

The MSME Conundrum - COVID Troubles for an Already Troubled Sector

OPEN ACCESS

Manuscript ID:
MGT-2022-10025271

Volume: 10

Issue: 2

Month: October

Year: 2022

P-ISSN: 2321-4643

E-ISSN: 2581-9402

Received: 19.07.2022

Accepted: 28.09.2022

Published: 01.10.2022

Citation:
Dua, Sonali Ahuja. "The MSME Conundrum - COVID Troubles for an Already Troubled Sector." *Shanlax International Journal of Management*, vol. 10, no. 2, 2022, pp. 49–55.

DOI:
<https://doi.org/10.34293/management.v10i2.5271>



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Abstract

India is a land of small entrepreneurs. MSMEs in India - comprising over five crore businesses and employing over eleven crore people - sum for nearly half of India's production. There are around 6.33 crore MSMEs in the country and they manufacture more than 8000 products.

MSMEs have faced challenges ranging from inadequate access to markets, poorly skilled manpower, poor technology adoption, high cost of capital, challenges in raw material procurement, and inadequate infrastructure. While the Government of India understands it needs to play a greater role in supporting MSMEs - as is evident from schemes like the Atmanirbhar Abhiyan - more needs to be done.

As if these challenges were not enough, MSMEs were hit hard by the COVID outbreak and the resultant lockdowns.

In this research paper, we explore the challenges faced by Indian MSMEs and the support that the government can offer them to help take on a future that looks skewed in favor of large enterprises.

Keywords: New Definition of MSME, COVID-19 crisis, Revival Strategies.

Introduction

MSMEs Definition - An Indian context

According to the MSME Act, the MSMEs are classified into two classes, i.e. Manufacturing Enterprises and Service enterprises.

The MSME Act of 2006 defines MSME as “*The organizations manufacturing products related to any sector specified in the first schedule of Industrial Act, 1951. The organizations involved in manufacturing and provision of services subject to limiting factors of funding in plant and machinery and other equipment*”.

However, the above criterion has been under the scanner. Recently, with the onset of COVID-19, the government of India changed the criterion for defining MSME. The definition of MSMEs was revised (w. e. f. 1st July 2020) as follows:

| Type of Enterprise | Investment | Turnover |
|--------------------|-------------------------|--------------------------|
| Micro | not more than 1 crore, | not more than 5 crores |
| Small | not more than 10 crores | not more than 50 crores |
| Medium | not more than 50 crores | not more than 250 crores |

Source: MINISTRY OF MSME

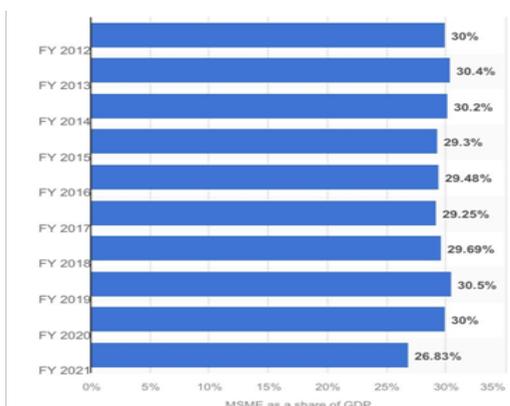
In the new definition, both manufacturing and service enterprises have been clubbed together and the MSMEs have been defined in terms of composite criteria of investment and turnover.

MSMEs in India - an Overview

MSME is a major contributor to the upward trajectory of the economy's development. It is the spine of the Indian economy. The importance of MSMEs can be understood by the fact that it absorbs around forty percent of the laborers.

Nearly 30% of India's GDP comes from micro, small, and medium-sized enterprises in the 2019 fiscal year. The GDP growth rate of approximately 13% that year over the year before, represented a rising contribution to the nation's GDP in recent years.

The Graph below Represents the Share of Micro, Small and Medium Enterprises in the GDP Across India from the Financial Year 2012 to 2021



Review of Literature

Das, 2008: It is evident from the initial days of the National Planning Commission that these enterprises would play a pivotal role in the development of the economy. Hence, efforts should be made to promote them on a sustainable basis. Their critical concerns be addressed.

