

The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006

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Necessity of Legislation For SMEs

Entire world is a global village today which has become possible through a paradigm of innovation in communication and information technologies. The process of liberalisation and market reforms has created wide ranging opportunities for the development of micro, small and medium enterprises (MSMEs). At the same time, changing world scenario has thrown up new challenges to the very existence of the sector. The on going programme of economic reforms and the changes at the international economic scene, have brought certain challenges and several new opportunities for the SME sector. The most important challenge faced by the sector is that of growing competition both globally and domestically. At the same time, the sector has also been facing some problems which relate to credit, infrastructure, technology, marketing and delayed payment hassles on account of so many rules and regulations. In order to enable this sector to avail the opportunities and play its role as an engine of growth, it is essential to address these problems effectively and urgently.

Given the above backdrop, the industrial policy statement of the State needs to set out clear and credible specific measures to improve the investment climate towards better regulation by removing barriers to competition as well as drive industrial growth by attracting private investment. The investment climate is central to growth and improves outcomes for society as a whole. It reflects the many location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand. The

motto is to bring the local population in the mainstream of industrialisation and look into the measures to develop entrepreneurship in India. Entrepreneur needs to be well conversant with the incentives, concessions and facilities provided by the Government to make full use of them, to increase the production, to expand his activities and to meet his social responsibility for the growth and prosperity of the industry, society and the nation.

Definition of SMEs

SMEs are the mainstay of most economies, particularly in terms of employment and overall development impacts. Although their individual social and environmental impacts are small, the cumulative impacts of SMEs are highly significant, offering the potential for significant progress towards sustainable development. The term "SME" is frequently used, it is seldom defined - yet this is essential to really understand the significance of the sector. What constitutes a small, medium or large company is by no means clear or uniform, even within individual countries. In India, after the enactment of " Micro, Small and Medium Enterprises Development Act, 2006 ", the term "SME" is classified as "notwithstanding anything contained in section 11B of the Industries (Development and Regulation) Act, 1951, the Central Government may, for the purpose of this Act, by order, notified and having regard to the provisions of subsection (4) and (5), classify any class or classes of enterprises, whether proprietorship, Hindu Undivided Family, association of persons, cooperative society, partnership firm, company or undertaking, by whatever name called,

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- (a) in the case of the enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 as
- (i) a micro enterprise, where the investment in plant and machinery does not exceed twenty five lakh rupees
 - (ii) a small enterprise, where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees; or
 - (iii) a medium enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees
- (b) in the case of the enterprises engaged in providing or rendering of services in relation to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 as
- (i) a micro enterprise, where the investment in equipment does not exceed ten lakh rupees
 - (ii) a small enterprises, where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees or
 - (iii) a medium enterprises, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.”

Explanation:

- (1) For the removal of the doubt it is clarified that in calculating the investment in plant and machinery, the cost of pollution control, research and development, industrial safety devices and such other items as may be specified by notification, shall be excluded and
- (2) It is clarified that the provisions of Section 29 B of Industries (Development and Regulations) Act, 1951, shall be applicable to the enterprises specified.

It needs to be noted that the above definition is not a one-time static measure, but could undergo need based changes depending on the recommendations of Advisory Committee constituted under the Act.

Objectives of MSMED ACT, 2006 -

Micro, Small and Medium enterprises Development Act, 2006 aimed to support economic recovery and sustained growth by encouraging a more diversified and efficient industrial structure. To achieve this objective, it is focused on these main areas, viz.

- (i) strengthening competition by establishing an appropriate legal and regulatory framework and removing barriers to competition and trade

- (ii) facilitating investment and trade by strengthening the framework governing the policy, credit facilities, grants, administration and utilisation of funds, development of skill in the employees, management and entrepreneurs, provisioning for marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages and (iii) developing a SME policy, regulatory and financing framework.

The Micro, Small and Medium Enterprises Development Act, 2006 was enacted on June 16, 2006. The Act has been notified in the Gazette and is now applicable to all the micro, small and medium enterprises. The Act aims at facilitating the promotion and development of SMEs in a competitive way. It seeks to empower the Central Government to notify programmes, guidelines or instructions for facilitating the promotion and growth of the small and medium enterprises. The Act also empowers the State Governments to specify by notification that provisions of labour laws as specified in clause 9(2) will not apply to SMEs employing upto 50 people. This is intended to facilitate the graduation of small enterprises to medium enterprises. One of its primary objectives is to make provisions for ensuring timely and smooth flow of credit to SMEs to minimize the instance of sickness among them. Enhancing the objectives of such enterprises announced with the guidelines of the Reserve Bank of India is also one of its objectives. The Act empowers the Central and State Governments to notify preference policies in respect of procurement of goods, services produced and provided by small enterprises by the ministries, departments and public sector enterprises. Also, the Act empowers the Central Government to create a fund to facilitate the promotion and development and competitiveness of SMEs.

