

AN OVERVIEW OF THE MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs) SECTOR



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INTRODUCTION

Worldwide, the micro and small enterprises (MSEs) have been accepted as the engine of economic growth and for promoting equitable development. The MSEs constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports.

Micro, small and medium enterprises are also referred to as Small and medium enterprises or SMEs, and small and medium-sized businesses or SMBs in some countries.

The abbreviation SME occurs commonly in the European Union and in international organizations, such as the World Bank, the United Nations and the World Trade Organization. The term small and medium-sized businesses or SMBs is predominantly used in the United States of America (USA).

In the European Union and USA , SMB's are companies whose headcount or turnover falls below certain limits. The business is classified as per the number of employees employed in the business.

In South Africa the term SMME for Small, Medium and Micro Enterprises is used. Elsewhere in Africa, they use MSME for Micro, Small and Medium Enterprises.

In India, the sector is generally referred to as the Micro, Small and Medium Enterprises (MSMEs). MSMEs play a pivotal role in the overall industrial economy of the country. In recent years the MSME sector has consistently registered higher growth rate compared to the overall industrial sector. The major advantage of the sector is its employment potential at low capital cost.

IMPORTANCE OF MSME SECTOR IN INDIA

The development of the micro, small and medium enterprises (SME) sector is on the priority of Government Agenda. As per the Results-Framework Document (RFD) for Ministry of Micro, Small and Medium Enterprises (2012-2013), the Mission of the government is to – “Promote growth and development of globally competitive Micro, small and Medium Enterprises, including Khadi, Village and Coir industries, in cooperation with concerned Ministries / Departments, State Governments and other stakeholders by providing support to existing enterprises and encouraging creation of new enterprises. To endeavor to achieve a cumulative growth of 40%-50% in the number of registered enterprises by the end of 12th Plan and enhance this sector's contribution to GDP from the present 8% to 10% by the end of 12th Plan.”

The role of micro, small and medium enterprises (MSMEs) in the economic and social development of the country is well established. As per the Report of the Working Group on Micro, Small and Medium Enterprises (MSMEs) Growth for 12th Five Year Plan (2012-2017), the sector accounts 45% of the manufacturing output and 40% of total exports of the country. The sector provides employment to about 69 million persons through 26 million enterprises throughout the country. Over 6000 products ranging from traditional to high-tech items are being manufactured by the MSMEs in the country. The labour to capital ratio in MSMEs and the overall growth in the sector is much higher than in the large industries. The geographic distribution of the MSMEs is also more even. Thus, MSMEs are important for the national objectives of growth with equity and inclusion.

Over the years, the small scale sector in India has progressed from the production of simple consumer goods to the manufacture of many sophisticated and precision products like electronics control systems, micro wave components, electro medical equipments, etc. The process of economic liberalization and market reforms has further exposed these enterprises to increasing levels of domestic and global competition.

The MSME sector in India is highly heterogeneous in terms of the size of the enterprises, variety of products and services produced and the levels of technology employed. While one end of the MSME spectrum contains highly innovative and high growth enterprises, more than 94% of MSMEs are unregistered, with a large number established in the informal or unorganized sector. The sector has a high growth potential and performs a critical role in the manufacturing and value chains. Micro, small and medium enterprises (MSME) sector is characterized by low investment requirement, operational flexibility and location wise mobility.

As per the quick estimates of 4th All-India Census of MSMEs, the number of enterprises is estimated to be about 26 million and these provide employment to an estimated 60 million persons. Of the 26 million MSMEs, only 1.5 million are in the registered segment while the remaining 24.5 million (94%) are in the unregistered segment.

The State-wise distribution of MSMEs show that more than 55% of these enterprises are in 6 States, namely, Uttar Pradesh, Maharashtra, Tamil Nadu, West Bengal, Andhra Pradesh and Karnataka. Further, about 7% of MSMEs are owned by women and more than 94% of the MSMEs are proprietorships or partnerships.

