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बैंक ऑफ महाराष्ट्र

Bank of Maharashtra

भारत सरकार का उद्यम

Revitalizing the MSME Financing Ecosystem

Bank of Maharashtra

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FOREWORD

Our country's economy is on growth trajectory and set to grow ahead of progressive countries in the world. Our fundamental demand cycle and growth indicators remain robust and set to grow in decent pace in future. Micro, Small, and Medium Enterprises (MSMEs) have been monumental in accelerating the growth. MSMEs serve as the backbone of country's economy as they contribute over 30% to the GDP of the Nation, with almost 50% contribution to exports, forming an integral part of the supply chain. They are also instrumental in ensuring financial inclusion by tapering regional imbalances, generating employment opportunities at relatively low capital costs.

Bank of Maharashtra, being one of the most progressive PSB in the country is working in consonance with the country's macroeconomic policy towards strengthening the MSMEs. During the recent few years Bank has unlocked its true potential while exhibiting growth in MSME sector lending, which has arrived through a series of well thought out decisions. Bank has undertaken noteworthy changes in the policies of MSME sector lending, review of all MSME products and adopted proactive approach while implementing policies with a focus on delivering seamless services.

Formation of new verticals like Digital Banking Zone enabling Digital Lending, TReDS Cell, Co-Lending Cell for increasing the MSME advances through digital platform are some important measures taken for promoting MSMEs. Specialized MSME Branches have been created for catering to MSMEs dedicatedly. Bank is entering into partnership with leading NBFCs to lend through Co-Lending model (CLM) to promote Financial Inclusion.

Bank has a slew of tailored products for ease of doing business for various activities viz. GST registered MSMEs, Doctors, Professional, Contractors, Hospitality Management sector. In addition, Bank introduced MSME Maha Swagatam scheme with lucrative features which reaped exceptional results for the bank.

Bank of Maharashtra has entered into tie up with various Fintech Companies to tap into the untapped regions cost-effectively. Bank is also focused on Cluster financing aligned with economic activities. Bank is taking extra mile efforts for organizing outreach programs, MSME Expos, Webinars across the country, through which entrepreneurs and industry associations are being connected. A start-up branch is opened at Pune to cater to the needs of the start-up ecosystem in the region.

There is rapid growth of the online ecosystem and our country has made significant infrastructure investments, which will yield results in times to come. We at Bank of Maharashtra are putting all out efforts to ramp up the digitization process and make end-to-end customer journeys. BoM's technology driven prowess is all set to add significantly towards facilitating services to MSMEs.

We are at an inflection point and there is a huge opportunity for MSMEs to cater to its domestic demand and to global markets. With synergy of technology and enabling proper delivery mechanism, MSMEs will script country's much anticipated growth story and fulfil the aspiration of becoming a $ 5 trillion economy.

BoM's continued performance is an evidence of support and patronage of valued clients like you. We shall continue our efforts & focused approach towards business needs, customer's preferences & changing landscape in technology in serving our Customers better.

I am confident Bank of Maharashtra with its progressive measures and tech-enabled delivery mechanism will continue to remain an integral part of the MSME sector's growth.

With all my best wishes,
Warm regards,

Mr. Asheesh Pandey
Executive Director
Bank of Maharashtra

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Message from **RESURGENT INDIA LTD.**

India, as a developing economy, heavily relies on Micro, Small, and Medium Enterprises (MSMEs) to secure its long-term economic prosperity. Despite their integral role in the nation's economic landscape, MSMEs encounter formidable hurdles when it comes to securing funding for their operations. Insufficient resources and inadequate financial management have hindered the growth of MSMEs in India.

The most prominent obstacle obstructing the expansion plans of MSMEs is the limited and untimely access to credit. The loan application process for MSMEs involves complex paperwork, stringent lending criteria, demanding collateral prerequisites, challenging repayment terms, and high-interest rates. Due to the elevated costs associated with servicing these loans, the relatively small loan sizes sought by MSMEs, and their limited ability to offer substantial collateral, financial institutions often hesitate to increase their exposure to this sector.

Beyond funding challenges, MSMEs grapple with a range of financial management difficulties that adversely affect their creditworthiness and borrowing capacity. Inadequate balance sheet management, the absence of comprehensive business plans, and various other factors act as significant barriers for MSMEs seeking to secure credit from lenders.

This report offers an extensive analysis of the MSME landscape in and provides a comprehensive overview of the numerous measures and initiatives implemented by the government and regulatory authorities to facilitate MSMEs in funding their growth and enhancing their operational efficiency.

Mr. Jyoti Prakash Gadia
Managing Director
Resurgent India Ltd

Message from **RESURGENT INDIA LTD.**

In recent decades, Micro, Small, and Medium Enterprises (MSMEs) have emerged as a crucial and dynamic sector within the Indian economy. They play a significant role in fostering entrepreneurship and innovation, contributing substantially to the country's economic and social development.

However, the survival and growth of MSMEs in India face several formidable funding challenges. Solving these intricate funding issues in the MSME sector relies on addressing key issues, such as the scarcity of affordable financing. Factors like limited access to capital, lack of awareness, and insufficient working capital have profound implications for the long-term profitability, competitiveness, and sustainability of this sector.

Despite regulatory relaxations by SEBI, which include lowering the minimum paid-up capital (Rs. 1 crore) and reducing the requirements for allottees to facilitate easier listing for a greater number of SMEs, many MSMEs still find it financially challenging to go public. The expenses associated with an Initial Public Offering (IPO), ranging between Rs. 45 and Rs. 50 lakh, remain a significant barrier. One potential solution could involve seeking support from institutional investors who could provide the necessary funds to cover these costs in exchange for a stake in the company.