Micro, Small and Medium Enterprises Board

The Micro, Small and Medium Enterprises Development Act, 2006 has empowered the Central Government to establish a National Board for MSMEs with its head office at Delhi. The objectives of the board will be, inter-alia, to examine the factors affecting the promotion and development of MSMEs and review the policies and programmes of the Central Government in regard to facilitating the promotion, development and enhancing the competitiveness of such enterprises and the impact thereof on such enterprises, besides advising the Central Government on the use of funds constituted under the Act.

The Board consists of a total 47 members including the Minister in charge of SMEs, as the ex - officio chairperson of the board. The chairmen of NABARD, SIDBI, Indian Banks Association and one officer of the Reserve Bank of India,

not below the rank of an Executive Director, will also be on the board. The Board will also be represented by twenty persons from the associations of MSMEs, including not less than three persons representing associations of women's enterprises and not less than three persons representing association of micro enterprises. Two representatives of central trade union organizations will have to be appointed by Central Government. One officer, not below the rank of Joint Secretary to the Government of India in the Ministry or Department of the Micro, Small & Medium Enterprises shall be the Member Secretary of the board.

Post Enactment Scenario

In a comparative study of the pre and post enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act 2006, the operating environment for SMEs is all set for an overhaul that would lead to a positive impact on growth and development of this sector. The key measures that would lead to the improvement of the operating environment for SMEs include, the establishment of an apex statutory body, introduction of the concept of an "enterprise," classification of enterprises, establishment procedure, procurement policies, delayed payments, repayments, penalty and dispute resolution, allowable deduction under the Income Tax Act 1961, closure of business, promotional and enabling provisions, and provisions for facilitating credit for the SMEs.

As mentioned earlier, the concept of "enterprises" as against "industries" is also introduced in the MSMED Act 2006. Broadly, it classifies enterprises engaged in manufacture/production of goods pertaining to any industry; and those engaged in providing/ rendering services. The Act also provides for the classification of enterprises into micro, small and medium units vis-a-vis the earlier definition only for the "tiny" and "small" as per the Industries (Development and Regulation) Act, 1951. MSMED Act 2006, provides for the establishing of National Board for MSMEs, an apex statutory body. Hence, it is now a statutory body that will have mandatory quarterly meetings. This board will replace the existing non-statutory SSI board. Earlier the SSI board was the apex non-statutory advisory body constituted by the Government of India to advise on issues pertaining to the SSI sector with more than hundred members.

The establishment procedure of SMEs is also set to evolve, with the earlier two-stage registration process of micro and small industry being dispensed with and replaced by filing of memoranda. The filing of memoranda is optional for micro and small enterprises in services sector but mandatory for medium enterprises in manufacturing sector.

Regarding the procurement policies, the MSMED Act 2006 provides for the notification of preference policies by the Central or a State Government in respect of procurement of goods and services produced and provided by the micro and small enterprises by its ministries and departments to its aided institutions and public sector companies. There were no statutory provisions in this regard prior to the enactment of the MSMED Act 2006.

The Act also provides for more stringent provisions to address the issue of payments between a buyer and a SME supplier. Where any supplier, supplies any goods or renders any services to any buyer, the buyer shall make payment therefor on or before the date agreed upon between him and the supplier in writing or where there is no agreement in this behalf, before the appointed day. Provided that in no case the period agreed upon between the supplier and the buyer in writing shall exceed forty five days from the day of acceptance or the day of deemed acceptance. Where any buyer fails to make payment of the amount to the supplier, the buyer shall, notwithstanding anything contained in any agreement between the buyer and the supplier or in any law for the time being in force, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed day or, as the case may be, from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank of India. The amount due from a buyer, together with the amount of interest, shall be recoverable by the supplier from the buyer by way of a suit or other proceeding under any law for the time being in force. Consequent upon the above provisions, "The Interest on Delayed payments to Small Scale and Ancillary Industrial Undertakings Act, 1993" stands repealed.

