ASSOCHAM
INDIA

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BANKERS-BORROWERS BUSINESS MEET–2017

10 Emerging Mantras

JUNE 2017 – NEW DELHI

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

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June 2017 – New Delhi

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

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MESSAGE

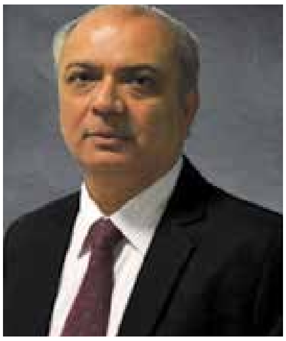
Second edition of ASSOCHAM Bankers Borrowers Meet-2016 had received an overwhelming response from the industry, in creating a vibrant platform for encouraging dialogue between the bankers and borrowers. Various issues were discussed and the outcome of this event was published and was circulated to leaders in the industry and the government.

Continuing the legacy, ASSOCHAM, with the support of industry leaders, experts and senior bankers is organizing "Bankers – Borrowers – Business Meet" with the agenda of 10 emerging mantras for SME / MSME businesses in the context of their banking needs and suggest effective measures that can be taken to strengthen the banking industry and SME borrowers.

In this context ASSOCHAM-APAS come out together with knowledge report focus on Bankers & SME Borrowers: 10 emerging Mantras. The meet has also been structured in keeping with these 10 emerging mantras. I would like to express my sincere appreciation to Mr. Ashvin Parekh, Managing Partner, APAS and his team for sharing their thoughts, insight and experiences.

I am confident that this report will be useful to readers across different sectors.

D. S. Rawat
Secretary General
ASSOCHAM



MESSAGE

The initiative of having a Bankers – Borrowers Business Meet first started in 2015 and was met with great enthusiasm. The theme for the event was ‘Business Advances – Issues and Concerns’ and the event got an overwhelming response from the industry.

The second edition was held in 2016 to continue with this dialogue and the theme for the event was ‘Empowering MSMEs’. This event, too, got an equally encouraging response.
For the year 2017, it is a proud privilege for APAS to be associated with ASSOCHAM in this series of the Bankers – Borrowers Business Meet events as their knowledge partner for the third year in a row, with the theme for this event being ’10 emerging mantras for banks and borrowers’.

MSME sector has been an integral contributor to the India growth story with its huge contribution to the country’s GDP and employment. It is important for the industry leaders to concentrate their energies on forecasting the changes, that lie ahead in the industry. ASSOCHAM and APAS, by way of Bankers – Borrowers Business Meet – 2017, facilitate a dialogue and establish common business language and effective relationship between the MSME sector and the Banking industry. This is to ensure that there is a good understanding and appreciation for the key areas of trends and changes. The emphasis has been to map the forces that lie ahead in both the industries including use of technology, new laws and regulations associated with lending. In many ways, these will create some drastic or mild repercussions, whether it is the introduction of the GST, Bankruptcy law, implementation of Ind-AS, etc. The challenge that lies ahead for both the bankers and borrowers is to understand the new trends, their impact to the lending relationship and successfully find solutions to create a constructive and healthy relationship between the bankers and the borrowers. At the cost of reiterating, the much talked about disruption that can arise out of technology challenges, need to be discussed and solutions be found in a collaborative manner. This report aims at discussing some of the critical and major issues. The event has also been structured in keeping with these ’10 emerging mantras’.

The discussions covered in the book are designed keeping in mind the fact that between the enabling environments and the business of small and medium sized borrowers, the latter should prevail. The enabling environments need to be examined and bespoke solutions be arrived at.

The event specifically focuses on enhancing the structure of the MSME sector in terms of credit flow, capacity building, skill development, and simultaneously, emphasizes on the expectations that the banking industry and the MSME sector have from each other in the light of these ’10 emerging mantras’.

As the knowledge partner, APAS is committed to highlight these requirements from both the sides namely bankers and borrowers. In order to fulfill this in an effective way, both APAS and ASSOCHAM are eager to have your feedback and suggestions.

As always, it has been an enjoying experience in developing this report. I would like to thank the team from ASSOCHAM led by Mr. Chandan Kumar for their continued support with his colleagues Mr. Rajesh Singh, Mr. Kushagra Joshi and my colleagues – Sujana Hari, Ankita Narnaware, Harsh Mirpuri, Miral Ajmera and Kalpesh Mantri for assisting me in developing this report.

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Introduction: Story of Micro, Small and Medium Enterprises

In the Indian economy, the MSME sector serves as the backbone to its growth story. It forms an integral part of the economy, with nearly 36million enterprises involving 80 million people. This especially includes nearly 2.6 million women-led enterprises and 20 million rural enterprises playing a key role in acting as a catalyst to the socio –economic transformation of the country. The contribution of this sector to the GDP has been growing consistently at 11.5% over the past 5 years outperforming the GDP and IIP growth rates.

Investment in plant and machinery		
Industry	**Manufacturing**	**Service**
Micro	Less than 25 Lakhs	Less than 10 Lakhs
Small	25 Lakhs to 5 Crores	10 Lakhs to 2 Crores
Medium	5 Crores to 10 Crores	2 crores to 5 Crores

The sector plays a crucial role in the financial objective of inclusion, generating employment, averting poverty and also balancing the rural-urban migration. These enterprises, help build a thriving entrepreneurial eco-system, in addition to promoting the use of indigenous technologies.

The contributions of this sector to the overall GDP is more than 30% and further accounts for nearly 45% of the Indian Industrial Output. Furthermore, it is a major contributor to exports from the country accounting for nearly 40% of the pie. It is important to understand the structure of this segment to better analyze its potential and support for further growth.

The composition of MSME sector

With nearly 36 million enterprises, only 1.6 million are registered under the organized sector. This situation gives rise to restrictions, both in access to formal markets and sources of finance, as well as support and effective regulation by the government.

On top of that, this sector has an additional 20 million enterprises in the unorganized sector, which are neither governed by any legal provisions nor have any official financial accounts. Most of these units are defined as micro enterprises.

Manufacturing and Services

Broadly, MSME sector is classified by two major activities – manufacturing and services. There is huge diversity within these two categories. The manufacturing accounts for an estimated 29% of the total in the segment and the rest by service providers. Yet, the top ten industries in manufacturing account for nearly 75% of the sectors total output. (Refer Table 2)

Manufacturers are involved in a wide variety of goods, from handmade products to high precision machine parts, contributing to the supply chain of local to large global enterprises. Here, food processing is the key manufacturing industry. It is also characterized by being more capital intensive with longer working capital cycles, and consequently have higher working capital requirements.

The service industry is dominated by retail trade, maintenance stores, transport operators and knowledge based enterprises etc. In the recent past the knowledge based industries have experienced a gradual growth in the sector.

Export and Import Led

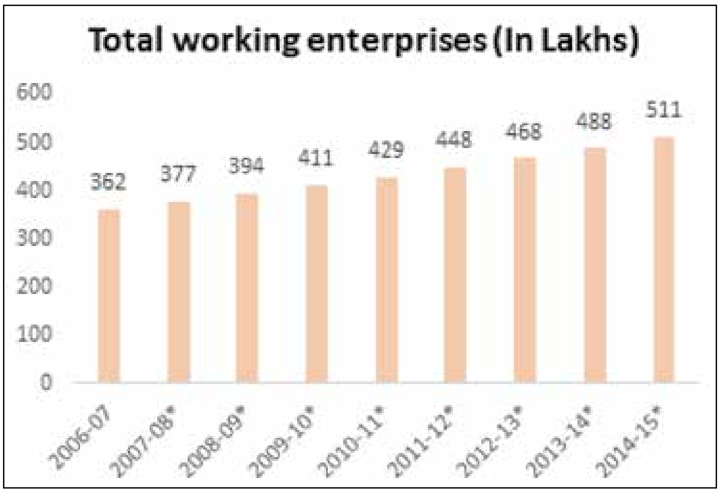
The MSME sector has been a major contributor to exports accounting for nearly 40% of total exports and constantly growing with major export destinations being USA, EU, UAE, etc.

Top products exported by MSME
Pearls, Precious stones, metals, coins, etc.
Electrical, electronic equipment
Pharmaceutical products
Articles of apparels, accessories
Article of iron or steel

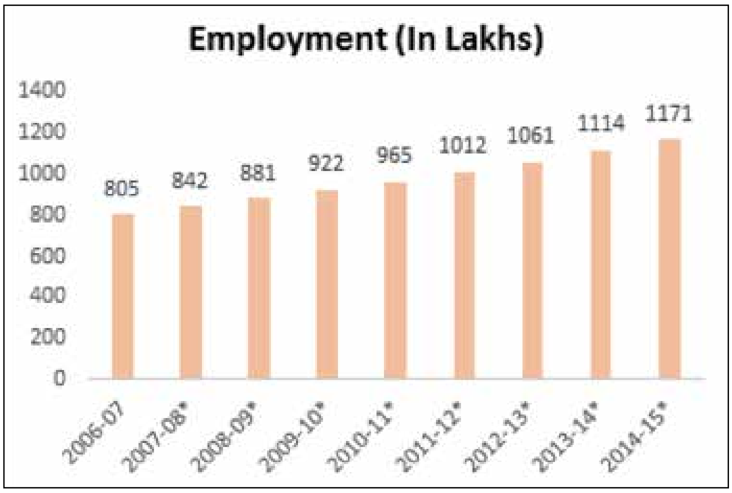
Source: IFC

MSME: Successes and Contribution to the Economy

The sector's growth and improvement has been consistent in the past 5 decades due to a combination of governmental support, implementation of technological enhancements and support provided by the banking sector. The opening up of our economy coupled with a high growth rate has been a major stimulus to these developments. Direct indicators of this development are the fixed investment witnessed in the sector, between FY07 and FY11 which has grown at a CAGR of 11.48% and employment also grew more than 5% year- over-year.



(Source: Fourth All India Census, 2006-07,
**Indicates projected data)*



(Source: Fourth All India Census, 2006-07,
**Indicates projected data)*

The growth of this sector has been impressive, it has graduated from the status of small scale industries to becoming a vital component in the manufacturing and services space. In spite of various constraints, these enterprises have made their presence felt both domestically and globally.

Potential of MSMEs

The sector is unique in its functioning, it supports big industries yet employs a big chunk of unskilled labor. Being manpower intensive, the sector has a great potential to reduce the socio-economic imbalances. It can support in the development of rural areas by increasing entrepreneurship and also reduce the stress on metros by balancing the inflow of migrant workers.

MSME Clusters

A cluster is defined as a concentration of enterprises producing same or similar products or strategic services and is situated within a contiguous geographical area spanning over a few villages, a town or a city and its surrounding areas in a district and face common opportunities and threats.

The essential characteristics of enterprises in a cluster are

a. Similarity or complementarity in the methods of production, quality control and testing, energy consumption, pollution control, etc.

b. Similar level of technology and marketing strategies/practices

c. Channels for communication among the members of the cluster

d. Common challenges and opportunities

These common opportunities and threats can

a. Give rise to external economies (e.g. specialised suppliers of raw materials, components and machinery; sector specific skills etc.);

b. Favour the emergence of specialized technical, administrative and financial services;

c. Create a conducive ground for the development of inter-firm cooperation and specialization as well as of cooperation among public and private local institutions to promote local production, innovation and collective learning

Accordingly, activities which are of daily use services and/or where scope for joint action or passive cooperation is minimal or where the product grouping is too wide for common threats/opportunities to emerge, are not to be considered. Clusters may be broadly divided into the following broad categories:

Industrial cluster: Having at least 100 enterprises and/or a minimum turnover of INR 100 million. Units in these clusters are functioning from factory premises with hired workers. Such clusters have a mix of micro, small, medium, a few large and at times, all micro units.

Micro-enterprise clusters: Such clusters are all micro units and are mostly done by household based units by mostly utilising home based workers. These include artisanal (handicrafts and handloom) and other micro enterprise clusters. A handloom cluster has a minimum of about 500 looms and that of handicrafts and other microenterprise clusters is estimated to have around 50 units.

Indian SME clusters

With a contribution of 45% to the country's industrial output and 40% to direct exports, the MSME sector has achieved significant milestones for the industrial development of India. Within the MSME sector, an important role is played by the numerous clusters that have been in existence for decades and sometimes, even for centuries. According to a United Nations Industrial Development Organisation (UNIDO) survey of Indian SME clusters, there are 400 SME clusters. Also, there are approximately 2000 rural and artisan based clusters in India. It is estimated that these clusters contribute 60% of the manufactured exports from India. The SME clusters in India are estimated to have a significantly high share in employment generation.

Some Indian SME clusters are so big that they account for 90% of India's total production output in selected products. For example, the knitwear cluster of Ludhiana. Almost the entire Gems and Jewellery exports are from the clusters of Surat and Mumbai. Similarly, the clusters of Chennai, Agra and Kolkata are well known for leather and leather products.

However, the majority of Indian clusters, especially in the handicrafts sector, are very small, with no more than hundred workers, so specialised that no other place in the world matches their skills and the quality of their output. This is the case, for example, of the Paithani sarees cluster in Maharashtra. However, only a tiny minority of such artisan clusters are globally competitive.

The formidable challenges created for the SME sector by the liberalisation of the Indian economy, as well as its closer integration within the global economy, have generated a great deal of interest within India on novel approaches to SME development. As a result, both private and public sector institutions at the Central as well as the State levels are increasingly undertaking cluster development initiatives.

Challenges for Indian industry

- Becoming more competitive in the global market by cost-cutting, productivity improvement and efficient management of supply chains, greater public and private investment in infrastructure
- Enhancing access to global markets by greater policy coordination within the Indian Government for a coherent approach to emerging trade policy issues, an institutional partnership between the private sector and the Government in devising specific marketing strategies
- Safeguarding Intellectual Property by effectively administering copyright and patent legislation, encouraging more innovations and patenting them
- Promoting Small-Scale and Cottage Industries, and Regional Cluster Development by removing policy impediments; financial support; technology, skills and quality upgrading; market support and improving links between small and large firms
- Increasing Exports

Cluster development initiatives in India

Several institutions in India have taken up cluster development initiatives besides various government initiatives.

- **Central Government**

✓ ***Development Commissioner, MSME***

The Ministry of MSME designs and implements the policies through its field organisations for promotion and growth of small and tiny enterprises, including the coir industries. The Ministry also coordinates with other Ministers/Departments on behalf of the Small Scale Industries (SSI) sector. The implementation of policies and various programmes/schemes for providing infrastructure and support services to small enterprises is undertaken through

- Its attached office, namely, the Small Industries Development Organisation (SIDO)
- Statutory bodies/other organisations like Khadi and Village Industries Commission (KVIC) and Coir Board
- A Public Sector Undertaking, National Small Industries Corporation (NSIC)
- Training institute – National Institute of Small Industry Extension Training (NISIET), now National Institute for Micro, Small and Medium Enterprises (NIMSME), Hyderabad

✓ ***SIDO***

The Government of India in the Ministry of MSME has taken a major step forward in the holistic development of SME clusters, beyond technology and a single point focus. In about 24 clusters in the country, cluster development initiatives will be taken up, modelled on the UNIDO cluster development approach. It has also been decided to reorient its officers in the process - intensive approach and to provide them with an enabling environment for successful implementation. For this purpose, the NIMSME, Hyderabad, has been designated the Resource Centre for training and related issues. NIMSME would become the second national resource agency for training on SME cluster initiatives; the other being the Entrepreneurship Development Institute of India (EDII), Ahmedabad, wherein capacities have already been built in collaboration with UNIDO for conducting advanced programmes for the training of cluster development agents.

- ✓ ***NSIC***

The National Small Industries Corporation Ltd. was established in 1955 by the Government of India with a view to promote, aid and foster the growth of Small Industries in the country.

The focus of the intervention in the selected 24 clusters was to ensure coordinated assistance under its various schemes and thus, a greater credit off take.

- ✓ ***Development Commissioner Handicrafts, Ministry of Textiles***

The Development Commissioner (Handicrafts), Government of India, has launched the Baba Sahab Ambedkar Hastshilp Vikas Yojana Scheme (AHVY) which aims at promoting Indian handicrafts by developing artisans clusters into professionally managed and self reliant community enterprises on the principles of effective member participation and mutual cooperation.

- ✓ ***Department of Science & Technology, Ministry of Science & Technology***

The Department of Science & Technology (DST) was established in May 1971 with the objective of promoting new areas of Science & Technology and to play the role of a nodal department for organising, coordinating and promoting S&T activities in the country.

- ✓ ***Textiles Committee of India, Ministry of Textiles***

The Textiles Committee has elaborated a National Programme for capacity building of textile SMEs. The methodology and approach for this programme are drawn from experiences of UNIDO, Textiles Committee and other Central and State government institutions in implementation of cluster based initiatives. 23 clusters were identified for implementation under this programme. In 2 of these clusters, the Textiles Committee collaborated with UNIDO.

- **National Support Institutions**

- ✓ ***Small Industries Development Bank of India (SIDBI) Technology Upgradation Programme***

SIDBI was established in 1990. Its cluster development work started as early as 1991 and SIDBI has intervened in around 30 clusters till date. SIDBI's mandate is to work for technology up-gradation in clusters' small and medium enterprises. The cluster development program is implemented through external agencies and consulting firms with the collaboration of the local office of SIDBI.

✓ State Bank of India (SBI) UPTECH Programme

SBI was the first institution to start in 1988, an explicitly stated cluster development programme: Project UPTECH. Project UPTECH takes up clusters through an elaborate process that initially involved primarily technology oriented interventions. The range of interventions is much wider now. In two of these clusters, SBI worked in partnership with UNIDO.

✓ National Bank for Agriculture & Rural Development (NABARD)

NABARD is a development Bank, established in 1982. Under the National Programme for Rural Industrialisation, NABARD planned to develop 50 rural clusters in a span of 5 years, from 1999 to 2004. Its objective is to strengthen existing clusters towards sustainable competitive advantage through technology upgradation/ transfer, raw material access, skill development, managerial inputs, credit and market support.

• State Governments

The state governments have been launching cluster development initiatives

✓ Government of Andhra Pradesh

In the framework of its first Policy designed exclusively for the SME sector, the Government of Andhra Pradesh decided in April 2003 to develop a cluster initiative in each of the 23 districts of the State with agencies such as Textiles Committee, CARE, NIFT, NID, etc. Two additional cluster development initiatives were implemented with UNIDO.

✓ Government of Madhya Pradesh

In the Rural Industries Policy dating from 1999 and subsequently in the Industrial Policy, the Government of Madhya Pradesh introduced a strong focus on cluster approach as a mean for economic development. It implemented cluster development initiatives in 2 handlooms clusters, Chanderi and Maheshwar, in partnership with UNIDO.

✓ Government of Gujarat

In Gujarat, where the Government identified 90 clusters, the Industrial Policy – 2000, incorporated a scheme to strengthen industrial clusters by creating common facilities and improving productivity in industrial units. The scheme aims at providing assistance to clusters for technology upgradation, quality improvement, training to workers as well as entrepreneurs and market promotion.

✓ *Government of Kerala*

The State Government of Kerala launched a major cluster development initiative for handloom weaving as well as industrial clusters. A batch of 18 Handlooms and Districts Industries Centres officials was trained at EDII Ahmedabad as Cluster Development Agents (CDAs) and the training was broad-based to field officers.

• Other institutions

Following institutions also have their respective cluster developmemt initiatives

✓ *Grameen Development Services (GDS)*

GDS, an NGO founded in 1993, is working for the welfare and development of the poor and disadvantaged. Its cluster development approach, applied in 2 clusters, has been designed to address poverty alleviation.

✓ *Rajasthan Chamber of Commerce and Industry (RCCI)*

RCCI has about 600 corporate members. Cluster related intervention objectives are

1. To develop an effective institutional framework
2. To develop and modernize textile and gem and jewellery sub sectors
3. To conduct need based training programs for small enterprises
4. To promote the products of SMEs nationally as well as internationally
5. To focus on environmentally sustainable development process in the region

The RCCI has taken activities in 16 clusters.

Promotion of MSME clusters

The Ministry of Micro, Small and Medium Enterprises (MSME), Government of India (GoI), has adopted cluster development approach as a key strategy for enhancing the productivity and competitiveness as well as capacity building of Micro & Small Enterprises (MSEs) and their collectives in the country through implementation of two important schemes

(i) Micro and Small Enterprises - Cluster Development Programme (MSE-CDP) and

(ii) Scheme of Fund for Regeneration of Traditional Industries (SFURTI).

There are no criteria fixed for selection of location for the said purpose as the schemes are demand driven and depend upon the availability of clusters.

• MSE – CDP

Objectives

1. To support the sustainability and growth of MSEs by addressing common issues such as improvement of technology, skills and quality, market access, access to capital, etc.
2. To build capacity of MSEs for common supportive action through formation of self-help groups, consortia, upgradation of associations, etc.
3. To create/upgrade infrastructural facilities in the new/existing industrial areas/ clusters of MSEs
4. To set up common facility centres (for testing, training centre, raw material depot, effluent treatment, complementing production processes, etc.)

Strategy and approach

Given the diverse nature of the MSEs in terms of both geographical location and sectoral composition, the MSE-CDP scheme aims at addressing the needs of the industries, through well defined clusters and geographical areas. This will enable achieving the economies of scale in terms of deployment of resources as well as focusing on the specific needs of similar industries. The capacity building of associations, setting up of special purpose vehicles (SPVs), consortia, etc., which are integral parts of the scheme, would enable the MSEs to leverage their resources and also to have better access to public resources, linkages to credit and enhance their marketing competitiveness.

Scope of the scheme

1. Diagnostic study

   This will lead to conducting a diagnostic study and making a report on the same.

2. Soft interventions

   This will lead to creation of general awareness, counseling, motivation and trust building, exposure visits, market development including exports, participation in seminars, workshops and training programmes on technology upgradation, etc.

