Agenda for the First Meeting of the Task Force under the chairmanship of Principal Secretary to the Prime Minister to be held on 25th September 2009 at 11.00 a.m. at Prime Minister's Office, South Block, New Delhi

Background

The Hon'ble Prime Minister met the representatives of 19 prominent MSME Associations on 26th August 2009 to discuss issues impacting the growth of the micro, small and medium enterprises (MSME) sector. During the meeting, several important issues were highlighted by the MSME Associations including shortage of credit, need for a focused procurement policy, prompt payment of MSME dues, simplification of labour laws to prevent inspector raj, formulation of a one-time settlement policy to strengthen the MSMEs, etc.

The Hon'ble Prime Minister assured the MSME representatives that the Government is committed to provide a fillip to this very important segment of the economy and announced the setting up of a high-level Task Force to reflect on the issues raised by the Associations and formulate an agenda for action within a period of three months after deliberations with all stakeholders. In line with the announcements made by the Hon'ble Prime Minister, a Task Force has been constituted under the chairmanship of Principal Secretary to the Prime Minister. The composition of the Task Force is enclosed at **Annexure I**.

Agenda No. 1: Sub-target for micro enterprises under priority sector lending

Adequate availability of credit has remained one of the major areas of concern for the micro and small enterprises (MSEs), particularly the lower segments of micro enterprises. Around 99% of the enterprises in the micro and small enterprise (MSE) sector are micro enterprises and predominantly fall under the domain of unorganised sector. As per the extant guidelines of the Reserve Bank of India (RBI), of the total MSE credit, 60% is earmarked for micro enterprises. As per the data furnished by the RBI for the period ending March 2009, lending to micro enterprises in the MSE credit from public sector banks constitute only 45.3%. Further, the share of advances to the micro enterprises in the Net Bank Credit (NBC) of the public sector banks has been declining over the years as shown in the following Table:

(Rs. crore)

At the end of March	Net Bank Credit (NBC)	Credit to micro enterprises	As a % of NBC
2000	3,16,427	24,272	7.8
2001	3,41,291	26,019	7.6
2202	3,96,954	27,030	6.8
2003	4,77,899	26,937	5.6
2004	5,58,849	30,826	5.5
2005	7,18,722	34,315	4.8

2006	10,17,614	33,314	3.3
2007	13,17,705	44,311	3.4
***2008 (P)**	13,64,268	66,702	4.9
***2009 (P)**	16,93,437	83,945	4.9

* As per revised definition. (P) - Provisional

To ensure adequate credit flow to this hitherto neglected sector, the need to stipulate a sub-target for micro enterprises under the priority sector lending has been pointed out by the MSE Associations.

Status

The Ministry of MSME has taken up the issue of earmarking 6% of NBC for micro enterprises under the priority sector lending targets with the Reserve Bank of India (RBI)/Department of Financial Services. Taking into account the NBC at the end of March 2009, this would facilitate an additional credit flow to the tune of about Rs.18,000 crore from the public sector banks.

Responding to the above, the RBI have informed that the domestic scheduled commercial banks have already been set various targets for lending to priority sector, i.e., overall priority sector target of 40% and sub-targets of 18% and 10% for lending to agricultural sector and weaker sections. Further, the RBI is of the view that fixation of additional targets may not serve much purpose and instead a suitable facilitating environment needs to be ensured to enable banks to extend advances to borrowers for undertaking viable activities.

Issues for Consideration

- The issue of fixing of a separate sub-target of 15% for the MSE sector under the priority sector lending targets was taken up earlier by the Ministry of MSME with the Reserve Bank of India/Department of Financial Services. However, as this would have resulted in crowding out of other priority sectors, the Ministry of MSME had taken up the issue of earmarking 6% of NBC for micro enterprises under the priority sector lending targets. The proposed sub-target is only 1% higher than the existing level of lending to the sector and is not expected to crowd out substantially other priority sectors.
- This suggestion has also been supported by the Inter-Ministerial Group (IMG) set up to decide on follow-up action for reports of National Commission for the Enterprises in the Unorganised Sector.
- The Task Force may like to consider this issue.