This report conducts an in-depth analysis of the MSME landscape and provides a thorough overview of the multifaceted measures and initiatives enacted by government to support MSMEs in financing their expansion and improving their operational efficiency.

Mr. K K Gupta
CAIIB, PGDBM (NIIBM), DFM,
DAM, DIBM, DMA, DEXIM,
B.A (ECO.)
Director
Resurgent India Limited

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A Closer Look at
MSME Classification

As India's GDP nears the $5 trillion mark, analysts forecast that the MSME sector will reach a valuation of Rs 1 trillion by the year 2028. This anticipated growth in the MSME sector aligns with India's ambitious economic goals, as it strives to become a major global economic player.

Our 5 trillion ambition is also closely tied up with the need for formalisation of MSMEs, as it would not only facilitate accurate tracking of their contributions to the economy but also ensure their sustainable development and integration into the formal financial and regulatory systems.

A universal definition for MSMEs does not exist, and they are typically categorized using either quantitative or qualitative approaches. The quantitative method is more common, with over 50 distinct definitions across 70 countries. The World Bank relies on criteria like the number of employees, total assets, and annual revenue to delineate MSMEs. While the number of employees is a straightforward metric, its applicability varies widely depending on the industry. For instance, manufacturing needs more workers than the service sector, and certain industries, such as semiconductors – a space several South Asian economies are vying for -- require substantial investments yet yield comparatively lower manufacturing outputs than others.

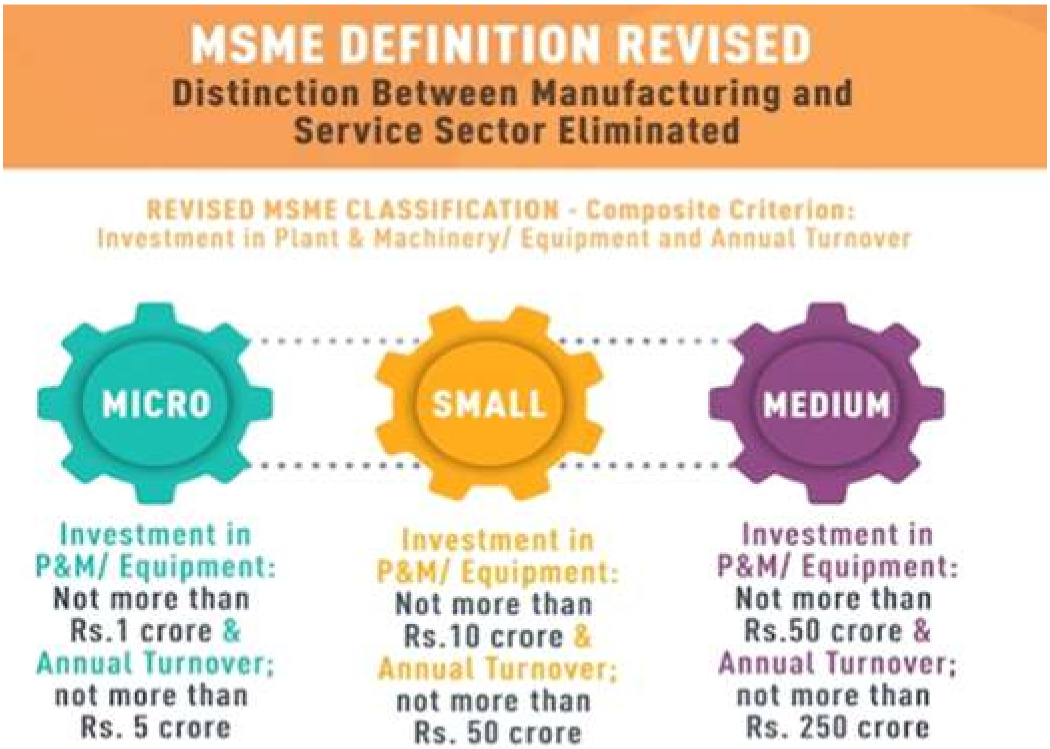
The Micro, Small and Medium Enterprises Development (MSMED) Act of 2006 in India was the first legal framework to introduce the concept of medium enterprises. Initially, MSMEs in India were categorized based on the investment in plants and machinery, which required self-declarations and physical verification.

The investment-based criteria had obvious limitations and it did not motivate industries to expand. Many businesses preferred to keep their plants small to maintain the benefits associated with being classified as MSMEs.

In 2018, the MSMED Amendment Bill proposed a notable change by transitioning from an investment-based classification system to one based on annual turnover. Turnover criteria were considered more reliable, transparent, and eliminated the need for physical inspections.

However, the turnover standards met with considerable scepticism for their potential to underrepresent businesses that qualify.

To address the limitations of both investment and turnover criteria, the Indian government introduced a new composite criteria system. Enterprises are now classified as micro, small, or medium based on a combination of investment and yearly turnover.



Large enterprises are defined as those surpassing the criteria for a medium-sized enterprise in both the old and new definitions.

In essence, these modifications to the classification criteria are intended to establish a more inclusive and equitable framework for the recognition and assistance of micro, small, and medium-sized enterprises in India. This framework now takes into consideration both investment and turnover factors.

Guidelines for calculating Investment in Plant & Machinery

The meaning of "plant and machinery or equipment": This shall have the same meaning as assigned to the plant and Machinery in the Income Tax Rules, 1962, framed under the Income Tax Act, 1961.

The investment pertains solely to tangible assets, with exceptions for land, buildings, furniture, and fittings. Intangible assets like goodwill and intellectual property are explicitly excluded.

