

Pulse

June 2014

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Enhancing Skill, Scale and Speed of Manufacturing MSMEs



Highlight

Today, the Indian economy is one of the fastest growing economies in the world. However, on account of the global meltdown the growth has been low in the past few years. Manufacturing sector (including Micro, Small and Medium Enterprises) plays a significant role in economic development of a country contributing almost 15% of the total Gross Domestic Product (GDP). A majority of the Micro, Small and Medium Enterprises (MSMEs) are involved in manufacturing of diversified products.

Historical data of past few years indicates that the share of MSMEs in GDP has been declining. The share of MSME declined from 36.8% for 2007-08 to 34.9% for 2011-12. The manufacturing sector as a whole is also on a declining trend in the past few years. To revitalize this sector the government has taken many policy level initiatives and started many programmes. However, many of the programmes and policy initiatives have a long gestation period for the results to become manifest and visible. In view to resolve challenges pertaining to short and medium term the Cabinet secretary constituted an Inter-Ministerial Committee to present recommendation to accelerate manufacturing in MSMEs.

The committee recommended building a supportive ecosystem at each stage of the life cycle of an enterprise in manufacturing. The life cycle stages being, setting up of business, doing business, expansion and exit. For each stage the committee recommended suggestions in terms of policy level amendments in programme which can undo issues pertaining to regulation, finance, infrastructure, technology and market.

Onicra believes that to build a supportive ecosystem around MSMEs in manufacturing there is need to identify potential MSMEs requiring support in terms of financial, technical, capacity building and marketing issues at each lifecycle stages and handhold them in optimizing their resources. Performance and credit rating can be used as a tool for identifying such entities at different lifecycle stages and could act as a decision making tool for an appropriate and timely action plan.

Background

India's position in the global economy

Indian economy today is the tenth largest in the world by nominal Gross Domestic Product (GDP) and the third largest by Purchasing Power Parity (PPP). Over the last two decades with its annual average GDP rate of 5.8% the country is one of the fastest growing economies in the world. However, on per capita income basis the country is ranked 141st by nominal GDP and 130th by PPP. Till 1991 the country followed a closed economic policy which was primarily influenced by socialist economics. A balance of payment crisis forced the country to liberalize its economy and since then the country's economy has grown rapidly.

Real GDP Growth Rates (in %) for Economies at Constant Prices

Country	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 (IMF Estimates)
Developed Economies													
Canada	1.69	2.80	1.93	3.14	3.16	2.62	2.01	1.18	-2.71	3.37	2.53	1.71	2.01
France	1.84	0.93	0.90	2.55	1.83	2.47	2.29	-0.08	-3.15	1.73	2.03	0.01	0.27
Germany	1.64	0.03	-0.39	0.69	0.85	3.89	3.39	0.81	-5.09	3.86	3.40	0.90	0.54
Japan	0.36	0.29	1.69	2.36	1.30	1.69	2.19	-1.04	-5.53	4.65	-0.45	1.45	1.54
United Kingdom	2.19	2.30	3.95	3.17	3.24	2.76	3.43	-0.77	-5.17	1.66	1.12	0.25	1.76
United States	0.95	1.78	2.79	3.80	3.35	2.67	1.79	-0.29	-2.80	2.51	1.85	2.78	1.88
BRICS nations													
Brazil	1.32	2.66	1.15	5.71	3.16	3.96	6.10	5.17	-0.33	7.53	2.73	1.03	2.28
Russia	5.09	4.74	7.25	7.15	6.39	8.15	8.54	5.25	-7.80	4.50	4.30	3.40	1.28
India	4.82	3.80	7.86	7.92	9.29	9.26	9.80	3.89	8.48	10.26	6.64	4.74	4.35
China	8.30	9.08	10.03	10.09	11.31	12.68	14.16	9.64	9.21	10.45	9.30	7.65	7.67
South Africa	2.74	3.67	2.95	4.56	5.28	5.60	5.55	3.62	-1.53	3.14	3.60	2.47	1.89
Average BRICS	4.45	4.79	5.85	7.09	7.08	7.93	8.83	5.51	1.61	7.18	5.31	3.86	5.75
Average - G20 Countries	1.73	2.30	3.89	4.97	4.77	5.12	5.23	2.87	-1.17	5.32	4.23	3.44	3.58
World	1.59	1.94	2.84	4.00	3.55	4.00	3.92	1.47	-2.06	4.09	2.95	2.54	2.39

