Confederation of Indian Industry

Union Budget 2013 -14 MSMEs – An Analysis

Key Policy Initiatives

1. Benefits or preferences enjoyed by them(MSMEs) will stay with them for upto three years after they grow out of the category in which they obtained the benefit

It is an acknowledged fact that Micro, small and medium enterprises (MSME) lack an incentive to grow. Too many of them do not grow because of the fear of losing the benefits associated with staying small or medium. Hence, the proposal that the benefits or preferences enjoyed by them will stay with them for upto three years after they grow out of the category in which they obtained the benefit, will provide a fillip to their growth ambitions, at the same time providing them the security of availing the benefits of remaining small.

The benefits to begin with, will be the non-tax benefits, that will be made available to a MSME unit for three years after it graduates to a higher category.

2. Small and medium enterprises, including start-up companies, will be permitted to list on the SME exchange without being required to make an initial public offer (IPO)

The proposal for easier listing of small and medium enterprises on SME exchanges without undergoing the tedious processes and higher compliance thresholds of initial public offers will als o make exiting investment easier for angels. This definitely makes early-stage investing more attractive.

Another potentially interesting outcome may arise if the changes simplify investment flows into sectors with restrictive foreign direct investment (FDI) limits. A multi-brand retailer, such as Flipkart, must now set up a complex structure to access overseas capital.

Under the new provisions, it may be possible for an angel based outside India to invest beyond stipulated FDI limits in a restricted sector,through the medium of an angel pool. However, this back door may eventually be plugged in the fine print. The concept of pools in any case reverses normal practice. Most angels are individuals doing their own due diligence. They often invest much less than ~1 crore (the minimum pool threshold). By denying the same tax breaks to individuals, or Category 2 and Category 3 AIFs, the Budget is asking angels to operate collectively and make bigger-ticket investments. This would help venture capitalists and angel investors tap the SME Exchange and find an appropriate price for their exits in the investments in SMEs.

It is also likely to provide a good depth in terms of good SMEs getting listed on the SME Exchange.

3. To to enhance the refinancing capability of SIDBI from the current level of refinancing capability of SIDBI from the current level of Rs.5,000 crore to Rs.10,000 crore per year.

The measure of making refinancing funds available through SIDBI, like in the past, would benefit SIDBI (in terms of increased business for loans to banks, which is risk free) and banks (which borrow from SIDBI, outside the purview of SLR and CRR requirements, and would cover their already committed lending exposures to MSMEs over the past 6 months from the date of drawal).

It is envisaged that the refinancing loan would be contracted at market denominated rates or a sub-market rate to make it attractive for the banks to borrow from SIDBI, a window which has practically dried out for SIDBI. It is impossible to determine and conclude that because of this facility an additional lending has taken place to the MSME sector, although both banks and SIDBI can generate statistics in support of the facility as both parties are interested.

4. Tax Perspective

It is suggested that the Large Industry could be entitled to tax benefits subject to the transaction having been completed (including timely payment to the SME supplier), extension of the applicability of the provisions of the Public Procurement Policy to the State Government Ministries, Departments and Public Sector Undertakings and its strict implementation by all concerned.

On the tax front, the proposed introduction of the Direct Taxes Code (DTC) in the current Budget session would carry the momentum forward, and suggests that the government is serious about key tax reforms.Similarly at a policy level, the FM's statement on the implementation of the Goods and Services Tax (GST) is encouraging; the approval of a fund of ~9,000 crore to compensate states means the ball is in the states' court.

From an administrative reforms standpoint, the proposal to set up a "Tax Administration Reforms Commission" is a positive move, and would go far towards overhauling India's image among foreign investors in particular.

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PERSPECTIVES OF THE MSME MEMBERS

Mr Deep Kapuria, Chairman, CII National MSME Council and

Given the economic circumstances in which the Union Budget 2013 was presented, the FM has done a commendable job for the SMEs - while on one end he has given support to the Start-ups/First Generation Entrepreneurs through listing on SME Exchanges without an IPO and encouraging the establishment of Incubators, however, on the other hand he has extended the preferential benefits for the SMEs for 3 years, after they outgrow the MSME category.

Similarly, he has allocated funds to SIDBI for Refinancing, for encouraging R & D and also for setting-up of a Factoring fund, that is expected to provide respite to the SMEs from the issue of Delayed Payments.

Sector specific duty reductions have also been made to Leather and Leather processing machinery , as well as Gems & Jewellery.

Mr Ramesh Datla, Immediate Past Chairman, CII National MSME Council and Managing Director, ELICO Ltd

Looking at the economic scenario in India and globally the union budget 2013 was balanced by addressing certain key issues related to MSME's.CII MSME Council has been pursing for many policy changes with the government and we are happy that this budget has address some of the key issues pursued by CII.