Agenda 2: Setting up of National Fund for the Unorganised Sector

The National Commission on Enterprises in the Unorganised Sector (NCEUS) has estimated the size of the unorganized non-farm sector enterprises at 58 million during 2006-07, providing employment to 104 million workers. Of these, 94% are with an investment of less than Rs.5 lakh. The size of the sector is estimated to increase up to 71 million by 2011-12 and the additional employment to be provided during 11th Plan would be 22 million. Despite its large size, the credit to this sector has shown a declining trend. As per RBI data, the share of credit to the micro enterprises (predominantly unorganized sector enterprises) in the net bank credit of the public sector banks has declined from 7.8% in 2000 (Rs.24,742 crore) to 4.9% in 2009 (Rs.83,945 crore).

On the role of SIDBI and NABARD, which were set up to cater to the credit needs of the unorganised sector, the Commission has observed that despite a number of important initiatives, the efforts by these institutions fall far short of meeting the credit and other developmental requirements of the non-farm unorganised sector. The Commission has also looked into the existing funds under SIDBI and NABARD and opined that though these are special purpose funds, they are not specifically targeted for the unorganised sector. Also, there is no national level institution to meet the credit requirements, to provide promotional and developmental support and above all, to advocate policy formulation for the unorganised sector.

For achieving the objective of faster and inclusive growth, there is a need to provide financial and other promotional and developmental services to the unorganised sector. In line with the recommendations of the NCEUS, the MSE Associations have been requesting that the National Fund for the Unorganised Sector as an exclusive national level development financial institution should be set up on priority basis.

<u>Status</u>

The Report on ‘Creation of a National Fund for Unorganised Sector’ was considered in the first meeting of the IMG held on 14th November 2008. Based on the decisions taken in the meeting of the IMG and the subsequent deliberations held with the Ministries/Departments concerned, a Note for consideration of the Cabinet was submitted to the Cabinet Secretariat. Subsequently, a meeting was held under the chairmanship of Secretary (Coordination), Cabinet Secretariat on 16th July 2009 to consider the aforesaid Note submitted by the Ministry of MSME. After detailed deliberations, the following decisions were taken: (a) The Department of Financial Services (DFS) will take action to put in place suitable administrative arrangements for operationalising a Special Cell in SIDBI for refinancing to micro enterprises; (b) DFS will take steps at the earliest to earmark Rs.1000 crore with the Special Cell; (c) DFS will also take appropriate steps for ensuring that there is continuous and close interaction between SIDBI and the representatives of the micro enterprises sector, and take other measures as necessary to increase the effectiveness of credit delivery to this sector; and (d) The operation of this arrangement may be reviewed after six months.

<u>Issues for Consideration</u>

- The NCEUS has estimated that only 18% of SIDBI's resources flow to this sector. Further, many of the Funds created under SIDBI like National Equity Fund, Technology Development Modernisation Fund, Mahila Vikas Nidhi, etc. have not produced the desired impact and had to be closed down. SIDBI's low attention towards the financing needs of the micro enterprises is because it is only one of its many activities – it is mandated to provide credit to small and medium enterprises as well. Hence, creation of a separate window in SIDBI would not fulfill the financing needs of the unorganized sector enterprises.
- A separate institution, which could either be a subsidiary under SIDBI or a Special Purpose Vehicle (SPV) of SIDBI and other financial institutions, would have the following advantages:
    - It would provide focused attention towards financing of the micro enterprises in the unorganized sector – as its mandate would be limited to them.
    - It would undertake promotional and development activities specifically designed towards micro enterprises in the unorganized sector – thereby providing mentoring and handholding support to these enterprises and assist in their capacity building for higher absorption of credit.
    - It would evolve credit delivery mechanisms and appraisal norms that are more suited to address the financing requirements of micro enterprises in the unorganized sector.
    - A separate window under SIDBI would utilize the funds made available through shortfalls in priority sector lending to that extent only as these are short-term loans. On the other hand, an independent institution funded through budgetary grants will be able to attract funds from other sources – international institutions like World Bank, IFAD, IFC, etc., domestic private institutions like IL & FS and other financial institution – which can be leveraged leading to a multiplier effect.
- Hence, the Ministry of MSME is of the view that a separate body for management of the Fund would be essential to address the credit needs of the enterprises in the unorganized sector.