Source: International Monetary Fund, World Economic Outlook (WEO) Database

An analysis of the world GDP shows that the growth rate of GDP declined marginally in 2008 after growing at a higher rate from 2001 till 2007. Further, due to global turmoil, the world economy has shown a negative growth rate of 2.06% in 2009. It also shows that the world GDP has been significantly driven by the growth rate of emerging economies. The developed countries include countries like Canada, France, Germany, Japan, United Kingdom and United States on the other hand developing countries include Brazil, Russia, India, China, etc.

The global meltdown has affected the world GDP immensely. The GDP growth rate remained below 3 percent till 2013 except for 2010 where it stood at 4.09 percent. India has also not been insulated by the global turmoil; however, a higher domestic consumption which has been the key driver for the Indian economy has somehow provided a buffer to the turmoil.

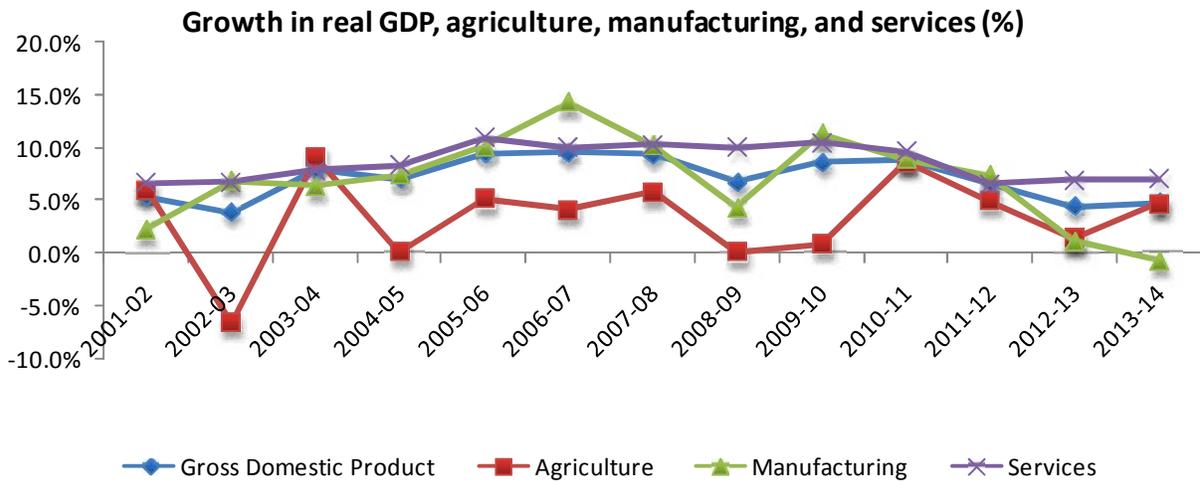
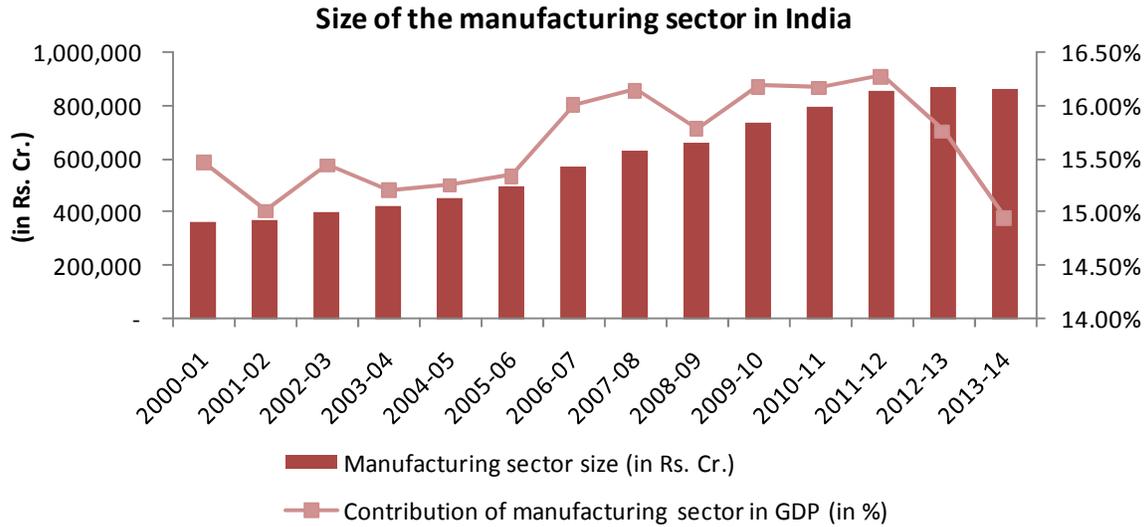
Significance of manufacturing sector in Indian economy and current trends

