



# MSMEs – the role of professionals

**Vinod Kothari**

**Vinod Kothari & Company**

**[Email: vinod@vinodkothari.com](mailto:vinod@vinodkothari.com)**

**Ph: 033 2281-7715/3742/1276**

**1012 Krishna**

**224 AJC Bose Road**

**Kolkata 700 017**



# Copyright

**This presentation is the property of Vinod Kothari & Company and no part of it can be copied, reproduced or distributed in any manner**



# The MSME sector: small is beautiful

- In the age of technology, scale has reached never-before dimensions
- Small may be beautiful, but small is not strong
- In any case, every economy has to foster small enterprises
- If small enterprises are overtaken by large enterprises, economy will be driven by oligopolies, leading to huge imbalances
- Importance of the MSME sector in India
  - The MSME sector comprises-
    - 50 % of India's total manufacture/ exports
    - 45% of India's industrial employment
    - 95% of all industrial units in the country

# Background

- The Government of India passed in June 2006 an Act regarding the Micro, Small , and Medium Enterprises. The Micro, Small and Medium Enterprise Development Act 2006 (MSMEDA) was the product of a consultative process involving over 300 industry associations, government bodies , and multiple stakeholders across India. The Act accomplishes many long- standing goal s of the government and stakeholders in the MSME sec tor. The contribution of SMEs alone have been greater than 7% to GDP
- Despite the importance, some of the obstacles faced by MSMEs are:
  - Inability to access finance and working capital loans from banks
  - Mistreatment by larger procurement companies
  - Difficult bureaucratic procedures for registration
  - Increasing availability of cheap foreign imports

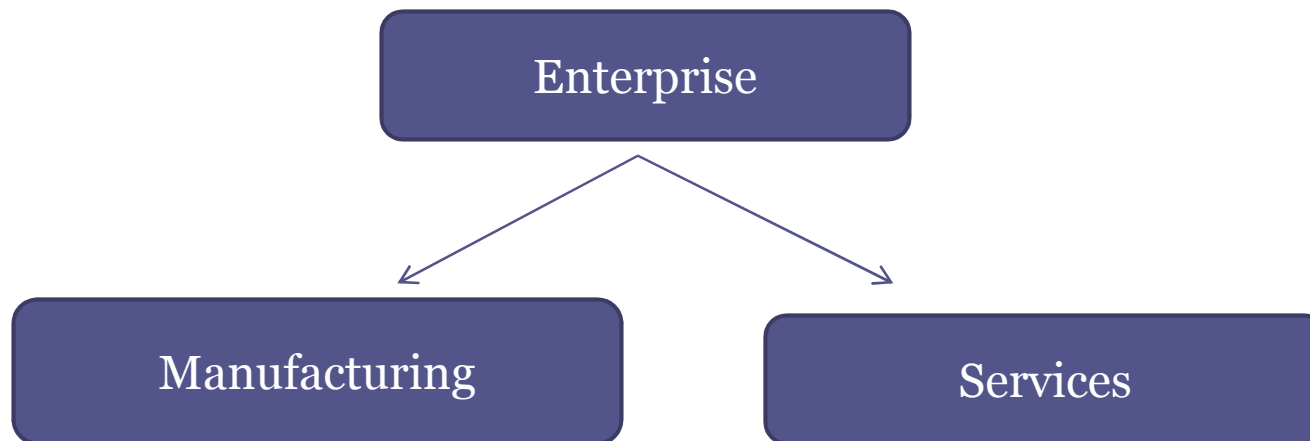
# Profile of Indian MSME sector

<b>PARTICULARS</b>	<b>VALUE</b>
No. of Micro and Small Enterprises	130 lakhs
Employment	410 lakhs
Share in GDP	8-9%
Share in manufacturing output	45%
Share in exports	40%

# Definition of MSME



- Enterprises are broadly classified into
  - Manufacturing
  - Those engaged in providing/rendering of services