Extending the preferential benefits for the MSME's for 3 years after they outgrow from their existing category, CSR activity can fund Technology Incubators certified by Ministry of S&T and MSME Rs 500cr for SIDBI to setup Factoring guarantee scheme, Doubling of allocation to SIDBI.

Other key announcements where the Rs 2200 fund for tool rooms and sector specific duty reductions and additional allocation for the NSDC will definitely help the MSME's in today's difficult times.

To encourage the listing on SME Exchange giving support to the Start-ups/First Generation Entrepreneurs through listing on SME Exchanges without an IPO is also a welcome move.

Delayed Payment is one key issue which is very critical for MSME's in today's environments, has not been addressed in this budget

Mr Kavi Arora, CEO, Religare Financial

The budget this year has been a progressive and forward looking one with special mention to MSMEs. Government has realized the finance gap to the sector and has announced some primary steps to bridge this hiatus. Announcements such as non-tax benefits for three years, more funds to

SIDBI to support refinancing and factoring, extension of technology fund scheme (TUFs) for textile industry, fund of Rs. 2200 cr for tool-room and technology development and lower interest for hand-loom weavers, will all add to the motivation for this sector. Especially for textiles which contributes to almost 10% for the total manufacturing output from MSMEs in India, this announcement of providing technology support will give an impetus to the sector.

I believe sector focused NBFCs like us had some more expectations in terms of special incentives and cost benefits to service MSMEs in India, that are not directly covered in this budget but hopefully we can get some refinancing benefits from funds allotted to SIDBI.

Mr P.Ganesh, Chairman CII MSME Sub-Committe SR & Chief Executive GEFAB Facade Solutions P Ltd

Intrest Subversion For MSME'S.
Incentivize the MSME sector based on performance. Most of units in the sector become sick due to high cost of finance. Encourage more number of units to establish shop, produce and sell . MSME sector is the largest employment generator in India after agriculture. A small percentage of the indirect taxes paid (ED, CST, VAT, Service Tax) by the unit may be used to incentivize the unit say 8 to 10%. This amount could be used to reduce the cost of finance by financial institutions. Only the deserving units will be benefitted.

Equity Participation by Banks.
All public sector and private sector banks should be mandated to participate in equity of MSME's aspiring to get listed. This will be a great help to the MSME's and the financial institutions will also get benefited by way of good returns. The banks can retire the equity after the lock in period of 3 years.

M. Babu Rao, Managing Director G.S.B. FORGE PVT. LTD.

CII should strongly take up extending the benefit of 15% investment allowance to MSMEs also by withdrawing the min limit of 100 Crores proposed in the budget.

This provision is rather discriminatory and should be done away with for the healthy growth of MSMEs in the country and giving a boost to the manufacturing sector.

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ECONOMIC SURVEY 2012- 13

MICRO, SMALL AND MEDIUM ENTERPRISES (MSME) SECTOR

9.24 The MSME sector covers both the registered and informal sectors. The classification of micro, small and medium enterprises at present is based on the criterion of investment in plant and machinery by each enterprise. Detailed information for the registered MSMEs on the various economic variables such as employment, investment, products, gross output, and exports is available based on the Fourth Census of MSME (2006-07). The size of the registered MSMEs was estimated to be about 15.84 lakh units with sub-sector wise composition in the proportion of 94.9 per cent micro enterprises, 4.89 per cent small and 0.17 per cent medium enterprises.

The total registered MSME sector comprised of 67.1 per cent manufacturing enterprises and 32.9 per cent services enterprises. About 45 per cent of these registered enterprises were located in rural areas. More detailed information based on the Fourth Census on the unorganized sector units, constituting about 94 per cent of the entire MSME sector is awaited.

9.25 In the recent past the Prime Minister's Task Force on MSMEs and the Twelfth Plan Working Group on MSMEs have discussed issues related to the MSME sector. The Twelfth Five Year Plan policy framework is guided by the recommendations of these key committees. The Plan covers various aspects of the MSME sector and its key recommendations fall under six broad verticals, viz. 1) finance and credit (ii) technology (iii) infrastructure (iv) marketing and procurement (v) skill development and training, and (vi) institutional structure. The Plan has a separate set of recommendations for the khadi and village industries and the coir sector. In order to boost the MSME sector, several schemes are under operation including the following ones.