The aforementioned provisions, coupled with the requirement under the Act to specify the unpaid amount to SME suppliers at the end of each accounting year and non-allowance of interest payable/ paid by the buyer as a deductible expenditure under the Income Tax Act, shall go a long way in addressing the vexed problem of delayed payments to SMEs. Similarly, other facilitating provisions for addressing the relations between a buyer and a supplier include, reference made to the MSE Facilitation Council for acting as an arbitrator or conciliator in respect of the matters referred to in that section and the provisions of the Arbitration and Conciliation Act, 1996 shall apply to such dispute as if the arbitration or conciliation were pursuant to an arbitration agreement. Further, no appeal against any decree, award or other order shall be entertained by any court or other authority unless the appellant has deposited with it seventy five percent of the amount in terms of the decree, award or, as the case

may be, other order in the manner directed by such court or, as the case may be, such authority. The State Government shall, by notification, establish one or more Industry Facilitation Councils, at such places, exercising such jurisdiction and for such areas, as may be specified in the notification. As regards the facilitation of credit/ finance for the SMEs, the policies and practices in respect of credit to the MSMEs shall be progressive and such as may be specified in the guidelines or instructions issued by the Reserve Bank of India. There was no statutory provision, in this regard earlier.

MSMED Act 2006 provides that the Central Government may, within a period of one year of the commencement of the Act, notify a scheme for facilitating closure of business by a micro, small and medium enterprise. This would be the most revolutionary development, for the SMEs in India.

Conclusion

Over the last five decades, the small scale segment has acquired a prominent place in the socioeconomic

development of the country. The segment has evolved in the recent past to include not only the traditional small scale industry units but also small scale service and business entities and micro, small and medium enterprise. It is a well established fact that the SMEs play an important role not only in the growth of industrial production and trade but also in employment generation, healthy contribution to the domestic market as also to export and balanced regional development. The Government of India as well as the Reserve Bank of India have, therefore, unfolded several policy initiatives to ensure the micro, small and medium enterprises are able to operate in a healthy environment and receive adequate credit flow as well several other incentives. The enactment of MSMED ACT, 2006 is undoubtedly a turning point for the development of Indian industry, as it addresses and streamlines at the same time, key governance and operational issues being faced by the micro, small and medium enterprises of India. This legislation would go a long way in changing the contours and dimensions of the SME segment, thereby paving the way for its accelerated growth. ■

Credit Guarantee Scheme (CGS) of Credit Guarantee Fund Trust for Small Industries (CGTSI)

The CGTSI was set up in July 2000 by Ministry of SSI, GOI and SIDBI to operate the Credit Guarantee Scheme (CGS) for small industries. The corpus fund of CGTSI, contributed in the ratio of 4:1 by GOI & SIDBI, was Rs.1181.56 crore as on March 31, 2006.

The Trust, which is operated by the SIDBI, helps small scale/tiny units engaged in IT based activities and agri-clinics and agri-business centres in accessing institutional credit, without facing difficulties of arranging collateral security and/or third party guarantee. CGTSI extends guarantee cover upto 75 per cent of the collateral free term loan or working capital facility extended by Member Lending Institutions (MLIs) to these units, subject to maximum credit of Rs.25.00 lakh per borrower. In other words, maximum of credit risk borne by the Trust is restricted to Rs.18.75 lakh only being 75% of Rs.25.00 lakh, though loans above Rs.25.00 lakh can also be covered under the scheme. It may be noted that the cover is not available if the sanctioned limit is less than Rs.5.00 lakh because as per RBI directives credit upto Rs.5.00 lakh extended to all SSI units is to be provided without collateral security.

To make the scheme more attractive and convenient, as per the announcement made by the Finance Minister while presenting Union Budget for 2006-07, the one time guarantee fee has been reduced by the Trust from 2.5 per cent to 1.5 per cent of the sanctioned amount with effect from April 1, 2006. Annual service fee at the specified rate (currently 0.75% per annum) on the outstanding amount is also payable to the Trust. To encourage the entrepreneurs, some banks have introduced

schemes to share the burden of guarantee fee and/or annual service charges with the eligible borrowers. In case of credit facilities extended to handicraft artisans which are registered with office of Development Commissioner (Handicrafts) and eligible for coverage in the scheme, the amount of guarantee fee and annual service charge is reimbursed by the office of DC (HC).

The credit facility is eligible to be covered only if the lender institution extends credit without any collateral/third party guarantee, interest rate is levied in accordance with the RBI or Government guidelines and borrower avails credit from a single lending institution. However, unit assisted by NSIC, SIDBI, NEDFi, SFC or any other state level financing institution can get bank finance and be covered under the scheme.

The scheme has gained popularity in the recent time due to recent measures and also due to the advantage that loans covered under CGTSI scheme carry zero per cent risk weight and require zero per cent provision for guaranteed portion. CGTSI gives online business transaction facility to its MLIs. As on March 31, 2006 guarantee in respect of 40,605 proposals from 55 Member Lending Institutions covering aggregate credit assistance of over Rs.1000 crore, shows a growth of 86% over the level of March 31, 2005.

Thus, the scheme is a very efficient risk management tool in the hands of financing institutions and it aims to enhance credit flow to micro enterprises.

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