YES BANK

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Policy Brief

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Policy Recommendations For Small and Medium Enterprises

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YES BANK, India's fifth largest private sector Bank, is the outcome of the professional & entrepreneurial commitment of its Founder Rana Kapoor and his top management team, to establish a high quality, customer centric, service driven, private Indian Bank catering to the Future Businesses of India. YES BANK has adopted international best practices, the highest standards of service quality and operational excellence, and offers comprehensive banking and financial solutions to all its valued customers.

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Pahle India Foundation (PIF) is a not for profit, financial, economic and political research think tank, dedicated to the task of making India first by putting India first. Over the years, we have learnt that there is no universally accepted development model. Each country has to take into account its people, its resources and its socio economic and cultural legacy for effective policy formulation and implementation. At PIF, we work towards this objective of creating the necessary paradigm shift in development thinking and practices in India to achieve this aspirational goal. PIF currently has an analytically strong team of dedicated researchers who are self motivated. PIF's highly qualified team specialises in analyzing India's political economy and its engagement with the global flows in finance, trade and technology.

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Policy Brief

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In recent times, the government has been focussing on transforming the gold market. Significant proportion of the MSME sector in India is occupied by many unorganised gems and jewellery players. They use indigenous technology, work out of micro clusters and have limited ability to compete in global markets. Stringent export policies, lack of credit, poor market access and connect, and high costs of compliance have hampered this sector in building capacity.

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The Centre's "Make in India" campaign to get Indian companies and global firms to invest and partner in the manufacturing sector is highly relevant for India's SMEs. The Ministry of Micro, Small and Medium Enterprises expects four of its ongoing initiatives to play key roles in ensuring the campaign's success - the public procurement policy, the Micro and Small Enterprises Cluster Development Programme (MSE-CDP), the Prime Minister's Employment Generation Programme (PMEGP), and skill development.

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SMEs in India have often expressed concern over high cost of compliance, limited access to finance, and impediments to access to market. While Budget 2017 gave multiple reasons for SMEs to cheer, enterprises continue to face difficulties related to receivable financing, availability of tool rooms and skill development.

Foreword

MSME sector has emerged as a vibrant and dynamic sector of the Indian economy over the last five decades. Despite experiencing several highs and lows in the past few years, it has been resilient to the challenging domestic and global business environment.

MSMEs not only have the potential to create jobs at lower capital cost than large industries, they also help in industrialization of rural and backward areas, thereby, reducing regional imbalances and assuring equitable distribution of national income and wealth. MSMEs are complementary to large industries as ancillary units and contribute enormously to the socio-economic development of the country.

India's massive rise in the Ease of Doing Business Rankings to 100 is a result of improving domestic business environment and investor confidence. Recent technological developments in Internet of Things and FinTech have provided micro and small enterprises support towards achieving wider global outreach, better access to cost effective credit facility and a progressive co-working environment. A woman entrepreneur in Varanasi or Indore who weaves high-end sarees can now sell her goods using social networking websites to customers across the world. There are plenty who have the opportunity to use the same technology to enhance their products, connect with buyers, source material, and improve profitability. Several banks, NBFCs, venture capital, and private equity funds are already investing in these 'start-ups' through customised products and delivery channels based on different stages of their business lifecycle.

The sector will do better if timely credit is delivered at an appropriate cost. Introduction of e-processes by FinTech companies and other such initiatives will help improve processes and reduce delays. The issue of delay (which adds to the cost of funds in loan processing, sanction, and release) could be eliminated through these 'state of the art' electronic platforms where the entire credit application lifecycle is fulfilled online. This can be facilitated through seamless availability of key information, particularly with rich transactional data available through GSTN, on credit worthiness.

We are pleased to present this second issue of recommendations put together as an outcome of three Pahle India Foundation and YES Global Institute SME seminars conducted between October to December 2017. We aim to create an action map to grow SME contribution to India's GDP to 15 per cent by 2020. We hope you will find this content insightful.