Ali & Husain, 2014; Eniola & Entebang, 2015: Development of the MSME sector is a prerequisite for the upward movement of the Indian economy. It constitutes above fifty percent of the production of the economy.

Bhuyan, 2016: Bhuyan mentioned that the MSME sector had a huge contribution toward employment generation. The formation of these units would lead to rural industrialization and thus reduce the regional disparities.

Kurien, Bhat, Rao, & Kurapati (2020): In their research paper focuses on the challenges that have surfaced for the MSMEs due to the pandemic. The Government of India (GOI) has taken many measures to control the epidemic, including the complete lockdown of the nation to flatten the epidemic curve and to reduce the fatality rate. Despite everything done the MSME faced severe problems and many had to even shut down their businesses.

Lalwani (2020) In this research paper talks about the actions that have been taken to minimize the risk to SMEs. The Taxation and Other Laws (relaxed of certain provisions) agreement was introduced On 31st March 2020 the Central Government extended the deadlines of the Income Tax Act (1961), the Central Excise Act (1944), and the Customs Act (1962), etc.

Sipahi, 2020: In order to stir the economy forward, countries have to reinforce their enterprises in the MSMEs sector

Chauhan, 2020; WTO, 2020

The Government has initiated urgent stimulus and precautionary measures in the interest of the MSMEs. Measures such as liquidity support to deal with cash flow issues, security of jobs and continuity of business, as well as measures to expand trade opportunities have been taken.

Rationale of the Study

Primary objectives of this research paper are:

1. Outline the systemic importance of MSMEs to the Indian economy in terms of output, employment opportunities, revenue generation, and exports.
2. Examine the traditional (pre-COVID) problems faced by the MSMEs
3. List the additional challenges from COVID outbreak and the related lockdowns.
4. The policy initiatives to revive the MSMEs sector by the government
5. Suggest revival strategy of MSMEs to sustain in post-pandemic situation

Research Methodology

The data relevant to this research paper has been gathered mainly from the published sources such as the annual report of the Ministry of MSMEs.

Discussion and Findings

MSME - a Sector already in trouble

Technology Lag

One of the biggest problems faced by the Indian MSMEs is they are generally behind on the technology adoption curve. The effect of technology is exponential as it helps with achieving economies of scale, reduces dependence on skilled manpower, increases productivity, reduces time-to-market, and so on. Technology - unless developed in house by the MSMEs themselves - is generally expensive to adopt. Therefore, by definition, MSMEs struggle to keep updated with the latest technology when compared with the larger market players. For MSMEs in India, the problem is not only that technology is expensive to implement, it is also a case that many entrepreneurs lack awareness of the latest in technology.

High Cost of Credit

Another challenge that the Indian MSMEs have to face is poor access to credit. The credit-related challenge has several aspects:

No unsecured credit - Banks seek collateral which MSMEs may not have and are more comfortable offering unsecured credit to large enterprises. Most promoters end up offering personal assets as collateral and others who do have sufficient assets are unable to access credit.

High cost of credit - Since MSMEs are deemed risky, they are charged higher rates of interest on the credit they are able to raise. Transaction costs (like cost of asset appraisal, loan appraisal, etc.) further add to the cost of credit for the MSMEs

Delayed access to credit - Even the credit that MSMEs are able to raise takes time because the departments (within banks / other lenders) working on MSMEs credit are either overworked (due to large numbers of cases) or generally slow.

Complex Legal and Taxation Compliance Framework

MSMEs are generally overwhelmed with a large number of compliances including company laws, labour laws, etc. Additionally, taxation laws have always been complex in the country. While the move to GST is a step in the right direction, still it has not fully eliminated the complexities for the MSMEs.

Burden from Populist Governments

Populist governments who offer freebies to the poor generally burden businesses (both small and large) with subsidies. One example is the difference in the rates of electricity supplied to farmers and small businesses. While the farmers across states get a significant amount of electricity free of charge or at nominal rates, small businesses must pay commercial rates for electricity which are generally higher, and therefore burdensome. These burdens hurt the MSMEs a lot more than the large businesses.

Inadequate Infrastructure Facilities

For MSMEs to compete, they need access to good infrastructure facilities. A simple example of good infrastructure is an uninterrupted power supply. If MSMEs can get access to a power supply and not have to worry about setting up expensive backup power, they would be far more productive and be in a position to compete with the big players.

