

The Legal Framework for MSMEs in India

ISED Policy Briefs

by
ISED Small Enterprise Observatory
jointly with
ISED Centre for Public Policy Studies



Institute of Small Enterprises and Development

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Published by P.M.Mathew, for Institute of Small Enterprises and Development. Printed and bound in India by Vivanta Printers, Cochin - 682 024

Series: ISED Policy Briefs
ISBN 978-93-80830-73-5
Price: Rs. 300.00 (India); US \$ 10.00 (Overseas)

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The purpose of 'ISED Policy Briefs' series, of the Institute of Small Enterprises and Development, is to present a short and informative analysis of some of the current issues relating to development of this constituency. It offers a brief background of issues, as also the latest analysis and findings. Monographs under this Series carry policy recommendations that can further be deliberated among policy circles, the media, and the general public.

Preface

Most progressive governments, across the world, have come out with some Basic Law that governs SME policy and practice in their countries. While the basic law is a reference point, it needs to have dynamic elements that can help to capture the emerging realities of future as well. In India, though the MSME Development Act was passed in 2006, significant changes have since taken place in the overall MSME environment, thereby demanding a review of the Act.

The MSME Development Act was passed against the felt needs as articulated by the MSME associations, and other stakeholders. While the Act was passed in 2006, based on international experience, as also the ground level situation that was available in the country then. The Act essentially provides for the following key subjects that are of importance to the sustainable development of the MSMEs in the country: 1. Promotion; 2. Development; 3. Enhancing competitiveness; and 4. Other incidental matters. Beyond its original vision and objectives, rapid changes have taken place in the economy in several ways. Many of the routine functional areas of MSME development and practices have got decimated. The growth of e-commerce, the escalated phenomenon of globalisation induced market distortions are issues that demand innovative solutions.

The purpose of this Policy Brief is to bring to light some of the least known aspects of the subject. It is also meant to initiate a wider discussion on the subject so that it may contribute to public policy and strategies.

This paper is the outcome of a project at the Institute of Small Enterprise and Development. The study was initiated by the ISED Center for Public Policy Studies, jointly with the ISED Small Enterprise Observatory. The support extended by the research team of the two Centers is gratefully acknowledged.

Cochin

February 23, 2017

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The Legal Framework for MSMEs

Abstract

Most progressive governments, across the world, have come out with some basic law that governs SME policy and practice. While such a basic law is a reference point, it needs to have dynamic elements that can help to capture the emerging realities of future as well. In India, though the MSME Development Act was passed in 2006, against the felt needs as articulated by the MSME associations, and other stakeholders. However, significant changes have since taken place in the overall MSME environment, thereby demanding a review of the legislation. The Act essentially provides for four key subjects that are of importance to sustainable development of MSMEs in the country: 1. Promotion; 2. Development; 3. Enhancing competitiveness; and 4. Other incidental matters. Beyond the above vision and objectives, rapid changes have taken place in the economy in several ways. Many of the routine functional areas of MSME development and practices have got decimated. The growth of e-commerce, and the escalated phenomenon of globalisation induced market distortions are issues that demand innovative solutions.

Key words: MSME Development Act, MSME Associations, Amendment

1.0. Introduction

Most progressive governments, across the world, have come out with a Basic Law that governs SME policy and practice in their countries. While the Basic Law is a reference point, it needs to have dynamic elements that can help to capture the emerging realities of future as well. In India, though the MSME Development Act was passed in 2006, significant changes have since taken place in the overall MSME environment, thereby demanding a review of the Act. This chapter looks into the issues around that.

2.0. Background of the Act.

The MSME Development Act was passed against the felt needs, as articulated by the MSME associations and other stakeholders. While the Act was passed in 2006, based on international experience, as also the ground level situation that was available in the country then. The Act essentially provides for the following key subjects that are of importance to the sustainable development of the MSMEs in the country:

1. Promotion;
2. Development;
3. Enhancing competitiveness; and
4. Other incidental matters.

In order to ensure that the above focal areas are taken care of, the Act provides for the following:

1. A National Apex Body that is representative of the Union and States, as also the various stake holders.
2. Classification of enterprises, and filing of entrepreneur's memoranda (alias registration)
3. Specification of an institutional structure, with their relative responsibilities.

4. Mechanisms to ensure prompt payment for MSMEs.

3.0. Changing role and Relevance of Law for MSME Promotion.

While the MSME Act 2006 was an important tool for formalizing a transition from an era of regulations, to one of promotion and development, the quantitative restrictions (QR) were progressively taken out. This was expected to provide 'a level playing field' for MSMEs on par with the larger units, as also within themselves.