3. Common Facility Centre (CFC)

   This will lead to creation of tangible "assets" as Common Facility Centers (CFCs) like Common Production/Processing Centre (for balancing/correcting/improving production line that cannot be undertaken by individual units), Design Centres, Testing Facilities, Training Centre, R&D Centres, Effluent Treatment Plant, Marketing Display/Selling Centre, Common Logistics Centre, Common Raw Material Bank/Sales Depot, etc.

4. Infrastructure Development Centre (ID)

This will lead to creation of infrastructural facilities like power distribution network, water, telecommunication, drainage and pollution control facilities, roads, banks, raw materials, storage and marketing outlets, common service facilities and technological backup services for MSEs in the new/ existing industrial estates/areas.

Financial assistance under the scheme

The financial assistances for various interventions are

1. Preparation of Diagnostic Study Report with Government of India (GoI) grant of maximum INR 2.5 lakh. For the field organisations (MSME-DIs) of the Ministry of MSME, this financial support will be INR 1 lakh.

2. Soft Interventions with GoI grant of 75% of the sanctioned amount of the maximum project cost of INR 25 lakh per cluster. For NE & Hill States, Clusters with more than 50% (a) micro/ village (b) women owned (c) SC/ST units, the GoI grant will be 90%.

3. Detailed Project Report (DPR) with GoI grant of maximum INR 5 lakh for preparation of a technical feasibility and viability project report.

4. Hard Interventions in the form of tangible assets like Common Facility Centre having machinery and equipment for critical processes, research and development, testing, etc. with GoI grant up to 70% of the cost of project of maximum INR 15 crore. For NE & Hill States, Clusters with more than 50% (a) micro/ village (b) women owned (c) SC/ST units, the GoI grant will be 90%.

5. Infrastructure Development with GoI grant up to 60% of the cost of project of INR 10 crore, excluding cost of land. GoI grant will be 80% for projects in NE & Hill States, industrial areas/ estates with more than 50% (a) micro (b) women owned (c) SC/ST units.

Progress Report

Cluster Development: A total of 1018 interventions in various clusters spread over 29 states and 1 UT in the country have so far been taken under the programme.

Particulars	Number
i) Total clusters taken	964 (till date)
• Ongoing clusters	193
- Diagnostic Study	113
- Soft interventions	12
- Hard interventions	68
• Completed Clusters	771
- Diagnostic Study	436

- Soft interventions	300
- Hard interventions	35
ii) Total infrastructure projects taken	179
- Ongoing projects	44
- Completed	135

Statement of funds sanctioned under MSE-CDP from 2011-12 to 2015-16 and 2016-17 (up to 10/9/2016)

Year	Budget	Expenditure (INR Crore)
2011-12	44.00	30.78
2012-13	49.26	23.44
2013-14	68.50	41.41
2014-15	84.60	63.18
2015-16	102.95	81.36
2016-17	135.00	50.37 (up to 10 Sept)

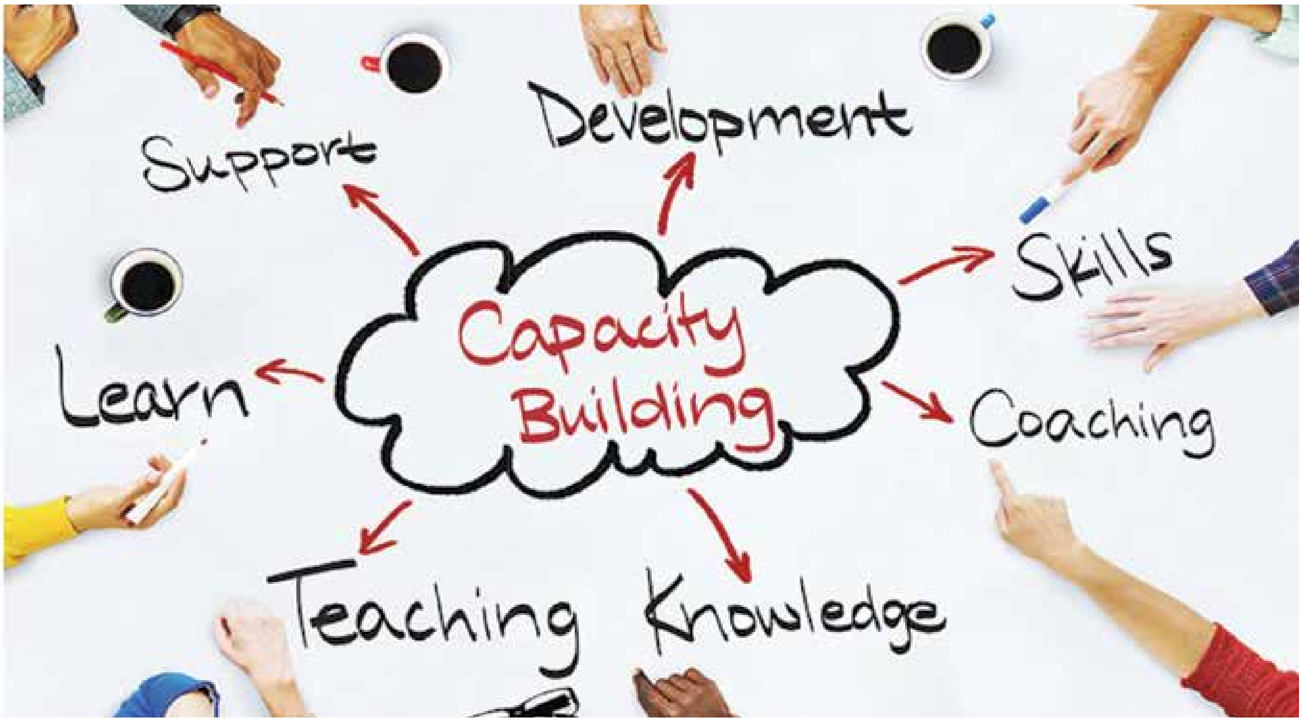
- ## SFURTI

Under the Scheme of Fund for Regeneration of Traditional Industries (SFURTI), the objectives are to organize the traditional industries and artisans into clusters to make them competitive and provide support for their long-term sustainability and economy of scale by imparting necessary skills, improvement in marketing infrastructure, by making provision for common facilities centre and providing improved tools and equipments for artisans etc.

SFURTI Scheme has been revamped in the XII plan and 71 clusters with an outlay of INR 149.44 crore are proposed to be developed in the first phase. It is envisaged under the revamped SFURTI to have 3 types of clusters as follows:

Type of clusters	Numbers	Outlay (INR in crore)	Artisans to be covered
Heritage Clusters	2	16.00	1000-2500 artisans per cluster (500-1200 artisans for NER, Hill, LWE affected area)
Major Clusters	10	30.00	500-1000 artisans per cluster (250-500 artisans for NER, Hill, LWE affected area)
Mini Clusters	59	88.50	Up to 500 artisans per cluster (Up to 250 artisans for NER, Hill, LWE affected area)
Total	71	134.50*	

**INR 14.94 crore also kept for thematic interventions, administrative, scheme management, monitoring and evaluation.*



Capacity Building and Skill Development

Capacity building of MSMEs

Scheme for capacity building for MSME sector

Background

A reliable database is a key input to policy decision-making process. This is more so for the micro and small enterprise (MSE) in view of its large size and wide disparity among the enterprises within the sector. The Office of the DC (MSME) conducts periodic census for strengthening/updating the database on MSE sector. So far, this office has conducted three censuses in the year 1971-72, 1992-93 and 2002-03. However, the limiting factor is the long gap between two censuses and the high cost involved in conducting census. In the intermittent period, two sources are used by this office for obtaining information/data on the status of the MSE sector. First is the District Industries Centres (DICs) of the State Governments, which furnish the updated information on the number of registered enterprises. But registered enterprises constitute only a small percentage of the total number of enterprises, thereby leaving a huge data gap. The second important source is the MSE Associations, which are spread across the country. The present database with this office suggests the number of such Associations is in the vicinity of 350, including both National and State level, and are mainly sector/product specific. This Office has been using the services of these Associations from time to time, especially with regard to data on number of unregistered enterprises, production, exports, etc. relating to specific product groups like pump industry, drugs and pharmaceuticals, etc. However, limited availability of funds is the main constraint faced by these Associations in building a reliable database.

To strengthen the database for the MSE sector, the promotional package includes, inter alia, a new 'Scheme for capacity building, strengthening of database and advocacy by Industry/Enterprise Associations'. The other proposal in this context is collection of statistics and information through annual sample surveys and quinquennial census.

The Associations of Micro and Small Enterprises (MSEs) do not have adequate capacity to collect and interpret data relating to changes in the market scenario, owing to the limited availability of funds and in the absence of expertise in the matter. As a result, their articulation of views on specific issues concerning to their product groups leaves much to be desired. In spite of the fact that the Associations of the MSEs have been made members of the MSME Board and the members of the steering committees of certain national programmes for development of some products, their existing weaknesses prevent them from playing the expected role effectively. Even in their role as facilitators for their members in government assisted schemes like setting up of sub-contracting exchanges, testing laboratories, etc., the capacity of these Associations has been found to be deficient. Associations play an important role in the Public Private Partnerships (PPP). Nevertheless, it is felt that many product groups go unheard because of their associations being weak. As a result, they are not able to effectively participate in programmes and policies of the Government.

Therefore, this Scheme will be of great help to the Associations in playing a positive role in the development of MSEs in the country and articulating their views on different aspects related to MSEs. To strengthen their role and increase their efficiency, financial assistance for the secretarial and advisory/extension services to selected national Associations are to be provided annually up to a maximum of INR 5 lakh per Association depending upon the size and reach of the Association. Under the Scheme, the beneficiary Associations will be required to provide the regular manpower at their own cost and office space and also make an equivalent/matching contribution towards cost of modernisation of their facilities and equipment and training of their personnel.

Further, there is a need to give due publicity to the initiatives taken by the Government for development of the MSE sector and have these issues regularly deliberated so that they can be improved upon for better and more effective implementation. At present, there is no regular mechanism for having these issues deliberated but it is felt that MSE Associations can play a crucial role in this context. Various National and State level Organizations/Associations concerned with the development of the MSE Sector have been organizing Seminars/ Symposiums/Workshops from time to time. But these initiatives have been quite ad-hoc and are constrained by the availability of funds. The Ministry of MSME/Office of DC (MSME) have been periodically receiving requests from various Industry Associations/Non-Governmental Organizations (NGOs), etc. for sponsoring/

providing financial support for holding Seminars/ Symposiums/Workshops on various issues concerning the MSME Sector. Such activities are an essential part of the Scheme for capacity building, strengthening of database and advocacy by Industry/Enterprise Associations. In view of this, the Ministry of MSME/Office of DC (MSME) has decided to provide financial support for holding Seminars/Symposiums/Workshops.

Under the Scheme, National/Regional/State/Local Level Industry Associations, which are registered for at least 3 years and are having a regular charter, list of members and audited accounts, etc.; would be eligible for the financial assistance for strengthening of data base as well as for conducting Seminars/Symposiums/Workshops.

Strengthening of database

To strengthen the role and increase the efficiency of the associations of Micro and Small Enterprises, financial assistance for the Secretarial and Advisory/extension services to selected associations may be provided up to a maximum of INR 5 lakh, depending upon the size and reach of the Association. To be eligible, the beneficiary Associations will be required to provide the regular manpower and office space at their own cost and also bear equivalent/ matching contribution towards cost of modernisation of their facilities and equipment and training of their personnel. Efforts will be made to cover a large number of Associations within the ambit of the Scheme and an Association receiving financial assistance under the Scheme will not be eligible to receive financial assistance again under the Scheme for the next three years.

Under the Scheme, the following machinery and equipment needed by the Associations for upgrading their capacity (both qualitatively and quantitatively) to collect and interpret data relating to changes in the market scenario, Sub-Contracting Exchanges, Testing Laboratories, etc. shall be eligible to receive financial assistance: -

Particulars	Amount in INR
Phase I	
Computer and its peripherals including software	4,00,000
Furniture and office equipments, eg. Fax etc.	1,50,000
Photocopier machine and its accessories	2,00,000
Phase II	
Consumables per annum	1,00,000
Training of the staff	50,000
Expenses on travel etc.	50,000
Contingent & other office expenses	50,000
Total	**10,00,000**

The Ministry of MSME/Office of DC (MSME) would provide 50% of the cost of modernization of the facilities and equipment and training of personnel, etc. The remaining 50% of the cost would be borne by the Associations.

1. First installment of 50% of the sanctioned amount – Upon approval of the proposal and subject to signing of the agreement
2. Balance 50% of the sanctioned amount – On furnishing of the utilization certificate as may be prescribed. The utilization certificate should be for the entire amount sanctioned in Phase I.

Seminars/Symposiums/Workshops

For organizing Seminars/Symposiums/Workshops, maximum of INR 2 lakh would be provided to National Level MSE Associations and INR 1 lakh to Regional/State/Local Level MSE Associations. The Associations can avail financial assistance under this component only once in a financial year. While seeking financial assistance, the Association concerned shall indicate the tentative cost for holding the Seminar/Symposium/Workshop along with details of participation expected and deliverables/outcome of the proposed Seminar/Symposium/ Workshop. Further, it shall undertake to meet 50% of the expenses in case of National level Associations and 25% in case of Regional/ State/Local level Associations, out of its own resources. On completion of the activity for which financial assistance has been sought/provided, the Association concerned shall give a Utilization Certificate to the satisfaction of the Government, failing which it would be debarred from receiving any financial support in future. Release of financial support would be as under: -

1. 50% of the sanctioned amount to the released, subject to:

a. Submission of detailed cost estimated by the Association

b. Undertaking by the Association to bear at least 50% of the cost from its own resources in case of National Level Associations and 25% in case of Regional/State/Local Level Associations

c. Recommendation by the Screening Committee

2. Balance 50% to be released subject to successful organization of the Programme, submission of final accounts Utilization Certificate and recommendation of the Committee

Skill Development

Entrepreneurship and Skill Development Schemes

The Ministry of MSME offers some schemes for entrepreneurship and skill development. They are as below.

1. **Trade Related Entrepreneurship Assistance and Development (TREAD) Scheme for women entrepreneurship**

Objectives

Experience has revealed that apart from counseling and training, delivery of credit poses the most serious problem for poor women. Since such women are not able to have an easy access to credit, it has been envisaged that the credit will be made available to applicant women through NGOs, who would be capable of handling funds in an appropriate manner. These NGOs will not only handle the disbursement of such loans needed by women, but would also provide them adequate counseling & training for taking up productive activities. The focal point of the scheme is to provide grant assistance to the nodal NGO which has been sanctioned bank loan for passing through the same to eligible women for taking up non-farm activities.

Features

- ***Credit***

There is a provision for Government of India Grant up to 30% of the loan/ credit, maximum up to INR 30 lakh as appraised by lending institutions/ banks. The lending institutions/ banks would finance loan assistance for women through NGOs for undertaking non-farm activities, who usually have no easy access to credit from banks due to cumbersome procedures and because of their inability to provide adequate security demanded by banks in the form of collaterals. GOI Grant and the loan portion from the lending agencies to assist such women shall be routed through NGOs engaged in assisting poor women through income generating activities. While the loan amount will be passed on to women beneficiaries, the Grant shall be utilized by the NGOs for activities accepted as grant activities in the appraisal report of the lending agency and capacity building of the NGOs. An NGO which has been selected for Government Grant will not be considered for GoI grant again in the subsequent two years from the date of release of GoI grant.

- ***Training and counselling***

Training organizations viz. Micro, Small and Medium Enterprises – Development Institutes (MSME-DIs), Entrepreneurship Development Institutes (EDIs), NIMSME, NIESBUD and NGOs conducting training programmes for empowerment of women beneficiaries identified under the scheme would be provided a grant upto a maximum limit of INR 1 lakh per programme, provided such institutions also bring their share to the extent of minimum 25% of the Government grant and 10% in case of NER, subject to the condition that applications from NER are recommended by NSIC/ IIE , Guwahati.

- ***Eliciting information on related needs***

Institutions such as Entrepreneurship Development Institutes (EDIs), NIMSME, NIESBUD, IIE, MSME-DIs, EDIs sponsored by State Govt. and any other suitable institution of repute will be provided need based Government grant limited up to INR 5 lakh per project primarily for undertaking activities aiming at empowerment of women such as field surveys, research studies, evaluation studies, designing of training modules, etc. covered under the scheme.

Performance

Sr. No.	Year	GoI grant released/expenditure (INR in lakh)	No. of women benefited
1	2004-05 to 2011-12	630.09	28,023
2	2012-13	138.79	11,168
3	2013-14	233.4	5455
4	2014-15	254.2	8265
5	2015-16	200	3560
Total		**1456.48**	**56,471**

2. Assistance to Training Institutions (ATI) Scheme

Description

The Scheme envisages financial assistance for strengthening the infrastructure of the existing Entrepreneurship Development Institutes (EDIs) and for supporting entrepreneurship and skill development activities. The main objectives of the scheme are development of indigenous entrepreneurship from all walks of life for developing micro and small enterprises, enlarging the entrepreneurial base and encouraging self-employment in rural as well as urban areas, by providing training to first generation entrepreneurs and assisting them in setting up of enterprises. The assistance shall be provided to these training institutions in the form of capital grant for creation/strengthening of infrastructure and programme support for conducting entrepreneurship development and skill development programmes.

The revised guidelines (effective from 01.09.2016) provide for financial assistance in the form of grant for: -

- Infrastructure support and capacity building of training institutions of Ministry of MSME and the existing State Level EDIs
- Research and Studies on MSME related matters
- MSME Chair
- Training (Skill Development programmes / Training of Trainers) by training institutions of Ministry of MSME

No financial assistance will be provided under the revised scheme for setting up of a new EDI. The private training institutions / NGOs are not covered under the scheme for financial assistance.

Nature of assistance

- The maximum assistance under the scheme to a State level EDI will be restricted to INR 250 lakh in each case. This grant would be utilised for development of physical infrastructure, equipment, faculty training and development of capability in undertaking studies and research on issues related to MSME sector.
- Research and Studies: The maximum assistance will be INR 15 lakh in each case.
- Training (SDP): Assistance will be provided to training institutions of Ministry of MSME for conducting Skill Development Programmes.

The existing State Level EDIs owned and controlled by a State/UT Government and training institutions of Ministry of MSME can apply for this scheme.

Training and skill development activities

1. NSIC

NSIC provides technical support to MSMEs through 'NSIC Technical Services Centres' (NTSCs) and a number of extension and sub centres spread across the country. The range of technical services provided through these centres include training in Hi-Tech as well as conventional trades, testing, common facilities, toolkits, energy audit, environment management etc.

In addition to this, access to latest information in connection with technology upgradation and its transfer is provided to MSMEs through the 'Technology Transfer Centre' at New Delhi.

2. MSME-DIs

Various types of training programmes conducted by various MSME-DIs are provided in the table below.

Programme name	Various topics covered
Entrepreneurship Development Programmes (EDP)	Computer Application, Computer Awareness, Beautician, Garment Manufacturing, Leather Goods Manufacturing, Call centre (IT) industry, Catering, Industrial Accounting, Fruits and Vegetable Products, etc.
Entrepreneurship Skill Development Programmes (ESDP)	Computer Application, Computer Hardware Maintenance, DTP, Motor Winding, CNC Operation and Programming, Mobile Handset Repairing, Computer Accounting, Food processing, Embroidery, Fashion Designing, Jewellery Designing, Soft Toys, Air Conditioning and Refrigeration, Consumer Chemical Products, etc.
Business Skill Development Programmes (BSDP)	- Product/ process design, Manufacturing Process involved - Testing, Selection & usage of appropriate machinery and equipment, Marketing avenues/ techniques, Product/ service pricing, Export opportunities, Cash flow, Preparation of project profiles, Quality management Standard, Quality Management Tools, Creativity, Value Engineering and Value analysis, Industrial Design - Patenting, scheme for TIFAC for energy new design
Management Development Programmes (MDP)	Management of Small Enterprises, Retail Management, Computer Management, Export Procedure and Documentation, Financial Management and Accounting, E-marketing, Sales Promotion and Marketing, Quality Management, Human Resource Management, Web Security Management, etc.

Industrial Motivation Campaigns (IMC)	Industrial motivation campaigns
Vocational and education training	Courses in tools engineering, skill enhancement courses for industry personnel, customised training programmes for industries

There are 30 MSME-DIs (formerly SISIs) set up in state capitals and other industrial cities all over the country.

3. Other institutes

• *National Institute of Micro, Small and Medium Enterprises (NIMSME), Hyderabad*

The National Institute of Micro, Small and Medium Enterprises (NIMSME), formerly National Institute of Small Industry Extension Training (NISIET) is an autonomous Society at Hyderabad under the administrative control of Office of DC(MSME). The Institute conducts National and International Training Programmes. NI-MSME has initiated several specialised and tailor-made training programmes. A few of them are:

- Management Development Programmes
- Programme on Area Development
- Programme on Feasibility Survey and Analysis
- Programme on Industrial Estates
- Programme for Young Engineers and Technocrats
- Vertically Integrated Course on Orientation through Small Industry Development for IAS / IES Officers
- Effective Development Programmes for Rationalised Employees of State and Central PSUs
- Exclusive Programmes for International Executives of Various Themes on Regular Basis
- Sensitivity Training in Production Planning and Control
- Faculty Development Programmes
- Programmes on Cluster Development
- Programmes on Focused Themes for Executives of North Eastern States

• *National Institute for Entrepreneurship and Small Business Development (NIES-BUD), NOIDA*

The National Institute for Entrepreneurship and Small Business Development (NIESBUD), New Delhi, is an autonomous body under the administrative control of the Office of the DC (MSME). The Institute conducts about 28 National and 5 International Training Programmes every year. Besides, the Institute undertakes research studies, consultancy assignments, development of training aids etc.

