs 5 crore	Investment <Rs 10 crore
2	Service Enterprise	Investment < Rs 10 lakh	Investment <Rs 2 crore	Investment <Rs 5 crore

Source: Press Information Bureau (PIB) (3 June 2020); <https://pib.gov.in/PressReleasePage.aspx?PRID=1628925>

**Table 2: New criteria: based on investment in plant and machinery and turnover**

<b>Manufacturing and Services</b>	<b>Micro</b>	<b>Small</b>	<b>Medium (Changes on 1 June 2020)</b>
Now, Manufacturing & Service are not differentiated	Investment <Rs 1 crore And Turnover <Rs 5 crore	Investment <Rs 10 crore And Turnover <Rs 50 crore	GoI Decision on 1 June 2020: Investment <Rs. 50 crore And Turnover < Rs.250 crore

Source: Press Information Bureau (PIB) (3 June 2020); <https://pib.gov.in/PressReleasePage.aspx?PRID=1628925>

The Government of India on 01.06.2020 decided further upward revision of the MSME Definition. For medium Enterprises, now it will be Rs. 50 Crore of investment and Rs. 250 Crore of turnover<sup>4</sup>.

Interestingly, a Livemint news<sup>5</sup> analysis using CMIE Prowess firm level database has shown that that the new definitions have excluded some small firms from the earlier inclusions<sup>6</sup>. The bulk of the new entrants are in the largest sub-segment (medium enterprises) [see following Table 3] and a small fraction in the micro segment. The small segment actually saw 496 firms (nearly 9% firms) excluded based on the new definition.

**Table 3: Most of the new inclusions are in the 'Medium' Category**

<b>Sl No.</b>	<b>Category (micro/small/medium)</b>	<b>Old Definition</b>	<b>New Definition</b>	<b>New Inclusions</b>	<b>New Exclusions</b>
1	Micro	2873	3006	133	
2	Small	5751	5255		-496
3	Medium	2129	5872	3743	
4	<b>MSME(Total) (Micro+Small+Medium)</b>	<b>10,753</b>	<b>14,133</b>	<b>[(3743+133)=3876-496]= 3380 (Net Inclusion)</b>	
5	Large (Non-MSME)	9687	6307		-3380
	<b>Total</b>	<b>20,440</b>	<b>20,440</b>	<b>7123</b>	<b>-3876</b>

Source: "MSME PACKAGE FAILS SMALL FIRMS"(28 July 2020) Livemint.

## 2. Financing Issues and Bad Assets of MSME

The deployment of bank credit towards MSME has shown moderate uptick in July 2020 compared to June 2020, in Micro & small categories, whereas it has increased reasonably in Medium categories, but declined marginally among large categories (see following Table). On the other hand, a careful observation reveals that while bank credit has reached to an upper limit in March 2020 for Micro & Small categories, it shows a declining trend after this; also for medium enterprises, the recent year's disbursement are low compared to previous years.

**Table 4: Deployment of Bank Credit to MSME (INR Crore) [2016-2020]\***

Sl No.	Category	March 2016 (INR Crore)	March 2017 (INR Crore)	March 2018 (INR Crore)	March 2019 (INR Crore)	27 March 2020	31 July 2019	19 June 2020	31 July 2020
1	Micro & Small	371467	369731	372999	375505	381825	361608	352696	354728
2	Medium	114821	104806	103680	106395	105598	105214	95670	101994
3	Large	2244389	2205296	2222589	2403878	2417728	2331538	2426844	2364594

Source: Handbook of Statistics of Indian Economy, RBI; and RBI Bulletin 11 September 2020.

\* Up to 31st July 2020.

An IFC report in November 2018, flagged that promoters of more than 22 million MSME in India have to depend on their own funds, or loans from friends and families for capital requirement. Such sources remain often inadequate or expensive. The credit gap was estimated at INR 25.8 trillion(USD 348 billion) implied that MSME's financing needs will increase at a rapid pace<sup>7</sup>.

Enterprises need institutional sources of debt and equity. But debt from Banks/NBFCs requires collateral, which sometimes becomes difficult for early-stage MSMEs and entrepreneurs. Hence, the aspect of risk capital/equity becomes crucial for many small-scale operators' working capital<sup>8</sup>.

In this regard, the GoI has initiated the setting up of Funds of Funds (FoF) with a corpus of INR 10,000 crore, for providing equity funding for MSMEs with growth potential<sup>9</sup>.

