



drishti

## Role of MSMEs in Indian Economy

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This article is based on “**Liquidity lifeline: On Nirmala’s MSME package**” which was published in The Hindu on 14/05/2020. It talks about the challenges of and steps to be taken to revive the MSMEs sector.

In order to revive the Indian economy amid **Covid-19 pandemic**, the government has announced an economic package under **Atmanirbhar Bharat Abhiyan**. The main thrust of the announcements has been the massive ₹3-lakh crore collateral-free assistance or sovereign credit guarantee to the **Micro, small and medium enterprises (MSMEs)**.

Like other sectors of the Indian economy, MSMEs have been hit badly due to lockdown imposed by the government to tackle Covid-19 pandemic. However, even before the current crisis, MSMEs growth has been marred by several challenges.

In such a situation, providing merely a stimulus package may not be effective, until adequate reforms are carried out to solve its pressing problems and to utilize its potential.

### Reason for Giving Credit Guarantees

- A credit guarantee by the government helps as it assures the bank that its loan will be repaid by the government in case the MSME falters.
- Efforts to pump liquidity via the bank have not been successful in the past, because banks simply do not want to lend any new money.
- Banks, quite justifiably, suspect that any new loans will only add to their growing mountain of non-performing assets.
- So the issue was banks had the money but were not willing to lend to the credit-starved sections of the economy.
- Thus, as part of the solution, credit guarantees are chosen by the government.

### Significance of MSMEs

- The significance of the MSMEs sector can be noted from the fact that it is the second-largest employment provider, after agriculture in India.

- In India, at present, there are nearly 56 million such enterprises in various industries, employing close to 124 million people.  
Of these, nearly 14% are women-led enterprises, and close to 60% are based in rural areas.
- In all, the MSME sector accounts for 8% of India's GDP and 45% of merchandise exports.
- Due to this, the MSME sector is called the growth engine of the nation.

## Challenges Pertaining to MSMEs

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### Lack of Adequate and Timely Access to Finance

- Access to finance continues to remain the biggest challenge for MSMEs and has constrained their growth.
- MSME funding from banks has been stalled, as decision-making managers are reluctant of loans going bad.
- After the **IL&FS crisis** and its effect on the other NBFCs (Non-Banking Finance Companies), MSMEs ran into deep trouble because of the liquidity crunch that followed.
- Due to this, MSMEs are not able to invest in manufacturing, purchase raw materials on time, access new technologies or acquire new skills due to lack of funds which is a big handicap especially in its fight with global competitors.

### Technological Disruption

- India's MSME sector is based on obsolete technology, which hampers its production efficiency
- With the emergence of new technologies like Artificial Intelligence, Data Analytics, Robotics and related technologies (collectively called as **Industry Revolution 4.0**) is a bigger challenge for MSMEs than for organized large-scale manufacturing.

### Regulatory Cholesterol

- MSMEs require a lot of government services and approvals, for which the entrepreneur has to run around various government departments.  
Getting construction permits, enforcing contracts, paying taxes, starting a business and trading across borders continue to constrain doing business.
- Regulatory risks and policy uncertainty in the past have dented investor confidence.

### Problem of Scale

- Majority of the firms in MSMEs are micro-enterprises.

- The MSME space is virtually a micro space formed by a plethora of small and local shops and hence, scaling them up is a problem, especially when fund access is challenging.

## Steps To Be Taken

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- **Increasing Domestic Manufacturing Capabilities:** The government can play a crucial role in creating domestic manufacturing capabilities by leveraging proposed public procurement and projects.
  - For example, Mega public projects such as Sagarmala, Bharatmala, industrial corridors, and the Pradhan Mantri Awas Yojana (PMAY) can stimulate domestic manufacturing activities.
  - This should be accompanied by a simplification of the regulatory process.
- **Cluster Manufacturing:** Efforts should be made to develop self-sufficient clusters of manufacturing competence, with Cluster Administrative Authorities, empowered to provide single window clearances to entrepreneurs and investors.
- **Leveraging Industrial Revolution 4.0:** Disruptive technology, while leading to job losses in traditional areas, also presents new job opportunities.
  - A greater connect between government-industry-academia is required to identify the changing requirements in manufacturing and prepare an employable workforce.
  - Also, the Industrial Revolution 4.0 will boost the Industrial supply chains in India.
- **Need to improve Ease of Doing business:** Reforms: India has already taken several steps, due to which ease of doing business in India has improved significantly (India's ranking in [ease of doing business report](#) has improved from 142 in 2014 to 63 in 2020).

However, still some reforms are needed in regard, especially in the field of land, labour reforms and in enforcing contracts.
- **Making Indian Products to Match Global Standards:** There is a need for harmonizing Indian quality standards with global standards in many sectors.
  - Lack of harmonization has affected Indian exports and prevented the leveraging of trade agreements adequately.
  - There is a need to promote **ZED manufacturing (Zero effect- Zero Defect)** as envisaged by [Make in India](#).

## Conclusion

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Collateral-free assistance or sovereign credit guarantees to the Micro, small and medium enterprises (MSMEs) will ease the financial crunch. However, the government should devise this scheme in such a way that the issue of **moral hazard can be averted**.

### Issue of Moral Hazard

- Collateral-free assistance and credit guarantees leave no incentive for the borrower to pay back, as he has nothing to lose.
- Also, as the banker is assured of payback from the government so why should he bother to check if the borrower is deserving or not.

## NEW LOOK MSMEs

### CURRENT: LINKED TO INVESTMENT

	Manufacturing	Services
<b>Micro</b>	Up to ₹25 lakh	Up to ₹10 lakh
<b>Small</b>	Over ₹25 lakh to ₹5 crore	Over ₹10 lakh to ₹2 crore
<b>Medium</b>	Over ₹5 crore to ₹10 crore	Over ₹2 crore to ₹5 crore



**MANUFACTURING:** Plant & machinery investment

Source: Ministry of MSME



**SERVICES:** Investment in equipment

### PROPOSED: LINKED TO TURNOVER

Micro:  
**Up to ₹5cr**

Small:  
**Over ₹5cr to ₹75cr**

Medium:  
**Over ₹75cr to ₹250cr**

### *Drishti Mains Question*

Discuss the role of MSMEs sector in India's growth and how far sovereign credit guarantee will help in reviving it.



Watch Video At:

<https://youtu.be/v-kravtGAs>

This editorial is based on **“Liquidity lifeline: On Nirmala’s MSME package”** which was published The Hindu on May 14<sup>th</sup>, 2020. Now watch this on our Youtube channel.