- ***Micro, Small and Medium Enterprises Training Institute (MSME-TI), Tiruvalla***

The erstwhile Production Centre for electronic motors was renewed as Micro, Small & Medium Enterprises Training Institute (MSME-TI), Tiruvalla, (formerly SEPTI), in the year 1992-93, with a view to conduct specialised skill oriented Entrepreneurship Development Programmes for educated unemployed youths. The Institute has been equipped with Electronic Laboratory, Computer Lab, CNC Lab, HEA Lab, AC&R Lab, General Engineering Workshop, EPABX and four training halls with Audio-Visual aids.

The Institute has been conducting skill oriented EDPs in various trades like General Engineering, Motor Rewinding, Household Electric Appliances, A/C and Refrigeration etc. The Institute generally conducts 16 EDPs in two phases every year. Apart from these, the Centre has also introduced certain Diploma and PG Diploma courses in Computer varying from 3 months to 12 months duration on a self-sustaining basis. The Centre also organises training for TRYSEM and PMRY beneficiaries.

- ***Indian Institute of Entrepreneurship (IIE), Guwahati***

Indian Institute of Entrepreneurship is an autonomous national institute established by Ministry of Micro, Small and Medium Enterprises. The activities of the Institute include

- identification of training needs
- designing and organizing programmers, both for development functionaries and entrepreneurs
- evolving effective training strategies and methodologies for different target groups and locations
- organising seminars, workshops and conferences for providing fora for interaction and exchange of views by various agencies and entrepreneurs
- undertaking research on entrepreneurship development
- documenting and disseminating information needed for policy formulation and implementation on self-employment and entrepreneurship

The various training courses offered by the institute include

- Faculty Development Programme in Entrepreneurship
- Entrepreneurship Development Program
- TEDP Herbal Medicine & Aromatic
- Entrepreneurship Awareness Programme
- TEDP on Gems & Jewellery
- TEDP on Woollen Garment Industry

- Training Programme on Cluster Development Approach for Urban Poor
- Regional Workshop on Empowerment of Women through Development of Micro Enterprises
- Project Identification, Formulation and Appraisal on Micro Enterprises for Urban Poor
- New Enterprise Creation
- Women EDP

- ***Central Footwear Training Centres, Chennai and Agra***

These training centres provide training and related inputs to develop and augment a class of trained personnel in Footwear technology and Allied industry in the country.

- ***Fragrance and Flavour Development Centre, Kannauj***

FFDC aims to serve as an interface between essential oil, fragrance and flavour industry and the R & D institutions, both in the field of Agro Technology and chemical technology. The main objective of the centre is to serve, sustain and upgrade the status of farmers and industry engaged in the aromatic cultivation and its processing, so as to make them both in local and global market.

- ***Electronics Service and Training Centre, Ram Nagar***

Electronics Service & Training Centre has been established by the Govt. of India to develop human resources to meet the essential requirements for transfer of technology in assembly and manufacturing of electronics items and parts. One of the main activities of the Centre is training of the personnel in the areas of production and quality control for electronic and I.T. industry.

Three kinds of training programmes are conducted at ESTC, namely:

- Skill Development Training for Employment
- Self Oriented Entrepreneur Development Training Programme
- Specialised Skill Upgradation Training Programme

- ***Institute for Design of Electrical Measuring Instruments, Mumbai (IDEMI)***

IDEMI, a joint venture of the Government of India and UNDP / UNIDO was set up to gear up the growth potential of indigenous instrument industry and hence, to meet the ever growing instrumentation needs of the country by augmenting productivity quality control in industrial sector – be it in Electrical, Electronics or Process Control Instruments. The Institute is looked upon as a nodal centre in view of its multifarious activities offered to suit various needs of instrument industry. The Institute offers Technical Training for wide range of professionals in numerous disciplines of Instrumentation.

Capacity building of bankers

Background

As discussed earlier, MSMEs' contribution to GDP and employment of the country is huge. The MSMEs develop a diverse range of products and services to meet the needs of the local markets, the global markets and the national and international value chains.

Focus on programmes, such as Make in India, Skill India and Digital India and initiatives such as revising the definition of MSMEs, providing framework for rehabilitation of MSMEs and introducing the Trade Receivables Discounting System to solve the problem of delayed payments, clearly indicate significance attached by the Government and the Reserve Bank to this sector.

Close to three lakh banking personnel have come into the system over the past six years, who probably have very limited exposure to MSMEs. It is essential to catalyse and skill this large number of newly recruited youngsters who are part of the team lending to MSME sector. The Reserve Bank's initiative in national skill building in lending to MSMEs comes against this background.

National Mission for Capacity Building of Bankers for financing MSME sector

Lending to MSMEs makes a strong business case for the banks in view of the changing dynamics in the economy, like demographic patterns, urbanisation trends, increasing thrust on industrialisation, addition of new customers under financial inclusion programme and growing levels of literacy. This was stated by Shri S S Mundra, Deputy Governor, Reserve Bank of India (RBI), while launching the National Mission for Capacity Building of Bankers for financing MSME Sector in College of Agricultural Banking, Pune.

The Deputy Governor urged banks to be sensitive towards the lifecycle needs of their MSME clients and develop innovative products that are suitable to their unique and seasonal requirements for working capital and for capital expenditure purposes. Pointing out at the various initiatives taken by the Reserve Bank and the Government of India, like Trade Receivables Discounting System (TReDS) and rehabilitation of sick MSMEs, the Deputy Governor hoped that these will go a long way in supporting and nurturing the sector.

"A paradigm shift in financing of Micro, Small and Medium Enterprises (MSMEs) will also happen as and when new Small Finance Banks are licensed. These will make the financing of MSMEs more competitive in the coming days. Banks will be able to face this competition only if they are more sensitive to the needs of the small entrepreneurs," he added.

Shri Mundra also released a training kit designed and developed by College of Agricultural Banking, which is targeted at

(i) managers of bank branches specialised in financing MSME

(ii) trainers of banks' training institutions/colleges/learning centres

The national seminar organised by the Reserve Bank's College of Agricultural Banking was attended by 31 banks,ranging from public, private and foreign banks.

The Reserve Bank has launched a national capacity building programme to sensitise and upskill bank officials dealing with MSME financing. Called the National Mission for Capacity Building of Bankers for financing MSME Sector (NAMCABS), the broad objectives of this programme are to develop skills for MSME lending and to develop entrepreneurial sensitivity among the field level functionaries of specialised MSME branches of commercial banks. With the Reserve Bank's College of Agricultural Banking (CAB) mandated to be the nodal institution to coordinate the efforts made in the banking system, the mission will be executed in four legs:

Sr. No.	Leg	To be conducted by
1	Training for vertical heads of MSME divisions in commercial banks	CAB
2	Training for trainers of regional training centres of commercial banks	CAB
3	Capacity building for branch managers of specialised MSME branches	Regional Offices of the RBI
4	Capacity building of staff of the specialised MSME branches	Regional training centres of commercial banks

Over 4500 officials dealing directly with MSME lending are expected to be trained through this initiative in one year.

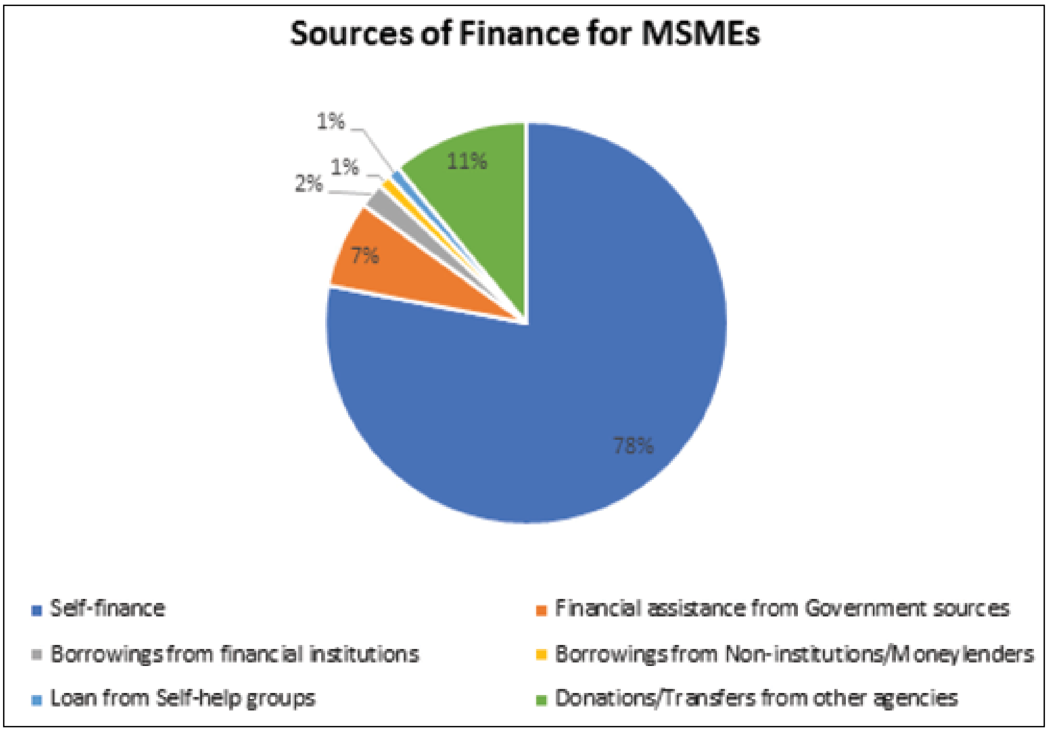
Alternative Financing

The financing to MSME plays an important role in their growth. Although, various steps are taken by the government, there is still miles to go in order to improve the access to timely finance to entrepreneurs in the MSME sector.

To further throw light on this issue, the gaps of debt servicing in this sector are enumerated below, to get a sense where action is required. Further to the debt gaps, equity gaps are also addressed in this report.

Credit Gap

The overall demand for finances in the MSME sector is estimated to be INR 32.5 trillion. Majority of these are in the form of debt. In the context of debt demand, what part of this demand is addressable and viable for the formal financial institution needs to be identified.



Debt Gap

The demand for debt varies among enterprises in the sector, with different expectations and capabilities. Let us explore this issue among different players in this sector.

Micro Enterprises

The micro and small sub-segments together account for the majority of the debt demand. As they mostly operate in industries such as retail trade, repair and maintenance, restaurants and textiles among others, have a significant demand for working capital.

Another key characteristic of this sub-segment, is that they largely prefer to transact in cash and do not possess recorded financials.

Small Enterprises

Enterprises in this segment require higher capital investments and tend to operate in value-add manufacturing and knowledge based services. It is estimated that 0.7 million small enterprises are viable for financing by formal sources.

The average credit requirement of this sub-segment is estimated to be INR 4 – 4.5 million and cash continues to be a preferred form of transactions. These enterprises have access to both formal and informal sources of financing, in case of formal it is found to have relationships with one or two institutions. Entrepreneurs here have relatively more knowledge regarding formal sources of finance.

Medium Enterprises

In case of this sub-segment, the enterprises are more structured, have a predictable demand for debt and prefer formal sources of finance. The average credit size tends to be higher and there is access to a traceable credit history. In addition, these organizations are professionally run and form relationships with multiple financial institutions.

Sector-Wise Demand

Among manufacturing and the services sector, even though the latter accounts for more in numbers, manufacturing is more capital intensive. It nearly accounts for 61% of the viable demand in the sector. Hence, higher requirement of working capital is characteristic of this industry. The average requirement for capital expenditure in manufacturing enterprises is INR 0.5 million per year.

The working capital cycle for enterprises, involved in trade finance, export oriented, servicing large supply chains, tend to be longer. In the services industry, enterprises involved in retail trade, repair and maintenance, and restaurants have typically cash business with shorter turnaround. On the other hand, the knowledge based services industry such software development, management consulting and Information Technology, the financing requirements of such are similar to those of manufacturing. The share of working capital as a portion of the average debt demand for service enterprise is estimated to be 30% and rest for the manufacturing.

The knowledge based services require working capital primarily for investing in people. For this, they depend on internal accruals or internal equity investments, as debts from formal financial institutions for financing manpower costs still remain a challenge.

Equity Gap

The equity gap in the sector is a combined result of demand-side challenges such as the legal structures of enterprises, as well as supply-side gaps, such as a lack of investment funds focused on MSMEs. The requirements for the sector are concentrated in the growth-stage enterprises (~70%).

One of the primary reasons being, the smaller ticket size per investment size tends to drive the overall transaction and management costs. In addition, it is estimated that all the micro and a big portion of small enterprises are in the proprietorship or partnership structure, making them resistant to external equity infusion.

Excluding the equity demand of INR 1.23 trillion from proprietorship and partnership enterprises, equity gap is estimated to be INR 0.67 trillion. With appropriate policy interventions and support to the MSME sector, a considerable part of the currently excluded demand can be made financially viable for the formal financial sector. Of the viable and addressable demand-supply gap, the debt gap is INR 2.93 trillion and the equity gap is INR 0.64 trillion.

Micro and Small Enterprises

In this sub-segment, there is a low level of willingness and ability of the entrepreneurs to control and mange formal sources of equity. Concerns of ownership and management forms a major deterrent for equity infusion.

The equity demand for enterprises in this sub-segment which have ownership structure other than proprietorship and partnership is high.

Medium Enterprises

With a more balanced debt-equity ratio due to increased ability of entrepreneurs to contribute capital, legal structures and scalable business models have a wider horizon in raising equity. The equity demand for medium enterprises is estimated to be INR 0.42 trillion.

The micro, small, and medium enterprise segments respectively account for INR 2.25 trillion, INR 0.5 trillion and INR 0.18 trillion, of the debt gap that is viable and can be addressed by financial institutions in the near term. Nearly 60% of the demand for finance arises from the manufacturing sector. The share of the debt gap in the manufacturing sector is also considerably higher at 73% of the total gap.

Credit flow to MSME sector

Major reforms for the MSME sector have taken place in the form of introduction of schemes which have benefitted the flow of credit to the sector. MSMEs require timely and adequate capital infusion through term loans and working capital loans, particularly during the early and growth stages. Historically the MSMEs have relied on following sources for financing their needs:

- Retained earnings, funding through sale of assets from some other entity
- Ancestral capital, personal savings, loans from relatives, loans from unregulated market
- Institutional financing from scheduled commercial banks
- Venture capital funds/seed funds

Venture Capital is emerging as an important source of finance for small and medium-sized firms, especially for starting the business and business expansion. An entrepreneur usually starts the business with his own funds, and those borrowed from banks.

Notwithstanding, other forms of financing mentioned above, the dependency of financing by commercial banks in this sector is very high. Let us further discuss the products offered and understand the debt process flow along with the roadblocks faced by banks in servicing this sector.

Types of Products Offered to MSMEs by Banks

Products offered to MSMEs can be divided into two types:

a) Fund based

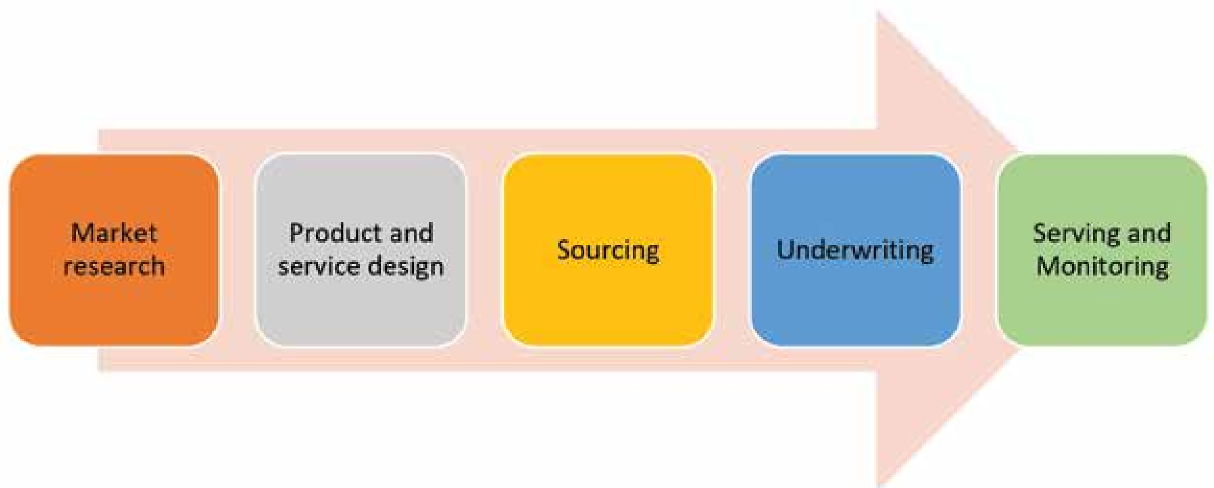
b) Non-fund based

List of key fund based products offered to MSME sector by banks are over-draft, cash credit, short-term loan, long-term loan, asset-based financing and credit cards. List of key non-fund based products offered to MSME sector by banks are letter of credit, bank guarantee, current account, savings account and remittance.

Debt process flowchart and Roadblocks

The financing environment for this sector has traditionally been serviced by the public-sector banks, following a one-size-fits-all strategy for credit quality assessment. In addition, fixed assets have been predominantly used as collateral. Furthermore, enterprises in this sector, excluding manufacturing units, do not have large investments in fixed assets. This practice has resulted in a financially underserved sector and with the traditional methods not being successful, banks have adopted different methods to improve this condition.

The process for debt finance to the MSME segment comprises the following: (a) understanding the market (b) product and service design (c) sourcing (d) underwriting (e) serving and (f) monitoring.



- **Understanding the market:** Segmentation of market remains a problem. The MSME sector is extremely heterogeneous and the market needs to be segmented beyond the size criterion of MSMEs. Several parameters such as area of operation, industry segment, vintage, legal structure, cluster operations are used by the financial institutions to judge the creditworthiness of the company and also which can be further leveraged to help banks to serve beyond institutional levels.

- **Product and Service Design:** The process of product and service design is closely related to understanding the market. Information about key business drivers and cash flow cycle remains a major hurdle in this sector. Clarity in the above-mentioned parameters would better help financial institutions develop targeted products and services. Furthermore, interest rate, collateral requirements and repayment cycle can be evaluated while designing products.

- **Sourcing:** Characterized by smaller ticket size and weak credit history leads to higher transaction costs while servicing an MSME clients. The cost of sourcing micro enterprise is same as that to a medium or small enterprise which is why, financial institutions prefer to serve a larger number of small and medium enterprises than micro enterprises. In order to circumvent this roadblock, the government is introducing cluster based infrastructure facilities to MSMEs of the same industry.

- **Underwriting:** The lack of information required to successfully assess the creditworthiness of the client in the sector poses a major hurdle.In order to overcome, banksinstead of relying solely on financials to assess creditworthiness of enterprises, financial institutions can use softer parameters such as relationship with customers and suppliers, background, and the psychometric profile of entrepreneurs. However, while softer aspects may help address informational asymmetry, it also carries the risk of increasing the cost.

- **Servicing:** A financial institution begins the relationship with an enterprise at disbursement stage, which is either on demand or in tranches, requiring multiple transactions. The main challenge in this part of the segment for the financial institutions lies in managing transaction and operating costs (which includes manpower cots) due to smaller credit size.

- **Monitoring:** Effective monitoring is essential to manage the asset quality and capture critical data that can be leveraged for future credit assessment of MSME clients. Through monitoring, financial institutions can positively impact portfolio quality, allowing for early warning of potential default. The lack of clear financials, absence of professional management, and seasonal changes in business makes it extremely difficult for financial institutions to monitor these accounts.

Banks have evolved the entire credit assessment process, inculcating new methods such as data mining, risk assessment techniques, credit risk management, and also using statistical methods. Additionally, products offered have also been backed with integrated IT applications and data mining capabilities covering areas such as working capital management, term loans, wealth management, bancassurance, etc. In spite of the improvements, banks still need to invest heavily in automation of risk monitoring processes and events based triggers which would help in ensuring uniformity in responses and in improving cost efficiencies.

Challenges in MSME Finance

There have been great strides in the performance of the MSME sector, yet the growth has been restricted by various factors.

The lack of availability of timely credit and high costs, collateral requirements and access to equity capital are considered the prime causes of concerns for this sector.

The financing needs of the sector depend on the size of operation, industry, customer segment, and stage of development. Financial institutions have limited their exposure to the sector due to a higher risk perception and limited access of MSMEs to immovable collateral.

In the normal source of financing, enterprises in MSMEs still rely on banks as a source of finance. Among these, public sector banks (PSBs) account for a major share, compared to private and foreign banks. Three factors play a considerable role in perpetuating the MSME financing gap like poor quality of projects seeking funding, the inability of MSMEs to make the best possible use of available resources of funding and the negative attitude displayed by MSMEs towards equity financing. The following obstacles prevent MSME from obtaining adequate financing-

Informational Asymmetries

Informational asymmetry is always present in enterprise financing transactions. Entrepreneurs possess privileged information about their businesses that cannot be easily accessed—or cannot be accessed at all—by prospective lenders or outside investors.

This leads to the following problems –

1. Lenders/investors cannot differentiate between high quality and low quality companies.
2. They may not be able to assess if the enterprise has utilized the funds in an appropriate manner.

Hence investors may adopt precautionary measures. One of them is financing needs to be collateralized. The information that MSME can realistically provide to external financiers (in the form of financial accounts, business plans, feasibility studies, etc.) lacks detail, isnot fullyaccurate and realistic. This problem is often provoked by low level of education. Hence, outside financiers adopt a very cautious attitude towards MSMEs, reduce the amount of financing sought or may refuse it completely. This problem is particularly acute in developing countries.

Risk Profile

MSMEs face difficulties in accessing finance to their higher risk profile. It is regarded as riskier for a number of reasons. Some of them are – uncertain competitive environment, variable rates of return and high rates of failure. They are less equipped in terms of both human and capital resources.

In developing countries, the volatile operating environment has a negative impact on the security of transactions. Also, there is a greater risk that lenders/investors will not get paid.