MSMEs in the country manufacture over 6,000 products. Some of the major subsectors in terms of manufacturing output are food products (18.97%), textiles and readymade garments (14.05%), basic metal (8.81%), chemical and chemical products (7.55%), metal products (7.52%), machinery and equipments (6.35%), transport equipments (4.5%), rubber and plastic products (3.9%), furniture (2.62%), paper and paper products (2.03%) and leather and leather products (1.98%).

The importance and contribution of the SME sector to the economic growth and prosperity is well established. Towards this, Government's policy initiatives like enactment of the Micro Small and Medium Enterprises Development (MSMED) Act, 2006, pruning of reserved SSI list, advising Financial Institutions to increase their flow of credit to the SME sector, are all initiatives towards boosting

entrepreneurship, investment and growth. Reservation of items for exclusive manufacture in MSME sector statutorily provided for in the Industries (Development and Regulation) Act, 1951, has been one of the important policy measures for promoting this sector.

MAJOR ISSUES CONCERNING THE MSME SECTOR

As per the Report of the Subgroup on Unorganized Sector (of the Working Group on MSMEs Growth during 12th Plan), although Indian MSMEs are a diverse and heterogeneous group, they face some common problems, which are briefly indicated below:

- Lack of availability of adequate and timely credit;
- High cost of credit;
- Collateral requirements;
- Limited access to equity capital;
- Problems in supply to government departments and agencies;
- Procurement of raw materials at a competitive cost;
- Problems of storage, designing, packaging and product display;
- Lack of access to global markets;
- Inadequate infrastructure facilities, including power, water, roads, etc.;
- Low technology levels and lack of access to modern technology;
- Lack of skilled manpower for manufacturing, services, marketing, etc.;
- Multiplicity of labour laws and complicated procedures associated with compliance of such laws;
- Absence of a suitable mechanism which enables the quick revival of viable sick enterprises and allows unviable entities to close down speedily; and
- Issues relating to taxation, both direct and indirect, and procedures thereof
- Lack of Social Security

A prominent drawback of the MSME sector is that a predominant number (94%) of the enterprises are in the unorganized sector. Due to this, there is lack of reliable and updated database and it hampers monitoring of development initiatives and formulation of appropriate schemes to meet the differential needs of the heterogeneous profile of the enterprises.

One of the major problems facing these enterprises is the access to equity and credit. Most of the time, the equity is coming from savings and loans from friends and relatives rather than through banking systems. Very often, the credit is coming from operations or domestic savings rather than established systems of cheap banking credit for working capital.

This sector also has poor paying capacity and therefore faces shortage of skilled manpower resulting in absence of managerial capabilities, marketing channels and brand building capacity.

DEVELOPMENT AND ADMINISTRATION OF MSMEs

The President under Notification dated 9th May 2007 has amended the Government of India (Allocation of Business) Rules, 1961. Pursuant to this amendment, Ministry of Agro and Rural Industries (Krishi Evam Gramin Udyog Mantralaya) and Ministry of Small Scale Industries (Laghu Udyog Mantralaya) have been merged into a single Ministry, namely, “MINISTRY OF MICRO, SMALL AND MEDIUM ENTERPRISES (SUKSHMA LAGHU AUR MADHYAM UDYAM MANTRALAYA)” .

The administration of the MSME sector falls under the jurisdiction of the Ministry of Micro, Small and Medium Enterprises (Sukshma Laghu Aur Madhyam Udyam Mantralaya), of the Government of India. It designs and implements policies and programmes through its field organisations and attached offices for promotion and growth of MSME sector.

The Office of Development Commissioner (Micro, Small and Medium Enterprises) functions as the nodal Development Agency under the Ministry of Micro, Small and Medium Enterprises (MSME). It is the apex body to advise, coordinate and formulate policies and programmes for the development and promotion of the MSME Sector. The office also maintains liaison with Central Ministries and other Central/State Government agencies/organisations financial institutions.