To calculate the investment in plant and machinery for existing enterprises, the estimation will rely on the Income Tax Return (ITR) submitted in previous years. The written down value of these tangible assets, as indicated in the most recent ITR filing (as of March 31), will be taken into account.

Calculating Investment in Plant & Machinery for New Enterprise

For newly established enterprises without any prior Income Tax Return (ITR) history, the investment amount will be determined based on the self-declaration provided by the enterprise's promoter. This relaxation will be applicable until the end of the financial year in which the enterprise submits its first ITR, which must occur by March 31.

When assessing the value of plant and machinery or equipment, whether new or secondhand, the purchase (invoice) value will be considered. The calculation will exclude the Goods and exclude the Goods and Services Tax (GST) and will rely on self-disclosure for new enterprises lacking any ITR history.

Certain items listed in Explanation I to sub-section (1) of section 7 of the Act will not be factored into the calculation of the investment in plant and machinery.

From the second year onwards, the investment in plant and machinery will be linked to the Income Tax Return.

Calculation of Turnover

When calculating the turnover of an enterprise, any revenue generated from the export of goods or services will not be included.

The turnover calculation will be derived from linked income tax returns and GST portals. However, for newly established enterprises, turnover will initially be determined based on self-declaration. From the second year onward, turnover will be linked to the Income Tax Return and GSTIN records.

Formalization and
Credit Growth

Micro-enterprises, constituting over two-thirds of the entire MSME sector, exhibit a notably elevated level of informality, underscoring the need to reconsider ways to formalise unregistered MSMEs. In May of this year, the Reserve Bank of India (RBI) directed all financial institutions, including banks and NBFCs, to recognize informal micro-enterprises registered on the Udyam portal as micro-enterprises for categorization under the priority sector lending (PSL) norms.

As of June 23, 2023, there were 2,01,27,965 registered MSMEs on the Udyam Portal. However, according to the National Sample Survey (NSS) 73rd round conducted by the National Sample Survey Office in 2015-16, there were 6.34 crore unincorporated non-agricultural MSMEs in the country. This underscores our continued dependence on data collected from a survey conducted eight years ago and the fact that lending schemes are primarily aiding only a fraction of the total number of MSMEs in the country.

Proportion of Proprietorships to Pvt. Ltd. Cos. Among Micro Enterprises

	2021-22					
	Micro Enterprises					
State/UT	Proprietary	Hindu Undivided Family	Partnership	Private Limited company	Public Limited Company	Proportion of Proprietorships to Pvt. Ltd. Cos.
TELANGANA	107384	866	9116	7655	427	7.13
WEST BENGAL	121094	1145	9098	7579	459	6.26
TRIPURA	3826	68	156	226	30	5.91
KERALA	74956	97	9637	4330	147	5.78
KARNATAKA	209521	5328	14641	12037	660	5.75
SIKKIM	1192	8	28	59	8	4.95
GOA	6811	11	523	320	7	4.70
ODISHA	77325	1355	3289	3597	285	4.65
HARYANA	135626	662	8235	6153	209	4.54
MIZORAM	2865	4	35	126	38	4.40
UTTAR PRADESH	333475	1414	15308	12679	568	3.80

MEGHALAYA	1658	4	41	63	3	3.80
MAHARASHTRA	838155	3717	43026	27223	1146	3.25
TAMI L NADU	399698	1830	28145	12908	715	3.23
ASSAM	50650	1601	2469	1544	111	3.05
ANDHRA PRADESH	98525	1114	7078	2974	643	3.02
JHARKHAND	65547	332	4440	1801	122	2.75
UTTARAKHAND	40621	116	2209	1110	45	2.73
MANIPUR	12154	18	261	327	15	2.69
BIHAR	188069	1653	4082	4852	381	2.58
GUJARAT	315077	2874	30656	8102	305	2.57
HIMACHAL PRADESH	21008	137	1047	528	25	2.51
CHHATTISGARH	55433	226	2170	1323	73	2.39
ARUNACHA L PRADESH	1749	4	25	40		2.29
MADHYA PRADESH	205794	808	5470	4229	299	2.05
RAJASTHAN	342753	1670	11471	5772	273	1.68
PUNJAB	148657	909	9866	2314	125	1.56
NAGALAND	2868	5	32	39	2	1.36

The ratio of proprietorships to private limited companies exposes a significant imbalance amongst formalised MSMEs. In India, there are around 3.4 proprietorships for every private limited company. Only 11% of micro-enterprises have access to credit.

Understanding why firms choose to operate informally is a good starting point. A retail chain with operations across six cities and two states and a corporate office in a single state deals with 3,182 compliances in a year, according to a report by Teamlease Regtech. Among them, 1,192 (or 37%) compliances contain imprisonment clauses.

Necessary compliances increase with the registration as a company. Managing multiple MSMEs is more straightforward as proprietorships, and doing so makes individuals eligible for multiple benefits.

MSMEs have owned multiple MSMEs on purpose. Keeping each entity small to get benefit from schemes like CGTMSE (available only to MSEs) forces them to infuse capital in the form of loans, rather than equity capital and has encouraged MSMEs to remain small and scattered.

ECLGS NPAs: MSMEs

As of Sept., '22	Micro	Small	Medium
NPA % (Accounts)	18.2	9	3.1
NPA % (Amount)	8.1	4.2	2.7

Category	% Share in NPA	% Share of NPA Accounts
Micro	43%	93.5%
Small	25%	2.8%
Medium	10%	0.5%
Other	22%	3.2%

As of March 31, 2023, guarantees extended under ECLGS amounted to Rs 3.65 lakh crore out of a total fund pool of Rs 5 lakh crore. The ECLGS NPA reached 4.38%, equivalent to Rs 16,000 crore by the end of FY23. Micro-enterprises account for 93.5% of the total NPA accounts.