Transaction Costs

The handling of MSME financing is an expensive business. The cost of appraising a loan application or of conducting a due diligence varies as per the size of financing. Fixed costs include administrative costs, legal fees, costs related to acquisition of information. For smaller loans or investments, it is difficult to recover these costs. This is mainly due to lack of management information systems, undeveloped state of the economic information industry and the poor state of public services. This problem can be resolved by raising the cost of financing through a higher interest rateorclosing fee. This approach is possible only to a certain extent.

Lack of Collateral

Lenders request for collateral to mitigate risks. Now, the lack of collateral is the most widely mentioned obstacle faced by MSMEs in accessing finance. In some cases, the enterprise is not able to provide sufficient collateral either because it is not firmly established or it is insufficient in view of the size of the loan requested. In other cases, the collateral may be insufficient simply because the managers-owners tend to siphon off resources from the company for personal or other purposes. Again, this is closely related to the risk profile. In developing countries, this issue is much more severe.

Institutional factors

Institutional and legal frameworks are undeveloped. This prevents the possibility of pledging the owned assets as collaterals. Many developing countries have highly concentrated and uncompetitive banking sectors. This is due to restrictive government regulations. Hence lending policies are made conservative or high interest rates are charged. If banks can thrive with a stable pool of well-established clients, they have no real incentive to improve the range of financial products — and no incentive to go down market, to meet the needs of small businesses.

Based on the engagement with variousorganizations and experts, following are some other key issues that emerge as constraints in the access of financing to MSME sector:

1. MSMEs in India rely on friends & family as sources of equity. This is due to lack of awareness about MSMEs as well as absence of formal governance structures in small businesses which deter investors.
2. MSMEs face the problem of delayed payments from their buyers, which are mostly large corporates which impacts their working capital as well as their next cycle of production by affecting their ability to service existing debt.
3. The utilization of the available credit guarantee and insurance schemes by banks has been lower than potential.
4. MSMEs lack adequate information about the various schemes and benefits made available by the government.
5. In some cases, they lack the technical knowhow and the necessary wherewithal to furnish the required information to avail these schemes.
6. Formal financial institutions such as banks face challenges in credit risk assessment of MSMEs, due to absence of financial information including historical cash flows, credit track record and tools to assess credit risk in the absence of the above.
7. Outreach to MSMEs, on-boarding as customers, building up of transaction & credit history and scaling up the utilization of various schemes available is challenged by the lack of formal legal structure/non-corporate nature ofmuch of the sector and the absence of a centralized database and system which can be used to target and track these enterprises.
8. Small enterprises also face challenges in registration and have complex compliance requirements.

In spite of the various policies created to augment financial support to MSMEs and the growth in the credit limits of banks, MSMEs still face challenges when it comes to accessing timely and sufficient credit at a reasonable cost. The credit flow to them is not aligned to the needs of the economic activities undertaken by them. Small businesses rely on multiple sources of financing ranging from internal sources namely personal funds and funds from friends, to external sources, both formal and informal, which include financing from banks, NBFCs, venture capital funds, trade credit factoring, etc. Due to this, importance of alternative source of financing for MSMEs in India has been increasing.

Development of alternate sources of finance like factoring, Supply chain finance and Angel funds or venture capital funds would prove beneficial.

These financial aids and processes will not only give the MSMEs a much-needed reprieve from their liquidity crunch, but also help them in instilling the rigor of process, transparency and quality.

Innovation is the only way to come out of the challenges and lead the way of doing business at every marketplace. Having the vision of high economic growth in place, MSME contribution and its growth becomes critical. Government and regulator have recognized crucial gap in the demand of credit to MSME and its supply from lending institutions. Meeting credit demand of MSMEs has always been a challenge to various lenders due to various reasons.

A number of factors affect MSME financing. Some developed countries take a capitalistic approach with little government incentives for MSME financing, while others use government guarantees and other measures to reduce risks and costs. In emerging economies, to date, most MSMEs (including formal sector firms) are financed from sources outside the formal financial sector, which is expensive for the enterprise and can hamper the flow of financing, thus hindering its growth. New capital requirements and banking regulations imposed on financial institutions worldwide are making the financing of MSMEs even more difficult and expensive. Against this backdrop, the emergence of alternative, technology-enabled means of financing, such as new business models based on advanced data analytics, supply chain and e-commerce based finance, crowdfunding and other innovations may offer a way out of the cost trap.

Government aims to foster the flow of financing to the real economy, with a focus on finance for MSMEs. This will involve, among other things, innovations in supply-chain financing and government procurement, use of technology to reduce risks, enhance efficiency leading to lower costs, securitization and other means of obtaining capital relief for traditional sources of finance, introducing non-traditional sources of long-term capital and capacity building for both financiers and MSMEs.

While asset-based finance is a widely-used tool in the MSME financing landscape, alternative forms of debt have had only limited usage by the MSME sector, even within the larger size segment which would be suited for structured finance and could benefit from accessing capital markets, to invest and seize growth opportunities. In fact, alternative debt differs from traditional lending in that investors in the capital market, rather than banks, provide the financing for MSMEs. To foster the development of a corporate bond market for MSMEs, mainly mid-caps, policy makers have especially targeted transparency and protection rules for investors, to favour greater participation and liquidity. Recent programmes have also encouraged the creation of MSME trading venues and the participation by unlisted and smaller companies. In some countries, public entities participate with private investors to funds that target the MSME bond market, with the aim of stimulating its development. Private placements of corporate bonds by unlisted companies, which are subject to less stringent reporting and credit rating requirements. However, lack of information on issuers and of standardized documentation, illiquid secondary markets and issues with insolvency laws currently limit the development of these markets.

Debt securitization and covered bonds, which also rely on capital markets, had increased at high rates before the global crisis, as an instrument for refinancing of banks and for their portfolio risk management. However, in the wake of the crisis, these instruments came under increasing scrutiny and criticism, and markets plummeted. The post-crisis deleveraging in the banking sector, however, has contributed to reviving the debate about the need for an efficient – and transparent – securitization market to extend MSME lending. In recent years, new measures have been introduced at supra-national and national level to re-launch the securitization markets and some countries have lifted the limitations that did not permit MSME loans as an asset class in covered bonds.

Crowdfunding (fund pooling) has grown rapidly since the middle of the 2000s, and at an increasing rate in the last few years, although it still represents a very minor share of financing for businesses. One specificity of this instrument is that it serves to finance specific projects rather than an enterprise. It has been used in particular by non-profit organizations and the entertainment industry, where non-monetary benefits or an enhanced community experience represent important motivations for donors and investors. Nevertheless, over time, crowdfunding has become an alternative source of funding across many other sectors, and it is increasingly used to support a wide range of for-profit activities and businesses.

The market for hybrid instruments, which combine debt and equity features into a single financing vehicle, has developed unevenly in many countries, but has recently attracted interest of policy makers across the board. These techniques represent an appealing form of finance for firms that are approaching a turning point in their life cycle, when the risks and opportunities of the business are increasing, a capital injection is needed, but they have limited or no access to debt financing or equity, or the owners do not want the dilution of control that would accompany equity finance. This can be the case of young high-growth companies, established firms with emerging growth opportunities, companies undergoing transitions or restructuring, as well as companies seeking to strengthen their capital structures. At the same time, these techniques are not well-suited for many MSMEs, as they require a well-established and stable earning power and market position, and demand a certain level of financial skills.

It is also necessary to improve the quality of start-up business plans and MSME investment projects, especially for the development of the riskier segment of the market. In many countries, a major impediment to the development of equity finance for young and small businesses is the lack of “investor ready” companies. Furthermore, MSMEs are generally ill-equipped to deal with investor due diligence requirements. Indeed, in some countries, an increasing concern about the lack of entrepreneurial skills and capabilities and low quality of investment projects is driving more attention to the demand side, such as training and mentoring.

The regulatory framework is a key enabler for the development of instruments that imply a greater risk for investors than traditional debt finance. However, designing and implementing effective regulation, which balances financial stability, investors’ protection and the opening of new financing channels for MSMEs, represents a challenge for policy makers and regulatory authorities. This is especially the case in light of the rapid evolution in the market, resulting from technological changes as well as the engineering of products that, in a low interest environment, respond to the appetite for high yields by financiers. Recent regulatory initiatives, which aim at making the financial sector safer, are perceived to be unduly onerous by some investors, who are also affected by the enduring uncertainty arising from expected regulatory revisions.

Alternative Financing Instruments

Traditional debt finance generates moderate returns for lenders and is therefore appropriate for low-to-moderate risk profiles. It typically sustains the ordinary activity and short-term needs of MSMEs, generally characterized by stable cash flow, modest growth, tested business models, and access to collateral or guarantees.

At the one end, the risk/return spectrum are financing instruments that sustain the short and medium-to-long term financing needs of MSMEs, but that rely on different mechanisms than traditional debt. This is the case of asset-based finance, such as asset-based lending, factoring and leasing, whereby a firm obtains cash, based not on its own credit standing, but on the value, that a particular asset generates in the course of its business. The close relationship between the liquidation value of an asset and the amount borrowed, as well as the broad range of assets that can be used to access lending, are the key factors that distinguish asset-based lending from traditional secured or collateralized lending, in which the loan amount and conditions also depend on the overall assessment of the firm’s credit worthiness. Furthermore, asset based lending generally provides more flexible terms than conventional secured lending, often allowing for revolving funds; as advances are paid off, the borrower can secure additional funds backed by other assets.

Trade credit is also an important source of finance for many MSMEs and start-ups, which can substitute or supplement short-term bank lending. This mainly consists of the extension of traditional credit instruments and credit-mitigation tools, such as loans and guarantees, to sustain import and export activities. Guarantees can take the form of letters of credit (L/C), which represent a bank obligation to pay, thereby reducing an export's payment risk on an importer/buyer.

Alternative forms of debt also exist, which can be considered "innovative" in the context of MSME financing because they have had until now limited applicability to the MSME sector. These alternative debt instruments include corporate bonds, securitized debt and covered bonds, in which investors in the capital markets, rather than banks, provide the financing for MSMEs. While corporate bonds are direct instruments of debt finance for MSMEs, securitization and covered bonds represent "indirect" tools for supporting MSME debt financing, in that the product issued to the firm is a loan. In particular, securitization of MSME debt allows banks to transfer their credit risk to the capital markets, as MSME loans are sold to a specialized company, which creates a new security backed by the payments of MSMEs. In this way, banks achieve capital relief and free up capacity for new loans to MSMEs. Over the last decade, securitized debt has grown rapidly, although the financial crisis hit this market severely. On the other hand, few MSMEs have succeeded in issuing corporate bonds, because of difficulties that small privately held companies have in meeting investor protection regulations and the high relative cost of bond issuance for small companies.

At the other end of the risk/return spectrum are financing instruments that enable an investor to accept more risk in exchange for a higher return, and are expected to produce a better alignment of the interests of certain kinds of MSMEs and the providers of finance. Hybrid instruments, form a bridge between traditional straight debt and pure equity. Seed and early stage finance addresses the high risk-return segment of the business financing spectrum, boosting firm creation and development, whereas other equity-related instruments, such as private equity and specialized platforms for MSME public listing, can provide financial resources for growth-oriented MSMEs.

The present study also considers the potential for MSME financing of new instruments, such as crowdfunding or peer-to-peer lending. These have grown rapidly in some countries and have attracted increasing attention by policy makers and regulators, also with a view to address concerns about transparency, investors' risk awareness and consumer protection.

Alternative Debts

Alternative forms of debt differ from traditional lending, in that investors in the capital market, rather than banks, provide the financing for MSMEs. These include "direct" tools for raising funds from investors in the capital market, such as corporate bonds, and "indirect" tools, such as securitized debt and covered bonds. With alternative debt, the MSME does not access capital markets directly, but rather receives bank loans, whose extension is supported by activities by the banking institutions in the capital market.

These instruments have existed for some time, but they can be viewed as "innovative" financing mechanisms for MSMEs and entrepreneurs, to the extent that they have had until now been applied in a limited fashion to the MSME sector.

Corporate bonds are debt obligations issued by private and public corporations. By issuing bonds, the company makes a legal commitment to pay interest on the principal, independent of the company's performance, and to return the principal when the bond matures. The terms of the contract can however provide the company with the right to "call", i.e. buy back, the bond before the maturity date. If it calls the bond, the company will pay back the principal and possibly an additional premium, which depends on when the call occurs in relation to the actual maturity date.

The corporate bond market has been traditionally dominated by large firms with long pedigree, stable earnings and relatively low volatility stocks. On the other hand, only a very minor share of MSMEs has approached the market.

Corporate bonds typically require the issuer to have a certain size and scale, an established credit history and earnings record, and limited volatility on revenues and earnings. As most MSMEs do not meet these criteria, in the bond market they would attract low rating and high coupons and have limited dividends to cover these regular payments. Also, bonds are a relatively costly instrument to raise finance. In fact, the costs of bonds may be as high as 10% of issuance. Besides the costs of issuance, another relevant unattractive feature of corporate bonds for MSMEs is the fixed schedule of interest and principal repayments, which requires a relatively stable cash flow pattern. If payments are missed, the company defaults and becomes vulnerable to bankruptcy. Also, the amount of debt enters the firm's balance sheet, which could affect future borrowing costs.

Debt Securitization and Covered Bonds

MSME loan securitization, a bank ("the originator") extends loans to its MSME customers (the "primary market"), bundles them in a pool (the "portfolio") and sells the portfolio to capital market investors through the issuance of notes, by a Special Purpose Vehicle (SPV) backed by the loan portfolio (Asset-Backed Securities, ABS). These asset-backed notes, rated by agencies, are placed with capital market investors, but can also be retained, at least in part, by the originator banks. Securitization allows banks to transform MSME loans in their balance sheets into liquidity assets, which can be used to increase lending itself.

Covered bonds work similarly to securitized debt, as they are debt securities (corporate bonds) backed by the cash flows from mortgages or loans.

Crowdfunding/P2P Lending

Crowdfunding is a technique to raise external finance from a large audience, rather than a small group of specialized investors (e.g. banks, business angels, venture capitalists), where everyone provides a small amount of the funding requested.

The concept of "crowdfunding" is related to the one of "crowdsourcing", which refers to the outsourcing to the "crowd" of specific tasks, such as the development, evaluation or sale of a product, by way of an open call over the internet. Through online platforms, the task, traditionally performed by contractors or employees, can be undertaken by individuals for free or in exchange for some specified return, whose value is however generally lower than the one of the contribution made to the firm. Crowd sourcers may in fact have intrinsic motivations, such as the pleasure of undertaking the task or participating to a community, as well as extrinsic motivations, related to monetary rewards, career benefits, learning or dissatisfaction with the current products.

Over time, crowd-lending has become increasingly mediated by online intermediaries. In the case of lending platforms, typically the lenders purchase notes issued by the sites, which use those funds to lend through Paypal or WebBank to borrowers. Thus, the online platform acts as an intermediary, for instance, collecting loan pledges from the crowd for private projects, releasing them at the moment a target is reached, according to a threshold principle, collecting repayment instalments from the debtor, and forwarding them to each crowd-lender. In some business models, the pledged amounts are transferred to an escrow account, which is managed by the platform or a partner bank. Once the threshold pledge is reached, payments are transferred from the escrow account to the project's account.

The P2P lenders can become a significant source of finance for the small borrowers is evident from the UK example where the P2P lending represents about 14% of the new lending to the MSMEs.Peer-to-peer loans are usually unsecured loans, i.e. no collateral is required on borrowers, although, in some cases companies may offer secured loans. Nevertheless, transaction fees and interest on loans are charged by the online intermediary, which depend on the borrowers' credit risk, as assessed by accessing credit information from third parties or on the basis of information submitted by the borrowers themselves. The online platforms typically develop credit models for loan approvals and pricing, and perform credit checks of borrowers. Indeed, P2P platforms make profits from commissions instead of the spread between deposit and loan. Longer the repayment period of a loan, higher the fees borrower has to pay.

In the case of equity or investment crowdfunding, a firm offers a certain proportion of its equity for a set amount of capital it is aiming to raise. Crowdfunded businesses do not have to adhere to the strict accounting standards required of public companies and, at the same time, unlike other risk capital providers, crowdfunding investors may have no experience in making such investments. As the model taps into the sub–section of the public with an interest in entrepreneurship, in many cases investment will also be motivated by non–financial aims, such as becoming part of an entrepreneurial venture or supporting a particular individual or business.

In recent years, crowdfunding has been the object of important regulatory attention in some countries. The regulatory efforts have aimed to ease the development of this financing channel, while addressing concerns about transparency and protection of investors.

Hybrid Instruments

Hybrid financing instruments lie in the middle of the investors' risk/return spectrum, from "pure" debt to "pure" equity, combining features of both debt and equity into a single financing vehicle. These instruments differ from straight debt finance, in so far as they imply greater sharing of risk and reward between the user of capital and the investor. The latter accepts more risk than a provider of a senior loan and expects a higher return, which implies a higher financing cost for the firm. However, the risk and the expected return are lower than in the case of equity, which thus implies the cost of financing for the enterprise is lower. In the event of insolvency, where the firm is unable to meet all its contractual obligations, investors in hybrid instruments have lower rankings than other creditors, but higher ranking than investors in "pure" equity capital. Some of the most commonly used hybrid instruments include: i) subordinated debt (loans or bonds); ii) participating loans, with profit or earning participation mechanisms; iii) silent participation; iv) convertible debt and warrants, whereby investors can convert debt into stock, thus receiving a reward that reflects the increased value of the company enabled by the capital provision, and; v) mezzanine finance, which combines two or more of these instruments within a facility.

Micro Units Development & Refinance Agency (MUDRA)

MUDRA has been set up on Aril 8, 2015 as a wholly owned subsidiary of SIDBI for funding the unfunded micro enterprises. MUDRA refinances banks, micro finance institutions, and other lending institutions which are in the business of lending to micro/small business entities. Thus, MUDRA strengthens the micro and small businesses across the country.

In FY2016-17, 3,97,01,047 loans have been sanctioned under Pradhan Mantri Mudra Yojana (PMMY) amounting to INR 1,80,528.84 Crores of which INR 1,75,312.13 Crores has been disbursed.

Funding Entrepreneurial Ventures

Financial assistance is available from institutions such as Nationalized Banks, Small Industries Development Bank of India, Regional Rural Banks, National Small Industries Corporation, State Financial Corporations, etc. depending upon the project requirement and promoters background. Financial assistance has two components. Loan for fixed capital is used to acquire Plant and Machinery, land and building. Working capital loan is used to meet day to day operational cost of the production. State Financial Corporation and National Small Industries Corporation generally provide working capital. However, under a package assistance, State Financial Corporations also provide a composite loan covering plant and machinery and working capital. Financial institution which is in close proximity to the project site is a better option.

Some portion of total investment has to be contributed by the Entrepreneur out of own sources. This is called margin money. Financial Institutions insist on 10 to 25% margin money depending upon the category of the entrepreneur, risk factor and existing scheme under which the project will be financed.

The general conditions for getting financial assistance are:

RBI has evolved measures for ensuring liquidity within MSME sector, that bit eased the liquidity issue however the challenges prevailed. The growth of the MSME sector hinges on availability of funds. Therefore, it is essential that the intended measures should have a lasting impact in both deepening and broad basing credit availability to the sector.

SIDBI is committed to play the role of a catalyst by augmenting the resources of banks and NBFCs through refinance and resource support for the growth of the sector. SIDBI has been working on addressing identified gaps in the MSME eco system and develop niche products, processes and delivery channels to address various gaps, such as, financing both in debt and equity funding through structured and innovative products.

In addition, the following steps are being taken.

a) To boost collateral free lending, the current guarantee cover under Credit Guarantee Scheme for Micro and Small enterprises on loans will be extended from INR 1 crore to INR 2 Crores.

b) The lock in period for loans covered under the existing credit guarantee scheme will be reduced from 24 to 18 months, to encourage banks to cover more loans under the guarantee scheme.

c) Government will issue an advisory to Central Public Sector Enterprises and request State Public Sector Enterprises to ensure prompt payment of bills of MSMEs. Easing of credit conditions generally should help PSUs to make such payments on schedule.

These measures by RBI improved the credit flow to medium enterprises.

Credit Rating of MSMEs

Credit rating agencies help MSMEs seek better and faster access to finance. These reveal new dimensions of information about MSMEs, whether they have credit history and collateral. New dimensions of information mean a more complete and accurate understanding of credit risk. It enables lenders to reduce credit risk, safely increase portfolio size, and decrease costs and time to lend.

Now, MSMEs need the right approach to deal with the rating agencies which in turn gets them the right ratings. Some of these strategies may seem like common sense; however, they represent solutions to the most common reasons why the typical MSME develops a less than perfect credit rating. These include late payments which is the most common negative information that appears on credit reports, credit card balances, avoidance of closure of unused accounts, application for credit only when needed, careful review of all credit reports and correction of any erroneous or outdated information that's listed, avoidance of too many hard enquiries, avoidance of bankruptcy, avoiding consolidation of balances onto one credit card, negotiation with the creditors or collection agencies.

SMERA Ratings Ltd.

SIDBI, along with Dun & Bradstreet (D&B) and several public and private sector banks, set up the SMERA Ratings Ltd. in September 2005, as an MSME dedicated third party rating agency to provide comprehensive, transparent ratings to MSMEs. Cumulatively, since its incorporation, SMERA has assigned ratings to 43,587 MSME units till now and has been providing special attention to micro and small enterprises.

Performance and Credit Rating (PCR) Scheme

Government has started a scheme for providing financial assistance for performance and credit rating under PCR scheme. The objective of the Scheme was to create awareness amongst micro & small enterprises about the strengths and weaknesses of their operations and their credit worthiness. The Scheme has been implemented by National Small Industries Corporation (NSIC). The rating under the scheme has being carried out through empaneled rating agencies i.e. CRISIL, ONICRA, ICRA, SMERA, Brickwork, India Ratings (earlier known as FITCH) and CARE. The enterprises are at liberty to select any of the rating agencies empaneled with NSIC. Rating fee payable by the micro & small enterprises is subsidized for the first year only.Any enterprise registered in India as a micro or small enterprise is eligible to apply.