APPLICABILITY OF VARIOUS LAWS TO MICRO, SMALL AND MEDIUM ENTERPRISES

MSMEs even though small in size, are an enterprise, and in being so, a huge list of laws of the country become applicable to them. These laws will be enacted either by the Central Government or State Government. Hence, variations are likely to exist from State to State in provisions of law relating to matters falling in the State and Concurrent Lists.

The MSMED Act 2006 itself lays down certain technicalities for MSMEs like:

- Classification of industries
- Registration under the Act

- Procedure of Filing of Entrepreneurs Memorandum
- Disclosure Requirement

At the same time knowledge of certain important provisions under Industrial (Development and Regulation) Act, 1951 is required.

The Following categories of Laws amongst others are applicable to MSME sector

- o Fiscal Laws
- o Foreign Exchange Laws
- o Foreign Trade Laws
- o Labour & Industrial Laws
- o Environmental and Safety Laws
- o Laws applicable to various forms of Business organisation
- o Intellectual Property Laws
- o Competition Law
- o Banking & Financial Institutions Laws
- o Industry Specific Laws

THE MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006 (MSMED ACT 2006)

The importance and contribution of the SME sector to the economic growth and prosperity is well established. Their role in terms of employment creation, upholding the entrepreneurial spirit and innovation has been crucial in fostering competitiveness in the economy. Towards meeting the National developmental objective of a growth rate of over 8% on a sustained basis, it is imperative for the industrial sector to grow at a faster pace supported by a vibrant SME sector. Towards this, Government's policy initiatives like enactment of the Micro Small and Medium Enterprises Development Act, 2006, pruning of reserved SSI list, advising Financial Institutions to increase their flow of credit to the SME sector, are all initiatives towards boosting entrepreneurship, investment and growth.

The Micro, Small and Medium Enterprises Development Bill 2005, having been passed by both the houses of Parliament, received the assent of the President on 16th June 2006. It came on the Statute Book as the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) and came into force from 02nd October, 2006. The enactment of the Bill is the outcome of the demands from various SME associations in the country as also of several expert committees. The Government of India appointed the Administrative Staff College of India (ASCI) to undertake a detailed study on the issues demanding a basic law for small industry. Earlier, the Abid Hussain Committee had recommended such a

basic law. The ASCI came out with its report in January 2001, and which was subsequently discussed in detail at various levels. Subsequently, a National Focus Group was setup, in order to evaluate this detailed report, consisting of three volumes.

One of the primary objectives of the Act is to make provisions for ensuring timely and smooth flow of credit to SME's and minimize sickness amongst them.

IMPORTANT PROVISIONS OF MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006

- It is mentioned that provisions of Section 29B of the Industrial (Development and Regulation) Act, 1951(IDRA Act) will be applicable to micro and small enterprises. Section 29B of the IDRA Act specifies that operation of the provisions of the IDRA Act are exempted, having regard to the smallness of the number of workers employed or to the amount invested in the industrial undertaking.
- Memorandum of micro, small and medium enterprises may be submitted by the relevant enterprises to the prescribed authority. Though this is a discretionary provision, penalty has been prescribed for non-compliance of this provision.
- Sec.15 of the Act ensures that the buyer of goods makes payment for the goods supplied to him immediately or before the date agreed upon between the buyer and supplier. In no case the agreed period should exceed forty five days from the day of acceptance of goods or deemed acceptance. Under this Act, supplier means a micro or small enterprise which has filed a memorandum with the concerned authorities.
- Sec.16 of the Act stipulates that in case the buyer fails to make payment to the supplier within the agreed period, then the buyer will be liable to pay compound interest at three times of the bank rate notified by the RBI from the date immediately following the date agreed upon. (Presently bank rate is 6%)
- The buyer should specify the unpaid amount with interest in his annual statement of accounts. Interest payable or interest paid under this Act should not be allowed as deduction for the purpose of computation of income under the Income Tax Act, 1961.
- Establishment of Micro and Small Enterprises Facilitation Council. This Council will have jurisdiction to act as an Arbitrator or Conciliator in a dispute between the supplier located within its jurisdiction and a buyer located anywhere in India.