The bad loan ratio in the micro, small and medium enterprises (MSMEs) segment stand at 12.5 per cent as of January 2020, as per data from SIDBI and TransUnion CIBIL<sup>10</sup>. While the non-performing assets (NPAs) ratio in micro segment was 9 per cent, the small and medium segments showed higher proportion of loans going sour at 11 per cent.

**Table 5: NPA Rates of Lenders to MSME over the Years (in per cent)**

Sl No.	Lender (PSB/Private/NBFCs)	December 2017	December 2018	December 2019
1	Public Sector Banks (PSBs)	16.6%	18.1%	18.7%
2	Private Banks	3.5%	3.8%	5.0%
3	NBFCs	7.3%	4.9%	7.6%

Source: Transunion CIBIL, Business Standard (9 May 2020)

[https://www.business-standard.com/article/sme/msme-sector-s-bad-loan-ratio-at-12-5-as-of-january-shows-report-120050900015\\_1.html](https://www.business-standard.com/article/sme/msme-sector-s-bad-loan-ratio-at-12-5-as-of-january-shows-report-120050900015_1.html)

### 3. Institutional Measures

Under the Emergency Credit Line backed by a Government guarantee, Banks from Public & Private Sectors have sanctioned loans worth over INR 79,000 crore as of June 20, 2020. The top lenders under the Scheme are SBI, HDFC Bank, Bank of Baroda, PNB & Canara Bank<sup>11</sup>.

As part of the Aatmanirbhar package Government had announced its plans for INR 3 lakh Crore as additional credit to MSMEs and small businesses. Such enterprises were to be eligible to receive up to 20% of their existing borrowing as additional loans at interest rates which were capped.

Separately, under RBI's Special Liquidity Facility announced in March-April, 2020, SIDBI has sanctioned over INR 10,220 crore to NBFCs, Micro Finance Institutions & Banks for lending to MSME & small borrowers. National Housing Bank (NHB) has sanctioned its entire facility of INR 10,000 crore to Housing Finance Companies. This refinance by SIDBI & NHB is in addition to ongoing schemes through which over INR 30,000 crore has been sanctioned. NBFCs & MFIs are being further helped under the Extended Partial Guarantee Scheme where approvals have crossed INR 5500 crore. Transactions for another Rs. 5000 crore are under process of approval while certain other deals are currently under negotiation.



**Table 6: Measures taken for MSMEs under “Atma-Nirbhar Bharat”**

Sl No.	Collateral Free Loans	Debt for Stressed MSMEs	Equity Infusion for MSMEs
1	INR 3-lakh crore collateral free automatic loans	INR 20,000 crore sub-ordinate debt for stressed MSMEs	INR 50,000 crore equity infusion for MSMEs through Fund of Funds (FoF)
2	Borrowers with up to INR 25 crore outstanding and INR 100 crore turnover eligible.	GoI will facilitate INR 20,000 crore as sub-ordinated debt.	FoF with corpus of INR 10,000 crore will be set up.
3	Loans to have four year tenure with moratorium of 12 months on Principal repayment.	Functioning MSMEs that are stressed are eligible.	Will provide equity funding for MSMEs with growth potential.
4	Interest to be capped	Government will provide a support of INR 4,000 crore to CGTMSE.	FoF will be operated through a mother fund and a few daughter funds.
5	100 per cent credit guarantee cover to Banks and NBFCs on principal and interest.	CGTMSE will provide partial credit guarantee support to banks.	Fund structure will help leverage INR 50,000 crore funds at daughter funds level.
6	Scheme can be availed till 31 October 2020.	Promoters of the MSME will be given debt by banks, which will then be infused by promoters as equity in the unit.	Will help to expand MSME size and capacity: encourage MSME to get listed on main Board of Stock Exchange.
7	No guarantee fee, no fresh collateral.	—	—

Source: MSME Newsletter (August 2020) Ministry of MSME, GoI; [https://msme.gov.in/sites/default/files/AUGUST\\_newsletter.pdf](https://msme.gov.in/sites/default/files/AUGUST_newsletter.pdf)

Apart from the measures taken under “Atma-Nirbhar Bharat”; Government of India (GoI) has taken many measures to revive the MSME sector, e.g. budget allocation for MSME has increased from Rs 6552 crore in FY 2018-19 to Rs 7572 crore in FY 2020-21, automation and digitization of the processes of business loans through launch of web portal [www.psbloansin59minutes.com](http://www.psbloansin59minutes.com), Interest Subvention Scheme for Incremental Credit to MSMEs, disbursement of record credit under Credit Guarantee Scheme for Micro & Small Enterprises in 2018-19 and 2019-20, new Technology Centers, launching of MSME Samadhan Portal for delayed payments and Sambandh Portal for Public Procurement Policy, CHAMPIONS portal etc.

