

## SMALL POLICY TWEAKS COULD BE ALL THAT WE NEED TO REVIVE MSMES

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

Reducing payment delays by state-run firms could solve their credit woes and help them expand

The present government has set great store by micro, small and medium enterprises (MSMEs) and entrepreneurship as engines of growth. Rightly so. The Mudra and Start-up India initiatives are illustrative of its keenness to promote a million new enterprises. These notwithstanding, credit growth to the MSME sector, particularly industries, is negative. Further, the problem of fund availability is not just of accessing institutional credit, but also about working capital availability.

One of the less known constraints facing the MSMEs is the significant delays in receiving payments from buyers, particularly public sector undertakings (PSUs), despite laws mandating a 45-day window, resulting in an often unsustainable working capital cycle. This often gets masked as a financing constraint. The Reserve Bank of India's expert panel, the MSME Committee chaired by UK Sinha, explored this at some length and proposed interesting solutions, a few of which we discuss here in the context of the upcoming budget.

First, the current grievance redressal system does not recognize the power asymmetry between the buyer and the seller. While it is theoretically possible for an MSME to take a defaulting buyer to arbitration, or use the government's Samaadhaan facilitation route, it is a David versus Goliath battle, with most MSMEs worried about losing business relationships if they take this step. To address this, the MSME Committee proposed that all MSMEs mandatorily upload their invoices above say, 1.0 crore, to an Information Utility (IU). A designated authority of the MSME ministry can then review this invoice data from the IU periodically and initiate a series of actions, starting with issuing a notice to the buyer and escalating to a disclosure on its website as a way to "name and shame" the defaulting buyer. This may also serve as relevant information for rating agencies and lenders, much in the same way that credit bureau reports serve in the context of individuals. This way, the burden of complaining does not fall on the MSME. This requires an amendment to the MSME Development Act, which would need invoice data to be uploaded and the designated authority to be notified under the Insolvency and Bankruptcy Board of India's IU Regulation No. 23.

In 2014, RBI licensed a few players to create trade receivables discounting platforms (TReDS). The objective was to enable multiple lenders to bid for invoices accepted by the buyer and thereby provide financing to the MSME seller on a non-recourse basis—transfer the risk from the MSME seller to the financier against the strength of a validated trade invoice. These platforms play a vital coordination role between the buyer (often large corporate or PSU), the seller (often an MSME), and the financier (banks and non-banking financial companies or NBFCs), and also enable the upload, acceptance, discounting and trading of invoices.

As of mid-2019, 3,708 MSME sellers, 604 buyers, 71 banks and five NBFCs engaged in factoring were registered on these platforms, and invoices worth 66.69 billion had been financed according to the MSME Committee's report.

These represent significantly lower activity and adoption levels than one would have hoped. Not many buyers are active on these platforms, despite the government's diktat for PSUs to

mandatorily enlist. At the heart of this issue is that buyers lack an incentive to use these. If they can get away with easier payment norms off such platforms, why would they commit to firm payment schedules on these? The MSME Committee recommended opening a "second window" for financing on these platforms, wherein the information on invoices would still be available for underwriting, but MSMEs would have the added comfort of recourse options, particularly in cases of low-rated buyers. It also encouraged opening up these platforms to all NBFCs so that there would be more liquidity. This may need an amendment of the Factoring Act. Existing credit guarantee funds such as the Credit Guarantee Fund Trust for Micro and Small Enterprises should back transactions for all lenders.

There are also concerns about the time taken to generate invoices and about multiple-financing of one invoice across different platforms. A process to ensure quick generation of invoices that are seamlessly registered with the Central Registry of Securitisation Asset Reconstruction and Security Interest will be important.

Another relevant initiative here is that of the Government e-Marketplace (GeM) meant to facilitate transparent government procurement of goods and services across departments. Its back-end infrastructure is quite sophisticated. There needs to be better integration between the GeM and the TReDS platforms, so that invoices on the GeM that have buyer acceptance can be smoothly listed on the TReDS.

As the government considers initiatives that will have a multiplier effect on a MSME revival, facilitating prompt payments should be an important priority. This, in turn, can unlock credit and help expand business activity. Small tweaks to already-launched initiatives can make a big difference.

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