The manufacturing sector has always been a key segment in the economic development, accounting for nearly 15 percent of real GDP in FY13. Apart from the contribution towards GDP growth, the segment also plays a major role in providing social stability through greater job creation thus enabling economic diversification and equitable income distribution. The major sub-sectors of the manufacturing industry include food products, metals, rubber and petrochemicals, chemicals and electrical machinery. These sectors together constitute almost 66% of the total revenue generated by the manufacturing sector.

Manufacturing			
Basic goods	Capital goods	Intermediate goods	Consumer goods
Electricity Coal Finished Steel Fertilisers Cement Steel casting Pipes and tubes (other than spun) Stamping and forging Sulphuric acid Caustic soda Heavy structural Aluminium ingots Copper (cathode)	Commercial vehicles Auto components Electric motors Railway locomotives Textile machinery Electric generators Machine tools Ship building and repairing Complete tractors Diesel engines Wagons Motor starters and contractors Broad gauge passenger carriers Boilers	Cotton yarn Petroleum refinery products Jute and mesta textiles Giant tyres Tin metal containers Bolts and nuts Plywood commercial Paints, enamel and varnishes	Paper and paper boards Cotton cloth Sugar Tea Wheat flour/maida Tetracycline Artificial leather cloth Cigarettes Beer Vanaspati/edible hydrogenated oil Penicillin Soaps Phone instrument Wristwatches

Source: Reserve Bank of India (RBI)

The manufacturing sector in India including the MSME segment has been in line with the growth in GDP over the past few years. The sector grew at CAGR of 7.22% during the period 2000-01 to 2013-14. On the other hand the GDP grew at CAGR of 7.26% during the period 2000-01 to 2013-14.



The above graph depicts that the manufacturing sector as a whole (including the MSMEs) has been declining over the past few years. After posting a high growth of 10.3% for 2007-08 the growth rate significantly declined for 2008-09 on account of global meltdown. Since then, the growth rate of the sector has been on the declining trend except for 2009-10. The sector also posted a negative growth rate for the year 2013-14.

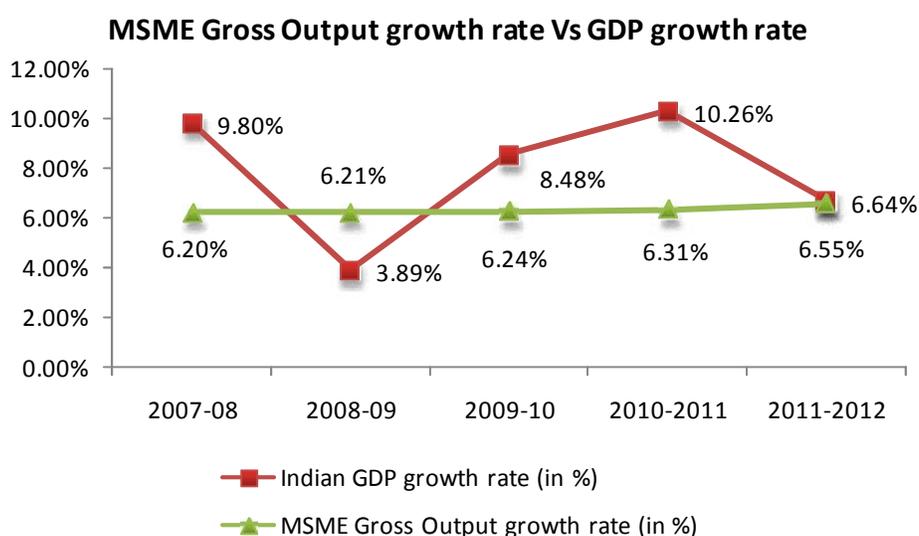
Role of MSMEs in growth of manufacturing sector

