Changes to Definition of MSMEs

Why in news?

The government, reportedly, will soon change the way it defines the micro, small and medium enterprises (MSMEs).

How did the proposal take shape?

- Earlier, Finance Minister Nirmala Sitharaman had said that the government would consider shifting to a "single definition" of MSMEs.
- The change in definition would require an amendment to the MSME Development Act.
- In 2018, the Union Cabinet had approved amendments to the MSMED Act.
- It had decided to shift from a criterion of classifying MSMEs based on 'investment in plant and machinery' to a criterion based on 'annual turnover'.

How significant is the MSME sector?

- According to an RBI report, the MSMEs are amongst the strongest drivers of economic development, innovation and employment.
- Since 2000-01, MSME sector growth has almost every year outstripped overall industrial growth in the country.
- The sector contributes in a significant way to the growth of the Indian economy with a vast network of about 63.38 million enterprises.
- It contributes about 45% to manufacturing output, more than 40% to exports, over 28% to the GDP.
- Importantly, it creates employment for about 111 million people.
- In terms of volume, this stands next to the agricultural sector.
- One of the key attractions of this sector is the huge employment generation potential at relatively lower capital investment.

How are MSMEs defined at present?

- The RBI, in its report, had noted that at present the sector is exceedingly heterogeneous.
- This is in terms of size of the enterprises and variety of products and services, and levels of technology employed.
- As is known, there has been no uniformity over the years about the definition

of what exactly one means by “small scale industries” in India.

- E.g. under the Industrial Development and Regulation (IDR) Act, 1951, small industries were conceived in terms of “number of employees”
- But it was found that obtaining reliable data on the number of employees was difficult.
- The alternative was to look at the investments in plant and machinery.
- It was relatively easier to reliably ascertain and verify this data.
- So, at present, the classification of MSMEs is done based on investment in accordance with the provision of Section 7 of the MSMED Act, 2006.

How is it done elsewhere?

- According to the World Bank, a business is classified as an MSME when it meets two of the three following criteria:
    1. employee strength
    2. assets size
    3. annual sales
- According to a 2014 report, as many as 267 definitions were used by different institutions in 155 economies.
- But the most widely used variable for defining an MSME was the number of employees; 92% of the institutions use this.
- Other definitions were based on turnover as well as the value of assets (49% and 36%, respectively).
- Around 11% used other variables like loan size, formality, years of experience, type of technology, size of the manufacturing space, and initial investment amount etc.
- However, notably, most of the countries used only one variable to define MSMEs.

How does a change in definition help?

- Definitions based on investment limits in plant and machinery/ equipment were decided when the Act was formulated in 2006.
- But that does not reflect the current increase in price index of plant and machinery/equipment.
- Moreover, given their small scale of operations and informal organisation, MSMEs do not always maintain proper books of accounts
- This essentially results in their not being classified as MSMEs.
- The change of definition is likely to address the above drawbacks and improve the ease of doing business for MSMEs.
- In the process, it would make it easier for them to pay taxes, attract investments and create more jobs.

Source: Indian Express

