MSMEs are key to India’s $5 trillion aspiration

While liquidity is being addressed, next phase will be all about capacity building

SMERA believes that the string of initiatives taken by the government to rejuvenate the economy can provide a significant boost to the MSME sector not just over the near term but also over the medium term. The steps taken to improve the liquidity position of the sector by instructing PSUs to clear the pending dues within a specified date and also ensuring timely settlement of GST refunds will ensure that their near term working capital position is adequate to sustain a healthy level of operations. This is over and above the special NPA dispensation that has already been provided by RBI to facilitate additional funding support to the MSMEs that are under stress. However, the key to their long term sustainability, scalability and competitiveness lie in strong capability building through technology and skill upgradation as well as better market access infrastructure. While the government continues to take steps in that direction through new programmes, we still need to implement the global best practices in terms of centrally co-ordinated and industry focused research and development that can spur the growth of export oriented MSMEs.

In the opinion of SMERA, the key step from the government rightly pertains to a liquidity improvement in the MSME ecosystem. Continuing delays in GST refunds particularly for exporters have impacted the working capital position of the sector. It has been reported that 90% of all the GST dues as on August, 2019 have already been settled by the government by September 2019; further, all future settlements are expected to happen within a 60 days period. Importantly, larger companies including PSUs regularly stretch payments to their MSME creditors or vendors. The practice usually occurs because of the latter’s lower bargaining power – adversely impacting their liquidity position. As a long term solution, TReDS has been identified as a necessary tool in this regard to monitor and facilitate financing of MSME receivables in line with the recommendations of the UK Sinha Committee. Additionally, the government has specifically instructed the CPSUs to focus on immediate settlement of their dues to MSMEs so that the latter have adequate liquidity to scale up their operations in the second half of the year.

The government has also advised public sector banks to avail of the special dispensation from RBI and avoid categorising MSMEs as fresh NPAs until March 31, 2019. This will surely be a relief to those MSMEs that are going through a fund crunch and importantly, help them to get additional limits from both banks and NBFCs. Public sector banks are instructed to pursue an outreach programme in close collaboration with NBFCs to ensure availability of finance to this segment. This is closely followed by the establishment of a Distressed Assets Fund (DAF) worth Rs. 5,000 Cr, which will further support MSMEs that are financially impacted due to systemic risks.

Since technology obsolescence is a major challenge for MSMEs in the manufacturing sector, the Government has also proposed the establishment of the Credit Linked Capital Subsidy Scheme for institutional loans up to Rs. 1 Cr. The scheme will aid small enterprises that avail loan to do capex in order to upgrade their technology; eligible firms will receive an upfront subsidy of 15%, thereby providing an incentive for fresh investments. Marketing oriented schemes that pertain to promoting the MSME eco-system through formalization and incentivization come next. Bharatcraft portal as well as a Free Trade Agreement Utilization Mission are initiatives that aim to provide export oriented MSMEs of fresh business opportunities.

As an eco-system, if Indian MSMEs were an economy, then they would collectively be the world's 16th largest economy by itself. If the government can ensure that this segment has the necessary capital and funding support, this sub-sovereign economy can very much double in size over the next six years.

Global Comparison: How India's peers have supported their MSMEs?

A detailed study on emerging market peers as well as developed export-oriented economies can be a good reference point for India to get valuable insights that can further strengthen the Indian SME sector. Among peers in ASEAN, Far East and Europe, Indian SMEs have the lowest contribution in terms of contribution to the GDP. At 37% (UK Sinha Committee however assesses the contribution to an even lower 28%) contribution, the country falls short of the 46% average recorded by peers. Chinese and German SMEs for instance contribute to 60% and 55% to their respective GDPs. Even countries such as South Korea, Malaysia and Taiwan have a GDP contribution of 51%, 41% and 42%, respectively.

In absolute terms the sector contributes just $122 billion to the Indian economy, in the context of the GDP size of $2.8 trillion. Consequently, there is a case for higher value added here given the fact that German and South Korean SMEs contribute $574 (GDP size $4 trillion) billion and $218 billion (GDP size $1.6 trillion) to their economies via exports, respectively. Chinese SMEs are in a different league altogether, with an export contribution of nearly $1.7 trillion to their economy. Clearly, there is a very large scope and opportunity to increase the contribution of MSMEs to India's GDP particularly through a pick-up in exports from the segment.

SMERA notes that universally, there appears to be a consensus around four main themes namely, productivity improvements, technology upgradation and transfer, skill development and enhanced profitability though global reach and higher value addition. Clearly, all themes revolve around the core objective of capacity building.

Best practices: Export oriented economies as well as other EMs worthy role models

To achieve this, one example comes from the German Fraunhofer Society, a public-private owned network that provides consultancy services for SMEs and engages in their capacity development. The network has been instrumental in the rejuvenation of the German SMEs and bring them at the cutting edge of technology. Even though the Niti Aayog might perform some of these functions in India, there is clearly no centrally driven network of research institutions that can take Indian SMEs to the next level. SIRIM-Fraunhofer Program, a collaboration with the network has done wonders for the Malaysian SME space, especially manufacturing. The programme, which is run by the south east Asian Government, provides process and technology audits for SMEs to improve their productivity. Since implementation, marked improvements in SME contributions have been recorded in the country.

Apparently, such an institutional framework can take care of the productivity improvement and technology upgradation themes. The other themes pertaining to skill development and enhanced profitability undoubtedly deal with labor quality, productivity and capabilities. Here again the German model of apprenticeship comes into focus. As per a Federal Ministry of Economic Affairs and Energy (BMWi) report, 80% of all vocational training places offered in Germany are provided by SMEs. The report also states that German SMEs employing less than 250 people spend 16.5% more on research project than they did in a preceding year.

In fact, the European power house's SMEs are compensating for lower R&D spend of larger companies in sectors such as mechanical engineering and communication/ information. Overall, the share of SMEs in total German R&D spend is around 13.2%. Another example comes from South Korea, where the country's Ministry of SMEs and Start-Ups (MSS) has initiated technology mentoring under tech incubator program for start-ups. There is also a provision of 'matching funds' credited to the saving accounts of high skilled individuals in order to keep them employed in SMEs – among other ingenuities.

The Skill India initiative has had mixed results and has not caught up with expectations lately. A so called 'Export Support System & Incubation' therefore holds the key to the solution of many troubles faced by Indian SMEs pertaining to low productivity and skill level. Several ASEAN nations as well as China have also extensively used the idea of bonded custom SEZs, which in turn take advantage of their coast lines and evolved their sectoral specializations. With over 7,500 km of coastline, India has a relatively miniscule number of dedicated SEZs focused on high value sectors such as electronics, automotive, textiles and food processing. The ones that do exist are mostly under state control and rarely have access controlled bonded industrial zones. A focused approach in terms of customized financing, skill development and hand holding will therefore provide the Indian SMEs an immense boost. A higher value creation is a product of higher inter-connectedness to the global value chain and here too, India must take advantage of its natural as well as demographic resources optimally.

About SMERA:

SMERA was incorporated in 2005 as an initiative of Ministry of Finance, Govt. of India and the Reserve Bank of India to help Indian MSMEs grow and get access to credit through independent and unbiased credit opinion that banks can rely on. Thus SMERA became the world's first MSME focused rating agency and introduced the concept of SME Ratings in India. SMERA is now a division of Acuité Ratings & Research Limited (a SEBI Registered and RBI Accredited Credit Rating Agency).

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