

**IMPORTANCE OF THE MSMES TO THE ECONOMY: CHALLENGES AND  
MEASURES**

**BY**

**Dr.T.VINILA**

**Assistant Professor of Commerce**

**Smt.N.P.Savitramma Govt Degree College(G) Chittoor.**

**Email : vinila\_thadipalli@rediffmail.com**

**International Journal of Social Science and Humanities Research**

## IMPORTANCE OF THE MSMEs TO THE ECONOMY: CHALLENGES AND MEASURES

*Dr. T.VINILA, Assistant Professor of Commerce, Smt.N.P.Savitramma Govt Degree College(G) Chittoor.*

---

### Introduction

The Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. It contributes significantly in the economic and social development of the country by fostering entrepreneurship and generating large employment opportunities at comparatively lower capital cost, next only to agriculture. MSMEs are complementary to large industries as ancillary units and this sector contributes significantly in the inclusive industrial development of the country. The 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. In a country like India with a population size of about 1.3 billion, the Micro, Small and Medium Enterprises (MSME) sector has a vital role in the economy. It fosters entrepreneurship and generates large employment opportunities. As MSMEs absorb the surplus agricultural labour, they help reduce the problem of disguised unemployment in rural areas. MSMEs are also complementary to large industries as ancillary units and also play an important role in the whole eco-system of the secondary and tertiary sector. The MSME sector is passing through a challenging phase. A micro enterprise is an enterprise whose investment in plant, machinery and equipment does not exceed Rs. 1 crore, and turnover does not exceed Rs. 5 crore. A small enterprise is an enterprise whose investment in plant, machinery and equipment does not exceed Rs. 10 crore, and turnover does not exceed Rs. 50 crore. Earlier industries that manufactured goods and provided services on a small scale or micro-scale basis were granted Small Scale Industries (SSI) registration by the Ministry of Small Scale Industries. However, after the government passed the MSME (Micro, Small and Medium Enterprises) Act in 2006, the small and micro-scale industries came under the MSME Act. On 9 May 2007, subsequent to the amendment of the Government of India (Allocation of Business) Rules, 1961, the Ministry of Small Scale Industries and the Ministry of Agro and Rural Industries were merged to form the Ministry of Micro, Small and Medium Enterprises. Thus, the SSIs are included under the Ministry of MSME. Currently, the SSIs are classified as small or micro-scale industries based on the turnover and investment limits provided under the MSME Act and they need to obtain MSME registration. The government

provides many benefits to the small scale industries having MSME registration at present. This paper underlining the importance of the MSMEs to the economy and challenges faced by them and measures undertaken by the Reserve Bank.

*KEYWORDS: ECONOMY,MSMEs*

### **Objectives :**

The present paper focused on the following objectives:

- To enlighten the importance of MSMEs to the economy
- To highlight the challenges faced by MSMEs
- To discuss various measures taken by RBI

### **Methodology:**

The Data and information is gathered from secondary source collected from various books reports authentic websites, journals and e-contents relating to MSMEs.

### **Need for the study:**

- To highlight the importance of MSMEs in the Indian Economy
- To make aware that MSMEs are playing a major role in employment and development of the economy
- To inform the public about the initiatives and reforms taken by the government is taking, necessary measures for development of MSMEs.

### **IMPORTANCE TO THE ECONOMY:**

The MSME sector contributes in a significant way to the growth of the Indian economy with a vast network of about 6.3 crore units and a share of around 30 per cent in nominal GDP in 2016-17<sup>1</sup>. The share of the sector in total manufacturing output was even higher at 45 per cent<sup>2</sup>. Taking cognisance of the wider set of benefits that the sector offers to the rest of the economy, the Government has envisioned to increase its contribution to GDP to over 50 per cent in next few years as the country aspires for a 5 trillion economy

As per the 73rd round of National Sample Survey (NSS) conducted during the period 2015-16, the estimated employment in MSME sector was around 11 crore. Within MSME sector, each of the three sub-sectors, namely, trade, manufacturing and other services accounted for about a third of total employment. Around 50 per cent of the total MSMEs operate in rural areas and provide 45 per cent of total employment. Interestingly, the micro enterprises account for 97 per cent of total employment in MSME sector<sup>4</sup>. This relates to the problem of what is called the missing middle<sup>5</sup>, which suggests that micro firms have failed to grow into smaller and medium firms and so on over time. This seems to have kept the micro sector bereft of enjoying economies of scale, investment into fixed assets, adoption of technology and innovation.