Micro, Small & Medium Enterprises (MSMEs) play a vital role in development of a country's economy given their role in job creation and their ability to foster entrepreneurship. MSME units contribute significantly to the manufacturing output of India. For the year 2011-12 the sector is estimated to employ about 1,012.59 Lac persons in over 447.73 Lac units throughout the country. Further, this sector has consistently registered a higher growth rate (6.5% on gross output for financial year 2012-13) compared to the rest of the industrial sector. There are over 6000 products ranging from conventional to sophisticated items, which are being manufactured by the MSMEs in India. Following table summarizes the growth of the MSME sector over the past few years in India:

SL. No.	Year	Total Working Enterprises (in Lac)	Employment (in Lac)	Market Value of Fixed Assets (in Rs. Crore)	Gross Output (in Rs. Crore)
1	2007-08	377.37	842.23	917,437.46	1,435,179.26
2	2008-09	393.70	881.14	971,407.49	1,524,234.83
3	2009-10	410.82	922.19	1,029,331.46	1,619,355.53
4	2010-11	428.77	965.69	1,094,893.42	1,721,553.42
5	2011-12	447.73	1,012.59	1,176,939.36	1,834,332.05

Source: Annual report, Ministry of Micro, Small and Medium Enterprises, 2012-13

Out of the total number of MSMEs 67% of the MSMEs are involved in manufacturing followed by service sector (17%) and repairing and maintenance sector (16%). In the Indian context, the MSMEs have become increasingly important with the growth of the sector outpacing the growth achieved by the country's Gross Domestic Product in 2008-09. This statistic appears even more impressive considering the poor condition of available infrastructure and limited access to finance that these units suffer from. However, since 2009-10 the growth rate has not been commensurate with that of GDP.



Challenges and issues of MSMEs in manufacturing

Despite being an important component of Indian economy, the sector faces immense challenge in terms of:

Adequate and timely supply of bank funding	One of the major challenge MSMEs face is access to sufficient funds required for purposes like capital expenditure or working capital financing. Banks and financial institutions, traditionally, have been reluctant in extending large volumes of credit to small businesses given the higher credit risk involved along with lack of adequate collateral assets to cover their exposure. According to the Reserve Bank of India (RBI), as on March 2009 the total credit extended by the Scheduled Commercial Banks (SCBs) to MSMEs (both existing and new) was just about 11.4% of the total net banking credit. The study also reflected that only 7.23% of the MSMEs (both existing and new) in India have access to institutional and non-institutional funds which reflects that the majority of the MSMEs are either self financed or do not have access to external funding. Even amongst these, fresh start-ups are hardly entrusted with any form of credit. ¹
Inadequate infrastructural facilities	Infrastructural facility of MSMEs still remains a primary concern, since lack of it poses a threat to the MSME's value chain processes like production, consumption and distribution of products. One of the major reasons behind the failure of Indian MSMEs is unavailability of adequate infrastructure and power, which are the key resources to operate any business successfully.
Modernization and technological up-gradation	Due to size (micro, small and medium) and nature of the business (mainly family driven) the MSMEs face challenge in modernization and technological up-gradation. These result in the manufacturing processes being cost inefficient and of poor quality standards. Although India is considered as vast talent pool for technical expertise, however, the country lacks in development and adaptation of new technologies specifically in the MSME sector.
Availability of highly skilled human resource	Human resource is one of the most essential asset which determine the growth of any organization. The remuneration offered by the MSMEs is often far below the remuneration offered by the mid or large corporates on account of which they face significant challenge in acquisition and retention of skilled workforce (particularly in middle level management level) and often have to settle with a less efficient workforce. Also, it is often discussed that the job generation by the sector might be a result of loss of jobs or negligent job opportunity from large businesses/corporate rather than attractiveness offered by them.
Market access	To become competitive with respect to mid and large corporates (both domestic and international), MSMEs need to respond efficiently to the evolving market trends and innovations. To reach the desired goal the MSMEs need to optimize their web presence and capabilities. Since, MSMEs in India are primarily small family run businesses which mostly cater to domestic market they heavily rely on traditional media like telephone directory, customer references and tenders floated in the newspaper to reach customers.

