

MSMEs — re-defined for growth

The expanded ambit now allows a larger pool of enterprises to get the benefits of the MSME Act and pandemic-induced reforms

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Micro, small and medium enterprises (MSMEs) are amongst the strongest drivers of the economy with a vast network of about six crore enterprises, contributing about 45 per cent to manufacturing output, 50 per cent to exports, around 30 per cent to GDP, and creating employment for about 11 crore — second only to agriculture. This sector mirrors the diversity in the economy in terms of the size of these enterprises, the variety of products and services, and the levels of tech employed.

MSMEs have been inordinately affected by the Covid-induced lockdown, transport disruptions, severance of supply chains, social distancing measures owing to their dominant presence in economic sectors like retail, trading and services. This disruptive effect has been compounded due to their limited financial resources and borrowing capacity. The government has introduced a slew of legislative, regulatory and financial measures to support the MSME sector amidst this unprecedented crisis unleashed by the pandemic.

The endeavour of the government is to create a policy environment to enable MSMEs grow in size, partner in emerging global value chains and provide dynamism to economic growth. The 2018-19 *Economic Survey* clearly established that MSMEs that grow not only create greater profits for their promoters but also contribute to job creation and productivity in the economy.

As a basic step, we need a clear definition of what enterprise can be specified as an MSME. The definition of micro and small enterprises

differs widely across countries and reflects the specific business environment and socio-cultural aspects in which they operate. As per a survey by World Bank, the most widely used variable for defining an MSME is the number of employees, while other definitions are based on turnover as well as the value of assets. The number of employees and sale volumes are probably the most accurate parameters to define an SME, but access to these data is limited. The crucial thing, however, is that most of the countries use only one variable to define MSMEs.

Composite formula

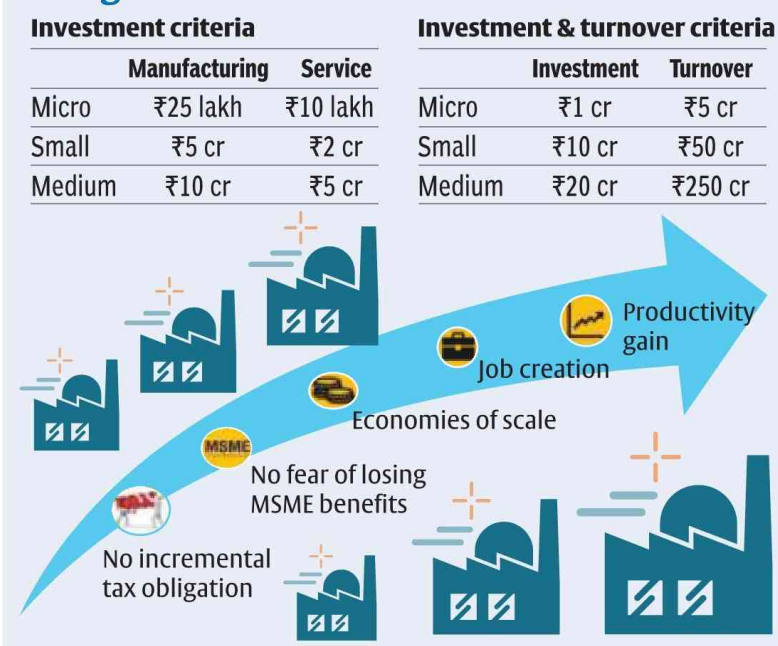
A major structural reform, in this direction, has been undertaken by the government by adopting a new composite formula of classification for manufacturing and service units in the MSME sector with effect from July 1, 2020. India defined Small Scale Industry (SSI), first in 1950s, as an industry with investment of up to ₹5 lakh in fixed assets and employment of 50-100 people with or without power.

By the 1960s, the employment criterion was dropped and the investment ceiling thereafter was constantly increased. The MSME Act in 2006, last laid down the definitions based on investment limits for 'micro and small' and added a definition of 'medium'. A static investment limit for a period of 13 years led to an increasing demand for change from many sectors where MSMEs

have substantial share such as pharmaceuticals, auto-component, food processing, among others.

The investment-based definition gave an undue 'first-mover' advantage to older enterprises vis-a-vis new enterprises and discouraged investments in new technology. It

Change in MSME definition



also required certification from authorities on the value of plant and machinery creating a window for 'rent-seeking'. Under the new definition, an enterprise qualifies as an MSME depending upon the broadened thresholds of amount of investment made with respect to (i) plant and machinery in case it undertakes manufacturing; or (ii) equipment in case it provides services (see Graphic). In addition to this existing investment conditionality, a new criterion for turnover has been introduced.

The turnover details of enterprises are being captured by Goods and Services Tax Network (GSTN) and enables MSMEs to reduce the burden of record keeping for compliance or for availing themselves of benefits. The distinction between manufacturing and services industries has been done away with and is likely to benefit retailers and contractors. The provision of excluding

the exports from counting of turnover will encourage the MSMEs to increase their exports without the fear of losing the benefits of an MSME unit.

The change in the definition of MSME is one of the most significant enabling changes made to the legal regime governing MSMEs, since the enactment of the MSME Act 2006. The expanded ambit of the MSME Act has now allowed the larger pool of enterprises to get the benefits of the Act as well as of the reforms introduced by the government for the MSME sector during the pandemic, without any additional tax liability. It is likely to improve the ease of doing business in operation for MSMEs, and in the process make it easier for them to attract investments and create more jobs.

A series of reforms undertaken across sectors also creates suitable circumstances for the MSME sector to grow. The two laws on agricul-

ture sector issued recently aim at deregulating agriculture markets and foster robust farm-firm linkages towards a robust supply chain. This reform is set to open the window of opportunity for processors, aggregators, large retailers and exporters who can now build long-term mutually rewarding relations with farmers. It will enable the agro-sector to move up the value-added chain and create wealth for themselves and the economy. An agro-MSME policy is under progress, with a focus on entrepreneurship development in rural, tribal agriculture and forest areas for manufacturing products using local raw materials.

Four codes

The government has also been working extensively to simplify, amalgamate and rationalise 44 Central labour laws into broad four codes — wages, industrial relations, social security, and operational safety, health and working conditions. The Wages Bill was enacted last year and the other three codes have been passed by the legislature. This is another step which will go a long way in promoting 'ease of doing business' and instil investor confidence in the MSME sector as it intends to reduce the burden of compliance of labour regulations.

The government has taken various complementary steps in designing a policy ecosystem for MSMEs to enable them to grow and contribute more effectively to the economy. The need is to support MSMEs to tide over this crisis and benefit from the enabling framework to give impetus to their and the economy's growth.

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