The share of MSME sector in India's merchandise exports stood at around 48 per cent in 2018-19<sup>6</sup>. This signifies that Indian MSMEs are becoming globally competitive and their products/services are being accepted overseas. In this background, special attention needs to be given to improve the competitiveness and technology up-gradation endeavours. Various schemes and programmes of the Government, therefore, should be continued and effectively implemented.

#### **CHALLENGES IN THE MSME SECTOR:**

Despite the MSME sector contributing significantly to the economy, it continues to face several challenges. The major challenges include physical infrastructure bottlenecks; absence of formalisation; inertia to technology adoption; capacity building; backward and forward linkages; lack of access to credit and risk capital; and the perennial problem of delayed payments, among others. Let me now elaborate on some of these issues.

##### ➤ **Infrastructure bottlenecks and Competition:**

Notwithstanding various efforts to upgrade the infrastructure, the MSME clusters, particularly the micro enterprises, are inadequately equipped with necessary support systems which not only impede their day-to-day business operations but also their future growth prospects. While infrastructure constraint is only one side of the story, I believe that MSMEs also need to do their bit to improve competitiveness. They need to shed their inhibition to adopt new technologies; accept e-payments; and foster in-house innovation which will help them manage their businesses digitally and compete globally. Given the current scenario of global trade, the age-old methods of operating business with low levels of technology adoption deprives them of potential economies of scale. Lack of expertise in product development, designing, packaging and marketing strategy due to their small size add up to

the pressure of adapting to the changing environment around them. The strategy for MSMEs should be to gradually expand in size and reduce the dependence on the incentive structure provided by the Government. Their aim should be eventually to compete on a global scale.

➤ **Employment:** Considered to be the engine of economies around the world, the MSME segment in India alone is estimated to have 6.3 crore units, which employs over 11.10 crore people. The sector accounts for 27% of GDP and is crucial to the functioning of the economy, including in terms of employment generation, exports, and lending opportunities.

➤ **Access to Credit and Formalisation:**

Credit plays a vital role in development of MSME sector as funds at a reasonable cost can increase their competitiveness. Credit disbursement to this sector has, however, remained sluggish in recent periods. At an aggregate level, the total credit outstanding from banks and NBFCs to the MSME sector was approximately 16.6 lakh crore as at end of September, 2019. Scheduled commercial banks account for 90 per cent of the share of total credit outstanding.

As many MSMEs mainly operate in the informal space, assessing their creditworthiness can be difficult due to information asymmetry, particularly with respect to the financial performance of their businesses. In the absence of collateral, under-writing the customer often entails higher operating cost. Furthermore, due to their small-scale operations, MSMEs are not able to raise risk capital. They are also unable to take advantage of most of the Government schemes which are mostly based on digital infrastructure and require beneficiaries to have some form of digital identity and presence. With the implementation of structural reforms like GST and JAM trinity, the informal units are, however, getting integrated with the mainstream in recent years.

➤ **Delayed Payments :**

A large number of MSMEs are ancillary units catering to the needs of large industries, both in the public and private sector. They often face the problem of delayed payments, affecting their cash flow and working capital availability. Most of the time, delay in realisation of such receivables increases their operating cycle and reduces their ability to procure new orders or fulfil the existing ones. A primary survey conducted by Reserve Bank in December 2019 showed that 44 per cent of MSMEs engaged in manufacturing activities faced delay in payments. The ones not receiving timely payment mainly belonged to basic metal and metal products, engineering, construction and infrastructure related industries. On the other hand,

delay in payments was lower at 27 per cent for services sector. Here transport operators mostly faced such situations. Although Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 contains provisions related to penalty in case of delayed payments by the buyers, weak bargaining power and the fear of losing the business prevents MSMEs to invoke this provision.

### **EXPERT COMMITTEE ON MSMEs:**

In order to understand the structural bottlenecks and factors affecting the performance of the MSMEs, RBI had set up an Expert Committee on MSMEs under the Chairmanship of Shri U.K Sinha in January 2019. The Committee has undertaken comprehensive review of the sector and given several recommendations for the economic and financial sustainability of the MSME sector. These recommendations are wide-ranging and broadly relate to legislative changes; infrastructure development; capacity building; technological upgradation; improving backward and forward linkages; improving financial support from formal sources; newer technological interventions for robust underwriting practices; and credit delivery, among others. While some of the recommendations of the Committee have already been implemented, others are under consideration by the authorities concerned.