- Penalty is prescribed for non filing of memorandum, non specification of unpaid amount with interest in the annual statement of accounts and failure to furnish the required information.

CLASSIFICATION OF ENTERPRISES

Classification of enterprises is dealt with under Section 7 of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.

In accordance with the MSMED Act, MSME enterprises are classified in two:

1) Manufacturing enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the Industries (Development and regulation) Act, 1951. The Manufacturing Enterprise are defined in terms of investment in Plant & Machinery.

2) Service enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment

The present ceiling on investment to be classified as micro, small or medium enterprises is as under:

A. In case of enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, the classification is as follows:

- 1) a micro enterprise, where the investment in plant and machinery does not exceed twenty-five lakh rupees;
- 2) a small enterprise, where the investment in plant and machinery is more than twenty-five lakh rupees but does not exceed five crore rupees; or
- 3) a medium enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees.

B. In case of enterprises engaged in providing or rendering of services, the classification is as follows:

- 1) a micro enterprise, where the investment in equipment does not exceed ten lakh rupees;
- 2) a small enterprise, where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees; or
- 3) a medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

REGISTRATION UNDER THE MSMED ACT, 2006

At discretion –

- (a) any person who intends to establish
- (b) A micro or small enterprise
- (c) A medium enterprise for services or
- (d) A prior SSI with registration certificate

Compulsory –

- (a) Any person who intends to establish a manufacturing medium enterprise in industry specified in the First Schedule to IDRA, 1951
- (b) A prior manufacturing industry specified in the First Schedule to IDRA, 1951 having investment in plant and machinery or more than one crore rupees but not exceeding ten crore rupees with IEM

Procedure of Filing of Entrepreneurs Memorandum and other matters, incidental thereto is as follows:

1. Form of the Entrepreneurs Memorandum can be downloaded from the internet, the address of which can be obtained from Directorate dealing with Micro, Small & Medium Enterprises of the State Governments/ UTs. or the hard copies of the same can be obtained from the District Industries Centres. This form can also be downloaded from the SIDO website i.e. www.laghu-udyog.com or www.smallindustryindia.com
2. Any person who intends to establish a micro or small enterprise, at his discretion; or a medium enterprise engaged in providing or rendering of services may, at his discretion or a medium enterprise engaged in the manufacture or production of goods shall file the Memorandum of Micro, Small or as the case may be, of Medium Enterprise with District Industries Centre of its area.
3. The District Industries Centre shall fill all the codes in the form of the Memorandum and issue an acknowledgement after allotting an EM number, date of issue and category of the unit within five days of the receipt of the form of Memorandum by post or same day, if the form of Memorandum is submitted in person as well as online.
4. Before issuing the acknowledgement, the District Industries Centres shall make sure that the form is complete in all respect and particularly the form is signed and is accompanied with an undertaking, which is a part of the form of Entrepreneurs Memorandum.