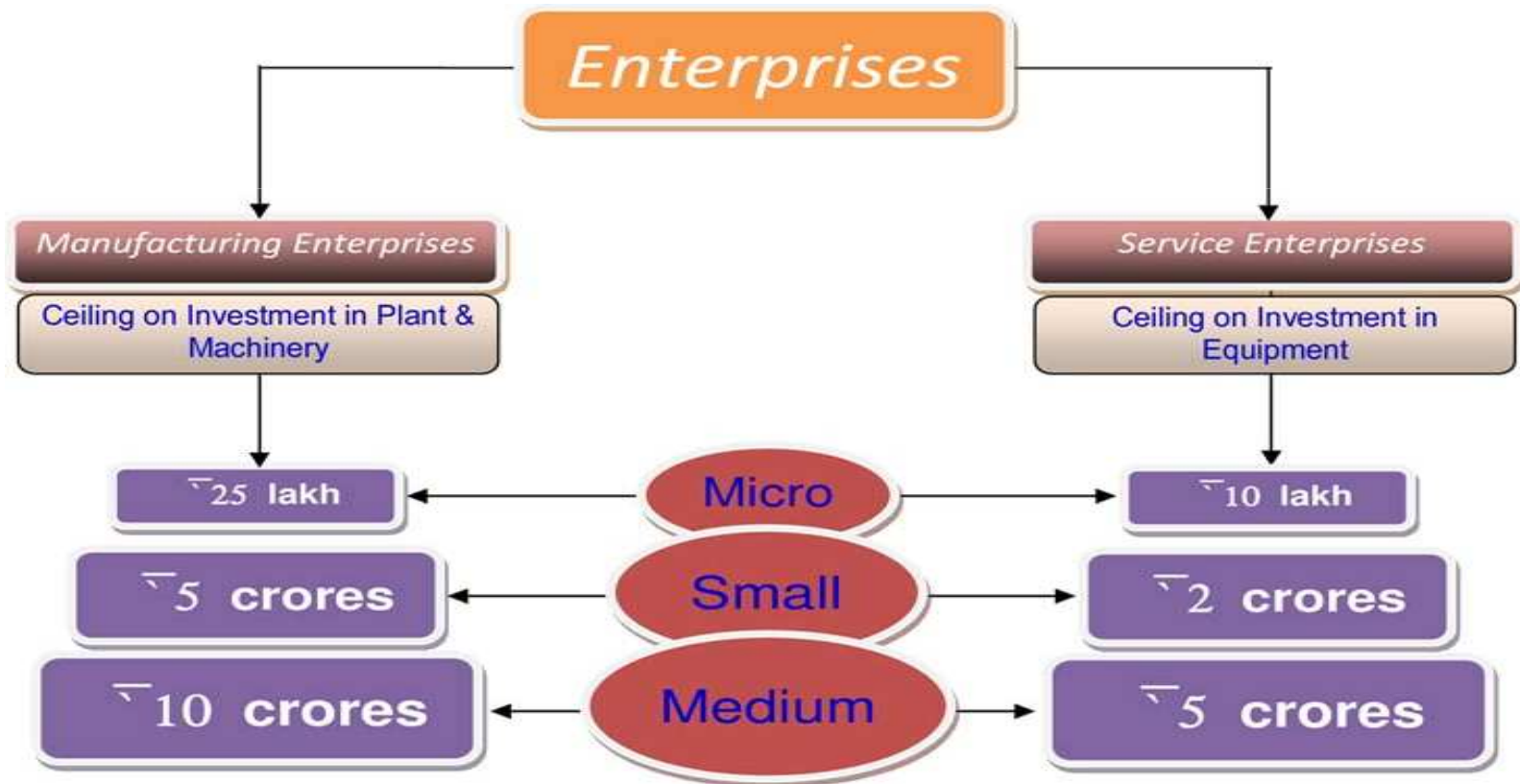


# Definition of “enterprise” under MSME Act

- “Enterprise” means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services
- Two limbs
  - Industrial undertaking engaged in manufacture of items listed in First Schedule of IDRA
  - What is First Schedule
    - Some 38 broadly defined industries are listed – essentially covering most industries
  - Service undertakings
    - The word “service” is not defined – implying all services as are contemporaneously understood are included
- Conspicuously absent
  - Trading entities

# Classification of Enterprises

- Both categories are further classified into micro, small, medium and large enterprises based on their investment in plant and machinery





## Computation of the limits of investment

- The original cost is taken
- Excluding investment in land and buildings
- Excluding pollution control and other notified equipment



# Registration Provisions of the MSME Act

- Optional registration for these:
  - Micro enterprises
  - Small enterprises
  - Medium enterprises rendering services
- Mandatory registration for these
  - Medium enterprise engaged in manufacturing
- These entities file an Entrepreneurship Memorandum



