Pulse.

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Role of Rating in Facilitating MSME to leverage on Make in India concept

- *Reigniting Manufacturing sector of India*
- *Introduction to Make in India Concept*
- *Integrating MSME to Global Value Chain*
- *Analysis*
    - *Rating evaluates the entrepreneurs and MSMEs and assess their operational, financial and technological capability to execute the project in hand*

Highlight

Micro, Small and Medium Enterprises (MSMEs) play a significant role in the development of the industrial economy of the country. MSMEs contribute close to 8 percent of the country's GDP, 45 percent of the manufacturing output. The major aspect of the sector is its immense employment potential at reasonable rate after agriculture. MSMEs have a wide presence across the country with production capacity of around 6000 diverse products and meeting needs of local as well as international markets.

However, in past few years, statistical data indicates that the growth in manufacturing sector has slowed down especially the share of MSMEs in GDP, manufacturing output and exports has declined to a great extent. The prime reasons for slowdown are higher interest rates imposed on consumer durable, several projects delayed owing to red-tapism, lack of will power in decision-making by the government, etc. All these dormant attributes have scaled down the confidence level, subsequently affecting the entire manufacturing sector in adverse manner.

To revitalize the bearish sentiments in manufacturing sector, government has triggered the "Make in India" campaign to boost manufacturing sector, aiming to redesign manufacturing sector as a key engine for India's economic growth. If "Make in India" campaign is successfully materialized, it will create a balanced road map and will link India into global supply chains, reduce trade deficit and increase the investor's confidence level at the same time.

Onicra believes that in order to encash upon the "Make in India" concept, there is a need to identify existing loopholes in MSME sector with respect to financial, technical, skill set, at each stage of manufacturing life cycle and providing requisite solution at the same time. For the scheme to achieve success, credit rating for new or existing MSME unit is required which acts as a risk assessment tool for lending institutions and builds greater confidence on their part in the proposals put forward by MSMEs. These ratings will help in assessing due diligence in terms of risk factors like managerial efficiency, project specific risk, operational efficiency, financial effectiveness. Rating would also create performance benchmarks for all small and medium businesses to grow and develop their scale of operations and be able to take on increased volume of projects.

Background

Re-igniting India's Manufacturing Sector

The global crisis has widely impacted manufacturing sectors across the globe. India is not immune to this global turmoil. Almost the entire manufacturing sector, ranging from metals and automobiles to capital goods and consumer durables are struggling to find market in India. The sluggish growth in manufacturing unit is being driven by slowdown in demand from domestic as well as global market. Subsequently, high interest rates on consumer durables, lackluster behavior of the government regarding land acquisition issues, stalled projects further discourages capital expenditure in the sector. Although, estimated statistical data issued by Central Statistics Office (CSO) indicated India's overall GDP growth during the period 2013 -2014 to be around 4.9%, rise of 0.4 basis points from previous period i.e. 2012-2013, but at the same time growth rate of manufacturing sector remained negative. Manufacturing output declined from 1.02% in FY13 to (0.68) % in FY14.