¹ http://www.onicra.com/images/pdf/Publications/Pulse_CGTMSE_Transparent.pdf

Recommendations by Inter-Ministerial Committee

Each and every enterprise goes through a life cycle due to the fact that technology and consumer tastes take time to adapt to new products and are always changing. A life cycle consists of various stages of development of an enterprise and each stage has its own unique characteristic which reflects the current point within the life cycle. The Inter-Ministerial Committee has identified four life cycle stages that an MSME goes through and has made suitable recommendations regarding challenges pertaining to regulation, finance, infrastructure, technology and market through these stages. Some of the key recommendations given by the committee are provided in the following tables²

Start-Up stage	Recommendations
Infrastructural facilities	<ul style="list-style-type: none"> - Allocation of land in vacant industrial estates to start-ups with viable business plan - Identification of mid-sized land close to urban areas for allotment to MSMEs - Construction of premises that could be given on rent to manufacturing start-ups - Harmonizing urban plans with economic activity
Regulation	<ul style="list-style-type: none"> - Manufacturing entities in the organized segment may be incentivized through concession in tax rates
Finance	<ul style="list-style-type: none"> - Provision of higher level of funding and subsidy through government programmes and funds like Prime Minister's Employment Generation Programme (PMEGP), Prime Minister's Entrepreneurship and Employment Generation Programme (PMEEGP), India Opportunity Venture Fund (IOVF) and Credit Guarantee Fund (CGF) to potential start-ups
Marketing	<ul style="list-style-type: none"> - Re-orientation and training of District Industries Centers (DICs) towards entrepreneurship development, advocacy, mentoring and handholding of start-up
Technology	<ul style="list-style-type: none"> - Simplification of services associated with registration for VAT and other local taxes, land/property and provision of utilities through use of IT - Handholding support through Technology Business Incubators (TBIs)

Doing and expanding business	Recommendations
Regulation	<ul style="list-style-type: none"> - Tax incentive for 3 to 5 years under a 'deferment scheme' if the unit is growing year on year above the national average - Provision for MSME units to continue availing of the non-tax benefits for additional three years upon graduation from the entitled category may be extended to tax benefits as well - Extending the benefit of investment allowance to small and medium manufacturers, by bringing down the floor level of investment eligibility from Rs. 100 crore

² Source: Recommendations of the Inter-Ministerial Committee for Accelerating Manufacturing in Micro, Small & Medium Enterprises Sector

	<ul style="list-style-type: none"> - Provision of Public Procurement Policy along similar lines by the state government to facilitate a demand pull growth of manufacturing in the MSME segment
Finance	<ul style="list-style-type: none"> - Support the credit gap in the form of credit facility or interest rate reduction in the MSME sector through fuller use of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and other schemes. In this aspect SIDBI should play a more active role in advocating, providing professional inputs and designing specialised instruments - Provision for unpaid bills of MSME suppliers to be treated as accrued income of the defaulting customer enterprise. Unpaid bills of MSMEs have often led to their sickness, which deters the growth of manufacturing activity - Popularise the bill factoring and discounting for MSME - Increase budget outlay on Textile Up gradation Fund Scheme (TUFS) and Credit Linked Capital Subsidy Scheme (CLCSS)
Marketing	<ul style="list-style-type: none"> - Setting up of a National Portal that would enable MSME suppliers offer competitive deals through web interface - Promoting of domestically manufactured products to counter imports in the (Electronic System Design & Manufacturing) ESDM by blocking the entry of technically inferior products into the country - Collaborations with B2C(Business to Customers) e-commerce platforms to significantly upscale e-commerce in the country - Engaging industry associations on a continuous basis to serve as an implementing arm of the government and operate as a single window system for hand holding MSMEs
Technology	<ul style="list-style-type: none"> - Setting up of innovation hubs to use research & development for manufacturing of high-end technology products - Establishment of Common Facilities Centres (CFC) particularly in export clusters (Textiles, Chemicals and Leather products) - Identification of lead clusters and lead units where the interventions under the National Manufacturing Competitiveness Programme (NMCP) like Lean Manufacturing, Design Clinic, Technology and Quality Up gradation and promotion of industrial clusters can be fast-tracked - Assessment of four regional and eight sub-regional testing centres to match with European and US standards - All enterprises to comply with product standards specified by the Bureau of Indian Standards (BIS) as a mandatory requirement, in a graduated time-bound manner - Focus on low end technology products for import substitution