## What is the benefit of filing?

- Note the meaning of “supplier” in sec 2 (n)
- It only includes those entrepreneurs who have filed the memorandum
- Hence, the benefits of mandatory payment provisions and interest are available only to those MSMEs which have filed the memorandum



# Preferences/ privileges to MSMEs

- General developmental programs of the Central Government
- Priority credit facilities by the banking system under MSME lending guidelines
- Procurement preference by central and state governments

# Dues to MSMEs

- **Mandatory payment under sec 15:**
  - Where supplier supplies any goods/services, buyer shall make payment
    - On or before the agreed date
    - Where there is no agreed date, within 15 days
    - In no case, longer than 45 days from the date of acceptance or deemed acceptance
  - Concept of “deemed acceptance” – where no objection is raised within 15 days of delivery of goods or services
- **Payment of interest:**
  - Mandatory provision with non-obstante clause requiring every buyer to pay
    - Compound interest on monthly rests
    - At 3 times the bank rate – if current bank rate is 6%, buyer pays 18%

# Recovery of dues to MSMEs

- Sec 17 provides that for any goods or services provided by MSME, the dues are payable with interest
- In case of any dispute, MSME may make reference to MSME Facilitation Council
- The Facilitation Council may, at the first instance, assist parties in getting the dispute resolved by conciliation
- If the conciliation does not work, the Facilitation Council may
  - Either itself stand as arbitrator
  - Or refer the matter to any institution or center providing ADR services
- The arbitration powers of the Facilitation Council are very strong:
  - It may assume arbitration based on the jurisdiction of the supplier, irrespective of the jurisdiction of buyer – sec 18 (4)
  - The power is notwithstanding anything else in any other law – hence, it overrides even the agreement among the parties
- A reference will be decided within 90 days
- Appeal against the order of the Council, or an arbitrator on the reference of the council, will be admitted only on deposit of 75% of the decreed amount



# Publication of dues to MSMEs

- Sec 22 requires following disclosures in the annual report:
  - Principal amount and interest payable to MSMEs
  - Several disclosures about amount of interest paid/payable
- Sec 23 provides interest payable by a buyer to MSME in accordance with provisions of the Act shall not be a deductible expense

# Separate Listing window for MSMEs

- SEBI approved framework for listing of MSMEs by inserting Chapter XA in ICDR Regulations in April 2010.
- Issuers whose post-issue capital will be upto Rs 10 crores may issue “specified securities” only in accordance with this Chapter
  - Between 10-25 crores, it is optional for the companies
- Separate SME window of a main exchange envisaged
- Lots of regulations of ICDR relaxed
- Some significant points
  - Listing of debentures is permitted even in case of private limited companies
  - Listing of equity shares permitted only if
    - It is a public company
  - Reporting requirements are less stringent
  - Separate listing agreement format
  - Note, however, that once securities are listed, the accounting standards will apply in case of listed companies
    - Exception in case of SMCs will be lost



# Essential listing norms

- Minimum 25% public shareholding
- Clause 52 lays down corporate governance provisions
  - $\frac{1}{3}^{\text{rd}}$  of the BoD must consist of independent directors
    - $\frac{1}{2}$ , if the chairman is not an independent
  - Audit committee provisions same as in case of listed companies
  - Report of corporate governance to be part of annual report
- Essentially same provisions as for large companies
  - This is unduly cumbersome, and may be a show stopper