Credit Guarantee Scheme for Micro and Small Enterprises is mainly a demand centric scheme. The performance for last three years is given in the table below:

**Table 7: The Performance of the Credit Guarantee Scheme (2017-18 to 2019-20)**

<b>Year</b>	<b>Number of Proposals Approved</b>	<b>Approved Amount (INR Crore)</b>
2017-18	2,63,195	19,065.90
2018-19	4,35,520	30,168.57
2019-20	8,46,650	45,851.22

Source: CGTMSE; <https://www.cgtmse.in/> and LOK SABHA UNSTARRED QUESTION: "DISBURSEMENT OF LOAN TO MSMEs" NO. 1983 TO BE ANSWERED ON: 22.09.2020.

As per data reported by Member Lending Institutions (MLIs), an amount of INR 1,63,103 crore has been sanctioned to 42,01,060 borrowers and an amount of INR 1,17,885 crore disbursed to 25,01,216 borrowers under the Emergency Credit Line Guarantee Scheme (ECLGS) as on September 9, 2020<sup>12</sup>.

Ministry of MSME has implemented SAMADHAAN Portal empowering micro and small entrepreneurs across the country to directly register their cases relating to delayed payments and SAMBANDH Portal for monitoring the implementation of Public Procurement Policy for micro and small enterprises in the country.

The World Bank has announced a USD 750 million package on 2nd July 2020 for India's medium and small enterprises, in line with its fight against Covid-19. The MSME Emergency Response Program, launched on 2nd July 2020, will address liquidity and credit needs of some 1.5 million enterprises to help them withstand the current shock<sup>13</sup>. The World Bank Group, including its private sector arm – the International Finance Corporation (IFC), will support the government's initiatives to protect the MSME sector by:

- **Unlocking Liquidity:** This program will support government's efforts to channel that liquidity to the MSME sector by de-risking lending from banks and Non-Banking Financial Companies (NBFCs) to MSMEs through a range of instruments, including credit guarantees.
- **Strengthening NBFCs and SFBs:** Improving the funding capacity of key market-oriented channels of credit, such as the NBFCs and Small Finance Bank (SFBs), will help them respond to the urgent and varied needs of the MSMEs. This will include supporting government's refinance facility for NBFCs. In parallel, the IFC is also providing direct support to SFBs through loans and equity.
- **Enabling financial innovations:** Only about 8 percent of the MSMEs are served by formal credit channels. The program will incentivize and mainstream the use of fintech and digital financial services in MSME lending and payments. Digital platforms will play an important role by enabling lenders, suppliers, and buyers to reach firms faster and at a lower cost, especially small enterprises who currently may not have access to the formal channels.

The World Bank has to date committed \$2.75 billion to support India's emergency COVID-19 response, including the new MSME project<sup>14</sup>. The first \$1 billion emergency support was announced in April this year for immediate support to India's health sector. Another \$1 billion project was approved in May to increase cash transfers and food benefits to the poor and vulnerable, including a more consolidated delivery platform – accessible to both rural and urban populations across state boundaries. The \$750 million loan from the International Bank for Reconstruction and Development (IBRD), has a maturity of 19 years including a 5-year grace period.

## Industry Risk

The economic lockdown imposed in the country on 23rd March, 2020 amid the Covid-19 pandemic outbreak has disturbed the entire economy which is also reflected in a 23.9% GDP decline in First Quarter (April-June) Q1 2020<sup>15</sup>. The economy remains shuttered even after the lockdown was partially relaxed on 4th May 2020. The MSMEs and the workers employed therein are one of the worst victims of the economic lockdown. Many workers have lost their jobs. The sector that was reeling under trouble got further stress under Covid-19, followed by a nationwide lockdown. Lack of cheap capital (especially for non-investment grade firms), labour shortages put further challenges. Post lockdown, many dealers failed to mobilise raw materials, as well as faced cash flow problems.

A substantial share of MSMEs is not using their current capacity implying most MSMEs face deficiency in demand. If such a situation continues, it means firms will lay off workers, laid-off workers will lose their salaries, which will further dampen demand. Orders for new investments and raw materials will be delayed or cancelled. One of the biggest challenges for MSMEs are fund crunch, also most of the MSMEs are below investment grade and unable to access Centre's relief packages. As Economic Times (24.09.2020) reported, only half of the targeted MSME have benefitted from the government's Emergency Credit Line Guarantee Scheme (ECLGS)<sup>16</sup>. Of the 4.5 million MSMEs eligible for relief under the scheme launched after the Covid-19 pandemic only 2.4 million (53 per cent) have secured loans<sup>17</sup>. The number of companies qualify to avail the benefit under ECLGS are those companies having access to institutional credit which is very less, around 5-10 per cent of the SMEs<sup>18</sup>. The extent of loan granted has also capped at twenty per cent of outstanding. Despite sovereign guarantee and low borrowing costs, MSMEs are pursuing cautious approach and waiting for demand to revive before resorting towards borrowing.