The reduction in the gross NPA ratio among MSMEs over the last few years presents only an incomplete picture as more than one-sixth of all accounts benefiting from ECLGS funds have now become NPAs.

Nevertheless, a staggering 65% of the MSME players availed benefits under the Emergency Credit Line Guarantee Scheme (ECLGS). The scheme's guarantee acted as collateral, which was viewed by lenders as a risk mitigant. At least 14.4 lakh MSMEs and around 12 per cent of the outstanding MSME credit was saved from slipping into NPA because of the ECLG scheme.

A System-wide Impact

Financial Year	Bank Credit to MSMEs by SCBs (Number in lakh, Amount in Rs. crore)							
	Micro Enterprises		Small Enterprises		Medium Enterprises		MSMES	
	No. of Accounts (lakh)	Amount Outstanding (crore)	No. of Accounts (lakh)	Amount Outstanding (crore)	No. of Accounts (lakh)	Amount Outstanding (crore)	No. of Accounts (lakh)	Amount Outstanding (crore)
2020-21	387.93	8,21,027.77	27.82	6,62,998.50	4.44	2,99,898.53	420.19	17,83,924.80
2021-22	239.58	8,82,693.58	21.88	7,22,274.25	3.22	4,06,089.15	264.67	20,11,056.98
2021-22 (end-Dec. 2021)	221.07	8,23,270.41	22.87	6,88,435.22	3.34	3,71,997.95	247.28	18,83,703.59
2022-23* (end-Dec. 2022)	193.64	9,78,646.26	16.83	7,34,260.08	3.2	4,37,686.00	213.68	21,50,592.34
% fall in the Number of accounts from 20-21 to 22-23	50	19	40	11	28	46	49	21

A worrying picture emerges on a closer look at the numbers for Bank Credit to MSMEs. The total number of MSMEs in the country availing bank credit has halved in the last 4 years. The number of MSMEs availing bank credit has continued to decline persistently.

MSMEs and the
Capital Markets

Capital markets have historically played a limited role in providing funding to micro, small, and medium-sized enterprises (MSMEs). However, the current economic uncertainties and the financial challenges faced by these businesses are prompting a notable change.

A significant portion of MSMEs lacks awareness about the requirements for stock exchange listings and often cannot afford the associated expenses, even on specialized and cost-effective platforms like those offered by the Bombay Stock Exchange and the National Stock Exchange. Nevertheless, resourceful entrepreneurs are finding ways to overcome these obstacles and pursue the goal of taking their businesses public. Their fundraising aspirations are typically modest, aiming to secure less than Rs. 10 crore in capital.

Several factors have contributed to the growth of small and medium-sized businesses (SMBs) in India in recent decades, including a dynamic business environment, supportive government initiatives, globalization, access to broader markets, funding opportunities from banks and financial institutions, and, perhaps most importantly, the determination and drive of Indian entrepreneurs.

Government programs such as Smart India, Startup India, Digital India, and Make in India are designed to promote fairness and equality among MSME operators, providing them with significant support to enhance their efficiency. Additionally, the increasing penetration of the internet and consumers' comfort with cashless transactions, facilitated by B2C e-commerce operators, are contributing to the expansion of the MSME sector.

SME exchanges, namely BSE SME and NSE EMERGE, currently host more than 595 firms that have collectively raised Rs 7,300 crores and boast a combined market valuation of Rs 79,000 crore. Among these platforms, BSE SME stands out as the most popular choice. It's worth noting that once a company lists on an SME exchange, both the NSE and the BSE offer the flexibility of transitioning to the main exchange when the timing is opportune. This option has already been utilized by 225 businesses.

One of the most significant advantages of listing on these SME exchanges is the elevated level of professionalism it brings to the companies. Listing tends to attract institutional investors who have demonstrated a keen interest in the SME sector. These listings have provided exit opportunities for private equity (PE) and venture capital (VC) funds. In other cases, they have led to acquisitions, additional fundraising, and substantial growth post-listing. As a result, this market has emerged as a legitimate and attractive option for early-stage enterprises seeking to secure expansion capital without incurring interest costs.

Regarding the transition of companies from the SME section to the main board, the BSE takes the lead with 147 such transitions, compared to the NSE's 109. This move allows these companies to access equity capital, increase their exposure and transparency, and unlock their full value potential.

Challenges in MSME Financing

Many micro, small, and medium enterprises (MSMEs) heavily depend on debt funding from banks and non-banking financial companies (NBFCs). The absence of verifiable financial data complicates the assessment of their financial track record, resulting in a significant gap between the demand for financing and its availability.

Traditional bank lending no longer relies solely on collateral; cash-generating models have emerged as new financing methods. To meet the eligibility criteria for financing, it is essential to project the firm's performance and financials accurately before lenders. This underscores the importance of meticulous financial planning.

Fintech solutions play a pivotal role in supporting enterprises. AI-driven models that make decisions based on limited financial and non-financial parameters of businesses have become prevalent. Online decisions are primarily made using score-based models in real-time, which is beneficial for MSMEs lacking a credit history.

Financial planning is crucial for enterprises seeking to qualify for finance, as many MSMEs lack a credit history, limiting their access to funds. Entrepreneurs face challenges meeting the criteria of conventional lending models, but NBFCs and Fintech companies are bridging this gap with alternative, technology-driven credit lending models. These alternative credit scoring models rely on digital data to assess borrowers' creditworthiness and risk, providing quick access to finance and improving financial eligibility for MSMEs. Entrepreneurs must adapt to these score-based models.