Besides third party rating, such rating helps in getting credit at attractive interest, recognition in global trade, prompt sanctions of credit from banks and financial institutions, subsidized rating fee structure for MSMEs, facilitate vendors/buyers in capability and capacity assessment of MSMEs and enable MSMEs to ascertain the strengths and weaknesses of their existing operations and take corrective measures.

On the other hand, the banks and financial institutions also stand to gain. One of the major benefits to banks and financial institutions is the availability of an independent evaluation of the strength and weaknesses of MSME seeking credit and thereby enabling banks and financial institutions manage their credit risk.

Characteristics of PCR Scheme

- A combination of credit and performance factors including operations, finance, business and management risk
- Uniform Rating Scale for all empanelled rating agencies.
- Micro and Small Enterprises have the liberty to choose among the empanelled Rating Agencies.
- Turn-Over based Fee structure
- Partial Reimbursement of Rating Fee through NSIC

Also, scheme for providing financial assistance on marketing support under Marketing Assistance Scheme has been started for MSME sector. The assistance is provided for organizing exhibitions abroad and participation in international exhibitions/trade fairs, co-sponsoring of exhibitions organized by other organizations/industry associations/agencies and organizing buyer-seller meets, intensive campaigns and marketing promotion events.

MSME sector has remained a long-neglected area in the country although it contributes most to the economy of the country mainly because of the unawareness, regulatory framework and lack of skilled manpower. Creating a world class eco-system to encourage initiatives in MSME sector remains a big challenge. However, the scenario is expected to bring about a positive change in the coming future with plethora of initiatives taken by the Government in areas such as financing, infrastructure, literacy, ease of doing business, etc. The success of these initiatives depends entirely upon their penetration in the society and the degree of receptivity.

Credit Guarantee fund Trust for Micro and Small Enterprises (CGTMSE)

CGTMSE, established jointly by SIDBI and the government of India, extends credit facilities to the micro and small enterprises sector. The scheme facilitates lending institutions by the evaluation of the credit proposals on the basis of intrinsic merits of the projects, rather than merely on adequacy of collaterals.

The cumulative guarantees approved by the trust till May 31, 2016 stood at 24.3 lakh for an amount of INR 1.13 Lakh crore.

Recently, the Government of India has announced the enhancement of Credit guarantee schemes for MSMEs for loans up to INR 2 Crores which initially was INR 1 Crore. This move further enhance access to funds for small businesses to fulfill growth potential.

The guarantee cover available under the scheme is to the extent of maximum 85% of the sanctioned amount of the credit facility. It is up to 75% of the credit facility up to INR 50 lakh (85% for loans up to INR 5 lakhs provided to micro enterprises, 80% for MSEs owned/ operated by women and all loans to NER including Sikkim) with a uniform guarantee at 50% for the entire amount if the credit exposure is above INR 50 lakh. In case of default, Trust settles the claim up to 75% (or 85% / 80% / 50% wherever applicable) of the amount in default of the credit facility extended by the lending institution. For this purpose, the amount in default is reckoned as the principal amount outstanding in the account of the borrower, in respect of term loan, and amount of outstanding working capital facilities, including interest, as on the date of the account turning NPA.

India SME Technology Services Limited

India SME Asset Reconstruction Company Ltd. (ISARC) commenced its operations in 2009, with primary objective of acquiring NPAs and to resolve them through an innovative mechanism with a special focus on MSME. As of March 31, 2016, ISARC has assets under management of INR 381 Crores representing outstanding security receipts and balance sheet assets.

Strategic Business Initiatives and Overall Operations

The business strategy of SIDBI has been reoriented towards filling up the financial and non- financial gaps in the MSME eco-system.

SIDBI extends refinance to Banks and Non-Banking Financial Companies (NBFCs) and also extend capacity building support to smaller commercial banks, Regional Rural banks (RRBs), Urban Co-operative banks (UCBs) andDistrictCooperative Banks (DCBs). Direct finance to MSMEs is being targeted at niche areas to address various financial gaps. This is done through specially designed products like risk capital, sustainable finance, factoring, invoice discounting, services sector financing, etc.

The equity/risk capital assistance supports growth requirements of MSMEs. It includes leveraging of senior loans, funding intangible requirements like expenditure for Research & Development, marketing / brand building, technical know-how, energy efficiency, quality control, working capital margin, etc. SIDBI provides assistance to start-ups and early stage ventures. During Financial Year 2011-12, Direct Risk Capital Scheme (DRCS) has been rechristened as Growth Capital & Equity Assistance Scheme for MSMEs (GEMs), with some modifications and additional features. This will help in assisting greater number of MSMEs.

SIDBI has executed a Memorandum of Understanding (MoU) with Technology Information, Forecasting and Assessment Council (TIFAC) for implementing the Technology Innovation Programme (Srijan Scheme). The main objective of the scheme is to support MSMEs towards development, up-scaling, demonstration and commercialization of innovative technology based projects.

SIDBI has also put in place a scheme to provide risk capital assistance to MSMEs. This has been done by way of line of credit / resource support. It also operates focused lending schemes with Line of Credit (LoC) support from various multilateral/bilateral international agencies. The main objective of these focused lending schemes is enhancing energy efficiency, reducing CO emissions and improving the profitability of the Indian MSMEs in the long run.

In addition to providing credit directly and indirectly, SIDBI has put in place a system for loan facilitation/syndication services to MSMEs. This will help them avail credit from banks/FIs. In order to further enable MSMEs to access credit from banks, SIDBI has taken the initiative to set up Credit Advisory centres (CACs) with industry associations in select MSME clusters. Already 41 such centres covering 150 clusters have been set up by SIDBI.

MSMEs lack the information on how to start a business, Govt. schemes, sources of various finances, marketing, technology, etc. In order to address the information gap, SIDBI has launched a website named as www.smallB.in which acts as virtual mentor and handholding tool for entrepreneurs to set up new units and grow the existing ones. Further, SIDBI, along with GIZ, Germany, has initiated financialliteracy campaign among MSMEs in different cluster.

Trade Finance

Trade finance in India

Indian sub-continent has always been center, where trade and exports have flourished and evolved overtime. The pace of evolution has been picked up significantly in the last few decades; with the global disruption being an equal contributor. Post-1991 liberalization era, country's development took a substantial turn in terms of political, economic and social stability.

One of the major contributing factors responsible for promotion of export trade is the availability of "Special Finance" both at pre and post-shipment stages. Various initial components of imports include raw material, machinery, etc. The raw material may be either indigenous or imported. For this, the importer has to often allow credit terms to an overseas buyer. Delivery period in international trade transactions is normally longer compared to the domestic counterpart and correspondingly. The lead time for getting payment from the overseas buyer is more. The exporter, therefore has extra turnaround time and has to be extra cautious to ensure that the overseas buyer is reliable one and payment for the goods/services sold/rendered will be realized expeditiously.

Therefore, the issues involved in export finance primarily involve

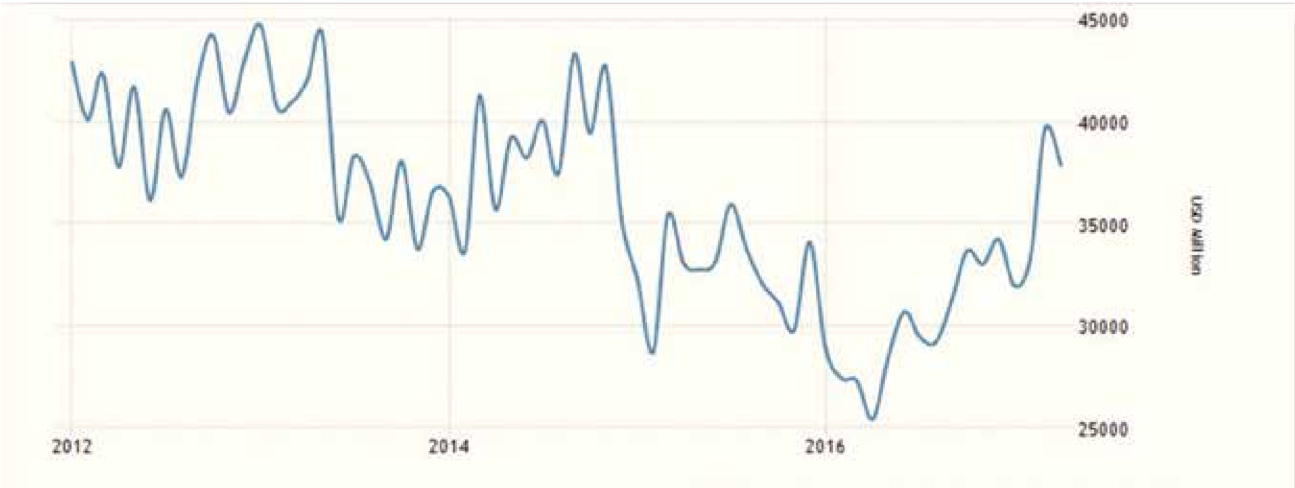
i) availability of adequate and timely finance,

ii) provision of concessional credit on order to make the export internationally competitive,

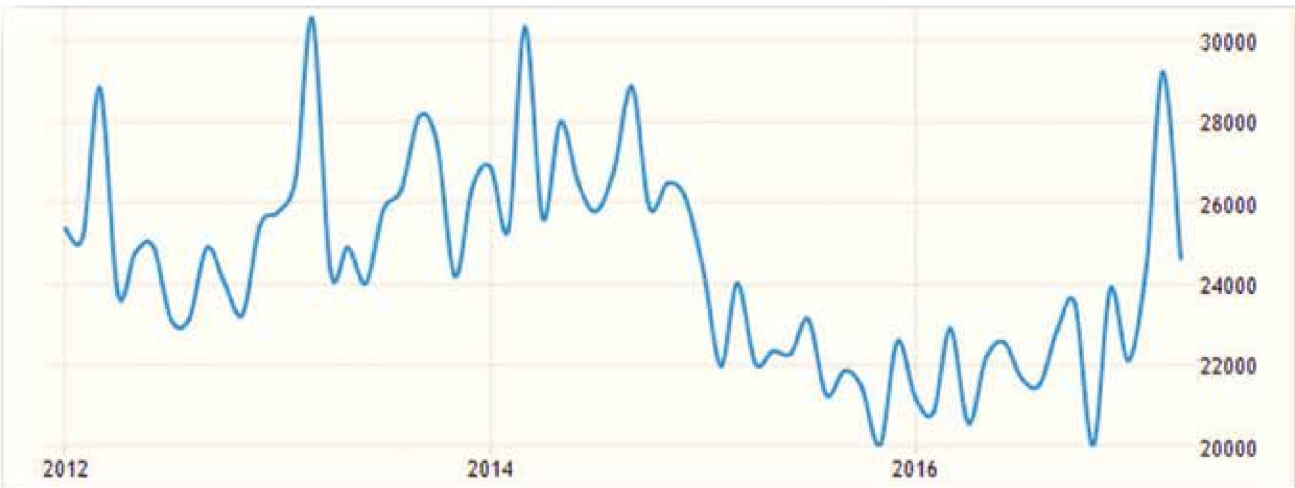
iii) institutional support to protect the losses on account of default risks of the overseas buyers, and

iv) availability of special deferred credit for promotion of project exports including turnkey assignments.

Given below are trade figures for India and global export figures:



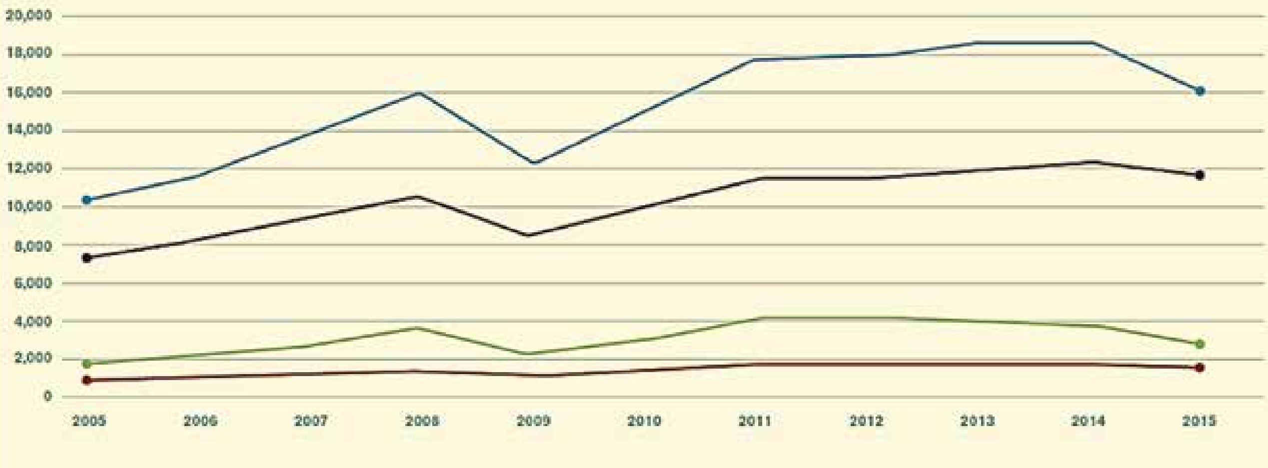
India's import figures from 2012-2016 (USD Bn) Source:



India's export figures from 2012-2016 (USD Bn)

Chart 4.1:

World merchandise exports, 2005-2015

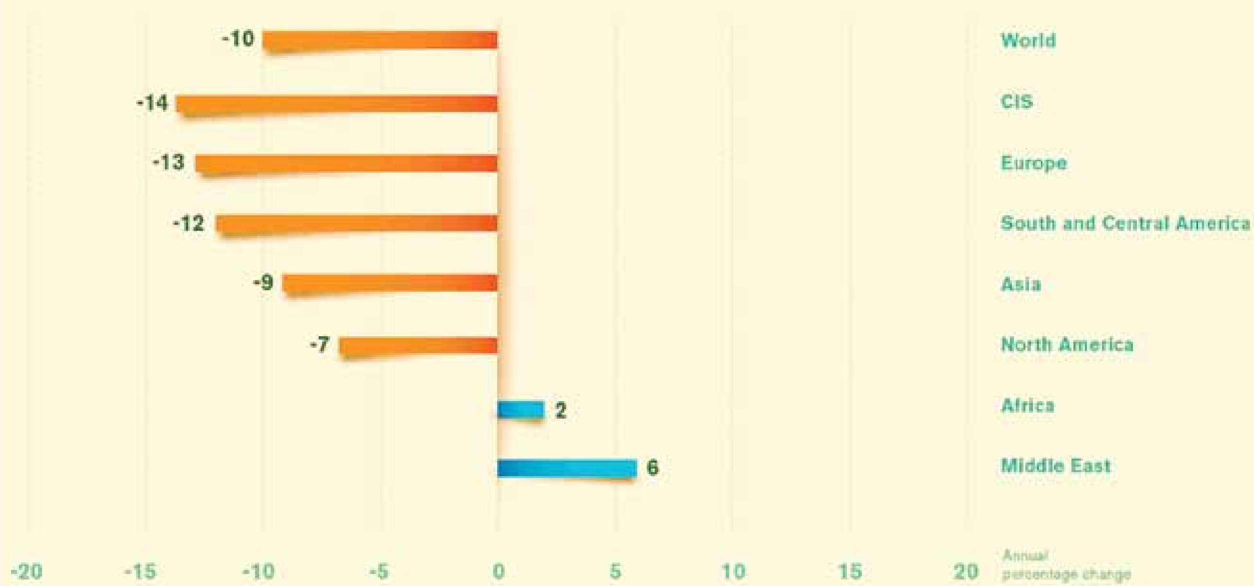


Source: WTO Secretariat.

Chart 4.11:

World transport exports by region, 2015

(annual percentage change)



Source: WTO-UNCTAD-ITC estimates.

Trade finance Infrastructure in India:

Export refinance mechanism in India, comprises of RBI as the regulator. The regulations in India stand stringent as they take care of the augmentation of their resources besides contributing to their profitability. The institutional framework also comprises of Export Credit Guarantee Corporation of India (ECGC) Limited which, through its various policies and guarantees issued to the exporters and banks, endeavours to mimimse the risks involved in international trade financing. Trends in Export Credit by Commercial Banks Since export credit grows with growth in exports. Despite on overreaching network of regulations, financing the exports or imports do not remain as smooth as they should be. Customers normally face hurdles such as rigidity of banks' credit mechanism along with delays in decision making process. Suggestions come forth towards relaxation of norms for financing along with need for introduction of innovative services. Similarly, bankers opine in favor of closer coordination with term lending institutions and better response from ECGC towards settlement of claims. Factors affecting exports at macro-level include exchange rate of rupee, availability of incentives and others. However, the amount of exports can be considered as the single most important factor determining export credit, the relationship between the exports and export credit by commercial banks during the last ten years is given in

Export finance in India:

Export finance can broadly be classified under following heads:

Pre-shipment Finance: This type of finance includes:

i) Packing credit, and

ii) Advance against receivables from the Government like duty back, international price reimbursement scheme (IPRS) etc.

Post-shipment Finance: This type of finance consists of

i) Negotiation of export documents under letters of credit,

ii) Purchase/discount of export documents,

iii) Advance against bills sent on collection basis,

iv) Advance against exports on consignment basis,

v) Advance against indrawn balances, and

vi) Advance against receivables form the Government like duty draw back etc. Besides, the short-term trade financing above, banks on participation with Exim Bank, the apex coordinating agency for export financing in the country, extend project financing (through working group or otherwise) for export projects. Banks are also involved in issuance of letters of guarantee (bid bonds, performance guarantees, advance payment guarantees etc.) on behalf their constituents.

Supporting the dialogue between SMEs, Banks and Export institutions:

Strategy to be adopted

Development of trade ties between different countries of the world creates a manifold interest. It increases the forex reserves of the country and on the other hand leads to development of the SME sector, by way of encouraging exports and imports. There are several key factors which act in strengthening the trade environment for the MSMEs. This section focuses on outlook towards development of Exports-oriented MSMEs, encouraging the development by way increasing institutional funding and creating perspectives to be pondered upon by the banks on understanding needs of MSMEs.

Strategic placement of institutions

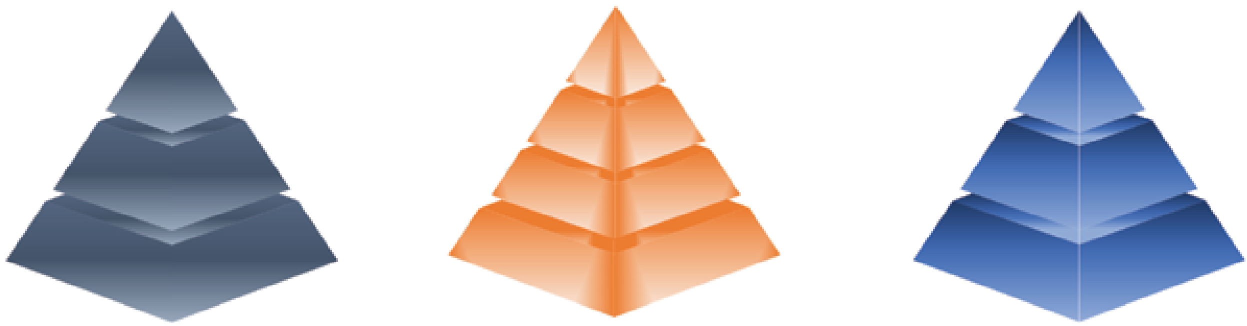
Source: https://www.slideshare.net/CH_APAC_Marketing/trade-finance-in-asia-embracing-the-future

Strengthening trade finance for SMEs:

Despite sea-change in India's export-infrastructure post-1991 reforms, the manufacturing-related export sector still remains behind in terms of policy-related reforms encouraging small manufacturers. In comparison to other Asian economies, India remains behind in terms of developing an eco-system which would encourage manufacturing. Current government, has however, created a political eco-system which has increased the inflows of funds via foreign investments to an all-time high.

This section describes in detail factors which could act as pillars to strengthening the current Export-orientation environment for MSMEs.

The factors are listed as below:



Strengthening the financial and overall management capacities of SME managers:

Encouraging SME lending by financial institutions through facilitating their understanding of SME needs and risks:

Fostering dialogue between Banks, TSIs and exporting SMEs

a. Strengthening the financial and overall management capacities of SME managers:

Building the capacities of SME managers is achieved through two channels: on the one hand through a structured training, advisory and coaching system provided by a network of experts and TSIs, and on the other hand through a set of self-tutorials, online tools and publications that enable SME managers to develop their skills on their own. In both cases, coaching and support aims at accompanying the SME managers prior, during and after the loan, to ensure they not only access finance but also meet their loan obligations, thereby becoming creditworthy borrowers. By reaching a critical mass of SMEs, the government should focus on business creation, export development, job generation, and thereby growth and poverty alleviation.

b. Encouraging SME lending by financial institutions through facilitating their understanding of SME needs and risks:

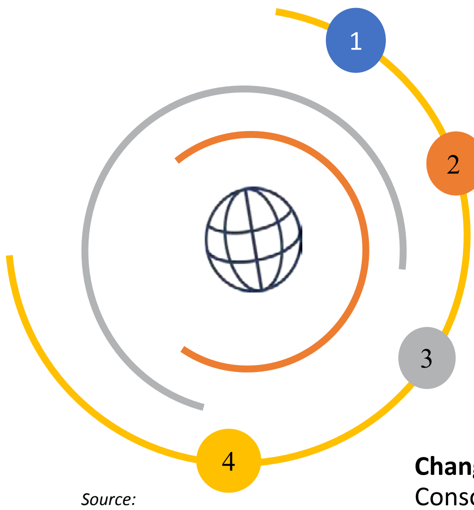
First of all, the program aims at facilitating the financial institutions' understanding of SME needs and risks. For this purpose, ITC, in close partnership with Exim Bank of India, developed an innovative risk assessment / risk management software (LoanCom). Besides looking into traditional financial parameters such as financial ratios, credit history and collateral, this software thoroughly assesses the SME's non-financial performance and potential. More precisely, the software looks into the SME's capacity to define sound and sustainable strategies, reach its business objectives through an efficient management of its production, marketing, distribution and transaction functions, and its ability to manage its resources efficiently. It quantifies the SME's performance along these categories, displays a visual representation of the SME's strengths and weaknesses (green, yellow or red light is provided for the banker's final decision), and provides recommendations to the financial institution on how to proceed.

c. Fostering dialogue between Banks, TSIs and exporting SMEs

The interventions cited above would have limited impact if conducted in isolation. This is why the Trade Finance for SMEs program is designed to interlink these components, so that partner TSIs, partner banks and SMEs selected naturally work side by side. In summary, a regional development bank provides a line of credit as part of a technical assistance package to a local commercial bank, namely the partner bank selected by ITC. ITC conducts some of the technical assistance, specifically the development and adaptation of its risk assessment / risk management software, and the capacity building of local TSIs to support exporting SMEs before, during and after the loan. By screening loan requests using ITC software and providingsuccessful candidates with coaching from local institutions, the chances of success of loan beneficiaries is considerably enhanced.