Challenges also arise in MSME lending due to the difficulties in carrying out credit appraisals of firms in the sector due to lack of credit history and reliable financial statements. Sometimes, lenders need to spend huge amount of time and effort in making their assessments resulting in high transaction costs as well as occasionally lenders prefer to lend on the basis of the mortgage of entrepreneur's personal property, which might exclude high-potential MSMEs unable to offer such security. However, lenders in recent times resorting towards more into digital information; as developments in digitization have resulted in the availability of new sources of information. Such developments have led to the emergence of digital financiers (often fintech startups) providing online loans based on digital information and artificial intelligence. Online market places are emerging, though in nascent stage; where MSME lenders and borrowers can transact<sup>19</sup>.

There is also a glaring variation in default rates on MSME loans based on lender categories. Between December 2017 and December 2019, the non performing asset (NPA) rate on MSME loans of public sector banks varied between 16.6 per cent and 18.7 per cent (see Table 5) well above the range of NPA rates of private sector banks (which was between 3.5 per cent and 5 percent). The NPA rates of NBFCs during this period ranged between 7.3 per cent and 7.6 per cent. The growing bad assets especially with PSB loans to MSME, indicates a need for a framework so that lender's can take more informed decisions. A more nuanced framework of pooling database could collate finance performance, loan details, and default data across lenders to enable to develop more robust credit models<sup>20</sup>. An illustration for this can be cited from Japan's "Credit Risk Database" (CRD)<sup>21</sup> via which member bank's share MSME data related to financial performance and default rates/statistics. This database maintains privacy and created for maintain updated database for enabling more informed decisions by lenders.

## Concluding Observations

The criticality of MSMEs in India stems from their contribution to GDP, exports and employment. But of late, the devastation of MSMEs caused by the triple whammy of demonetization, rolling out of the Goods and Services Tax (GST) and now COVID 19 has been increasingly realised. Several attempts have been made by the Government of India and the Reserve Bank of India to resuscitate the MSMEs. But fundamental issues of timeliness, adequacy, collateral and cost of credit need to be asked. Given the investment requirements in MSMEs, we need to identify financing issues, viz., their lower capital-intensive nature with lower operation and maintenance (O&M) cost, exposure limit of banks to sectors and inadequate sector-specific risks awareness among financial institutions. Basic issues hampering the growth of the sector relate inter-alia to get them up and running, their viability, margins and profits. Accordingly, an attempt needs to be made to examine ease-of-doing business for MSMEs by synchronized measures with a sense of urgency. Towards this end, the Centre's scheme to bear the difference between the compound interest and simple interest on retail and MSME loans of borrowers with aggregate outstanding borrowings less than ₹ 2 crore between 1st March 2020 and 31st August 2020 would provide pre Diwali cheer to small borrowers. The impetus for the direction from the government to the banks to identify eligible beneficiaries and then ensure that the extra 'interest on interest' be refunded by 5 November 2020 came from the Supreme Court's admonition to expedite relief to small borrowers.

The bankers have to ensure proper identification of all eligible loans, which had not become non-performing assets (NPAs) as on 29th February 2020. These loans cover a wide section of the lending portfolio (viz., education, housing, consumer durables, automobiles, consumption, credit card borrowings, and MSMEs) of the banks. Banks are required to refund the difference between the compound interest charged for the six-month period and the simple interest. In making all the specified borrowers eligible for the 'ex-gratia', the government has sought to ensure equity between those who may have availed of the repayment moratorium and others who had opted to continue to service their borrowings<sup>22</sup>. While this move has been largely welcomed, particularly by small borrowers, there have been concerns on the adequacy of this relief measure, given the scale and magnitude of the devastation wrought in terms of demand destruction, supply chain disruption, material and labour shortages and regulatory challenges caused by the COVID 19 pandemic. The incremental hit to the fiscal balance because of the relief to the MSMEs needs to be looked at in the context of their significant contribution to output, income

and employment for a comprehensive assessment and perspective. There is also the not inconsiderable issue of 'moral hazard' by not distinguishing between the persons, groups and segments which sorely need these benefits and those which can do without these benefits.

## FOOTNOTES

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