Beyond the above vision and objectives, rapid changes have taken place in the economy in several ways. Many of the routine functional areas of MSME development and practice have got decimated. The growth of e-commerce, and the escalated phenomenon of globalisation induced market distortions, are issues that demand innovative solutions.

At the national level, new opportunities have come up in the form of flagship programmes such as 'Make in India' and 'Skill India'. Finance, which was a critical issue, gained a new dimension, and solutions came in the form of broad basing strategies and institutional platforms like the MUDRA.

MSME Governance underwent rapid changes. While, the large Centrally sponsored programmes such as Cluster Development Programme were sourced and implemented by the State Governments, such national patterns themselves underwent radical changes. Under the Niti Aayog regime, the State governments have every freedom to chalk out innovative programs and implement them, This essentially implies an enhanced competitive spirit among the states.

There have been important changes in the Governance structure. Innovative technology interventions, such as Udhog Aadhar, have provided new opportunities for entrepreneurs. This also demands a fresh look at the work of the DICs and their relevance and contribution in the current scenario.

4.0. Critical Gaps and the Way Forward

The fundamental purpose of a Basic law on MSMEs, is to provide a framework to work upon. This framework is meant to act as a sign post, around which, various stakeholder interests can be articulated and decisions taken. However, since the introduction of the Act in 2006, no such major initiative has taken place. In this context, it is important to have a fresh look at the role and relevance of the MSME Act as well as the implementation of some of the directions it provides.

Despite the commendable position of the MSME Development Act 2006 as a basic frame of action, the time has come for providing it a new vision and direction, according to the exigencies of the times. The critical gaps relate to the following functional areas:

1. Scope for a large campaign-mode intervention for MSME promotion
2. Policy priority to MSMEs
3. Demographic analysis and monitoring
4. Need for a comprehensive insurance system
5. Knowledge creation and management mechanism
6. Financial sector-real sector synergy mechanism
7. A mechanism for defining the MSME role according to the changing circumstances.

The above critical gaps need to be clearly defined and steps taken to suggest measures for plugging them. We may discuss this, in relation to the following key action points:

4.1. Perspectives on the MSME Act 2006

The basic perspective on the MSME Act in India today is as a reference point defining the size distribution of enterprises. There has been repeated arguments in favour of revising and upscaling the investment limits. While, according to the rate of inflation and the changing needs of the times, there is a need for an upward revision of the investment limits, defining size is not simply the purpose of the MSME Act. The Act recognizes the availability of other methods of classification (cf Sn 7(9) of the Act). This enabling provision should be used to redefine the SMEs in a more comprehensive manner, taking also into account the requirements and characteristics of various product sectors. Size, by itself, does not make any economic sense. Size becomes a relevant criterion only when its relationship

with the subsector is identified. Accordingly, it would be instructive for the Government of India to come out with separate Policy Statements for micro enterprises and the services sector.

4.1.1. Redefinition of the role of the NBMSME

The MSME Act envisages a role for the National Board for Micro, Small, and Medium Enterprises (NBMSME), which is more of a high power nature. This implies that, the Board can play several constructive roles as regards critical MSME problems are concerned.

The evidences available over the last 10 years, however, indicates that the Board could have played much more dynamic roles. The track record, however, does not speak of that. It is important to reactivate the Board with clearer mandates and directives.

4.1.2. The State of MSMEs

Where there is a dedicated Ministry, it is important that, in association with related official forums such as the Board and the Act, it should be able to bring in much greater dynamism into the MSME sector. While the people of India expect such dynamism from the Act, it is important to translate such dynamism into activities.

The people of India have every right to know of the state of MSMEs in the country. As such, one would expect that there would be a strong knowledge base that can help the Parliament and the people to understand and rally for the development of this sector.

4.1.3. Making Rules at the State level

While the MSME Act adequately captures the federal system of the country and its aspirations, it is important that there need to be a respect for such initiatives at the State level also. The Act provides a framework only. Though it provides for the State Legislative Assemblies to frame appropriate Rules, over the last 10 years, this has not happened in many States.

4.1.4. MSME Administration

At the State level, a Central Law and a few schemes cannot be sufficient in meeting the people's aspirations fully. Meeting these aspirations require that the States themselves create their own decision making platforms. In this context, it would be instructive to frame State Level Acts, thereby leading to appropriate institutional structures.

4.1.5. Perspective on Enterprise and Entrepreneurship

A fundamental purpose of the MSME Act is to promote