Historically, capital markets have not been the preferred funding method for MSMEs due to the absence of a conducive ecosystem. MSMEs typically seek specific attributes in a funding source:

Timeframe for Funding: MSMEs often require immediate financing, particularly for working capital needs.

Procedural Ease: MSMEs lack dedicated compliance teams and support for navigating complex capital market procedures. Simplifying and reducing the cost of these processes is essential.

Despite recent initiatives, MSME participation in the stock exchange has declined, possibly due to a sluggish market environment. However, there is potential for improvement in creating a more supportive capital market ecosystem for MSMEs.

While an IPO is an efficient way for new firms to raise equity capital, MSMEs have faced challenges in attracting public financing through IPOs. Stringent rules, fears of public issue failure, and inadequate support have deterred them.

To address these issues, stakeholders should consider reevaluating the SME IPO system and making it more favorable for SME listings. A dedicated window for SMEs to launch their IPOs and a reconsideration of the minimum lot size could encourage greater retail investor participation. Currently, the minimum lot size for SME IPOs is Rs 1 lakh, significantly higher than the Rs 10,000-15,000 minimum for mainboard IPOs, discouraging retail investors from participating in SME IPOs. Regulators should reconsider this minimum lot size to promote SME IPOs.

Potential Solutions to Encourage MSMEs in Capital Markets:

Specialized SME IPO Window : Create a dedicated platform or window for SMEs to launch their initial public offerings (IPOs). This separate space can cater to the unique needs and challenges of SMEs, making it more attractive for them to enter the capital markets.

Independent Advisory Body : Establish an independent government-supported body that provides guidance and consultancy to MSMEs looking to access capital markets. This advisory body can help MSMEs navigate the complexities of capital market readiness at a nominal cost, potentially subsidized by the government. This would enhance trust in MSMEs as their financial data would be vetted by a quasi-governmental body.

Investor Incentives : Offer incentives to investors to encourage participation in MSME IPOs. Consider tax exemptions or other benefits for those who invest in these offerings. This can mitigate the perceived higher risk associated with MSME investments and make them more appealing to a broader range of investors.

Investor Education : Implement investor education programs to familiarize potential investors with the dynamics of MSME investments. This would help demystify the sector and attract more investors, making it a mainstream investment option.

Larger Investor Pool : Encourage the participation of a broader range of investors, which would increase trading volumes and promote efficient price discovery in MSME IPOs. A larger investor pool would also enhance liquidity, making these stocks more attractive to both MSMEs and investors.

Promote SME Bond Issuances : Encourage MSMEs to participate in debt capital markets by promoting the issuance of SME bonds. These bonds can offer MSMEs access to cheaper interest rates compared to other financial intermediaries, making debt financing a more attractive option.

Government Support : The government's role is crucial in fostering the growth of MSMEs in capital markets. By providing continued support and incentives, the government can ensure that the MSME sector remains resilient in the face of short-term challenges, sustaining long-term growth.

Addressing Nature, Climate, and Biodiversity Risks : It is imperative to confront the challenges posed by nature and climate risks, including the potential loss of biodiversity. The MSME sector should take proactive measures to manage ESG (Environmental, Social, and Governance) risks. By doing so, they can secure sustainable, long-term benefits. Moreover, their efforts to reduce carbon emissions play a crucial role in mitigating climate-related risks. In the process, they become eligible for various financial and non-financial incentives over time.

Incorporating these solutions can help bridge the gap between MSMEs and capital markets, creating a more conducive environment for these enterprises to access the financing they need to thrive and contribute to economic growth.

Driving India's

Manufacturing and Export Growth

India's export growth has experienced a significant boost due to six major trends that have been accelerated in the past two years. These trends have enhanced the overall appeal of exports across various sectors in India. The six key trends are :

- Supply chain diversification
- Advantages for India in certain manufacturing sectors
- Government initiatives to bolster manufacturing in the country
- Capital expenditure infusion into manufacturing sectors
- Heightened merger and acquisition (M&A) activity
- Private equity/venture capital (PE/VC)-led the investment in manufacturing

Global trade has rebounded from the challenges posed by the Covid-19 pandemic, but it continues to face obstacles such as anticipated economic downturns, increasing protectionism, regionalism, and ongoing supply chain disruptions. Despite these global dynamics, India is well-positioned for sustained growth, thanks to government measures aimed at reducing trade barriers, promoting manufacturing, and expanding infrastructure. This has contributed to significant growth in Indian exports.

Numerous initiatives have been launched to support MSME exporters in expanding their market presence, enhancing accessibility for companies, and facilitating access to capital. These efforts have provided a much-needed boost to the industry. However, there remains a critical challenge hindering the full potential of this market in driving India's economic progress: limited accessibility to finance.

The difficulties in funding this industry are well-acknowledged and encompass issues such as incomplete and outdated documentation, as well as a lack of financial literacy among MSMEs. To address these challenges, it is imperative to innovate the entire approach to credit assessment and monitoring. This innovation is designed to enhance export quality, performance, and market and outdated documentation, as well as a lack of financial literacy among MSMEs. To address these challenges, it is imperative to innovate the entire approach to credit assessment and monitoring. This innovation is designed to enhance export quality, performance, and market reach and encompasses various activities, including sponsorship, promotion, seminars, conferences, and research and development.

Export incentives represent the government's efforts to provide advantages to exporters in exchange for their contribution in generating foreign revenue and offsetting the expenses associated with exporting products and services beyond the nation's borders.

Remission of Duties and Taxes on Export Products (RoDTEP): This export incentive scheme was initiated on January 1, 2021. Under RoDTEP, exporters in India are entitled to receive a refund for the taxes and duties they have paid while manufacturing or processing goods intended for export. This scheme aims to make Indian exports more competitive in the global market by mitigating the burden of domestic taxes and duties on exported products.