Sincerely,

Sumit Gupta
Group President and National Head, Business and Rural Banking

Opportunities for SMEs in Gems & Jewellery Sector

Opportunities for SMEs in Gems & Jewellery Sector

Indian gems and jewellery market is estimated to be around USD 60 billion in 2017 of which USD 35.6 billion was exported. The sector is expected to reach USD 105 billion by 2020. It currently contributes 15 per cent of total exports. However, this segment continues to be dominated by unorganised players; only approximately 16 per cent of the total retail market is organised. The Indian jewellery market is largely driven by customers who are reluctant to switch jewellers, as they are wary of the quality and purity of the products sold by other jewellers. While the trend is shifting with the organised sector offering wider variety of designs, and increase in awareness related to hallmarking and certifications of gold and diamond, the sector continues to be fragmented, and the value chain remains dominated by SMEs.

The Sector Matters

- **Foreign Exchange:** The sector earned USD 274.64 billion foreign exchange in 2016-17; i.e. approximately 15.7 per cent of total export earnings.
- **Exports:** The gems and jewellery sector is a critical piece in the export-led growth strategy. Based on data from the Gems and Jewellery Export Promotion Council (GJPEC), total export of USD 35.56 billion[1] comprised of 64 per cent through diamonds, 40 per cent through gold and 1 per cent through coloured gems. India contributes around 95 per cent of global diamond exports (24.024 million carat).
- **Employment:** The sector provides direct employment to about 2.5 million and indirect employment to another 2.5 million people.
- **Foreign Direct Investment (FDI):** The Indian government presently allows 100 per cent FDI in the sector through the automatic route. As per the Department of Industrial Policy and Promotion (DIPP), the cumulative FDI inflows in the diamond

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[1] https://www.gjepc.org/admin/StatisticsExport/37535221_export_gem_jewellery%20November%2017.pdf

and gold jewellery sector in the period between April 2000 and September 2016 was USD 851.34 million.

Challenges

- **Skilled Workforce:** We have very few learning centres dedicated to training the workforce engaged in the sector. India is facing high competition from China which boasts of affordable labour, automated cutting and polishing processes, and skilled workmanship. Moreover, the sector prefers contract labour, which makes it unattractive for fresh labour.

- **Raw Material:** India imports around 90 per cent of its raw material of which rough diamonds account for around 50 per cent. Since India is heavily dependent on imports for its raw material, higher imports should eventually translate into higher exports too.

- **Credit/Financial Support:** As aforementioned the sector is heavily dependent on imports. Expensive credit facilities provided by financial institutions make the business financially unviable, even more so for the exporters. High rate for export credit, low credit limits for gems, lack of trust between lending agencies and the small and medium jewellers are some of the sector specific issues faced.

- **Competition:** India is facing competition from diamond producing nations like Botswana, Namibia and South Africa, which are furthering their game up the value chain. Considering that consumers are very conscious of the quality of the products, India faces stiff competition from technologically advanced China and Israel, in the medium and large-size diamond market, where precision is pivotal.

Policy Recommendations

In a seminar titled "Opportunities for SMEs in Gems and Jewellery Sector" following solutions to key issues raised by the sector were discussed.

- **Gold Metal Loan (GML) Tenure**

  Nominated banks which can extend gold metal loan to domestic jewellery manufacturers should be permitted to decide the GML tenure based on their proprietary models and customer relationships. Banks should use their existing infrastructure to monitor the end purpose. Moreover, in case of a sudden decline in prices, (increase in loan to value), banks should be able to restructure the loan and extend the tenure, if need be, of their own accord. GML must also be extended to domestic jewellers and not just manufacturers.

- **Industry Status for Gems and Jewellery**

  Gems and Jewellery contributes around 6 per cent to the GDP and employs around 5 million people. Against this backdrop, the significance of this sector cannot be overlooked, similar to industries like textiles and food processing. The sector entails a detailed value chain, caters to specific skills, has special logistic and export requirements. It is only becoming that a single Ministry or department be assigned with the task of bolstering growth of the concerned sector. It will provide a forum for an otherwise fragmented sector, enable players to collaborate, build expertise, exchange knowledge and consolidate the sector.