Procurement of Raw Materials

The smooth availability of supplies and resources is critical for any business. In the case of MSMEs in India, it is a big concern because it can generally be done within the local territory to save transportation costs. This gives the suppliers undue power over the MSMEs to allow them to overcharge and deliver at convenience.

Poor Access to Skilled Manpower

Even though India has a large pool of young population but where it still lags is that the manpower is not as productive as it could be. The reasons are as follows:

- a. Generally the workforce does not get employed in the sectors that suit their profile. Even though the agriculture sector employs a huge number of people, still this sector is equally guilty of under-employing the youth as more people are engaged in generating relatively low economic output.
- b. The human force is poorly skilled - Indians have traditionally looked at education and college degrees as a way out of poverty. A large number of college graduates, are generally not employable in the industry. A set of skilled personnel is required to work efficiently and effectively

Lack of Market Accessibility

The most common reasons for lack of market accessibility are:

- Inadequate capital for marketing
- Inadequate access to marketing tools
- Poor access to government procurement

Additional Challenges by COVID

MSMEs in India were still dealing with the impact of demonetization and GST implementation when COVID spread to India. With the number of COVID infections increasing, the government implemented a lockdown in the first quarter of 2020. This was a total lockdown barring every individual not on medical services duty, to stay indoors. This forced nearly all businesses to shut down right away.

Daily wage earners employed by MSMEs were unable to earn and pay for food, lodging and other basics and were left with no option but to migrate back to their respective hometowns. Even salaried employees saw their salaries stopped or reduced. While the shut down of business was a jolt for the MSMEs, the unavailability of former employees hit the MSMEs hard even when the lockdown restrictions were lifted. In addition, payments and credit flow choked resulting in an all-round pain for the sector. The cycle was repeated over every lockdown implemented by the government resulting in several MSMEs suffering existential crises.

Overcoming the Challenges

Access to Technology

The Government has offered support to upgrade their technology through the Credit Linked Capital Subsidy Scheme (CLCSS) to new or existing MSMEs. CLCSS provides an upfront capital subsidy of 15% to MSMEs operating in 51 sub-sectors or products.

However, the government also needs to run programs to educate the MSMEs and entrepreneurs on the affordable technologies that will help them gear up for competition.

Financial Support and Access to Credit

- a. The Government of India has set up Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), a trust which facilitates MSMEs to get credit up to 2 Crores without any collateral requirements. The scheme offers

further benefits in the form of fixed guarantee costs of 0.75% to 1.80% for borrowers who maintain a good repayment track record.

- b. Interest Equalisation Scheme offers interest equalisation of 5% per annum under pre & post-shipment rupee export credit to MSME exporters.
- c. Reimbursements - various reimbursement schemes can be availed by the MSMEs to get ISO Certification fees, Credit Rating fees, and Patent registration fees reimbursed in part or full.

Industrial Estates for MSMEs

Government can step up its support to MSMEs by creating Industrial Estates, IT Parks, Trade Zones, Manufacturing clusters, etc. Creation of such clusters allows for significant cost savings in infrastructure development & transportation. These clusters also allow for reducing pollution in towns and cities, engineering reverse migration from overcrowded cities, etc.

Infrastructure

- a. Transportation infrastructure development would allow for easy access to raw material from all over the country. This infrastructure covers multi-lane highways, railway network, waterways, intra-city and inter-city connectivity, etc.
- b. Telecommunication infrastructure covers 5G network, internet fibre network, datacentres, communication satellites, etc. and their affordable availability would go a long way in supporting MSMEs. Government has created this infrastructure through entities like BSNL, VSNL, MTNL, etc. but enabling the private sector and attracting private capital is a more viable route to creating this infrastructure and, in turn, helping MSMEs.
- c. Power Infrastructure - India's dependence on fossil fuels and the increasing pressures of fluctuating import costs and environmental degradation are rightly forcing the government of India towards renewable resources of power generation - notably solar power. With aggressive focus on enabling the set up of power generation units, the government can not only help MSMEs indirectly by providing them uninterrupted and affordable power, but directly by creating MSMEs operating in the entire value chain of renewable power generation.

d. Hazardous Waste Disposal Infrastructure - this is an important infrastructure that needs significant work. With more and more digitization, we are dependent on products that generate hazardous waste during their manufacture, use and disposal. Government could mandate MSMEs to take up this important aspect of infrastructure.