Service Exports from India Scheme (SEIS): SEIS is designed to promote and optimize the export of specified services from India. It recognizes the significance of service exports in generating foreign exchange and encourages service exporters. Under SEIS, service exporters in India are eligible for incentives ranging from 3% to 7% based on their net foreign exchange earnings from designated services.

Advance Authorisation Scheme (AAS): The Advance Authorisation Scheme allows for the duty-free import of raw materials that are used in the manufacturing of export goods. In other words, if imported commodities are intended for the production of export products, they are exempt from import duties. This scheme is particularly advantageous for businesses involved in manufacturing and export, as it reduces the cost of raw materials. Import duties that are typically waived include Basic Customs Duty, Additional Customs Charge, Education Cess, Anti-dumping duty, Safeguard Duty, Transition Product-Specific Safeguard duty, Integrated tax, and Compensation Cess.

Duty Drawback Incentive: The duty drawback incentive is a scheme designed to provide reimbursement for government-imposed duties. It is administered and monitored by the Department of Revenue, specifically the Customs Department. Under this initiative, customs and excise duties paid on both imported and domestic materials used in the production of exported goods are refunded to the exporters. The rate of duty drawback varies depending on the specific product being exported.

Rebate on State and Central Tax and Levy (RoSCTL): RoSCTL is a scheme that benefits manufacturers of made-up products and garments. Under this scheme, the government provides duty credit scrips to incentivize exports. These scrips can be transferred or sold and are based on the Free on Board (FOB) value of the exported goods. The unique feature of RoSCTL is that it directly deposits rebate funds into the exporter's bank account. This simplifies the process and provides a financial boost to exporters, making it easier for them to expand their overseas markets.

Market Promotion and Development Assistance Scheme (MPDA): MPDA is a unified scheme that combines various initiatives previously implemented by the Khadi sector, including activities marketing, market promotion, and marketing development assistance. Additionally, this scheme provides grants and subsidies for the construction of Khadi plazas. The primary objective of MPDA is to enhance the earnings of artisans working in the Khadi sector by promoting and developing markets for Khadi products.

Export Market Revamped Scheme of Fund for Regeneration of Traditional Industries (SFURTI): This scheme is aimed at reorganizing traditional industries and artisans into clusters, with the goal of enhancing their competitiveness and ensuring their long-term sustainability. SFURTI also focuses on improving the marketability of products from these clusters by offering support for the development of new products, interventions in design, improved packaging, and the enhancement of marketing infrastructure.

Quality Management Standards (QMS) and Quality Technology Tools (QTT): This initiative falls under the Ministry of Micro, Small, and Medium Scale Enterprises and is part of the National Manufacturing Competitiveness Programme (NMCP). Its purpose is to enable the manufacturing sector to compete effectively by emphasizing the importance of Quality Management Standards (QMS) and Quality Technology Tools (QTT).

Financial institutions play a crucial role in raising awareness among MSMEs about Environmental, Social, and Governance (ESG) risks and guiding them on strategies to reduce their carbon footprints, fostering a path toward sustainable growth.

To enhance ESG awareness and performance measurement tailored to the unique needs of MSMEs, the development of an MSME-specific ESG scoring and rating framework is essential. This framework will enable a comprehensive assessment of MSME units' ESG-related practices and their impact.

The resulting ESG scores should be transparently shared with MSME entrepreneurs, empowering them with valuable insights to make informed decisions and adapt their operations to align with ESG principles.

Additionally, in the context of supporting the MSME sector, supply chain finance has emerged as an effective tool. It can provide the much-needed support to MSMEs, particularly in the context of global supply chains. Indian banks have significant capabilities which could be leveraged for global supply chain finance. By integrating supply chain finance strategies, financial institutions can enhance the resilience and sustainability of MSMEs, ensuring their continued growth and success in the global marketplace.

Responding to
MSME Issues

Delayed Payments and TREDS

TReDS provides a digital marketplace where MSMEs can upload their unpaid invoices and receive financing from multiple financiers including banks and non-banking financial companies (NBFCs). This platform addresses a critical challenge faced by MSMEs. Around 80 per cent of the annual delayed payments amount is owed to MSMEs. A recent report attributed around 41% of all stressed loans in the MSME sector to this issue.

Measures implemented, such as disallowing penal interest paid for delayed payment to MSMEs as deductible expenditure, disclosure of overdue payments in audited accounts of companies, the Samadhan portal, and TReDS, have not fully resolved the issue.

The TReDS platform, although well-intentioned, has limitations as large buyers retain control of the process in the system – they are required to validate invoices submitted by suppliers. Large firms (who do not stand to benefit from the process) are hesitant to file invoices from unknown suppliers, which leads to a lack of trust in the system.

New RBI guidelines (Jan 2022) allowed NBFCs with asset size more than Rs. 1,000 crore to be enrolled into TReDS. It still leaves out younger fintech companies, limiting the platform's ability to serve micro businesses. Also, micro-enterprises are often left out due to their size and lack of interest from larger lenders. In 2020–21, the median debtor days for microenterprises was 195 days, compared to 68 days for smaller enterprises and 47 days for medium-sized companies.

Measures needed to avoid delayed payments to MSMEs

Budget 2023 proposed to allow expense deduction by the buyers under Section 43B (h) only when payments are made. Previously, the government permitted a deduction for an expense when revenue was recognized, even if creditors had not been paid yet.

The power imbalance between small suppliers and large purchasers, combined with the fear of losing business, results in non-reporting, manipulation, and circumvention of provisions.