1. Procurement Policy: The government has notified a Public Procurement Policy for Goods Produced and Services rendered by Micro & Small Enterprises (MSE) order, 2012 effective from 1st April, 2012. The policy mandates that all the central ministries / departments / central public sector undertakings (CPSUs) shall procure a minimum of 20 per cent of their annual

value of goods / services required by them from MSEs. Further, policy has earmarked a subtarget of 4 per cent procurement out of this 20 per cent from MSEs owned by scheduled caste/ scheduled tribe (SC / ST) entrepreneurs.

2. MSE- Cluster Development Programme (MSECDP):The Ministry of MSME has adopted a cluster approach for holistic development of MSE in a cost effective manner. To build capacity of MSMEs for common supportive actions, soft interventions are undertaken in the existing clusters/new industrial areas/ estates or existing industrial areas/estates. To ensure transparency and speedy implementation of the MSE-CDP, office of the Development

Commissioner, MSME has started an online application system from 1 April 2012. Hard interventions are taken up to create/upgrade infrastructure facilities and setting up of common facility centres in new/existing industrial estates/clusters.

3. Credit Guarantee Scheme: The Government is implementing the Credit Guarantee Fund Scheme for MSEs with the objective of facilitating flow of credit to the MSEs, particularly to micro enterprises by providing guarantee cover for loans upto ` 100 lakh without collateral / third party guarantees. For making the scheme more attractive to both lenders as well as borrowers, several modifications have been undertaken which, inter alia, include: (a) enhancement in the loan limit to `100 lakh; (b) enhancement of guarantee cover from 75 per cent to 85 per cent for loans upto ` 5 lakh; (c) enhancement of guarantee cover from 75 per cent to 80 per cent for MSEs owned/operated by women and for loans in north eastern region (NER); (d) reduction in one-time guarantee fee from 1.5 per cent to 1 per cent and annual service charges from 0.75 per cent to 0.5 per cent for loans upto ` 5 lakh and (e) reduction in one-time guarantee fee for NER from 1.5 per cent to 0.75 per cent.

4. Credit Linked Capital Subsidy Scheme for Micro and Small Enterprises (CLCSS) for MSEs: The scheme aims at facilitating technology upgradation of MSEs by providing 15 per cent capital subsidy (limited to maximum ` 15 lakh) for purchase of plant & machinery. Maximum limit of eligible loan for calculation of subsidy under the scheme is ` 100 lakh. Presently, 48 well established and improved technologies/sub sectors have been approved under the scheme.The CLCSS is implemented through 11 nodal banks/agencies including the Small Industries Development Bank of India (SIDBI), National Bank for Agriculture and Rural Development (NABARD) and Tamil Nadu Industrial Investment Corporation (TICC), Chennai (TIIC) and National Small Industries Development Corporation (NSIC) Ltd.

CHALLENGES AND OUTLOOK

9.38 India has not improved significantly in terms of the ease of doing business and ranks very low in comparison to other industrial peers. The MSME sector in particular faces multiple approval and operational restrictions. The process of setting up and exiting business is time consuming and complicated requiring expensive third party assistance. Since states have the major role in administering MSME sector, the prevailing ecosystem therefore varies from state to state. Exit rules as per the Companies Act, 1956 are complex and costly and do not permit reaping the benefits from reallocation of resources.

9.39 Sourcing of finance at competitive cost is another major constraint for both the organized and the unorganized MSME enterprises. Financing other than internal accruals is costly and prohibitive. The Prime Minister's Task Force on MSMEs had recommended a 20 per cent year-on-year growth in credit to micro and small enterprises to ensure enhanced credit flow. It had also recommended allocation of 60 per cent of the micro and small enterprises advances to the micro enterprises to be achieved in a phased

manner. The resource flow, however, needs to improve. Research and technology upgradation activities also need to be scaled up.

Presently only a small number of incubators operates in the country which is very low relative to other countries. New incubators will need to be set up on a Public-Private Partnership basis. To attract more investment and talent, incubators need to be allowed to distribute profits back to investors. With some of these changes indutrial growth could become steadier.

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Pending Agenda

1. Roll Back Alternate Minimum Tax (AMT)

CII has recommended a complete roll back of AMT for SMEs. In case a complete roll back of AMT is not possible for proprietary or partnership concerns, then there is a strong case for removing AMT in tax exempted states.

CII is of the view that identities such as those operating in certain special category states or those reinvesting their profits in SEZ enjoying exemption under Section 80IC or Section 10AA of the Income Tax Act should be kept outside the purview of AMT, till the period of availability of such exemption to that particular unit i.e. five assessment years from the date of commencement of production.

2. Relaxation to pay Advance Tax

CII is of the view that payment of advance tax by SMEs should be made flexible with the option to pay advance tax during the following quarter. This would help to ease the burden on SMEs which are already facing payment problems on account of factors such as penalties and high interest rates prevailing on advances received from banks at a time when economic slowdown is affecting profits of micro and small units.