Simplify Legal and Taxation Compliances for MSMEs

The list of compliances that MSMEs must comply with are onerous. These are

ROC Compliances - Appointment of Auditor, Preparation of your Company Financial Statements, Disclosure of Director's Interests & Declaration Regarding Disqualification, Registered Office, Issue of Share Certificates to Subscribers, maintaining Statutory Registers, PAN & TAN, MGT 14, etc.

Taxation-related compliances cover - TDS/ TCS payment, GST payment and GST filing, Other payments of periodic dues, Filing of quarterly TDS returns, Advance tax payment, Filing of IT returns, Filing of tax audit reports, Tax audits.

These account for a significant amount of time, effort and mindshare and MSMEs with small teams are simply unable to manage all compliances on their own. To get external assistance is not only financially burdensome, but also risky because non-compliance with any of the above results in hefty penalties from the government agencies. Government must look at all the compliances objectively and work towards reducing this burden on the resource-starved MSMEs.

Governments (Both State and Central) must be Prevented from Burdening MSMEs with Undue Burdens of Subsidies

Governments find it easy to burden the businesses with additional burdens of subsidy support, cess on income, etc. Among all businesses, the MSMEs due to their size are hit harder. While in the long run, governments must move away from subsidies, in the interim they must take steps to avoid unfairly burdening the MSMEs with this burden.

Skilled Workforce

Government has undertaken several skilling programmes with the aim to produce a world class workforce. Over the last decade, several skilling

programmes and schemes have been rolled out to fund training of candidates across sectors. The government has founded organizations like National Skill Development Corporation (NSDC), NCVET, Sector Skill Councils, State Skill Development Missions, etc. to fund and execute programmes to produce industry-ready skilled workforce. These organizations are also engaged in generating awareness of youth to enrol in these skill development programmes. These organizations are operating on the Public-Private Partnership (PPP) model and have seen some success in their mission. However, the whole skill development environment needs to find more optimization to meet industry demand at lower costs. Ultimately, the government needs to generate a culture of large corporations funding this training to indirectly benefit the MSMEs.

Enabling Private (Non-Bank) Capital to Serve MSMEs through NBFCs

India is currently seeing a significant growth in investments in startups and new age companies. Such private startups and new age companies in the financial technology and NBFC space can be encouraged by the Government and RBI to create a funding pool for MSMEs. At the same time, both the Government and RBI need to be conservative enough to keep these private credit providers on a tight leash to avoid predatory loans from harming the financial health of the borrowing MSMEs who are generally not very financially savvy.

B2G Platforms - GeMS Portal

Governments - both central and state - are one of the largest buyers of products and services in the country. Government is generally a preferred buyer for MSMEs because their payments never make it to "bad receivables" for the vendors. Because of this, governments have been a victim of corruption by errant officers and connected vendors, leaving the genuine vendors behind. Therefore, to make government purchases more transparent and to provide real time information for potential MSME vendors (so that they do not miss out on the right tenders and Requests for Proposal (RFPs), the government has centralised the entire government procurement on the GeMS portal. This move will help the genuine MSMEs to get business from the government. This will also prevent corruption.

B2C Portal - ONDC Portal to Democratise Ecommerce

The exponential growth in India's ecommerce, led by the likes of Amazon, Flipkart, Myntra, Snapdeal, Zomato, Grofers, etc. have left the small businesses behind. For small businesses, their only option to reach the end customer is through these platforms as resellers. At the moment, as Amazon and Flipkart have become so big that the MSMEs have no option but to become resellers on these platforms. Becoming a reseller on these platforms subjects these MSMEs to aggressive margin deductions by the platforms and unfair profit sharing.

Keeping the plight of MSMEs in mind, the government has launched the Open Network for Digital Commerce (ONDC), to serve as an online commerce platform that provides inclusivity for small vendors. All vendors - mostly MSMEs will be able to make their products / services catalogues visible on ONDC.