### **MEASURES UNDERTAKEN BY RBI**

#### **Measures to Improve the Credit Flow :**

- The Reserve Bank has taken several measures in the recent period to improve the flow of credit to the MSME sector. Banks form the predominant source of formal credit to MSMEs with all such loans by banks qualifying for Priority Sector Lending classification. In August 2019, we have further incentivised banks to lend to MSMEs through the NBFC sector. Consequently, bank credit to registered NBFCs (other than Micro Finance Institutions) for on-lending to micro and small enterprises up to 20 lakh per borrower are eligible for classification as priority sector lending.
- A scheme of one-time restructuring without an asset classification downgrade was permitted to GST registered MSME accounts that were in default but standard as on January 1, 2019. As the process of formalisation of the MSME sector has a positive impact on financial

stability and this process is still underway, the scheme has been extended to accounts that are standard but in default as on January 1, 2020 and restructuring, wherever eligible, has to be implemented latest by December 31, 2020. This will enhance the scope of the scheme by benefitting the eligible MSME entities which could not be restructured under the provisions of the circular dated January 1, 2019 as also the MSME entities which have become stressed thereafter. So far, banks have restructured 6 lakh accounts out of 15 lakh eligible accounts under the scheme. Our primary survey suggested lack of awareness about the scheme among the MSMEs. Incremental loans to MSMEs along with retail loans for automobiles and residential housing will be exempted from CRR from fortnight ending January 31, 2020 up to fortnight ending July 31, 2020.

- Subsequent to the introduction of an external benchmark system in October 2019, the monetary policy transmission has improved where new floating rate loans to the micro and small entrepreneurs were linked to the external benchmark. With a view to further strengthening monetary policy transmission, all new floating rate loans to medium enterprises extended by banks from April 01, 2020 will also be linked to the external benchmarks.
- **Delayed Payments:** The Reserve Bank introduced the Trade Receivables Discounting System (TReDS) in 2014. TReDS is an electronic platform where receivables of MSMEs drawn against buyers (large corporates, PSUs, Government departments) are financed through multiple financiers at competitive rates. This is done through an auction-based mechanism. To widen the scope of TReDS and to incentivise more players to be part of this platform, banks' exposure through this platform were brought under priority sector lending in 2016. Presently, three entities [viz., Receivables Exchange of India Ltd. (RXIL), A. TReDS, and Mynd Solutions] licensed by the Reserve Bank are operating the platform for more than two years. Further, the Reserve Bank recently allowed 'on tap' authorization to entities desirous to provide platforms for TReDS. Hence, in coming years, competition in receivables discounting space is bound to increase with the entry of new players. This requires the corporates, both in the public and private sector, to join the TReDS platform and make the system more efficient.
- In 2018, the Government made it mandatory for all companies with a turnover greater than 500 crores to register with TReDS. As on February 2020, while 8211 MSME sellers were registered while only 1530 buyers were participating on the platforms. I would appeal to the

ASSOCHAM to encourage and handhold all its members to participate in the TReDS platform.

- In the Union Budget 2020-21, the Government has announced app-based invoice financing products to obviate the problem of delayed payments of MSME. The mechanism may prove complementary to the TReDS platform and would further alleviate the problem of delayed payments.
- As the MSME sector holds immense potential, the need is to have a right set of policies and enabling framework which guide and support MSMEs to effectively handle their existing problems and venture into new areas. While both the Government and the RBI have introduced a plethora of measures for improving access to finance and to promote growth of the sector, the small size of individual units and informal nature of the sector continue to pose challenges.
- The traditional bank lending system by banks is based on financial statements and collateral of the borrower. With increased availability of data from several sources, including GSTN, income tax, credit bureaus, etc., it is now possible to appraise the MSME loan proposals expeditiously by doing due diligence online. Further, with the help of Account Aggregators (AA), lenders will have access to potential borrower's financial information at a single point, of course, with his/her consent. Furthermore, emergence of FinTech companies has made it possible to assess credit worthiness of MSMEs by utilising unexplored data sources such as digital transaction trails, data generated through e-commerce sites, etc. Some lenders are collaborating with FinTech companies to take advantage of such surrogate data for speedier credit underwriting for extending loans to MSME sector. These new architectures would expand the reach of credit.
- While the new models are beneficial for those units which are digitally active, a large segment of MSME units access credit through traditional lending models. While micro enterprises act as a starting stage of entrepreneurship that requires low investment in technology, units graduating to small and medium enterprises have to enhance their technical capacity and explore newer markets in order to stay competitive for sustainable growth. Recent policy efforts will provide an enabling environment and facilitate the MSME sector seize the new emerging opportunities. I must add that as a regulator, we in RBI have to safeguard financial stability while ensuring wider access to finance. Banks and other players on their part have to ensure prudent lending.