3. Achieving Synergy between Small, Medium and Large Industry

It is recommended that the Large industry that are purchasing from the MSMEs, may be entitled to avail a tax benefit, subject to the transaction having been completed (including timely payment to the SME supplier).

The resultant synergies, that are expected for the various components in the Supply chain are :

1. Incentivisation of the vendee through direct tax benefits, for adhering to the payment terms & conditions, agreed upon with the Vendor;
2. Streamlining of working capital cycle for the vendor & decrease its dependence on external/short term finance and the resultant cost of finance;
3. Facilitate capital investment by the vendee in the technological upgradation/R & D, of its vendors, in line with its changing market conditions/requirements;
4. Enable the vendee to claim part/full depreciation benefits of the capital investment, for the technological upgradation/R & D;
5. Ensure modernization & upgradation of the Vendors technology, while providing them with a captive demand, for their products;
6. Ensure capacity building interventions by the vendees, in the products/processes of the vendors and avail tax benefits, for all such expenditure incurred;
7. Provide the vendee with a reliable, credible & committed source of supply.

4. Delayed Payments

To mitigate the problem arising out of Delayed Payments to the MSMEs, and given the problem of incorrect reporting by the companies which have mounting dues to MSMEs, enforcement is a serious problem and has been ineffective. While data may be available, accessing it has been very difficult, considering they are embedded deep inside the PDF documents with the MCA.

With the introduction of XBRL,this process can be streamlined. As a step towards effective implementation of this rule, there is a need to modify the reporting requirement of MSMEs by asking them to report receivables that they have from the large units.

With XBRL data, the government can match the data and take immediate action signaling its concern towards MSMEs.

5. MSME Definition

The multiple classifications criteria's for defining an Indian MSME has actually created confusion among the Entrepreneurs regarding compliance with various legislations - and at the same time increase the procedures .

It is suggested that the compliance norms for the MSMEs may be based on the similar classification criteria, as specified by the Ministry of Micro, Small and Medium Enterprises, that may be redefined, given the period that has lapsed, since the enactment of the MSMED Act in 2006.

6.Public Procurement Policy

Public Procurement Policy has been duly notified, however there is lack of acceptance at the state level;& its Implementation by the Central Government Ministries, Departments and Public Sector Undertakings.

It is suggested - Extension of the applicability of the provisions of the Public Procurement Policy to the State Government Ministries, Departments and Public Sector Undertakings; and Facilitating the adaptation and implementation by the Central Government Ministries, Departments and Public Sector Undertakings.

7. Incentivise Innovation by MSMEs, in Defence

MSMEs ability to manage innovation should be leveraged for Defence Research. DRDO should give a grant upto Rs 5 crores for proof of concept and prototype work. If the innovation is accepted by MoD, PSU, Large Indian or Foreign Defence Supplier, a royalty or one time fee would be paid, that shall be shared by the MSME and DRDO MSME and DRDO shall co-own the IPR

8. Information & Communication Technology

In order to encourage ICT use by MSMEs there is need, for enhanced depreciation on IT products. This would greatly enhance their competitiveness.

It is recommended that the government consider according 100% depreciation, once in a block of three financial years, for an annual investment in IT equipment and software up to a limit of rupees twenty five lakhs, to the MSMEs (for the purpose of the scheme the standard definition of MSMEs as prescribed by the Ministry of Micro, Small and Medium Enterprises, GoI, be considered).

The ICT hardware/software equipment for which this depreciation is accorded should be excise duty paid/cleared and the software is original (genuine)/duly licensed.

9. Technology

To enhance the self-reliance on energy and also be responsible towards the environment it is important to promote of Climate friendly energy technologies. There is a need to create Central Climate Friendly Technology Fund to help MSMEs to adopt such technologies.

10. Availability of Credit & Finance

To address the issue of timely and low cost availability of credit to the MSMEs, RBI may constitute a group along with the Indian Banks Association and the credit rating agencies to work out a uniform credit rating format and processes to bring about transparency and speed to this important issue.

11. Industrial Infrastructure

To facilitate the availability of Industrial infrastructure, a corporation/SPV to be created, which will hold the industrial land/building under its ownership. The MSMEs will use the facilities paying rent/service charges for initial 7-10 years.

When the concerned MSME will be financially stable enough it will purchase the property with the option to buy at a fair price at the end of 10 years. This arrangement will (a) help the new enterprises to use the available funds more profitably and (b) facilitate painless exit for the unsuccessful ones.

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