5. The District Industries Centre shall maintain record of all the Entrepreneurs Memorandum so filed in respect of micro and small enterprises and medium enterprises engaged in providing and rendering services. District Industries Centres shall forward a copy of the Entrepreneurs Memorandum so filed with EM number allotted to the Small Industries Service Institutes of their State/Jurisdiction.
6. The District Industries Centre shall maintain record of all the Entrepreneurs Memorandum so filed in respect of medium enterprises engaged in production/manufacturing of products and forward one copy each of the Entrepreneurs Memorandum with EM number allotted to Small Industries Service Institutes of their State/Jurisdiction and to Joint Development Commissioner (MSME Pol.) in the Office of the Development Commissioner (Small Scale Industries).
7. The form of Memorandum is in two parts. Any person who intends to establish a micro, small or medium enterprise engaged in providing or rendering of services may file or those who want to establish medium enterprise engaged in the production or manufacture of products shall file Part 1 of the Entrepreneurs Memorandum to District Industries Centre.
8. Once the above enterprises start production or start providing or rendering services, they should file Part II of the Entrepreneurs Memorandum to District Industries Centre.
9. In case of non-filing of Part II of the Entrepreneurs Memorandum within two years of the filing of Part I, the Memorandum (Part I) filed by the entrepreneur will become invalid.
10. In case of change in the investment in plant and machinery or in equipment, the enterprises who have already filed Entrepreneurs Memorandum should inform the District Industries Centre of the same in writing within one month of the change in investment.
11. In case of change of products and that of services or addition in products or services, the enterprises who have already filed Entrepreneurs Memorandum should inform the District Industries Centre of the same in writing within one month of the change.
12. The District Industries Centre shall, in addition of keeping a record, in writing, shall also maintain records electronically on computer.

DISCLOSURE REQUIREMENTS

The Act strengthens provisions relating to delayed payments to SME's by specifying a maximum credit period and higher penal interest if delayed beyond that period. Further, Section 32 of the Act repeals the provisions of "Interest on Delayed payments to Small Scale and Ancillary Industrial Undertakings Act, 1993" that was applicable to some of the enterprises covered under this Act.

The Act requires certain additional information to be furnished in the Annual Accounts of enterprises, which are subjected to an audit under any law for the time being in force and who are buyers of goods or services from micro or small enterprises.

It is important to note that such disclosures are in addition to those required to be made under Schedule VI of the Companies Act, 1956 in respect of the total outstanding to small scale industrial undertaking and the names of such undertakings together with interest outstanding for more than 30 days. The disclosure requirements in Section 22 requires any buyer, whose annual accounts audited under any law for the time being in force, to furnish the following additional information in his annual statement of accounts:

| Item No. | Disclosures required under the Micro, Small & Medium Development Act, 2006 |
|-----------------|--|
| I | Delayed payments due as at the end of each accounting year on account of Principal - Rs. XXX and Interest due thereon - Rs. XXX |
| II | Total interest paid on all delayed payments during the year under the provisions of the Act - Rs. XXX |
| III | Interest due on principal amounts paid beyond the due date during the year but without the interest amounts under this Act - Rs, XXX |
| IV | Interest accrued but not due- Rs, XXX (Represents interest accrued as at the end of the year but not due as interest is computed at monthly rests from the due date) |
| V | Total Interest Due but not paid - Rs. XXX (Represents all interest amounts remaining due together with that from prior year(s) until such date when the interest was actually paid to the small enterprises. Mainly to ascertain the amount of interest disallowable for income tax purposes) |

USEFUL WEBSITES

Ministry of Micro, Small and Medium Enterprises

<http://msme.gov.in/>

Development Commissioner, Ministry of Micro, Small and Medium Enterprises:

<http://dcmsme.gov.in/>

MSME Development Institute, Agra

<http://www.msmediagra.gov.in/default.asp>

Federation of Indian micro and small & medium enterprises:

<http://www.fisme.org.in/>

World Association for Small and Medium Enterprises

<http://www.wasmeinfo.org/>

National manufacturing competitiveness council

<http://www.nmcc.nic.in/>

About the Author

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Mr. Rajkumar S Adukia is an eminent business consultant, academician, writer, and speaker. A senior partner of Adukia & Associates he has authored more than 34 books on a wide range of subjects. His books on IFRS namely, "Encyclopedia on IFRS (3000 pages) and The Handbook on IFRS (1000 pages) has served number of professionals who are on the lookout for a practical guidance on IFRS. The book on "Professional Opportunities for Chartered Accountants" is a handy tool and ready referencer to all Chartered Accountants.