- **Research, Development, and Standardisation**

  It is admissible that as consumer tastes and preferences evolve, it is the prerogative of the market to meet the provide for the same. We need to provide incentives for innovation in the sector, be it related to designs, refining, business enterprise or manufacturing technology. Global standards of purity need to be maintained to garner consumer trust and business predictability. We need to standardise the hallmarking process in India, and adopt the globally accepted standards. This will not only help the sector access international markets without any scope of slighting trust, it will save the cost of repeated testing and hallmarking.

- **Manpower**

  - Skill Development

    The gems and jewellery sector is known for its special skill requirements and craftsmanship. As the sector expects high growth, it provides additional employment opportunities. Setting up specialised centres, at Government run technology institutes which may offer courses ranging from basic cutting to high end specializations should be set up. This can be done in conjunction with the Ministry of Human Resource Development and Ministry of Employment and Skill Development. Apprentices can be onboarded by nominated organized players, to further provide practical coaching and issue certificates.

  - Working Conditions

    There has been heightened concern over poor working conditions and wages in the sector. Safety kits, and equipment to preserve the health conditions of the labour need to be mandated. Regular audits at both, large and small size workshops to ascertain the safety of workers is a non-negotiable requirement. To attract young talent, and prevent them from switching careers to sectors that provide better working environment, it is in the interest of the stakeholders to ensure the right infrastructure and social well-being of their workers.

Driving Make in India Through SMEs

Driving Make in India Through SMEs

It is common observation that to gain access to credit, technology, and markets, small and medium enterprises (SMEs) in India are required to prove their mettle even before they have triggered their operations. As a result, significant number of entrepreneurs either hail from financially self-sufficient families or have support from venture capitalists. The ecosystem for small scale entrepreneurs with vanilla ideas and modest means has not turned out in the most amicable shape. Fortuitously, in 2014, when the incumbent government assumed office, it not only empathised with the problems faced by both, new and established entrepreneurs, but also made cogent announcements to further the cause of employment through entrepreneurship. One such announcement was the PM's flagship programme, "Make in India".

The Make in India initiative was aimed at making India a manufacturing hub for national and multi-national companies. These large-scale units would engage with multiple stakeholders, and eventually integrate small and medium enterprises in their value chain to bolster the economy from multiple directions.

Challenges Faced by SMEs while Making in India

- **Access to Finance:** As banks go through balance sheet restructuring, it is relevant to discuss willingness of banks to lend to small ticket SMEs. After recording bad loans worth INR 443,000 crore, their reluctance is understandable. While the foreign direct investment (FDI) route is open, their contribution to the SME sector will be limited.
- **Industrial Zones:** India has very few industrial zones that are well equipped with state of art infrastructure and plug and play facilities. There is a need to demark zones, equip them with power supply, digital infrastructure, and strategically locate them near highways for better connectivity.
- **Skilled Workforce:** India has an extremely attractive demographic mix. This dividend is waiting to be skilled and utilized. Lack of vocational training programmes in the curriculum and a theoretically heavy education system results in very learned, yet unemployable youth. The Pradhan Mantri Kaushal Vikas

Yojana (PMKVY), should work in tandem with the Department of Industrial Policy & Promotion (DIPP) to ensure skill development is allied with expectations of the industry.

- **Research:** To endure international competitiveness, India will need to buck up its investments in research and development. Despite the fiscal benefits extended by the Government towards investment in research laboratories, India Inc. refuses to take cognizance of the long-term significance of these investments.

Make in India is a very promising and innovative initiative for the SMEs. The direct and indirect outputs of the Make in India concept include more job opportunities, thereby reduce unemployment, enhance purchase power to better-living styles, better state of the art of infrastructure, smart cities etc.

Policy Recommendations

In a seminar titled "Driving Make in India Through SMEs" following solutions to key issues raised by the sector were discussed.