# Finance



# Private Equity



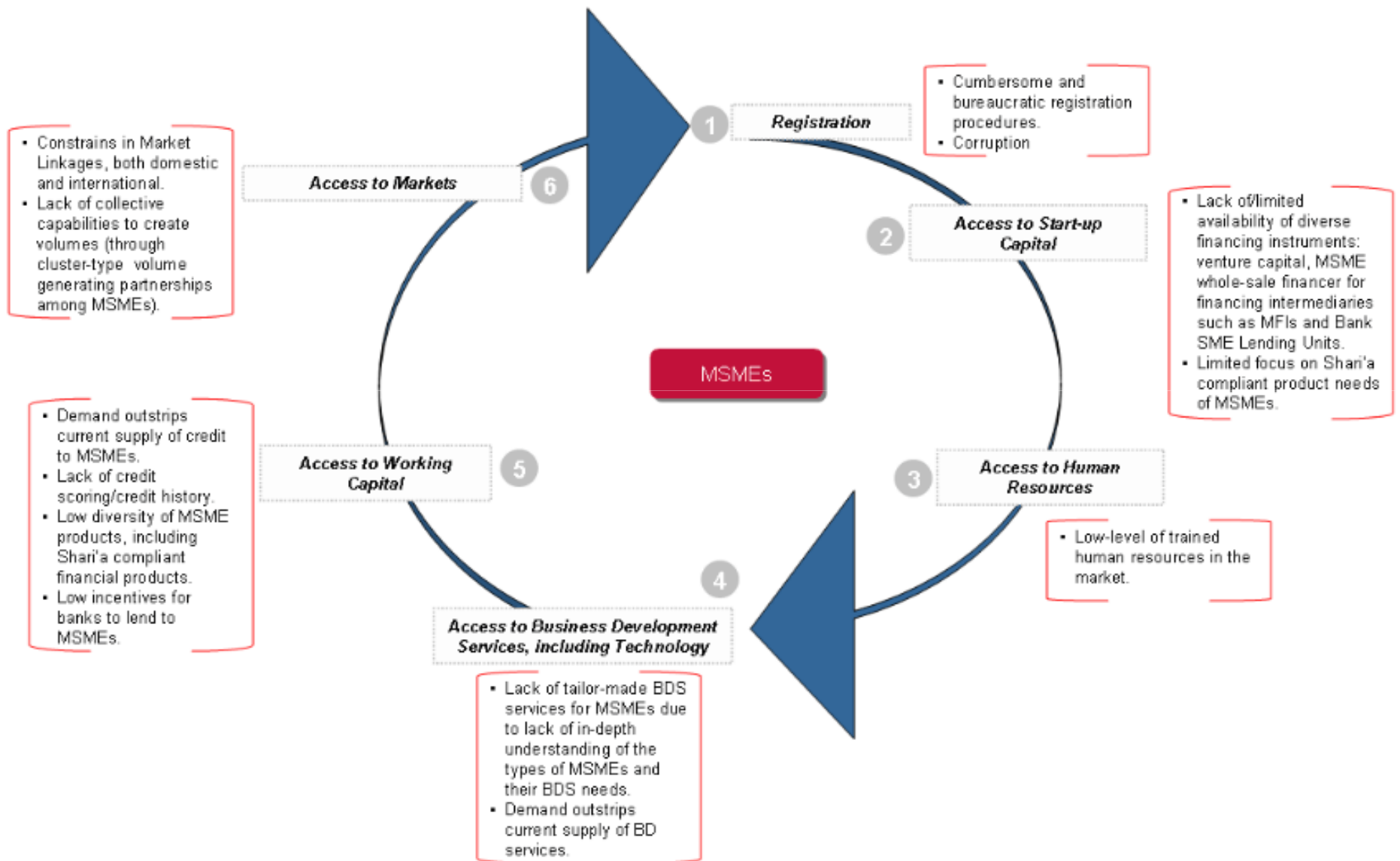


# Opportunities for private equity funding

- Private equity is solely a private arrangement between the investor
- Several private equity funds specialise in equity investments in SMEs.
- Legal issues
  - Private companies may also accept private equity – of course, exit provisions need to be carefully incorporated in the articles

# Priority sector lending norms of RBI

- Bank lending to medium enterprises does not count as priority sector
- Securitised investments are also counted, provided originated by banks/ FIs
- SIDBI has been running small enterprises financial centres - funding through these centers also qualifies for priority sector
- Domestic Banks have to lend at least 40% of adjusted net bank credit to priority sector
- Banks have to achieve 20% YoY growth in lending to MSMEs; also 10% growth in lending to number of MSMEs
- There are time lines for disposal of SME loan applications – 2 weeks and 4 weeks based on loan size
- No collateral for loans upto Rs 10 lacs
- At least one MSME branch in each district
- There is a separate CDR scheme in case of MSMEs





## Accounting standards

- Accounting standards normally provide exception to small and medium companies, based on capital and turnover criteria
- However, if a company attains status of a listed company, accounting norms become applicable

# Role of CS



# What can professionals do?

- Biggest challenge is corporate governance
  - SMEs are essentially closely –held. However, the moment they look outward for stakes of others, corporate governance becomes critical
  - Not just a formality or a compliance, but essential part of accountability and control
  - Company secretaries are essential links in establishing corporate governance systems
- Private equity funding
- SME stock exchange listing
- Bank funding
- Arbitral services for MSME- buyer disputes
- Single window advisory services