Closure & exit stage	Recommendations
Infrastructural facilities	<ul style="list-style-type: none"> - Establishment of MSME Rehabilitation Cell (MRC) at Zonal / Circle Head Quarters for monitoring of timely rehabilitation of sick MSE units
Regulation	<ul style="list-style-type: none"> - Simplification of procedures and redesigning bankruptcy laws to streamline procedures, reducing discretion and intermediation, and to make information available in formats that are easily understood and to help viable organisations in distress

	<ul style="list-style-type: none">- Re-examination of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act for deferring the commencement of recovery proceedings against the sick Micro and Small Enterprise borrowers so that these small borrowers get additional time to revive their business- Provision for amendment in the- Micro, Small And Medium Enterprises Development (MSMED) Act, 2006 to provide a mechanism for the orderly handling of financial distress by introducing a temporary stay, followed by orderly and speedy liquidation, revival or sale options
Finance	<ul style="list-style-type: none">- Provision of interest free loan with a repayment period of 7 years, to prevent a MSME from going bankrupt during a financial crisis



Analysis

Bridging the gap through performance and credit rating

For empowering MSMEs to achieve its position in the Indian economy and to become competitive in the international markets, it is necessary to support them both financially and technically and handhold them to make optimum utilization of the resources, both human and economic. However, identifying potential MSMEs and segregating them according to their creditworthiness and performance remains a mountainous task.

Onicra believes that performance and credit rating can act as a tool for identifying such entities given the scope it covers. A rating assesses a firm's financial viability and capability to honor business obligations, provide an insight into its sales, operational and financial composition, thereby assessing the risk element, and highlights the overall health of the enterprise from an external point of view. A rating also compares a firm's performance with the industry standards.

Given below are the recommendations on how performance and credit rating can act as a tool in identification of eligible MSMEs according to their enterprise life cycle:

Start-Up stage	
Ratings as a tool for star-ups to avail startup capital	The intent of introducing credit ratings under the CGTMSE scheme is to get more MSMEs (specifically the new ones) included under the ambit of the scheme. There are a number of credit viable units that can be financed under the CGTMSE. These are largely first generation entrepreneurs who are unable to prove their credibility and thus are considered non-bankable by the banking institutions. Rating can be used as a tool for assessing eligibility of MSMEs under the CGTMSE scheme

Doing and expanding business	
Ratings as a tool for providing financing facility	The performance and credit rating report covers a large portion of business and promoter related information and with addition of some more information areas the rating reports can be well utilized to assess the viability of equity funding in a MSME unit. Schemes like SIDBIs MSME growth fund can leverage the widespread reach of MSME ratings to promote equity funding in the sector
Ratings as a tool for promoting technology up-gradation	Under the performance and credit rating scheme the rated enterprise is evaluated on financial and performance parameters. With addition of relevant information areas, the need for technology up-gradation for the SME enterprise can be assessed easily. Thus the rating report can also be used as a tool for disbursement of the Credit Linked Capital Subsidy Scheme (CLCSS) for technology up-gradation

Closure & exist stage	
Rating as a tool for debt restructuring for sick units	Debt restructuring mechanism for MSMEs similar to mechanisms like CDR (Corporate Debt Restructuring) that are used by large corporate can be a tool for revitalizing the sick MSME units. In this aspect credit and performance rating of MSME can be the used as a yard stick for identification of sick units and decision on approval of such restructuring proposals



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