- **Enhance Exports through Generalized System of Preferences**

  One of the obvious ways to motivate SMEs to make in India, is by providing them access to markets. Currently, 29 countries have extended benefits under Generalized System of Preferences (GSP) to India, which include duty-free export of Indian products to those countries and (or) special rates for being the Most Favoured Nation. This status makes Indian goods competitive in these nations; allows exporters to enter new markets and enhance presence in established markets. Fortunately, the Indian leadership is actively engaging in foreign policy dialog at multiple forums. This makes a strong case for geo-economic discussions that will expand the GSP footprint.

- **Last Mile Communication**

  There is a visible gap between the number of SMEs that are eligible for beneficiary schemes and those that eventually avail the benefits. One of the primary reasons that have translated into this gap is lack of awareness among the SMEs. The eligible SMEs are not aware of these schemes, and on several occasions, these SMEs may not have the compliance track record, needed to avail these schemes.

- Due to paucity of resources, currently outreach programmes are conducted by the Ministry of Micro, Small and Medium Enterprises in collaboration with multiple parties. These parties should be trained by communication experts, to ensure the messaging is in accordance with the communicated party.
- Existing beneficiaries should be reached and updated in person about other existing/new schemes that they should apply for. In essence, SMEs need to be encouraged to avail benefits through frequent dialog and flexible scheme structures.

■ **Employment Intensive Sector**

One of the primary goals of Make in India was to generate employment.

- As a mid-term intervention, map sectors to the number of jobs they create, per unit of investment. This would establish an indicative potential each sector has, towards contributing to job creation.
- Identify the sectors, that create maximum jobs per unit investment.
- Extend interest subvention, credit assistance, and most importantly, tools to access markets, to these sectors.
- Also, prioritize these sectors, from the point of view of skill development, research, and ease of doing business. This will make these sectors attractive, and eventually make India globally competitive in these sectors (similar to Bangladesh in the garment industry).

■ **Skill Development**

Taking a cue from the previous recommendation, we should identify skill requirements of those sectors that create maximum employment per unit of investment.

- The National Skill Development Corporation (NSDC) can then work on creating competencies, which is a combination of attitude, knowledge and skill.

- The Apprenticeship Act, which incentivizes the industry to on-board apprentices, should extend incentives, irrespective of the strength of workforce in that unit. This will make a large number of firms eligible for contributing towards skill development.
- The Apprenticeship Act also needs to focus on ease of skilling for institutions that volunteer to train apprentices by reducing compliance track record and audit requirements.
    - For example, currently, there is a requirement of salary slips of three months, which delays receipt of payments for these institutions.
    - Skill programmes should be allowed to run on weekends and have flexible schedules, to ensure even the employed workforce is inducted towards skill upgradation.
- Set up an institution that is responsible for skill certification. There is a certain section of practitioners that has highlighted concerns on the existing level and method of certification. An independent public office set up for this purpose should operate on a curriculum set up by the industry, so that the skills are in tandem with the expectations of employers.

■ **Trade Related Entrepreneurship Assistance and Development**

SMEs have been continuously exporting indirectly to global markets. However, the benefits of better pricing and margins are reaped by few large merchant exporters who in turn source from SMEs and ship the goods. Many SMEs have not been able to export directly due to

- Lack of marketing skills
- Limited knowledge of opportunities in and understanding of global markets
- The documentation and process of exports
- Lack of working capital to execute quick orders
- Risk perception towards the inward payment from overseas buyers

All the above skill-sets can be imparted by suitable training and development workshops in collaboration with the sector specific and cluster specific industry associations.

What SMEs Expect in 2018-19

What SMEs Expect in 2018-19

With two structural reforms namely demonetization and implementation of Goods and Services Tax (GST), the incumbent Government has ensured it sets the tone for inclusive economic growth on the back of progressive governance. As a next step, it would be fitting to count on Small and Medium Enterprises (SMEs) as equal partners in growth and equip them with tools to certain their participation.

In a seminar titled "What SMEs Expect in 2018-19", the industry suggested following asks from the Ministry of Micro, Small and Medium Enterprises (MSME) for the financial year 2018-19. The industry urged that the Ministry of MSME consider these asks, in the hope of the same finding their place in the Union Budget 2018.