Agenda 3: Interest Subvention on Micro Enterprises Loans

High cost of credit is one of the major problems faced by micro and small enterprises (MSEs) in accessing the requisite credit facilities from the banks/institutional sources. Despite several measures taken by the RBI in recent times, the interest rates charged by banks on MSE loans continue to be on higher side. This has adversely impacted the competitiveness of the sector and resulted in significant decline in orders, particularly those relating to exports. Since MSEs are predominantly dependent on banks/financial institutions for meeting their credit requirements, it is important that credit to the sector is made available at a cheaper rate for enhancing its competitiveness.

The agriculture sector is being provided loans at an interest rate of 7% through interest subvention. Recently, the Government has also announced interest subvention for the housing sector. The MSE Associations have been demanding that interest subvention on similar lines may also be provided to the micro enterprises for lowering the cost of credit to this labour-intensive sector.

<u>Status</u>

The issue of lowering the interest rates for loans to the micro enterprises was considered by the IMG in its meeting held on 10th July 2009 and it was agreed that the Ministry of MSME may formulate a scheme to provide interest subvention to micro enterprises sector. To provide interest subvention of 3% to the existing borrowers (loan outstanding of Rs.1,00,000 lakh crore at end March 2009) will require funds of Rs.3,000 crore per annum. If subvention is also extended to incremental credit (projected growth of 25%), the annual additional requirement is Rs.750 crore, Rs.1680 crore and Rs.2850 crore in the three years of the Eleventh Plan.

<u>Issues for consideration</u>

- Considering the importance of promotion and growth of micro enterprises sector from the standpoint of employment generation, the Task Force may consider recommending formulation of a scheme to provide interest subvention to the sector.

<u>Agenda 4: Setting up of SME Exchange</u>

One of the critical constraints on the growth of MSMEs is its inability to raise equity funds/risk capital. Despite banks being selective and cautious in lending to them, the MSMEs have primarily relied on debt financing from banks and non-bank financial institutions. This is mainly because the Indian equity markets have been averse to funding smaller and early stage businesses. At present, the sources of equity funds/risk capital for the MSMEs are very limited.

One of the main reasons for this is the absence of a Stock Exchange for MSMEs or a separate platform of an existing stock exchange for the MSMEs. These enterprises are, therefore, unable to access capital market. An exchange designed for the needs of the Indian SMEs will have several advantages. Firstly, a dedicated SME Exchange shall lead to diversification of sources of finance for the SMEs by paving the path for raising risk capital. Another aspect of a growth in equity culture through this platform for SMEs is greater shareholder activism. The public scrutiny of SMEs is expected to raise productivity of the MSMEs by improving their governance processes and practices.

An SME exchange will also build the bridge between SMEs and the private equity and venture capital by providing an exit route.

Status

The Securities Exchange Board of India (SEBI) Board in its meeting held on 25th October 2007 had agreed to creation of a separate Exchange for the SMEs. Accordingly, in May 2008 a discussion paper was brought out on this issue and based on the feedback the SEBI had issued a framework for recognition and supervision of Stock Exchanges/Platforms of Stock Exchanges for SMEs in November 2008. This framework provided details regarding the eligibility criteria for setting up of new stock exchange/platform of an existing stock exchange for the SMEs, trading, clearing and settlement. Subsequent to the issue of framework and invitation to set up an exchange, SEBI has received Expression of Interest from some organisations to set up a platform for SMEs. These proposals are being examined by SEBI with respect to the norms that need to be relaxed further for setting up SME exchanges.