Corporates are required to specify unpaid amounts with interest in the annual statement of accounts. However, auditors often resort to a general disclaimer stating that MSME data is not available with the client.

The fact that tax declaration is done at the end of a financial year also gives some latitude for payment delays under Section 43B(h). In order to address non-reporting, late payments and defaults across the trade credit ecosystem, the provision should be made applicable to all credit-based GST transactions and linked to the GSTN system. This will help resolve the issue of delayed payments by ensuring that all credit-based GST transactions are monitored in real-time, making it easier to identify non-reporting, late payments, and defaults.

Taking action against a company that delays or defaults on payment by impacting its credit rating will go a long way in fortifying the payment system. (It may be necessary to allow for some flexibility in the 45-day payment period initially in order to establish a stable payment system. Otherwise, some companies may avoid making direct credit purchases from Micro and Small Enterprises (MSEs) to evade regulations.)

Champions portal

Before the launch of the Champions portal, which took place after May 31, 2020, MSMEs' issues and grievances were managed through the Internet Grievance Monitoring System (IGMS). However, it became evident that a more comprehensive and technologically advanced platform was required to better assist and foster the growth of MSMEs within the country. As a result, the Champions portal was developed and introduced with the goal of serving as a unified, empowered, robust, and technology-driven platform to support and promote MSMEs.

The Champions portal offers a wide array of services, including access to financing, skill enhancement opportunities, and connections to markets, all aimed at helping MSMEs overcome the obstacles they encounter and expand their enterprises. Additionally, it provides MSMEs with a single point of contact for all their requirements, simplifying their access to government services and assistance. In essence, the Champions portal is designed to be a comprehensive resource for MSMEs in India, equipping them with the tools and assistance they need to thrive in a competitive business environment.

In order to support Micro, Small, and Medium Enterprises (MSMEs) during these challenging times, encompassing financial constraints, raw material shortages, labor issues, and regulatory hurdles, the government initiated several measures. In addition to addressing immediate challenges, these initiatives were designed to empower MSMEs to seize fresh opportunities emerging in both the manufacturing and services sectors. The government's goal was to identify and nurture promising MSMEs, often referred to as "sparks," which possess the resilience to withstand current challenges and the potential to become national and international leaders in their respective industries.

The government's portal dedicated to addressing grievances of small businesses has recorded a significant increase in the number of grievances successfully resolved. As of July 12, 2022, a total of 48,308 complaints from MSMEs were resolved, marking a substantial rise from the 35,562 complaints resolved as of July 15, 2021. The portal was initially launched on June 1, 2020, and this increase demonstrates its effectiveness in addressing the concerns of small businesses. The portal encompasses various aspects of e-governance, including grievance resolution and providing support to MSMEs.

Overall, it received approximately 50,000 queries.

Furthermore, several months after its launch, the government took a step forward by integrating artificial intelligence (AI) and machine learning (ML) into the portal. This integration allowed the government to obtain social media insights related to MSMEs, enabling them to understand the sentiment of the entire MSME sector without stakeholders going to the portal. Additionally, it facilitated the real-time monitoring of the emotions and sentiments of individuals associated with or dependent on MSMEs. This development indicates the government's utilization of AI for obtaining more detailed and granular data pertaining to the MSME sector.

The Micro, Small and Medium Enterprises Development (MSMED) Act incorporates provisions related to Delayed Payments to Micro and Small Enterprises (MSEs). To facilitate the resolution of payment disputes between MSME units and their counterparts, Micro and Small Enterprises Facilitation Councils (MSEFCs), often referred to as 'MSME Courts,' were established by respective state governments. These MSEFCs serve as arbitrators in settling disputes related to payments within the MSME sector.

Dispute Resolution Process at MSEFC: How to File a Case

When a buyer fails to make payment or delays payment to a seller for purchased goods or services, the seller, as per the provisions outlined in the MSMED Act of 2006, has the option to file a legal claim against the buyer unit. This claim is submitted before the Micro and Small Enterprise Facilitation Council (MSEFC) for the recovery of the outstanding amount.

To initiate the process, the case or claim can be submitted online via the official website. Once the MSEFC accepts the filed case, both the buyer and seller units, along with their respective legal representatives (Advocates/Lawyers), are called upon to present their perspectives and arguments. The MSEFC then renders a decision based on the information provided. It is essential to draft the application accurately to meet the Act's requirements.

After a thorough examination of the case, the MSEFC issues directives to the buyer unit, specifying the payment of the outstanding amount along with applicable interest and compound interest, in accordance with the provisions of the MSMED Act of 2006.

There is a pressing need for establishing a robust institutional mechanism dedicated to serving the interests of MSMEs. This mechanism should focus on simplifying compliance processes and reducing associated costs, particularly for MSMEs and smaller enterprises.

Offshore

Borrowings

External Commercial Borrowings (ECB) pertain to the debt acquired by eligible entities in India for commercial purposes from recognized foreign sources, as per the regulations outlined by the Reserve Bank of India (RBI). The RBI governs ECBs through the Master Direction - External Commercial Borrowings, Trade Credits, and Structured Obligations, in accordance with the Foreign Exchange Management Act, 1999 (FEMA).

ECBs serve as essential financial instruments for Indian firms and organizations seeking to raise funds internationally, particularly for attracting fresh investments. It's important to note that ECBs encompass a broader spectrum of financial instruments compared to Foreign Currency Convertible Bonds (FCCBs) and Foreign Currency Exchangeable Bonds (FCEBs). While FCCBs primarily aim at capital raising, ECBs encompass various commercial loans, including securitized instruments, bank loans, suppliers' credit, buyers' credit, and bonds, with an average minimum maturity period of three years.