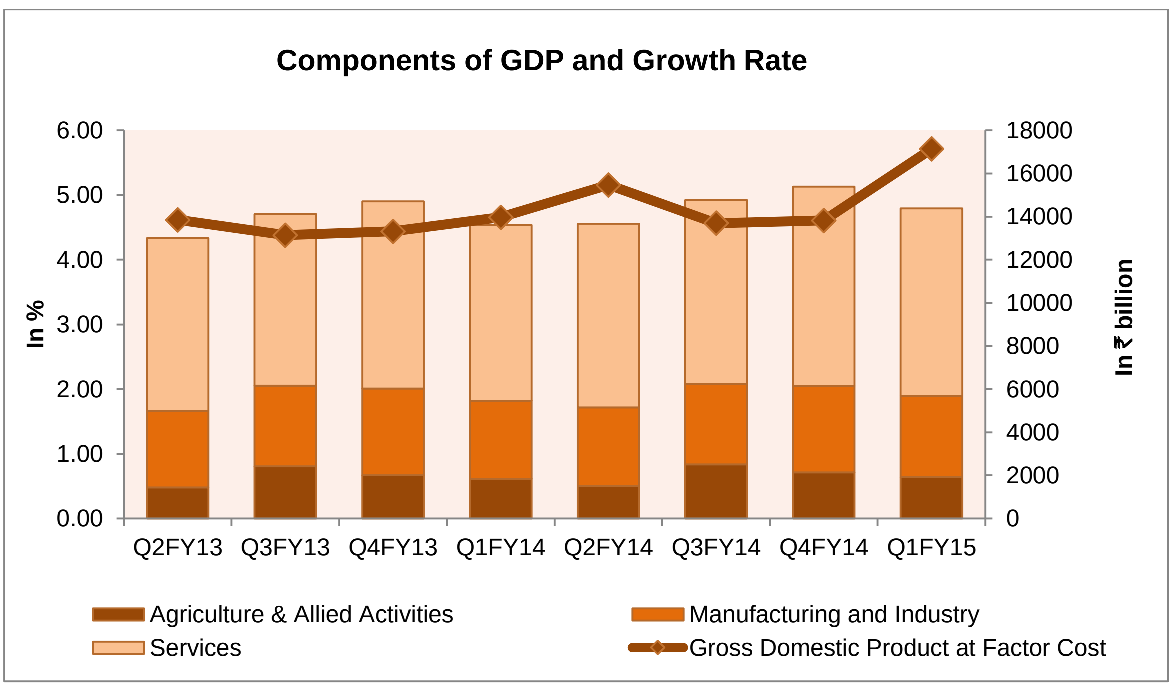
Growth rate in different sectors of Indian Economy

#Manufacturing sector poorly performed in FY14

SL. No.	Sector Wise	Period (2012-2013)	Period (2013-2014)
1	Agriculture, Forestry & Fishing	1.93%	4.76%
2	Manufacturing	2.06%	-0.68%
3	Services	7.13%	6.79%

Source: Ministry of Statistics and Programme Implementation

Declining trend in manufacturing sector



Source: Ministry of Statistics and Programme Implementation

The manufacturing sector has been adversely affected not only through decline in consumer spending but also through exponential fall in confidence levels of consumers. At present, manufacturing sector contributes close to 15% of India's GDP which clearly indicates that this sector is highly penalized. India needs a boost in manufacturing sector to increase per-capita income and create employment. There is no doubt that manufacturing sector employs millions of workers, reduce country's trade deficit, provide a stable source of foreign currency, and create a smooth & rapid path for country's economic development. India is an obvious source of cheap labor and large domestic market. This wide demographic feature coupled with better infrastructure and easier regulations vis-à-vis set up of manufacturing unit especially MSME will surely propel manufacturing sector.

By contrast, manufacturing's share has stagnated at 15-16% for nearly three decades with services sector share rising to 56% and agriculture to 17% in FY14. This has hampered growth, even though the manufacturing sector grew 15% YoY during 2003-2008.

Around the same time, Asian peers concentrated their efforts on expanding manufacturing, boosting growth and keeping external imbalances in check. India's manufacturing value-added (MVA) as a percentage of GDP stood at 13% in 2013, compared to 24% for Indonesia and 30% in China and South Korea

"Make in India" to promote indigenisation and import substitution

In order to make India a powerful indigenous manufacturing hub and bring about economic transformation, the government has come up with a concept of **"Make in India"**. With successful implementation of **"Make in India"** concept, India's gross domestic product (GDP) is expected to grow over $4.5 trillion by FY20. With the help of **Make in India**, the dependence on imports can be brought down and at the same time, current account deficit can also be controlled. **"Make in India"** will not only encourage the indigenous manufacturing sector but also give tough competition to foreign rivals.