Issues for consideration

- SEBI needs to expedite setting up of SME exchanges in consultation with all the stakeholders, including Ministry of MSME.

Agenda 5: Amendments to MSMED Act, 2006

The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, which came into effect from 2nd October 2006, seeks to facilitate the development of these enterprises as also enhance their competitiveness. It provides the first-ever legal framework for recognition of the concept of “enterprise” which comprises both manufacturing and service entities. It defines medium enterprises for the first time and seeks to integrate the three tiers of these enterprises, namely, micro, small and medium. Under the Act, enterprises have been classified into (i) manufacturing and (ii) those engaged in providing/rendering of services. Both categories of enterprises have been further classified into micro, small and medium enterprises based on their investment in plant and machinery (for manufacturing enterprises) and equipments (in case of enterprises providing or rendering services) which is as under:

- Manufacturing enterprises: It has been classified into:
  - Micro Enterprises - investment up to Rs.25 lakh.
  - Small Enterprises - investment above Rs.25 lakh & up to Rs.5 crore.
  - Medium Enterprises - investment above Rs.5 crore & up to Rs.10 crore.
- Service enterprises: It has been classified into:
  - Micro Enterprises – investment up to Rs.10 lakh.
  - Small Enterprises – investment above Rs.10 lakh & up to Rs.2 crore.

- Medium Enterprises – investment above Rs.2 crore & up to Rs.5 crore.

The Act, inter alia, provides for more rigorous provisions to counter the problems of delayed payments to the MSEs. Besides laying down that payments must be made to MSEs within 45 days of supply, the legislation lays down the institutional framework in the shape of MSE Facilitation Councils to be constituted by each State that would help in quick resolution of such disputes. To take care of delayed payments of MSEs, notification No.G.S.R. 719 (E) dated 16th November 2007 has been issued by Ministry of Corporate Affairs which contains an amendment in Schedule IV of the Companies Act, 1956. It specifies the format of balance sheet and profit & loss account of companies to declare the amount of interest due to be paid to MSEs and the penal interest accrued thereon. Notification No.S.O.961 (E) dated 13th April 2009 has been issued by Central Board of Direct Taxes (CBDT), Ministry of Finance to amend Income Tax Rules, 1962 in Form No.3CD. This has made amount of interest inadmissible under section 23 of the MSMED Act, 2006.

The Act also provides for an apex consultative body at the national level, namely, National Board for MSMEs headed by Minister (MSME). The Board comprises of representatives of all sections of stakeholders, including Central Ministries, State Governments, RBI, SIDBI, MSME Associations, Central Trade Union Organisations, etc. The Act also provides for an Advisory Committee headed by Secretary (MSME) and comprising of representatives of Central Ministries, State Governments and MSME Associations. Establishment of specific Funds for the promotion, development and enhancing competitiveness of these enterprises, notification of schemes/programmes for this purpose, progressive credit policies and practices and preference in Government procurements to products and services of the micro and small enterprises are some of the other features of the Act.

Issues

The MSE Associations have pointed out that the provisions relating to delayed payments under the Act are not being implemented. They have been demanding that the provisions need to be further strengthened through appropriate amendments in the Act. However, as the MSMED Act is in its early phase of implementation, any amendment at this stage would be pre-mature. Further, a more widespread consultation with the stakeholders would need to be undertaken to take a decision on this issue.

Agenda 6: Action Taken Report on recommendations of the Working Group on Rehabilitation of Sick SMEs

In recognition of the problems being faced by the MSME sector, particularly with respect to rehabilitation of potentially viable sick units, the RBI had constituted a Working Group on ‘Rehabilitation of Sick SMEs’ under the chairmanship of Dr. K.C. Chakrabarty, the then Chairman &

Managing Director, Punjab National Bank in June 2007. The Working Group submitted its report to the RBI in April 2008, covering comprehensively the entire gamut of issues and problems (credit and non-credit related) confronting the sector. The major recommendations of the Working Group are enclosed at **Annexure II to IV**.