Challenges faced by trade finance sector

Untapped Segment
Supplychainfinancing has been focusing on the buyer'sside (withsoundcredit ratings) while the supplier sideremainsundeveloped



Relentlessregulatory pressure
Strengthening the regualtionsaround KYC, International Sanctions and AML have deeplyimpactedtraditionalbanks' business processeslengthening the on-boarding process and increasing the workload on Operations

Obsoleteprocesses
Trade finance still relies on heavyprocessesinvolving the exchange of paper documents between multiple parties, threatening the customerexperience and increasing the banks' overallcosts

Changingcompetition
Consolidation happening in the industry at global scale (ANZ withdrawingfrom Asia)
Niche firms have sprung up considerably, withparticular focus on enhancingtechnology for facilitatingcustomers
Backwardintegration by firms like Alibaba, which have trade-centricactivities and nowthemselves finance tradeactivities

Source: https://www.slideshare.net/CH_APAC_Marketing/trade-finance-in-asia-embracing-the-future

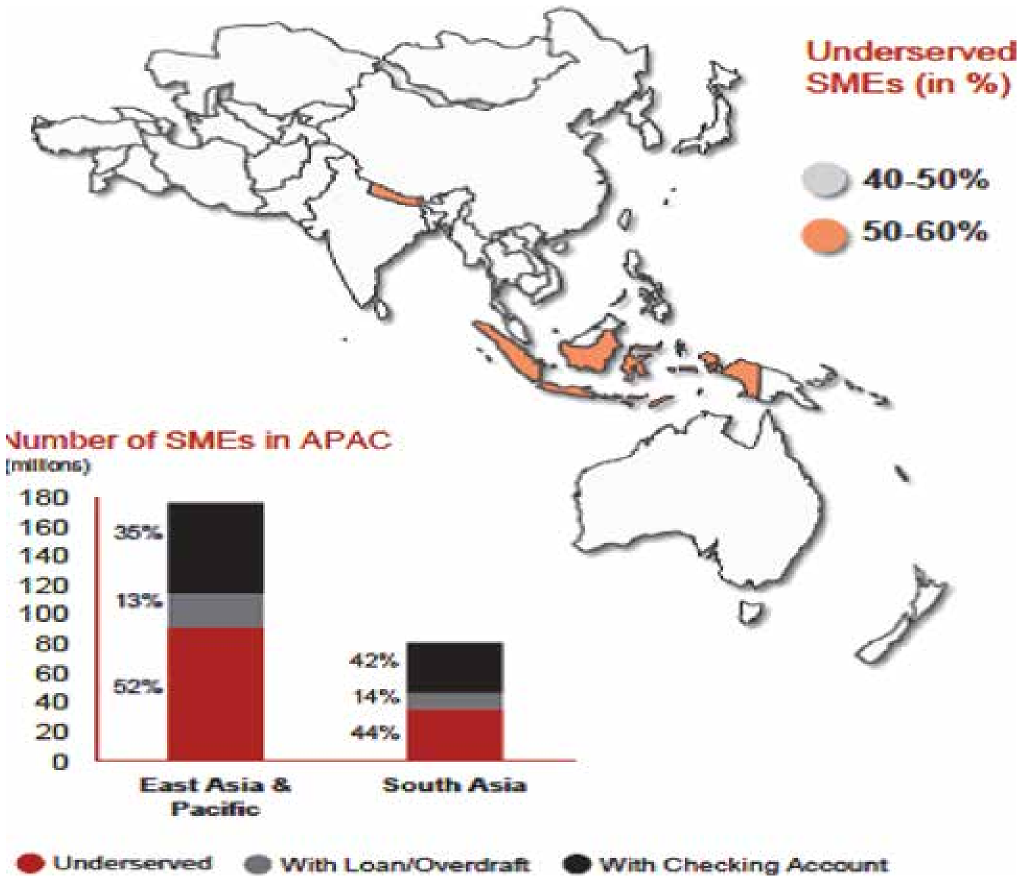
Developments in trade finance:

This section talks about developments in trade finance, and proposed developments to address the needs of the under served section in Asia specifically.

The section initially lays the backdrop of the amount of gap to be addressed in terms of under served section, then identifies alternative arrangement models for supply chain finance and digitization of trade finance.

Current composition of SMEs in Asia:

Number of under served SMEs in Asia: Asia countries currently are hot-bed of export oriented economies. Financing export-oriented units in these areas, however has not been accomplished completely. Newer businesses require more amount of due-diligence which in turn lengthens their turn-around time. The amount of under served regions in the APAC countries in co-relation to their number is given below:



Source: https://www.slideshare.net/CH_APAC_Marketing/trade-finance-in-asia-embracing-the-future

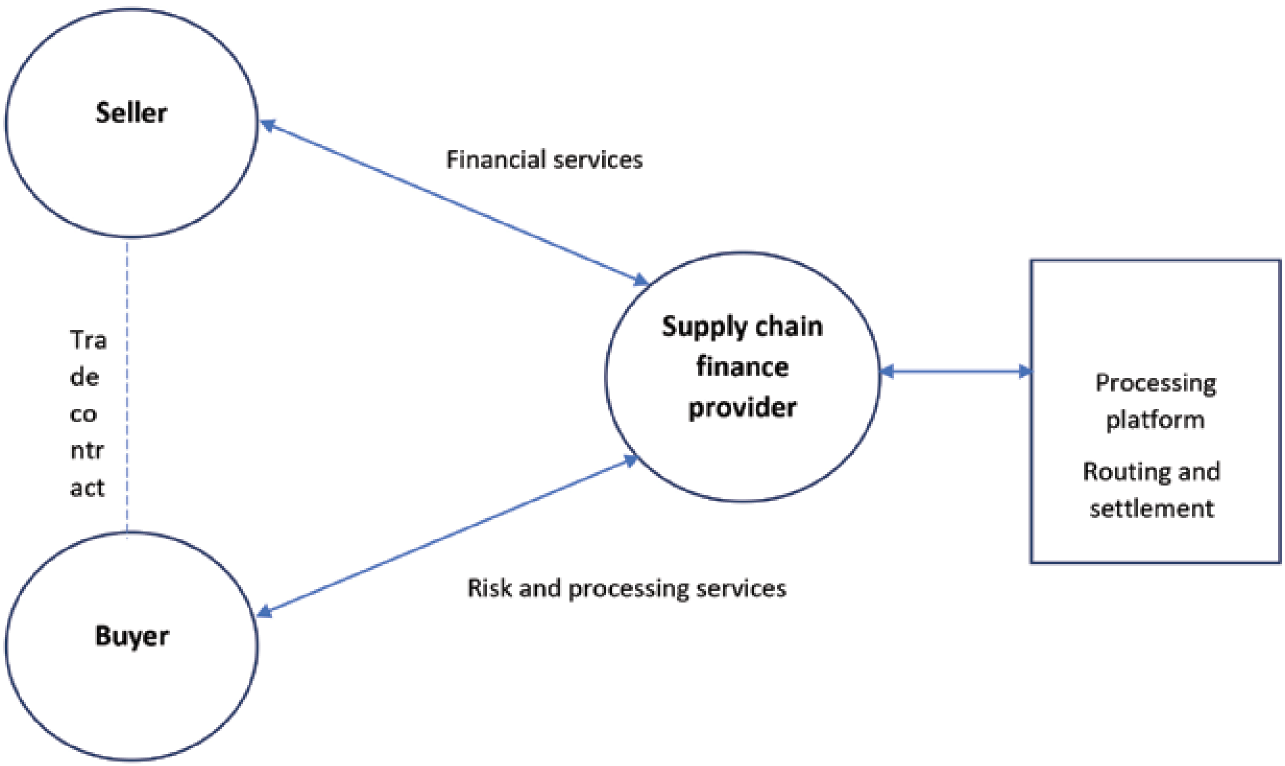
Poor credit accreditation, uneven flow of revenues, and several other factors act as key reasons for making above given areas as being unserviceable. In several cases, duration of time required, accessibility, are also one of the few reasons for being unserviceable.

On a broader perspective, this problem can be tackled by co-operation by both borrower and lender. The banks need not necessarily augment their credit assessment model, but can attempt altercating the model for financial disbursal. The section below talks about current model for credit disbursal and what it can be converted into.

Revising the Supply-chain finance model:

In order to provide finance to the under serviced areas, banks can control the entire end-to-end supply chain finance module for such entities. Current model encompasses a three-way closed model as given below:

3-corner model:

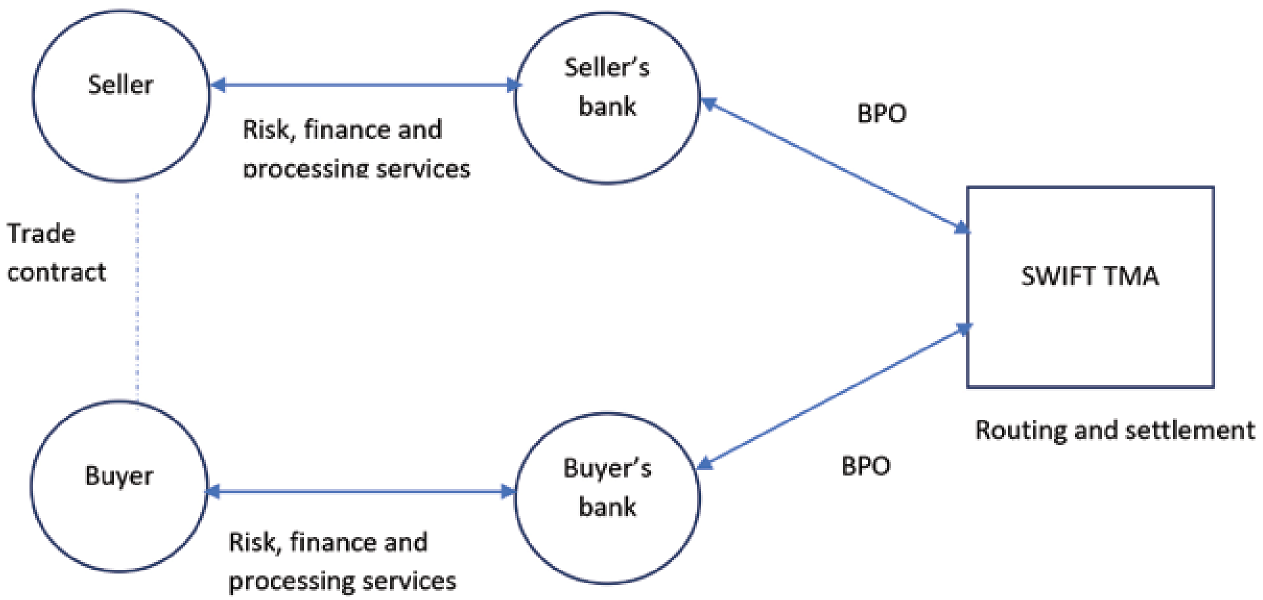


Source: https://www.slideshare.net/CH_APAC_Marketing/trade-finance-in-asia-embracing-the-future

Business relationships in the above cases are mostly between SCF service providers and large corporate buyers with high credit ratings. The above model demonstrates a buyer-led solution, where SCF providers finance their buyers' accounts to provide early payments for their clients' suppliers. The approach is buyer-centric with frequent occurrences of suppliers' on-boarding issues.

4-corner model:

The above model can be converted into a 4-corner interoperable model. Here, the assessment of the risk is done by the banks of the buyer and seller themselves. The model is given below:



**BPO-Bank payment obligation, Source: https://www.slideshare.net/CH_APAC_Marketing/trade-finance-in-asia-embracing-the-future*

In 4-corner model, the business relationships are usually between banks (Partnerships) and all types of business profiles, including SME suppliers. This kind of model is supplier-led solution i.e. the banks provide early payment to suppliers by purchasing their accounts receivables (receivables finance). The on-boarding process of the buyers and sellers are conducted separately by their banks separately. This model supposes the existence of open, interoperable standards.

Digitization

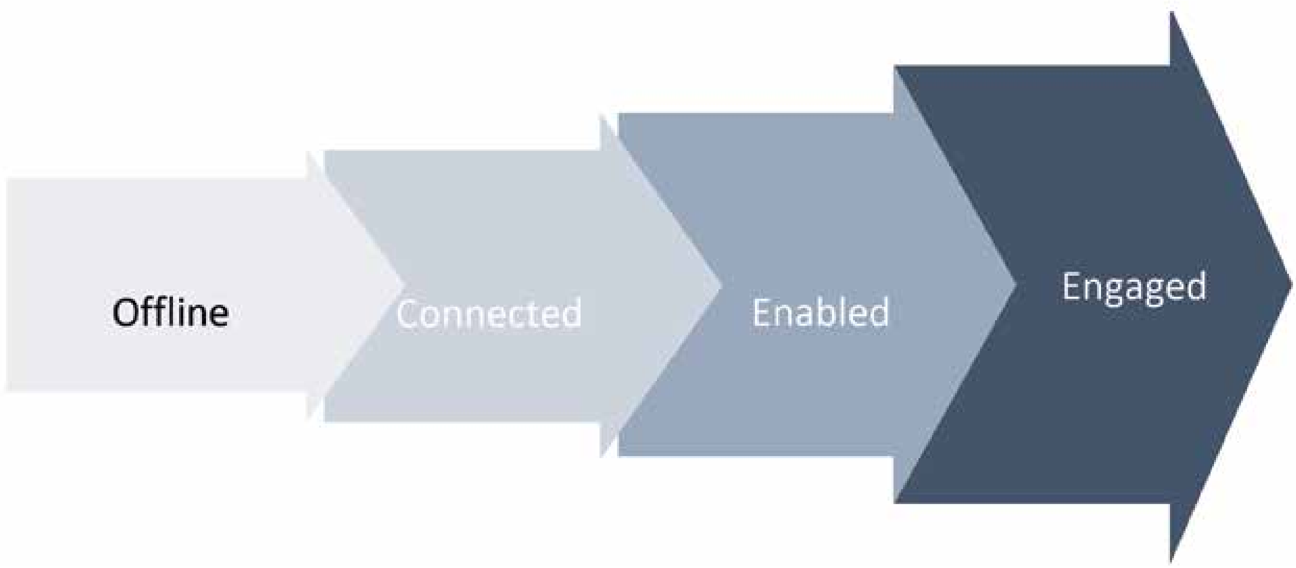
Industrial revolution saw United States becoming the largest growing economy in the world. The growth was attributed to emergence of new set-up of industries, the small and medium enterprises. Post-2008 crisis, India and China, owing to their immense potential for consumption are the fastest growing economies in the world. India's development can be segregated into a three-way effort, i.e. political, infrastructural and social. Easing up of political pressures has lifted the vent to release the pressure on infrastructural requirements that has eased social obligation and reinforced the society with entrepreneurial spirits. This has led to influx of several small and medium businesses in the country, whose specific focus lies on manufacturing.

India's alignment as a service-oriented economy has been tweaked to a great extent, and has inclined towards building up a balanced economy, by encouraging manufacturing and easing up the regulatory hurdles in the architecture of SME-environment in India.

Modernization in this sector, is hence, unavoidable. The modernization has been envisaged by the industry experts in terms of various terms including but not limited to manufacturing, operations, marketing, management, etc. This section talks about the amount of digitization in various forms that has rooted in and further scope of development. The section specifically focuses on digitization of trade finance processes, owing to the anonymity the sector brings in.

Exposure to digitization:

The extent of exposure to digitization to SMEs has been calibrated into 4 categories given below:



Source: https://assets.kpmg.com/content/dam/kpmg/in/pdf/2017/01/Impact-of-internet-and-digitisation.pdf

The above arrows are an indication of various levels at which technology could be penetrated in to SMEs. Offline SMEs use mostly just elementary forms of technology for their functioning, such as office tools and accounting and billing software. Connected and enabled tier further engage in backend operations software such as ERP. The exposure in their case, however, remains operational only. SMEs in the engaged tier, possess highest amount of digital engagement in various aspects of businesses. They intend to bring in maximum amount of synchronicity in their day-to-day as well as planning operations. The marketing front as well is properly engaged by the CRM and database management tools. There are various tools available in market which engage with these businesses in various forms and cater to them as per their requirements of size and capacity. The augmentation can be brought about in terms of utilizing these services.

Benefits derived out of digitization:

With the increase in exposure and spread of awareness, the anonymity of the SME-owners towards digitization has reduced considerably. They have started realizing the potential of digitization in various areas, and have started exploring it too. Following sections highlights the various benefits of digitization:

Greater scope for mechanization:

Increasing the mechanization of either a manufacturing plant or a service industry, leads to increase in its scale of economies, automatically. Mechanization can be either envisaged or imported. The increase in capacity, leads to coping up with pressures of pricing and profit-sharing.

Process upgradation:

Digitization can be used to upgrade the processing facilities, employee resource management and also improve the customer interface. For such entities, it can also lead to improved marketing of products. Digitization can also benefit various parts of manufacturing such as reduction in lead time of the manufacturing units. Such kind of processes can effectively reduce the turnaround time.

Greater access to information:

Active entrepreneurs can improve their access to the markets by way of accessing the current and target customer base and improve their marketing strategies. Further improvement can be brought about by entrepreneurs exposing themselves to successful case-studies of start-ups and considerably improve their manufacturing, operations, supply chain, employee management, marketing, product management, etc. Thus, digitization is a step-forward for entrepreneurs looking to improvise their businesses and staying at the upper-end of the curve.

Digitization of trade finance in India: Scope and prospective

International trade has tripled as a share of global GDP since 1945 and banks have been the backbone for such a development. The annual global revenues from trade finance now approximately stand at $50 billion. International trade practices have undergone sea change over the years including change in reciprocity processes, documentation and methods of payments. Documentary trade, traditionally facilitated by letters of credit (LCs) issued by banks, is steadily being replaced by open-account trade. Increased legal certainty, the ease of international communication and new abundance of technology and information on counterparties indicate the amount of confidence and faith in reciprocity entrusted by importers and exporters. On the other hand, regulations are proving costly to manage the trades.

Scope of development in digitization:

The development of digitization can be reinforced on all fronts of the process. Envisaging a wholesome development would require easy and hassle-free processing could be one of the stepping stones.

Digitization of distinct aspects of trade finance:

Digitalization of front-end:

As seen above, there are two aspects of trade finance which tend to co-exist right now. First one indicates towards the amount of under served sections in Asia, who do not have access to trade or supply chain finance due to incomplete backgrounds for assessment of credit ratings. Another perspective points out towards the abundance of information on borrowers, the customer-centric of such information, which has considerably reduced the processing time for such applicants. Thus, this indicates towards increase in risk-related provisions for such institutions which fund the former set of customers. For the second set of customers, various factors that could add in to the customer experience would be: process transparency, risk reduction, availability of credit, and rapid low-cost facilitation of transactions

Banks can enhance the customer interaction procedures and achieve the competitive edge by focusing on this segment of banking.