India is heavily dependent on imports for a large number of goods and services. While import of certain goods like crude is inevitable, many other products across consumer sectors like electronic white goods, lighting, and consumables which are not technology intensive, have a significant potential to be substituted by local enterprises. Further, there is potential to incentivise investments in high technology areas in order to develop capabilities in high engineering import substitution and indigenisation in many areas of healthcare, automotive, defence, electronics and telecom. A strong support of industry association and academia is also needed to guide MSME foray into areas where they can substitute imports. Line ministries/departments can help identify major imports of products of their respective domain whose manufacturing involves low to medium end technology complexity.

Integrating Global Value Chain with MSME

MSME can be the backbone for the existing and future high growth businesses with both domestic and foreign companies investing under the 'Make in India' initiative and this will prove to be a significant step in the area of indigenisation. In recent years, India has progressed from the production of simple consumer goods to the manufacture of complex products like electronic control systems, electro medical equipment, microwave component etc. As a result of globalization and alarming demands, MSMEs have adequate opportunities in sectors such as information technology, telecom, textiles and garment, automobiles, leather products, chemicals, pharmaceutical, food processing, petrochemical, etc.

MSME sector accounts for 36% of total exports of the country, mainly consisting of pearls, precious stones, metals, electrical, electronic equipment, pharmaceutical products, organic chemicals, iron and steel articles, etc. It can play a vital role in curbing import and boosting export system in Indian economy. As per Foreign Trade Policy (2009-14) announced by the GOI, India has an excellent opportunity to shine in technology led exports with focus shifting to newer products. Therefore, MSMEs can be instrumental in transforming "Make in India" dream to the next level.

In recent years, the MSME sector has consistently registered a higher growth rate compared to the overall industrial sector. For manufacturing output to grow, a supportive ecosystem is required for each of the stages of the enterprises starting from promotion and creation to expansion till closure or exit.

Rating to help MSMEs in showcasing their potential and building trust among large corporation

Despite the impressive rate of growth achieved by the MSME division, concerns remain over their ability to deliver consistent product quality as per requisite national and international standards. This is essentially due to the constraints facing the MSMEs in terms of poor state of infrastructural facilities, lack of state of the art technology and limited access to credit. Given these issues, the sector finds it difficult to make critical investments needed to augment productivity and competitiveness. The concern also stems from **paucity of reliable information** about such units in view of limited regulations and compliances covering such businesses.

Onicra believes that rating can be an effective tool to assess the capabilities of the MSME with regard to execution of the orders received, which makes an assessment of the MSME with regard to its capabilities to service the requirements, generated under various government departments. Also, apart from providing an assessment of the capability of the evaluated entity, the study should also provide an idea to procuring agencies about the potential of the business to scale up in accordance with the need of the government department. These measures will eliminate the risk emanating from trading with entities which are unable to efficiently and effectively service their quota of government supply in terms of both the price and quantity of the product supplied while setting a benchmark for other aspirants to strive to achieve the performance and quality levels necessary to become a supplier to the government.

Ratings consider financial and non-financial parameters and provide a detailed understanding of the financial, operational and technical capability of the organization. The rating report acts as a credible source of information which has also been a major problem area for potential customers and investors interested in the MSME division.

The rating agency would conduct a 360-degree evaluation of business entities, clearly stating the product offerings, production capacity and financial prudence with which the business is managed. The report would provide a first-hand account of the facilities, resources, equipments, manpower, production capacity, on-going HR policies, adherence to quality norms etc. It would also incorporate feedback from various stakeholders including customers, suppliers, bankers & employees of the business. Also, the data gathered through yearly financial statements and other certified documents would be analyzed by a team of experts to provide specific insights on business performance. However, considering the problems afflicting the MSME units and the malaises constraining their development, merely creating suitable demand conditions would not serve the purpose of overall development. It is equally important to identify and associate with capable units which can adequately meet the volume and quality requirements of large corporate and ensure consistency of supplies at the right price.

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