Status

The RBI has issued a circular dated 4th May 2009 to all scheduled commercial banks enclosing therewith recommendations made by the Working Group that needs to be considered by them. The banks have been advised to consider speedy implementation of the recommendations made by the Working Group with regard to timely and adequate flow of credit to the MSE sector. Further, the RBI has also advised the banks to undertake a review and put in place the following policies for the MSE sector, duly approved by the Board of Directors:

(i) Loan policy governing extension of credit facilities;

(ii) Restructuring/rehabilitation policy for revival of potentially viable sick units/ enterprises; and

(iii) Non-discretionary One Time Settlement (OTS) scheme for recovery of non-performing loans.

However, the RBI has not fully addressed the following recommendations contained in the report of the Working Group:

(a) The Working Group had recommended change in the definition of sick MSEs, time-bound decision on viability, streamlining of procedure for declaring a unit as unviable and giving opportunity to units to present their case if found unviable to bring in greater transparency in the matter of rehabilitation. The RBI needs to consider these recommendations and provide for fresh guidelines to banks so as to put in place an effective mechanism for rehabilitation of sick MSEs.

(b) The Working Group had recommended that RBI may come out with a more liberalized OTS Scheme, which may inter alia provide for settlement at a discount to the principal outstanding on the date of NPA and promoters made eligible for obtaining finance after settlement of the dues under OTS. The RBI need to issue guidelines on the lines of the aforesaid recommendations to the banks so that there is uniformity in approach among banks in settlement of NPAs under OTS.

In addition to the above, the recommendations contained in the report of the Working Group relating to the Central Government were forwarded by the RBI to the Ministry of MSME. After examination of the aforesaid recommendations, the Ministry of MSME has taken up these recommendations with the Ministries/Departments concerned (viz. Department of Financial

Services, Department of Revenue, Department of Science and Technology and Ministry of Labour & Employment) for appropriate action. On specific recommendations pertaining to the Ministry of MSME, action has been taken/ initiated. The recommendations relating to the State Governments were forwarded by the RBI to the State Level Bankers' Committee (SLBC) Convenor Banks for taking up the issue in the SLBC meetings.

Agenda 7: Simplification of Labour Laws

Multiplicity of Labour Laws and the complicated procedures thereof are a source of concern to the MSE sector. MSEs, particularly micro enterprises, are mostly run by single entrepreneurs with few workers and hence do not have enough employees to handle enormous paper work for maintaining too many records and reports as required by Labour Laws. Some of the demands of the MSE Associations in this context are:

(i) There should be a separate (single and comprehensive) law for the enterprises in the unorganized sector enterprises;

(ii) There should be single-point registration and payment for MSEs relating to labour welfare measures.

Agenda 8: Procurement Preference Policy for Micro and Small Enterprises

The micro and small enterprises (MSEs) constitute one of the most employment-intensive segments of the Indian economy, contributing significantly to the manufacturing output and national exports. It is estimated that this sector accounts for about 45 per cent of the manufacturing output and 40 percent of the total exports of the country. Studies indicate that the MSEs are at a disadvantage in many ways vis-à-vis medium and large enterprises. Some of such areas relate to access to timely and adequate credit at reasonable costs, lack of resources for product designing/packaging, infrastructural bottlenecks, etc. Accordingly, one of the policy instruments used to protect and promote the sector has been reservation of products for exclusive manufacture in the MSE sector. However, with the gradual de-reservation of items (now only 21 items reserved for the sector), such protection is no longer available.