- Besides, we in RBI have started launching cohorts under the Regulatory Sandbox. First such cohort was launched in November 2019 with the theme of ‘Retail Payments’ to spur innovation in digital payments space to design and test newer payment services for the unserved and underserved segments. In due course, we propose to run a regulatory sandbox for cohorts focussed on lending. This would promote innovation in MSME lending segment. The project on Public Credit Registry (PCR) will fundamentally address the information asymmetry that impedes access to credit for micro and small entrepreneurs. The PCR has been envisaged as a database of core credit information. The registry would play crucial role in reducing credit gap in the segment.
- Given the fact that the MSME sector contributes significantly to exports, it is essential that they should be integrated with global value chains (GVC) to remain competitive as it offers unique opportunity to become technologically and digitally empowered. Being part of GVC would enable MSMEs to produce quality goods and services which will have greater acceptability in the global market. The major challenges for the sector to connect to the GVC are lack of information, knowledge of markets and quality standards.

#### **CONCLUSION:**

Lauding the large part played by the Medium, Small, and Micro Enterprises (MSMEs) in India’s economic rebound, the latest ASSOCHAM-CRISIL joint study adds that the sector is expected to achieve mid-teen growth in **fiscal 2022** with the pick-up of economic activities. Crediting MSMEs for putting the country on the firm path of economic recovery in 2022 after having had it tough in 2021, Bhushan Parekh, Director, CRISIL SME Solution, elaborated in the report, “A raft of measures by the government under its Aatmanirbhar Bharat banner has provided reprieve to MSME segment in recent months. These include Rs 20,000 crore subordinate debt for stressed MSMEs, Rs 50,000 crore equity infusion through MSME Fund of Funds (SRI Fund), 3-lakh crore Emergency Credit Line Guarantee Scheme (**ECLGS**) for businesses, including MSMEs (which was subsequently increased to Rs 5-lakh crore in Union Budget 2022-23), change in definition of what constitutes an MSME, and no global tenders for government procurement up to Rs 200 crore.”

The report also notes that if MSME lending by banking and non-banking finance companies (**NBFCs**) in fiscal 2021 rose to 7% on-year, then the credit is expected to grow by 7-9% (around Rs 18-lakh crore) on-year in fiscal 2022 supported by favourable government measures as well as rise in demand. While the banks continue to dominate around 80% of the MSME-lending book, it is, however, expected to reverse in the future.

One of the factors driving the change is the digitalization of the **MSME sector**. The digital footprint of MSMEs expanded in 2021, according to the CRISIL survey of over 500 MSMEs. This has not only helped in providing enhanced customer experience, operational efficiency and workforce enhancement, but also facilitates access to financial services.

MSME also has 50% share in exports since the past five years. The report states that exports-linked MSME sectors have been on the path to recovery and will continue to do so in the next fiscal. “In the long term as well, the segment will continue to offer attractive opportunities for financiers as the global economy recovers and adoption of China-plus-one strategy by large players to diversify their supply chains provides a boost to export-linked MSMEs.

### **REFERENCES:**

<sup>1</sup> Annual Report, Ministry of MSME 2018-19,2019-20,2020-21.

<sup>2</sup> Report of the Expert Committee on Micro, Small and Medium Enterprises (Chairman: U.K. Sinha), June 25, 2019.

<sup>3</sup> Ministry of Micro, Small and Medium Enterprises, Government of India, September 24, 2019.

<sup>4</sup> Annual Report Ministry of MSME 2018-19

<sup>5</sup> Krueger, A. O. (2013). The missing middle. Economic reform in India: Challenges, prospects, and lessons, 299.

<sup>6</sup> Ministry of Micro, Small and Medium Enterprises, Government of India, July 2019.

Annual Report, Coir Board . (2011–2019). Government of India.

[http://coirboard.gov.in/?page\\_id=199](http://coirboard.gov.in/?page_id=199) (accessed on 2nd February, 2020)

Behera, H., Wahi, G. (2017). How have MSME sector credit and exports fared? (Mint Street Memo No. 13), 1– <https://rbidocs.rbi.org.in/rdocs/MintStreetMemos/13MSMN17082018.pdf>

Berger, A. N., Udell, G. F. (1998). The economics of small business finance: The roles of private equity and debt markets in the financial growth cycle. *Journal of Banking and Finance*, 22(6&8), 613–673.

Ministry of Micro, Small and Medium Enterprises . (2007). Annual report 2006–2007. Government of India. <https://msme.gov.in/sites/default/files/ssi-ar-eng-2006-07.pdf>



Ministry of Micro, Small and Medium Enterprises . (2008). Annual report 2007–2008. Governmen of India.

[https://msme.gov.in/sites/default/files/MSME%20ANNUAL%20REPORT%202007-08\\_English.pdf](https://msme.gov.in/sites/default/files/MSME%20ANNUAL%20REPORT%202007-08_English.pdf)

\*\*\*\*\*