Efficiency in operations:

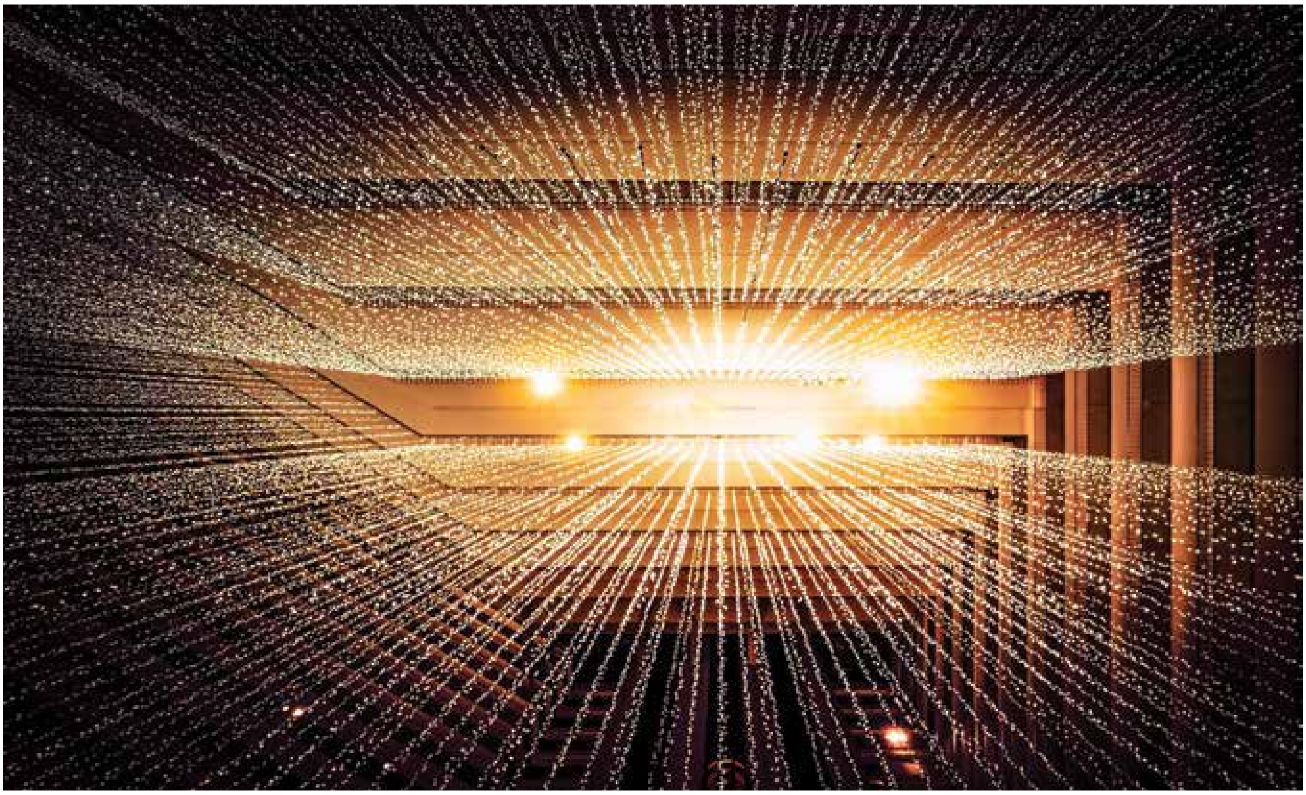
The legal and financial processes involved in trade are still predominantly paper based. This makes the process cumbersome and time-consuming. Digital-inflection to such processes can reduce considerable amount of time and paperwork. This can also increase the agility in the processes.

Potential for blockchain:

Banks and financial institutions have been slow to adopt to blockchain technology. It could, however, improve the customer identification and data management process to a whole new level. Distributed ledgers on blockchain can validate ownership, certify transactions and make payments, reducing duplicate and fraudulent documentation.

Blockchain is an opportunity not only for banks but also for fintech start-ups. There are small institutions, which focus on trade finance and provides services like enabling exchange of bills of lading across a decentralized ledger in order to decrease the cost and risk. These institutions also focus on digitizing both LCs and supply chain.

Blockchain has the potential not only to reduce cost through automation, but also to increase speed and security.



Electronic commerce (E-commerce)

Introduction

Electronic commerce (E-commerce) means sale or purchase of goods or services conducted over network of computers or mobile phones by methods specially designed for this purpose. Almost all the items that we need in today's life are now available on electronic market.

E-commerce sector in India has witnessed tremendous growth. Channelized by the robust investment in the sector, the e-Commerce industry is expected to form the largest part of the Indian Internet market with a value of approximately USD 100 Billion by 2020. In Asia, China and India have emerged as the fastest growing E-commerce market. In addition to transforming and revolutionising the retail sector in India, it is also facilitating MSMEs to jump the evolution loop by providing means of financing, technology and training. Advent of technology enabled innovations such as Digital Payments, Hyper-local Logistics, Analytics driven Customer Engagement and Digital Advertisements have enabled the e-Commerce industry to grow at a much faster rate.

The recent rise in digital literacy has led to an influx of investment in e-commerce firms, levelling the market for new players to set up their base, while churn out innovative patterns to disrupt old functioning.

In the era of technology, e-commerce, a virtual marketplace, is acting as a catalyst in expanding business activities and customer base. The integration of technology has drastically changed the functioning of businesses and their relationship with customers and those who act as mediators between the companies and customers. The evolution of e-commerce is coupled with changing lifestyle of people who now-a-days are more inclined to technology that lead to reduction in cost and travelling time. Also, the availability of goods from any end of the world, acts as an icing to the already nuanced cakes. Availability of broadband services, increasing internet penetration and growing purchasing power are supporting the growth of online retailing in India.

Opportunities for MSMEs

E-commerce has made life much easier not only for customers but also for MSMEs and other businesses. The future is full of exciting prospects for them, and a lot of opportunities are up for grabs by the virtue of an e-commerce boom in India. It has been estimated that MSMEs can boost their revenues using e-commerce platforms with increased speed to market and global outreach. MSMEs can overcome the difficulties they face in expanding their customer base.

SMEs can leverage for their growth." According to the report, a survey of 951 small and medium enterprises in various industrial and geographical clusters across India shows that of those who do use the Internet, 64% have seen an increase in sales and 69% an increase in customers.

> A study carried out by FICCI-Nathan in 2013 on internet's role in the performance of India's MSMEs states that the internet has turned out to be one of the most promising tools which MSMEs can leverage for their growth. According to the report, 64% of 951 surveyed MSMEs have seen an increase in sales and 69%have seen an increase in customers due to internet.

Cost reduction

MSMEs are required to spend their capital in marketing and distribution to attract customers. E-commerce platforms support MSMEs by drastically cutting down their traditional offline marketing and advertisements costs thereby optimizing their spending.

Additionally, MSMEs can take benefits of a third-party platforms with a very low investment. This will reduce their overhead costs and improve profitability. The capital saved can be used to improve the quality of products and/or services and to develop better competitive strategy which will have a constructive impact on the profitability.

Efficiency

Improvement in technology increases the efficiency of supply chain which is the most important aspect any business. E-commerce platforms facilitates supply chain for MSMEs as they don't need to invest in logistics, warehouses and stores at various places if they are on the platforms.

Accessibility and Market reach

There is no limitation on geographical boundaries in the virtual marketplace and business can be conducted 24x7. The seller can connect to several buyers across different geographical areas. E-commerce allows MSMEs to approach and acquire the market faster by eliminating the redundant processes and the process of communication can be streamlined to reach the customer as quickly as possible.

Customer BID (Base, Insights and Delight)

Customer Base: E-commerce helps MSMEs carry on their business activities transcending geographical barriers, thereby increasing the customer base and revenue. It also speeds up the process of acquisition of customers. The referral system on the internet also helps the business to tap into more potential customers. Additionally, it also helps MSMEs in creating a central database of customers to carry out marketing and communication activities.

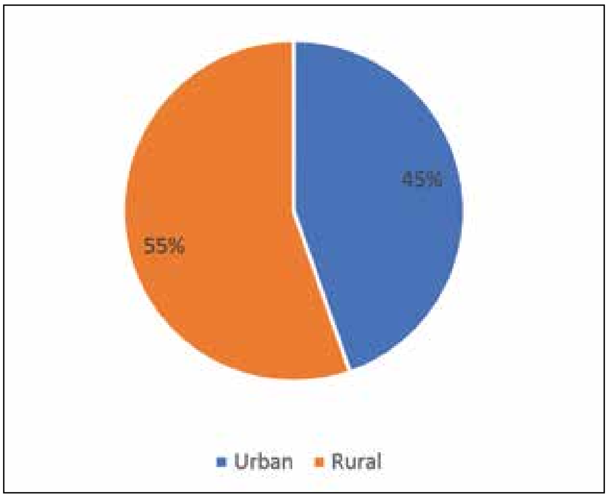
Customer Insights: E-commerce platforms act as an informative and communication channel between sellers and buyers and provides insights about products and services offered. It also benefits the businesses by giving better information about the needs of the customers and the market sentiments.

Customer Delight: E-commerce assists MSMEs to provide a better experience to the customers. Optimized after-sale services, quick responses to the inquiries of the customer and an interactive process creates a strong and loyal customer base which help the MSMEs in the long run as these loyal customers themselves act as strong brand promoters. Another benefit of e-commerce is that it provides a prompt feedback channel through which any complaint can be addressed immediately.

It is by now well established that e-commerce has the potential of transforming the MSME sector, unleashing its true potential, converting to greater scope for businesses and higher efficiencies as well as profits. Let's understand the challenges faced by MSME sector in adopting to e-commerce methods.

Challenges for MSMEs

Distribution of MSMEs are divided across rural and urban areas, with nearly 45% in urban and 55% in rural area. As larger percentage of MSMEs are concentrated in rural area, they lack adequate information about e-commerce and interest to carry on their business on online platform. High concentration of retailers on e-commerce platforms has led to high levels of competition.



Source: Fourth All India Census of MSME, 2006-07

Additionally, inadequate information technology skills and security and trust issues create barriers in using e-commerce platforms. Some of the challenges faced by MSMEs in using e-commerce platforms are:

1. **Unskilled Staff:** MSMEs typically cannot afford high-skilled staff to mandate e-commerce operations such as product upload, online marketing, shipment and after-sales service.

2. **Lack of Expertise in Supporting Activities:** As the merchants move to online channels, they lack expertise in supporting activities where they seek the support of e-Commerce platforms andlogistics partners such as managing inventory, handling invoicing and providing consumer insights.

3. **Technology Integration and Perception Gap:** Merchants are not well versed with e-commerce technology frameworks and business operations. Merchants also have the perception that offline recovery is faster than online recovery. Also, small merchants fear that their transactions will fall in audit trail.

4. **Low Internet Penetration:** Growth of e-commerce is dependent on various factors and the most important thing among them is internet penetration. Internet penetration in the country is very low. Although there have been various initiatives by the government like “Digital India”, still a large population of the country remains offline mainly due to infrastructure and connectivity issues. It discourages MSMEs from going online.

5. **Lack of Training:** Lack of training for doing e-commerce transactions is a critical road blockfor the migration to online platforms.

6. **Differential Delivery Rates:** Merchants have to deal with different rate cards with different platforms,which becomes an operational challenge. Merchants also have to deal with multiple platforms as often one platform might not adequately cover the areas as per their requirement.

7. **Higher "Returns" due to Cash on Delivery (CoD):** Higher "Returns" due to CoD facility for customers add up to logistics costs of MSMEs. Returns of goods alone account for an estimated loss in the range of 5%on the MRP of goods sold, with a typical rate of return of goods of 15-20%expected by platform owners.

FinTech Companies for Financing MSMEs

Banking sector has been leveraging technology for quite some time now, whether it is use of computers for book-keeping, products like credit and debit cards or use of ATM for delivery of services etc., all were fintech innovations in their time.

MSME lending being a hugely underserved market is a major opportunity for FinTech Start-ups to build and scale up sustainable businesses by offering services such as credit underwriting, marketplace lending, etc. Given the huge business potential the number of FinTech companies in the MSME Financing space, FinTech companies are improving access to finance for MSMEs by giving loans themselves, connecting MSMEs to banks and financial institutions (Marketplace Model) (e.g. Lendingkart, smelending.com, etc.) or becoming financial product aggregators (e.g. BankBazaar, PolicyBazaar, FundsIndia.com, etc.).

The FinTech companies have leveraged the growing technology and have targeted MSME sector in bridging the funding gap with innovative and flexible credit products. With very quick turnaround time and flexibility in loan size and tenors, FinTech companies minimizes the hassle for MSMEs in getting credit. FinTech lending companies and the market place based lending, thus, have an underlying potential to emerge as an alternative source of finance for the small businesses. These FinTech firms are backed up by big data analytics and with use of traditional and non-traditional methods, they assess the credit worthiness of MSMEs. Many of the FinTech firms abroad employ unorthodox techniques, including psychometric tests to run checks on their borrowers, determine their social media reputation and do rigorous due diligence before lending. This is possible due to strong growth in internet penetration, e-commerce and smartphone-based services which have created a huge amount of data on individuals and small businesses. The availability of records from credit bureaus, utility and credit card bill payments, etc., has enabled the FinTech firms to gather large volume of available information on potential borrowers. As more and more data is getting digitized, the cost and effort involved in assessing the creditworthiness of MSMEs is declining significantly. These firms are also willing to lend to small businesses that might not have collateral, significant revenues or years of experience.

Government Initiatives

The e-commerce boom in India is driving the growth of MSMEs, which in turn is contributing to new job opportunities and growth in GDP. As MSMEs are backbone of an Indian economy, the government is also taking various initiatives in e-commerce sector to promote their growth. Some of the initiatives are listed below:

1. E-commerce shopping portal

National Small Industries Corporation Ltd. (NSIC), a government body established in 1955, works with a mission of promoting, aiding and fostering the growth of small scale industries and industry related small-scale services/business enterprises in the country. It has created an e-commerce shopping portal on 31/07/2014 dedicated to MSMEs on which MSMEs will be able to sell products as well as industrial equipment. It will serve as a good marketing platform for MSMEs. The B2C platform – www.msmeshopping.com – also has some benefits for the sellers:

- The registration fee is INR 5,000 for one year, irrespective of the number or value of products sold. There are no transaction charges as well.
- It plans to launch country-wide publicity campaigns.
- There is also going to be a campaign for suppliers' interaction with MSME Associations.
- Major features of the portal include- online registration, web store management, popular products section, multi-product cart, online buying and selling, customer support through call center, payment gateway for membership subscription, enhanced security features, etc.
- In addition, NSIC also assists MSMEs through MSME Global Mart Web Portal www.msmemart.com which provides an online platform for B2B marketing activities. The salient features of the portal include interactive database of MSMEs, Global and National Tender Notices, self-web development tool, centralized mail system, unlimited global trade leads, trust seal of NSIC, multiple language support, payment Gateway for membership subscription, etc. The portal has database of registered members looking for business opportunities, sustainable partnership, sub-contracting and participation in Public Procurement.

2. Mahila-e-Haat

In order to drive new generation of women towards financial independence, the Government has launched an online portal named Mahila-e-Haat, to provide access to markets where thousands of women can display and sell their products all over the country. The online marketing portal is expected to benefit around 10,000 self-help groups and 1.25 lakh women in India.

3. Foreign Direct Investment (FDI)

As per the FDI Policy, FDI up to 100% under automatic route is permitted in B2B e-commerce. FDI is not permitted in B2C e-commerce. However, FDI in B2C e-commerce is permitted in following circumstances:

i. A manufacturer is permitted to sell its products manufactured in India through e-commerce retail.

ii. A single brand retail trading entity operating through brick and mortar stores, is permitted to undertake retail trading through e-commerce.

iii. An Indian manufacturer is permitted to sell its own single brand products through e-commerce retail. India manufacturer would be the investee entity, which is the owner of the India brand and which manufactures in India, in terms of value, at least 70% of its products in house, and sources, at most 30% from Indian manufacturers.

Conclusion

E-commerce is an evolving sector and with continuous developments in technology one can no longer neglect the potential in it. Making presence in virtual marketplace will provide MSME sector in India a platform to mark their presence across geographies and to compete globally. E-commerce helps not only MSMEs in reducing their expenses and boost their revenues but also to the growth of an Indian GDP.

Bankruptcy and Insolvency Code

The Insolvency and Bankruptcy Code passed by the Parliament is a welcome overhaul of the existing framework dealing with insolvency of corporates, individuals, partnerships, and other entities. It paved the way for much needed reforms while focusing on creditor driven insolvency resolution.

Background

At present, multiple overlapping laws and judicial forums are present. They deal with financial failure and insolvency of companies and individuals in India. The current legal and institutional framework does not provide any support to the lenders in terms of recovery or restructuring of defaulted assets. This even causes stress on the Indian credit system. Recognizing that reforms in the bankruptcy and insolvency regime are critical for improvising the business environment, the Government introduced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance.

After sufficient public consultation and recommendations from a joint committee of Parliament, both houses of Parliament have now passed the Insolvency and Bankruptcy Code, 2016 (Code).

While the legislation of the Code is a historical development for economic reforms in India, its effect will be seen at the right time when the institutional infrastructure and implementing rules as envisaged under the Code are formed.

The code

The Code offers a uniform, comprehensive insolvency legislation encompassing all companies, partnerships, and individuals (other than financial firms). The Government is proposing a separate framework for bankruptcy resolution in failing banks and financial sector entities.

One of the fundamental features of the Code is that it allows creditors to assess the viability of a debtor as a business decision, and agree upon a plan for its revival or a speedy liquidation. The Code creates a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms, that will facilitate a formal and time bound insolvency resolution process and liquidation.

Highlights

- The Code creates time-bound processes for insolvency resolution of companies and individuals. These processes will be completed within 180 days. If insolvency cannot be resolved, the assets of the borrowers may be sold to repay creditors.
- The resolution processes will be conducted by licensed insolvency professionals (IPs). These IPs will be members of insolvency professional agencies (IPAs). IPAs will also furnish performance bonds equal to the assets of a company under insolvency resolution.
- Information utilities (IUs) will be established to collect, collate, and disseminate financial information to facilitate insolvency resolution.
- The National Company Law Tribunal (NCLT) will adjudicate insolvency resolution for companies. The Debt Recovery Tribunal (DRT) will adjudicate insolvency resolution for individuals.
- The Insolvency and Bankruptcy Board of India will be set up to regulate functioning of IPs, IPAs, and IUs.

Key issues and Analysis

- Time-bound insolvency resolution will require establishment of several new entities. Also, given the pendency and disposal rate of DRTs, their current capacity may be inadequate to take up the additional role.
- IPAs, regulated by the Board, will be created for regulating the functioning of IPs. This approach of having regulated entities further regulate professionals may be contrary to the current practice of regulating licensed professionals. Further, requiring a high value of performance bond may deter the formation of IPAs.

- The Code provides an order of priority to distribute assets during liquidation. It is unclear why: (i) secured creditors will receive their entire outstanding amount, rather than up to their collateral value, (ii) unsecured creditors have priority over trade creditors, and (iii) government dues will be repaid after unsecured creditors.
- The Code provides for the creation of multiple IUs. However, it does not specify that full information about a company will be accessible through a single query from any IU. This may lead to financial information being scattered across these IUs.
- The Code creates an Insolvency and Bankruptcy Fund. However, it does not specify the manner in which the Fund will be used.

Compared to large companies, MSMEs are very vulnerable to distress as the capacity to endure the distress is not there or very scarce. Secondly, distress need not be self-inflicted; it can be due to changes economic scenario, distress in key buyers' business, a shift in customer preference etc. Distress Management is an important exercise to nurse back the enterprise to a productive state. Legal cover in the form of Insolvency and Bankruptcy code is a great support to manage the distress.

Is it boon or bane to MSMEs?

There were some discussions about the impact of new code on MSMEs. According to some, the new code would make MSMEs very vulnerable to recovery action. However, here have been contradicting views as well that says, the new code might be a boon to MSMEs who have limited power to endure the distress. It means new law will act as a deterrent to initiate recovery action

and viability of business will undergo another round of scrutiny by the court. This window of opportunity is needed for every distressed entrepreneur to get the breathing space in the middle of a crisis and it gives enough time for entrepreneurs to review the reasons for distress and measures they can take to retrieve the growth. Since it is a court administered process, the process will remain transparent and pragmatic. Most of the MSMEs are promoter-run units, with very little presence of professionals in the organization due to the high costs. In such a scenario, the so-called "insolvency experts" (who will take over the companies on behalf of financial institutions in case of a default as per the proposed Act) will naturally not be able to run the units. The units will be put to auction, which is a long and time-consuming exercise, particularly when the real estate and industrial sectors are in such a bad shape.

In fact, "the productive assets" can be best used by the industry they are being used for and by no one else. As per the provisions of the proposed Bill, it seems that even a minor default will lead to the company being placed into the hands of a private "Insolvency Expert" and the company will be dissolved unless 75% of the creditors agree to continue its operations. More drastically, all the workers will be automatically dismissed.

The Bill would only assist minority financial manipulators and would be against the economic interest of Indian business, public sector banks and workmen.

The Bill has been drafted with the mindless attitude that assumes “destruction is liberalization”. According to a recent article in a financial daily, based on the data obtained from the RBI, Asset Reconstruction Companies (ARCs) have spent barely INR 3,400 crore to acquire total assets of the book value of INR 1.89 lakh crore, till date.

This shows that the cozy club of ARCs have paid only an amount of 2% to acquire the debts. The same has to be contrasted with the approach of the banks towards entrepreneurs and borrowers to whom the banks refuse to give minor adjustments or even short moratoriums.

As per the Government, the present Bill has been necessitated because of the failure of the Board for Industrial and Financial Reconstruction (BIFR), working under Sick Industrial Companies Act (SICA, 1985, Special Provision), to provide relief or rehabilitation to industry as well as to financial institutions. While the actual cause of BIFR not being able to deliver, goods has been the failure of the Government to appoint adequate members on the Bench which delays adjudication of matters. The SICA provides for up to 14 members. Currently (till January 24, 2016), the BIFR Bench has one member.

Banks can easily prevent a company from taking recourse to the BIFR and sell off the assets under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI). This empowers banks or financial institutions to recover their non-performing assets without the intervention of the Court and supersedes any other law. The SARFAESI Act describes itself to be “a law with stringent provisions”. Then, do we need yet another law with even more stringent provisions?

In a socialist country like India, the continuous emphasis by the Government and the Finance Ministry is on how fast a business can be closed and the same is being touted as a major step towards Prime Minister’s initiative of “Make in India”. That is quite ironical. It is repeatedly being harped upon that now it takes 4.3 years to close a business but after the proposed Act becomes a law, it will only take six months for the closure of a business. It can be well understood that the Act which thrives on “helping to close the business” cannot nurse industry or business back to health. So, it must not be passed into a law. The proposed law is a clear-cut mockery of Prime Minister Narendra Modi’s Make-in-India initiative.

Surprisingly, nobody seems to be bothered that almost 45 per cent of our industry is in the micro, small and medium enterprises’ (MSME) sector, which is reeling under severe recession. This recession has been induced due to deep industrial recession of the last few years, coupled with the onslaught of cheap Chinese goods. On account of this, the NPA figure, which stood at around 89,000 as on March 31, 2012, have crossed the mark of 5 lakhs as on March 31, 2015 in the MSME sector, which is actually the tip of the iceberg. For every declared NPA, there would be several NPAs, which have been kept secret.