To overcome the inherent disadvantages, internationally the MSEs are provided governmental support through targeted benefits/facilities such as earmarking of a specific percentage of government procurement for exclusive purchase from MSEs and assistance in market development, export promotion, etc. In the USA, the Small Business Administration assigns annual growth for procurement by Federal Departments, in consultation with them, for ensuring compliance of the legislated minimum procurement of 23 per cent from small business. There is a need for Government support with statutory backing in the form of a Public Procurement Policy to provide MSEs the opportunity to obtain a share Government procurement with a view to increase the market share of these enterprises. Although no firm figures are available, some estimates indicate an annual Government procurement (including PSUs) in India of over Rs.1,70,000 crore of which the share of MSEs is around 4-5% only.

Status

The Ministry of MSME prepared a draft Note for the Cabinet on 'Procurement Preference Policy for MSEs', which was circulated to the Ministries/Departments concerned for their comments. This has also been discussed with the Ministries/ Departments in a series of meetings. Based on their comments, the draft Note for the Cabinet is being finalized.

Agenda 9: Issues relating to Insolvency/Bankruptcy and Exit Policy

Temporary financial stresses, sickness and terminal failures are unavoidable facts in the life of an enterprise. Besides, there are times when an entrepreneur voluntarily decides to exit. Two sets of legal mechanisms - of insolvency and bankruptcy, are indispensable to deal with the situations mentioned above to ensure payment of unpaid dues to creditors, sharing of debtor' assents fairly and an honourable exit to the debtor. The insolvency mechanism in India, provided through Presidency Town Insolvency Act, 1909 or Provincial Town Insolvency Act, 1920, is archaic and completely dysfunctional. There is no bankruptcy mechanism – neither law nor specialized body. There is no BIFR equivalent for MSMEs. Provisions of winding up and of limited liability under Companies Act are also not applicable on MSMEs as 97% of them are either Proprietorship or Partnership firms.

The MSME Associations have highlighted that because of absence of these mechanism, whenever there is financial stress (voluntary or forced; temporary or terminal), there is no method for MSMEs to deal with commercio-legal requirements of multi-agency creditors (involving statutory dues, debts of banks and FIs) - as any of these creditors could stall the restructuring exercise, force closure on enterprise and secure imprisonment sentence for entrepreneur.

Suggestions

Some of the measures suggested by the MSME Associations in this context are:

- Amendments in Insolvency Acts (Presidency Town Insolvency Act, 1909 and Provincial Town Insolvency Act, 1920) or replacement by new (single and comprehensive) law;
- Enactment of suitable Bankruptcy Law and constitution of Authority/Registrar/ Central Registry System where all the orders declaring a person as insolvent may be filed;

- An institutional mechanism which provides for a stay on creditor action for a reasonable time to allow distressed company to revive before the court orders liquidation and incorporation of such mechanism within the Limited Liability Partnership Act and the proposed Companies Act;
- Need to institute specialized bankruptcy and insolvency courts (fast track) and a cadre of specialists providing a 'single window' to address all related matters of restructuring, liquidation, bankruptcy and insolvency; and
- Suitable revisits to other central and state statutes affecting current recovery procedures and awards of jail sentences.

Agenda 10: Issues relating to Taxation

The major advantage of the MSME sector is its employment potential at low capital costs. To maintain the competitiveness of this sector, it seems desirable to provide fiscal measures directly aimed to help the sector. Some of the major demands of the MSE Associations are:

- Enhancement of the exemption limit from Rs.1.50 crore to Rs.3 crore under the General Excise Exemption (GEE) Scheme;
- Enhancement of the eligibility limit from Rs.4 crore to Rs.5 crore under the General Excise Exemption (GEE) Scheme;
- Enhancement of exemption limit for Service Tax from Rs.10 lakh to Rs.30 lakh;
- Exemption from Service Tax to MSEs providing Business Auxiliary Services;
- Provision for investment allowance for MSEs be introduced.

Status/Issues for consideration

- The Ministry of MSME has taken up most of the aforesaid issues in its Pre-Budget Proposals submitted to the Department of Revenue, Ministry of Finance.
- The Task Force may like to consider providing fiscal incentives to the MSEs on the above lines.

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