In addition to being a Chartered Accountant, Company Secretary, Cost Accountant, MBA, Dip IFR (UK), Mr. Adukia also holds a Degree in Law and Diploma in Labor Laws. He has been involved in the activities of the Institute of Chartered

Accountants of India (ICAI) since 1984 as a convenor of Kalbadevi CPE study circle. He was the Chairman of the Western Region of Institute of Chartered Accountants of India in 1997 and has been actively involved in various committees of ICAI. He became a member of the Central Council in 1998 and ever since he has worked tirelessly towards knowledge sharing, professional development and enhancing professional opportunities for members. He is a regular contributor to the various committees of the ICAI. He is currently the Chairman of Committee for Members in Industry and Internal Audit Standard Board of ICAI.

Mr. Adukia is a rank holder from Bombay University. He did his graduation from Sydenham College of Commerce & Economics. He received a Gold Medal for highest marks in Accountancy & Auditing in the Examination. He passed the Chartered Accountancy with 1st Rank in Inter CA & 6th Rank in Final CA, and 3rd Rank in Final Cost Accountancy Course in 1983. He started his practice as a Chartered Accountant on 1st July 1983, in the three decades following which he left no stone unturned, be it academic expertise or professional development. His level of knowledge, source of information, professional expertise spread across a wide range of subjects has made him a strong and sought after professional in every form of professional assignment. He has been coordinating with various professional institutions, associations' universities, University Grants Commission and other educational institutions. Besides he has actively participated with accountability and standards-setting organizations in India and at the international level. He was a member of J.J. Irani committee which drafted Companies Bill 2008. He is also member of Secretarial Standards Board of ICSI. He represented ASSOCHAM as member of Cost Accounting Standards Board of ICWAI. He was a member of working group of Competition Commission of India, National Housing Bank, NABARD, RBI, CBI etc.

He has served on the Board of Directors in the capacity of independent director at BOI Asset management Co. Ltd, Bharat Sanchar Nigam Limited and SBI Mutual Funds Management Pvt Ltd. He was also a member of the London Fraud Investigation Team. Mr. Rajkumar Adukia specializes in IFRS, Enterprise Risk Management, Internal Audit, Business Advisory and Planning, Commercial Law Compliance, XBRL, Labor Laws, Real Estate, Foreign Exchange Management, Insurance, Project Work, Carbon Credit, Taxation and Trusts. His clientele include large corporations, owner-managed companies, small manufacturers, service businesses, property management and construction, exporters and importers, and professionals. He has undertaken specific assignments on fraud investigation and reporting in the corporate sector and has developed background material on the same.

Based on his rich experience, he has written numerous articles on critical aspects of finance-accounting, auditing, taxation, valuation, public finance. His authoritative articles appear regularly in financial papers like Business India, Financial Express, Economic Times and other professional / business magazines. He has authored several accounting and auditing manuals. He has authored books on vast range of topics

including IFRS, Internal Audit, Bank Audit, Green Audit, SEZ, CARO, PMLA, Antidumping, Income Tax Search, Survey and Seizure, Real Estate etc. His books are known for their practicality and for their proactive approaches to meeting practice needs.

Mr. Rajkumar is a frequent speaker on trade and finance at seminars and conferences organized by the Institute of Chartered Accountants of India, various Chambers of Commerce, Income Tax Offices and other Professional Associations. He has also lectured at the S.P. Jain Institute of Management, Intensive Coaching Classes for Inter & Final CA students and Direct Taxes Regional Training Institute of CBDT. He also develops and delivers short courses, seminars and workshops on changes and opportunities in trade and finance. He has extensive experience as a speaker, moderator and panelist at workshops and conferences held for both students and professionals both nationally and internationally.. Mr. Adukia has delivered lectures abroad at forums of International Federation of Accountants and has travelled across countries for professional work.

Professional Association: *Mr. Rajkumar S Adukia with his well chartered approach towards professional assignments has explored every possible opportunity in the fields of business and profession. Interested professionals are welcome to share their thoughts in this regard.*