In such a scenario, should we not be interested in nursing back lakhs and lakhs of MSMEs? Should we just pounce on them, armed with such draconian laws, and murder them for incurring losses due to conditions which were beyond their control?

The prime question is that should our country be run on US-based capitalist economic model? If an industry has fallen on bad times due to various reasons, particularly MSMEs (where usually even the residential house of entrepreneurs/promoters is mortgaged to banks), then should they not be nursed back to health? We should not be in a tearing hurry to take possession of their assets, including their residential houses, throw them on the road and cause the workers engaged to lose jobs.

The Bankruptcy Code is drafted on an assumption that all the borrowers are cheats and the companies must be seized and handed over to private professionals or private insolvency consultants. It does not contemplate the situation that most of the entrepreneurs are genuine and have invested their life-savings and life-work in their companies and sometimes face temporary financial difficulties. It will be better to have reliance on time-tested laws like SERFAESI and SICA, instead of new laws that will simply kill the industry. If at all the Government still wants to go ahead with this Bill, then the MSME sector must be kept out of its purview.

If Code in existence, the party could have approached the Court and sought relief to bring back the unit to viability. In such circumstances, DRT/NCLT would order to mitigate the debt load and make the unit viable with better debt terms. Secondly, the value of enterprises would have been protected even while undergoing Insolvency proceeding.

We have explained the risk side of benefit above. On the opportunity side, MSMEs will get a better flow of funding to their business as more lenders with softer terms will enter the market to lend the loan in view of better recovery climate under the Code.

The key point is: Insolvency code will help quicker turnaround and gets breathing space to come back to growth. Also, going forward, it will act as a catalyst to innovations among lenders and hence will diversify the funding sources. Hence it is a Boon to MSMEs.

India currently ranks 136 out of 189 countries in the World Bank's index on the ease of resolving insolvencies. India's weak insolvency regime, its significant inefficiencies and systematic abuse are some of the reasons for the distressed state of credit markets in India today. The Code promises to bring about far-reaching reforms with a thrust on creditor driven insolvency resolution. It aims at early identification of financial failure and maximizing the asset value of insolvent firms. The Code also has provisions to address cross border insolvency through bilateral agreements and reciprocal arrangements with other countries.

The unified regime envisages a structured and time-bound process for insolvency resolution and liquidation, which should significantly improve debt recovery rates and revitalize the ailing Indian corporate bond markets.

Ind AS

On February 15th, 2015, the Ministry of Corporate Affairs, in consultation with the National Advisory Committee on Accounting Standards, notified the Companies Ind AS Rules, 2015, laying down the roadmap for the implementation of Indian Accounting Standards.

This revised accounting system would bring financials to economic reality and provide for better disclosures of financial statements. It would thus improve the quality of financial reporting. The reported profitability would be more volatile. Companies in sectors like Infrastructure, retail, IT, capital goods, auto ancillaries are likely to be impacted than others.

Also, the revised accounting standards are not likely to have a material impact on the business fundamentals. Hence, cashflows and economic risks would remain unaffected.

Impact of Ind AS

The Ind AS covers all aspects of financial statements. The financial statements of majority sectors would be impacted because of the following changes –

- Revenue recognition norms
- Changes in net worth on account of fair valuation of instruments, property and acquired entities
- Treatment of intangible assets and goodwill
- Guidelines on consolidation of financial statements
- Changes in P&L on account of derivatives as well as foreign currency loan obligations
- Proposed dividend and deferred tax assets
- Employee-based share payments
- Reclassification of actuarial gains and losses

The above-mentioned areas of accounting changes are likely to affect a majority of companies, the extent of impact will largely be driven by differences in reported net worth.

Sector specific impact by Crisil is as follows –

Areas of accounting change	Auto	IT	Pharma	Infrastructure & Capital goods	Telecom	Retail
Revenue recognition	✓	✓	–	✓	✓	✓
Fair valuation of PPE	✓	–	–	–	–	✓
Fair valuation of financial instruments (net worth)	✓	✓	✓	✓	✓	✓
Fair valuation of gains and losses	✓	✓	✓	–	✓	–
Amortization of goodwill/intangibles	–	✓	✓	–	–	–
Consolidation	✓	✓	✓	✓	–	–
Capitalization of exchange differences on foreign currency loans	✓	✓	–	✓	✓	–
Reclassification of actuarial gains/losses as OCI	–	✓	✓	–	–	–
Employee stock option	✓	✓	✓	–	–	–
Capitalization of spares/costs as fixed assets	✓	–	–	✓	–	–
Lease accounting	–	–	–	–	✓	✓
Service concession agreement	–	–	–	✓	–	–

Some of the Key focus areas for Banks and NBFCs

1. Effective Interest rate
2. Interest income on Non-performing assets
3. Relevant date for recognition of gains/ losses on dealing with securities
4. Accounting for customer loyalty programs
5. Sale of NPAs

Implications for banks

- One of the most significant implications of Ind AS adoption by banks and NBFCs could be increased loan loss provisioning and consequent impact on capital if the new impairment rules of Ind AS 109, 'Financial instruments', are adopted in their entirety. These rules require the recognition of expected credit losses based on forward-looking information and not just incurred losses. Reliable data and credit models will also be needed to properly apply these provisions.
- Implementing Ind AS is likely to impact key performance metrics and will require thoughtful communication with the board of directors, shareholders and other stakeholders. Internally, Ind AS implementation can have a wide-ranging impact on an entity's processes, systems, controls, income taxes and contractual arrangements. Successful Ind AS implementation will require a thorough strategic assessment, a robust step-by-step plan, alignment of resources and training, strong project management and, finally, smooth integration of various changes into normal business operations. In conclusion, sustainable processes must be established so that the Ind AS implementation exercise continues to yield meaningful information long after it has been completed.

The accounting standards would have impact on company's profits, goodwill, net-worth and in some cases even market capitalization. Indian companies are also expecting increased tax demands and are even putting aside some funds for potential litigations.

It has already been stated that holding company, subsidiary, joint venture and associate entity of the above covered entities will also have to comply with Ind AS.

Goods and Services Tax (GST)

GST Journey so far

In February 1986, Vishwanath Pratap Singh, Finance Minister in Rajiv Gandhi's government, proposed in the Budget a major overhaul of the excise taxation structure. This was aimed to reduce the cascading effect of multipoint taxes. With that he announced the introduction of a Modified Value Added Tax or MODVAT scheme that would allow manufacturers to obtain instant and complete reimbursement of excise duty paid on components and raw materials. It would also promise transparency and complete disclosure. The scheme was to be implemented in stages. Its rollout on March 1, 1986, marked the first crack at reforming the country's indirect tax structure.

Subsequently, Manmohan Singh started discussions on a Value-Added Tax at the state level. During the tenure of Yashwant Sinha as the Finance Minister, it was decided to put an end to the sales tax war among states, and to have uniform floor rates for sales tax of various commodities with effect from January 1, 2000.

Earlier, in 2003, after the Fiscal Responsibility and Budget Management Act that had been approved by Parliament, but was yet to be notified, Finance Minister Jaswant Singh called a meeting of his officers to discuss the implementation of the new law.

Vijay Kelkar laid down that meeting targets of lower fiscal deficit would increase revenues, and not necessarily lower the spending in a growing economy (India's GDP in 2003 was a little over $ 600 billion) with a severe infrastructure deficit. Kelkar's point was that India should use this opportunity to work on a modern tax law — by shifting the focus from a tax on production to a tax on consumption, and by creating a single national market that would provide a huge boost to Indian manufacturing.

India was signing regional tax treaties, which Kelkar recognized could hurt Indian industry and hobble the competitiveness of local firms. A Constitution Amendment Bill had been approved that empowered the government to tax the services. Kelkar, along with Arbind Modi and Ajay Shah, started work on a report on the Task Force for the Implementation of the FRBM. That was the first report on a design for the GST — which suggested a single low rate: 7% for states and 5% for the Centre, and which detailed a plan for a grand bargain with states to get the proposed new taxation structure off the ground.

After the NDA lost the 2004 polls, the UPA's Finance Minister, P Chidambaram worked out the financial support to states and campaigned for the introduction of VAT. After overcoming resistance, by 2005, Chidambaram could announce a national VAT or GST, covering both the Centre and the states. The following year's budget signalled April 1, 2010, as the date for launching GST.

By 2009, the first discussion paper on GST was unveiled by the Finance Ministry. In 2011, Finance Minister Pranab Mukherjee introduced a Bill to provide the enabling framework for GST. The Parliamentary Committee on Finance led by Yashwant Sinha suggested changes. During that period, resistance to the proposed GST was led by BJP-ruled Madhya Pradesh and Gujarat. However, the resistance was quite strong.

After the Narendra Modi government came to power, efforts were renewed, and the legislation was approved in the Lok Sabha in 2015. But the government's lack of numbers in the Upper House led to a long standoff with the Opposition in 2016. Finance Minister Arun Jaitley led negotiations with several stakeholders. The passage of key bills then paved the way for the launch of GST on July 1, 2017.

The Rajya Sabha on 6th April 2017, passed four supplementary legislations which will enable the government to rollout the landmark Goods and Services Tax Bill on July 1. The four Bills are the Central Goods and Services Tax Bill, 2017, the Integrated Goods and Services Tax Bill, 2017, the Goods and Services Tax (Compensation to States) Bill, 2017 and the Union Territory Goods and Services Tax Bill, 2017. The CGST will give powers to the Centre to levy tax after excise and service taxes and additional customs duty are subsumed. The IGST will be a tax on inter-state movement of goods and services. The UTGST is for Union territories such as Chandigarh and Daman and Diu.

Salient features of GST

- Applicable to both intra-state and inter-state transactions
- Applicable at the time of supply
- Administration at Central and State level
- Follows a two-rate structure
- Levied on import of goods and services into India

As discussed above, the MMSME sector contributes 40% of Indian exports. This sector is about to go bigger with the recent spate of reforms. Today, through various government and RBI led initiatives the fi¬nancing for MSMEs have progressed. A Credit Suisse report stated that the MSME Loan Market is estimated to grow $3,020 billion over the next decade. This brings good tidings to the existing and seedling MSMEs in India. RBI reforms like guidelines on purchase and sale of priority sector lending certifi¬cates (PSLC) helps promote efficient lending practices for MSME sector.

Government plan to rate MSMEs would also enable the sector to improve quality of manufacturing and gain a foothold in the international market. Other government led initiatives such as setting up of Bankruptcy Bill will enhance the ease of doing business for MSMEs. In this report, we will also look at the bankruptcy and insolvency code's impact on MSME sector. All these reforms paired with the government passing the GST bill ensured a strong backing to the MSMEs in India.

Impact of GST on MSMEs

GST would boost the competitiveness of MSMEs. The pros and cons of GST on MSME sector have been discussed below.

Pros:

- Starting business becomes easier
- Improved MSME market expansion
- Lower logistical overheads
- Aids MSMEs dealing in sales and services
- Unified market
- Purchase of Capital Goods

Cons:

- The burden of lower threshold
- No tax di¬fferentiation for luxury items and services
- Increase in cost of product
- Selective tax levying
- The burden of higher tax rate for Service Provider
- Excess Working Capital Requirement
- Realignment of Purchase and Supply Chain
- Dual Control
- High Compliance burden and tax on advances
- Taxation under reverse charge for un-registered purchases
- Taxation on stock transfers and deemed supplies
- Time limit for the return of Goods sent on sale or return basis
- Condition of payment and filing of return for availing input tax credit
- Power to arrest and prosecution

Industries in MSME sector that would be affected

Every major reform is faced with certain hurdles, arguments and resistance from various stakeholders. However, from an MSME perspective, GST will bring in many positives compared to the current systems such as easy process of availing input credit, single point tax, elimination of cascading tax system, and simpler taxation. These pros o¬ffset the cons. THE WAY FORWARD while hopes rests with GST to boost the GDP growth and reduce the fiscal deficit. The extent of such impact will depend on a favorable consensus on GST rates for all business segments and integrated implementation of the same.

Proposed tax structure under GST by the government

The government has kept many items under 18% tax slab. The government categorized 1211 items under various tax slabs. Here is the tax slab these items would attract:

No Tax Goods

No tax will be imposed on items like fresh meat, fish chicken, eggs, milk, butter milk, curd, natural honey, fresh fruits and vegetables, flour, besan, bread, prasad, salt, bindi. Sindoor, stamps, judicial papers, printed books, newspapers, bangles, handloom, etc.

No Tax Services

Hotels and lodges with tariff below INR 1,000, Grandfathering service has been exempted under GST.

5% Goods

Items such as fish fillet, cream, skimmed milk powder, branded paneer, frozen vegetables, coffee, tea, spices, pizza bread, rusk, sabudana, kerosene, coal, medicines, stent, lifeboats will attract tax of 5%.

5% Services

Transport services (Railways, air transport), small restaurants will be under the 5% category because their main input is petroleum, which is outside GST ambit.

12% Goods

Frozen meat products, butter, cheese, ghee, dry fruits in packaged form, animal fat, sausage, fruit juices, namkeen, Ayurvedic medicines, tooth powder, agarbatti, coloring books, picture books, umbrella, sewing machine, cellphones will be under 12% tax slab.

12% Services

Non-AC hotels, business class air ticket, fertilizers, Work Contracts will fall under 12% GST tax slab.

18% Goods

Most items are under this tax slab which include flavored refined sugar, pasta, cornflakes, pastries and cakes, preserved vegetables, jams, sauces, soups, ice cream, instant food mixes, mineral water, tissues, envelopes, tampons, note books, steel products, printed circuits, camera, speakers, and monitors.

18% Services

AC hotels that serve liquor, telecom services, IT services, branded garments and financial services will attract 18% tax under GST.

28% Goods

Chewing gum, molasses, chocolate not containing cocoa, waffles and wafers coated with chocolate, pan masala, aerated water, paint, deodorants, shaving creams, after shave, hair shampoo, dye, sunscreen, wallpaper, ceramic tiles, water heater, dishwasher, weighing machine, washing machine, ATM, vending machines, vacuum cleaner, shavers, hair clippers, automobiles, motorcycles, aircraft for personal use, will attract 28% tax - the highest under GST system.

28% Services

5-star hotels, race club betting, cinema will attract tax 28% tax slab under GST

Compliance

All the compliance procedures under GST — Registration, Payments, Refunds and Returns will now be carried out through online portals only and thus MSMEs need not worry about interacting with department officers for carrying out these compliances, which are considered as a headache in the current tax regime.

Below we have provided a high-level impact analysis of GST on small and medium businesses in India.

Compliance Procedure	Positives	Negatives
Registration	Online registration will ensure timely receipt of certificate of registration and minimal bureaucracy interface	Not all the MSMEs have technical expertise to deal with online systems, thus most of them will need intermediaries to obtain registration for them. This will add to their registration cost.
Payment	Electronic compliance will bring transparency and will also reduce the compliance cost.	Since funds are required to be maintained in the form of electronic credit ledger with the tax department, it may result in liquidity crunch.
Refund	Electronic refund procedures will fast track the process and enhance liquidity for MSMEs	Refunds can be claimed only after filing of relevant returns. Also, it depends on the compliances done by the supplier and his rating.
Returns	All returns are required to be filed electronically and input tax credit and tax liability adjustment will happen automatically based on these returns	Minimum of thirty-seven returns are required to be filed by every registered taxpayer during a financial year. Thus, MSMEs will have to deploy additional resources and eventual cost of compliance will increase

No doubt that GST is aimed to increase the taxpayer base, majorly MSMEs into its scope and will put a burden of compliance and associated costs to them. But eventually, GST will turn these MSMEs more competitive with a level playing field between large enterprises and them. Furthermore, these Indian MSMEs would be able to compete with foreign competition coming from cheap cost centers such as China, Philippines, and Bangladesh.

Overall Impact of GST -

- Impact of GST on common man has reduced and the council has maintained status co on GST rates on the items largely consumed by the upper middle class
- It is like a mini budget short of projection of estimated revenue

- uniform tax structure and its consequent ease of doing business will propel growth in the industry
- The industry is expected to contribute 280 billion dollars to the GDP by 2026 and will pass on benefits of uniform taxation across the country to travelers
- Most businesses would be able to get significantly more credits under GST, leading to a benefit for most businesses
- service providers are expected to have a more complex compliance environment under GST as compared to the current service tax compliance regime
- It will bring in a systematic approach and enhance transparency which will aid growth of businesses. It will help the industry to concentrate on its core competencies

Structural benefits in the offing

We believe that GST is a structural reform and is expected to accelerate the pace of GDP growth in India, despite implementation challenges in near term. As highlighted in our earlier reports, the GST regime will usher in lower taxes, seamless input tax credit, logistics savings and market share swings from unorganized to organized players.

About APAS

Ashvin Parekh advisory services LLP founded in June 2013 and is headquartered in Mumbai, the finance capital of India. APAS is a leading financial advisory firm, providing a wide range of consulting services to a diversified client base, including financial conglomerates, business houses, banking companies, life general and health insurers, financial institutions, regulators and the government.

Our focus is primarily on business development through advisory services in strategy, processes, and people areas. In strategy areas we focus on diversification, strategic alliances, mergers and acquisitions and business restructuring. We also offer services in the areas of transformation and value creation. In the operation strategy areas we also render services at product and product design, intermediation and distribution areas, business risk management and governance aspects of the management.

In keeping with the services we offer, we have experts in business and transaction advisory areas. We have teams drawn from the industry to offer services to our clients in business and operation areas in the financial services space.

We have teams focusing on the new banking reforms including the formation of the new banking companies arising out of the new licenses. We will offer operational support in the areas of financial inclusion, holding company structures and project management services. We also have focus on the new reforms in the areas of subsidarisation of foreign banks. In addition we also conduct high level diagnostic studies for public sector and private sector banks.

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ASSOCHAM

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EVOLUTION OF VALUE CREATOR

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

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ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/ Associations spread all over the country.

VISION

Empower Indian enterprise by inculcating knowledge that will be the catalyst of growth in the barrierless technology driven global market and help them upscale, align and emerge as formidable player in respective business segments.

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As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

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ASSOCHAM represents the interests of more than 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

Currently, ASSOCHAM has more than 100 National Councils covering the entire gamut of economic activities in India. It has been especially acknowledged as a significant voice of Indian industry in the field of Corporate Social Responsibility, Environment & Safety, HR & Labour Affairs, Corporate Governance, Information Technology, Biotechnology, Telecom, Banking & Finance, Company Law, Corporate Finance, Economic and International Affairs, Mergers & Acquisitions, Tourism, Civil Aviation, Infrastructure, Energy & Power, Education, Legal Reforms, Real Estate and Rural Development, Competency Building & Skill Development to mention a few.

INSIGHT INTO 'NEW BUSINESS MODELS'

ASSOCHAM has been a significant contributory factor in the emergence of new-age Indian Corporates, characterized by a new mindset and global ambition for dominating the international business. The Chamber has addressed itself to the key areas like India as Investment Destination, Achieving International Competitiveness, Promoting International Trade, Corporate Strategies for Enhancing Stakeholders Value, Government Policies in sustaining India's Development, Infrastructure Development for enhancing India's Competitiveness, Building Indian MNCs, Role of Financial Sector the Catalyst for India's Transformation.

ASSOCHAM derives its strengths from the following Promoter Chambers: Bombay Chamber of Commerce & Industry, Mumbai; Cochin Chambers of Commerce & Industry, Cochin: Indian Merchant's Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi.

Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

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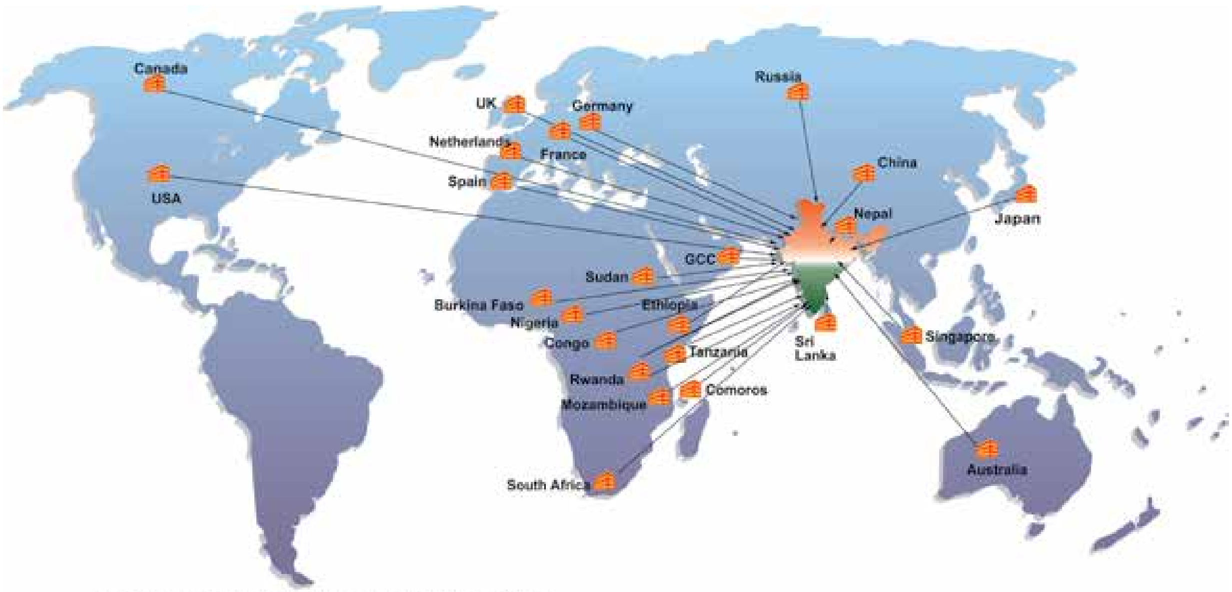

The pictorial presentation of the world map does not purport to be the political and geographical maps of the world and India and is not drawn to scale. This is only indicative.

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