This platform will provide an open digital storefront with catalogs of restaurants, grocers, and vendors visible to all buyers on platforms to decide whom to purchase from. Since April 2020, ONDC has been testing grocery and food delivery in select cities.

With aggressive marketing and less predatory profit sharing, ONDC could be the government's way of protecting the MSMEs from being devoured by the large companies.

Special Schemes to Ease the COVID Pain - Atmanirbhar Bharat Scheme (ABS)

Non-Financial Support under the ABS:

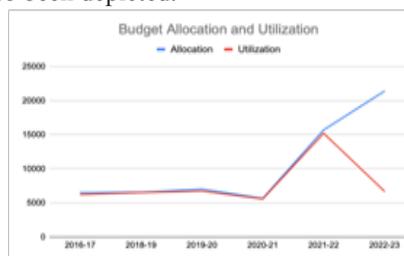
1. The revised definition of MSMEs - has allowed for a larger number of entities to get covered under the definition of MSMEs and hence get the right benefits. Under the newly revised definition both manufacturing and service sectors are now considered the same for the classification based on investment. In addition, the investment limit for both sectors is increased along with a new criterion of turnover to help bring in many new enterprises within the ambit of the MSME definition to benefit from the Government schemes.
2. Global tenders under Rs 200 crores disallowed: The government has decided to offer tenders for any procurement up to Rs. 200 crores to the Indian

MSMEs by disallowing overseas competition. This will greatly help the Indian MSMEs.

3. Marketing Assistance: Government has taken steps to provide e-market linkage for MSMEs to replace physical trade fairs and exhibitions. This step will enable cutting of expenses and time.
4. Liquidity Support - The government has mandated that all MSME receivables from the government to be released within 45 days. This will serve to greatly ease the COVID liquidity woes of this sector.

Financial Support under the ABS

In the line chart given below, the actions taken by the Government are shown. The budget allocation for MSMEs has been substantially enhanced in 2021-22 and 2022-23 to facilitate the enterprises in the duress due to Covid. The employment of funds has also been depicted.

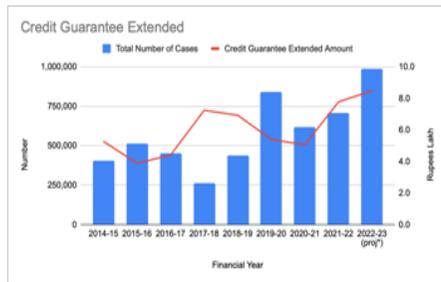


Source: Ministry of MSME

5. The government has created a Fund-of-Fund of 50,000 Crores of equity infusion for MSMEs. The initial corpus of this fund-of-funds will be Rs 10,000 crores and is expected to support the MSMEs to grow in size and reach IPO listings.
6. Subordinate Debt for stressed MSMEs: Another Rs 20,000 crores of subordinate debt has been allocated for stressed MSMEs. This fund is expected to support nearly 2 lakh MSMEs by helping them to restart their businesses and secure jobs for their workforce.
7. Rs 3 Lakh Crores Collateral-free loan: The government has announced a collateral-free loan fund of Rs 3 Lakh Crores to help boost liquidity & working capital for MSMEs. This fund is expected to target nearly 45 lakh units and help them resume business activity.

Another interesting piece of data from the Ministry of MSME shows that the government (year-to-date) has offered credit guarantee schemes

to over 4.1 lakh MSMEs and a record high average of Rs 8.48 lakhs.



Source: Ministry of MSME

In the the above chart, the number for total number of cases has been annualised from the five-month number of 4.11 lakh for 5-months till August 2022 to 9.87 lakh for 12-months till March 2023. From the chart it is visible that the government's credit guarantee scheme for MSMEs has picked up in the year 2022-23 not just in number of cases of support but also the average Rupee support per case.

Conclusion

The revised definition of MSME will certainly encourage more entrepreneurs to set up their own units and this will result in an increase in output, employment, product diversification, investment and export. The impact of the new definition of MSMEs on the economic performance is yet to be known. The above discussion shows that the MSMEs have to deal with numerous problems which hinder their growth. The fundamental issues need to be tackled on a sustainable basis. Therefore timely and substantial policy measures for the betterment of all the stakeholders should be taken by the government to attain the goal of Self Reliant Bharat.

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