Policy Recommendations

- **Access to Finance**

  Lack of access to finance is a major obstacle for the growth of MSME sectors and this could be typically owing to a combination of factors such as information asymmetries in the market, higher risks, sizeable transaction costs and lack of adequate collateral and to this end it is important that the upcoming budget addresses the issue of channelizing greater credit to the sector.

  - With advent of GST, there is little room for creativity for SMEs in terms of book keeping and sources of financing. This will result in shift of credit rating in the northward direction. In such a scenario, SMEs should be encouraged to issue bonds, that can be tabled for private placement or public issuance, depending on the credit worthiness and compliance of the issuance in question.

  - To facilitate credit access, financing institutions need to have access to the existing/potential demand in the market. To solve for this information asymmetry, an MSME database which uses the Udyog Aadhar as an identifier needs to be gleaned and made available on a subscription basis. Interested parties can access this database and reach out to SMEs based on their sectoral/geographical/size preferences.

Incentive to Generate Employment

The SME sector has the potential to play a decisive role in generating employment. Currently, the sector hires contractual and part-time workforce, to meet its operational requirements. The sector operates in this model, primarily because of two reasons. One, hiring full-time workforce entails high employee provident fund obligations. Two, there is little incentive for enterprises to invest in training and development for short-term employees.

- Schemes which facilitate sharing of employee provident fund obligations up to a certain limit should be rolled out. Similar structure of support may be extended to enterprises that provide medical insurance to their workforce.
- There should be support from the government, for those SMEs which expense beyond a certain limit, towards training and development, by way of sharing the training expense or even providing these trainings.

Infrastructure Opportunities

'Bharat Mala', an INR 7 lakh crore project is expected to generate employment of 50 crore man days in the next four years. Timely delivery of this project will be key to increase in localized demand and job creation. Bidding process for certain tasks should enable a level playing field for SME firms, since in a competitive ecosystem, SMEs will not be able to compete with large corporates.

Tax Structure

- Tax Slabs for MSME Firms: Of the SME pool in India, 90.1 per cent are proprietorships, 4.0 per cent are partnerships and only 2.8 per cent are private limited companies. There is no provision that rationalizes the tax slabs based on profits booked by the enterprise. Firms with low turnover can be pushed into the tax net by providing tax slabs based on profit before tax.
- Tax Incentives for Job Creation: Large-size corporates are able to avail tax break on depreciation of plant and machinery. However, this break may not be materially significant for an SME. Tax incentives related to incremental employment generated by the firm during the fiscal year should be provided to labour intensive SMEs.

- Minimum Employment Generation: There needs to be a minimum employment generation programme, that every SME is expected to comply with. Exceptions may be provided with requisite documentation. Firms that exceed the minimum employment requirement, should be allowed to claim tax break on the salary payout of the incremental jobs created.

Relooking at Cluster Development

- First and foremost, we need to acknowledge that SMEs have limitations with respect to both, financial resources and operational capabilities. Against this backdrop, it is obvious that they face challenges in improving efficiency and maintaining compliance requirements. This problem may be addressed by relooking at the cluster development approach.
- Clusters should collaborate to maximize their output levels. Since clusters are primitively defined based on their sector of business, they should begin to do business together i.e. share capital and operational facilities as a community. This will not only help them optimize expenses, also give them better bargaining power in terms of procuring resources. For this to be an attractive way of doing business, the SME framework should encourage clusters by providing higher ease of business and infrastructure.
- Clusters in India are limited to being a group of similar units, set in close proximity. There is another layer, i.e. infrastructure for resources. For example, a manufacturing cluster needs to have facilities that will make clusters an attractive option for workforce. Typically, these clusters are set away from the main town. This immediately makes it an unattractive proposition for workers. The Tata Steel township at Jamshedpur is a spectacular example of attracting workforce to a city that would otherwise not be the most preferred location for blue and white collared executives.

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