In the wake of post-crisis banking sector deleveraging, there is a growing discussion on the necessity for an efficient and transparent securitization market. Such a market could enable the banking sector to access funds at a relatively lower cost and expand small and medium-sized enterprise (SME) lending. ECBs underscore the significance of developing both primary and secondary markets for securitizing SME loans, aiming to promote SME lending.

Drawbacks of ECBs:

While we have discussed several advantages of External Commercial Borrowings (ECBs), it's important to acknowledge some potential drawbacks. One concern is that companies might become complacent or less cautious when they have access to funds at lower interest rates, even though overseas interest rates are currently high. This could lead to irresponsible borrowing practices, resulting in increased debt on the company's balance sheet. This, in turn, can negatively impact financial ratios. Rating agencies tend to view companies with higher debt levels unfavorably, potentially leading to a downgrade in their market status. Additionally, the company's shares could experience a decline in market value over time.

Since raising funds through External Commercial Borrowing involves transactions in foreign currencies, both the principal and interest must be repaid in foreign currencies. This exposes the company to exchange rate risks. Despite the lower interest rates available through ECBs, there are various guidelines and restrictions that cannot be circumvented. These limitations primarily pertain to the borrowing amount and maturity period. Borrowings exceeding USD 20 million typically require maturity periods of at least five years, while amounts under USD 20 million usually have average maturity periods of at least three years.

FCCBs, despite offering lower interest rates compared to loans, come with certain drawbacks that can make them less attractive to borrowers. One significant concern is the potential for equity dilution if FCCBs are converted into equity, which can deter borrowers. Additionally, if a company's stock performance is weak or has experienced a decline, lenders may be hesitant to opt for FCCBs.

The financial performance indicators of companies that have utilized ECBs exhibit a pattern that aligns with the stock price performance. In bull markets, companies with ECB debt typically experience little financial strain. However, during bear markets, when profits decline and the local currency depreciates, companies with substantial ECB exposure often see a significant reduction in their Interest Cover, Return on Equity, and PAT margin. These indicators suggest a deteriorating financial position for such companies. Moreover, FCCBs may not be converted into equity if the stock is trading below the FCCB conversion price, which is often the case in depressed equity markets. In such situations, the company that issued the FCCB can face severe liquidity and solvency challenges as it is obligated to repay its external debt commitment, even though it had originally planned to convert it into equity at the time of redemption.

In the event of default in such a scenario, the company may consider several options:

1. Refinance the FCCBs by extending the bonds with later maturity dates, often at higher interest rates . (coupons).
2. Reduce the conversion-to-equity price, and further dilute promoter holdings.
3. Negotiate with bondholders to accept a haircut, which entails only a partial repayment of their principal amount.

Advantages of External Commercial Borrowings (ECBs) over loans obtained from domestic sources

While equity becomes locked in, an ECB is a structured loan with a predefined repayment schedule that allows for the flexibility of early repayment, refinancing, or modifications as needed. An ECB loan can be either secured or unsecured.

Additionally, since overseas borrowing typically offers significantly lower interest rates compared to those of Indian banks, it presents a mutually beneficial proposition. Indian companies can access funds at lower interest rates, often below 5%, while overseas entities can earn interest on surplus funds at rates higher than their local bank rates.

The following are some key advantages of raising capital through ECBs:

- Access to Foreign Currency Funds: Companies often require funds in foreign currencies for various purposes, such as paying international suppliers, which may not be readily available in India.
- Wider Funding Options: The ECB market is expansive, enabling companies to fulfill substantial capital requirements from international sources, surpassing what can typically be achieved through domestic channels. Importantly, ECBs do not necessarily involve equity transactions, ensuring that the company's ownership stakes remain unaffected, as borrowers do not grant voting rights to debtors. This allows companies to raise funds without relinquishing control.
- Diversified Investor Base: Borrowers can diversify their investor base when using ECBs, resulting in increased stability and flexibility for the borrowing entity.
- Economic Benefits: ECBs can also be advantageous for the overall economy. The government of India can direct inflows into specific sectors, boosting their growth potential. For instance, the government can allocate a higher percentage of ECB funding to support small and medium-sized enterprises (SMEs) and infrastructure projects, contributing significantly to the nation's overall economic growth.

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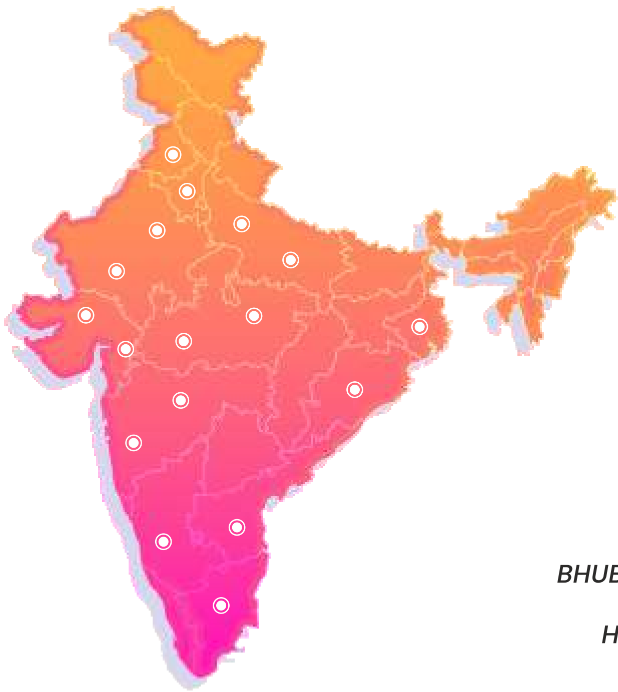

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