POLICY BRIEF

Strengthening India's MSMEs during Pandemic Recovery

Women can benefit from sector-specific training and industry certification. Photo credit: ADB.

Enhancing the competitiveness and sustainability of small businesses requires sustained reforms that include digitalization and innovation.

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Introduction

Micro, small, and medium-sized enterprises (MSMEs) have been key contributors to inclusive growth and in creating sustainable livelihood in semi-urban and rural India. In 2015–2016, 63.4 million MSMEs employed 111 million workers, making the sector the second-largest employer after agriculture. MSMEs contributed around 30% to the country’s gross domestic product (GDP) and about 40% to exports in 2018–2019 (Government of India, Ministry of Micro, Small and Medium Enterprises 2019; Government of India, Ministry of MSME 2015; and India Brand Equity Foundation 2013).

However, the COVID-19 pandemic severely disrupted production, logistics, and supply chains. The decrease in consumer demand in the domestic and export markets amplified the challenges faced by MSMEs.

India has taken pandemic recovery initiatives that strengthen the MSME ecosystem in India, improve
cluster competitiveness, support women-led MSMEs, and promote exports. According to the Reserve Bank of India Expert Committee on MSMEs, these require sustained reforms in the following pillars: (i) integrated cluster infrastructure development; (ii) access to finance; (iii) skills training; (iv) product diversification; (v) marketing and branding; (vi) access to technology and digital tools; and (vii) institutional and regulatory support.

The Asian Development Bank (ADB) publication *Enhancing Competitiveness and Productivity of India’s Micro, Small, and Medium-Sized Enterprises during Pandemic Recovery* discusses the key challenges faced by India’s MSMEs and recommendations for each pillar and highlights the best practices.

**Context**

The nationwide lockdown between April and June 2020 hampered production and logistics supply chains of MSMEs. Unsold inventory, order cancellations, and lost sales opportunities increased, with around 73% of MSMEs reporting a drop in orders. About 40% attempted to borrow to survive as liquidity constraints grew due to delays in payments and continued outflows on wages, rents, and other fixed costs.

Women-led enterprises, which make up around 20% of MSMEs, were disproportionately affected by the pandemic due to the increase in unpaid work. Worst hit were sectors with high participation of women, such as personal services, beauty, textiles, and food processing. Prevailing gender-based digital divides prevented women’s access to online marketplaces.

The Government of India has offered a special economic relief package worth 20,000 billion Indian rupees (approximately $271 billion). Called the Atma Nirbhar Bharat Abhiyan, it offers financial assistance to MSMEs, which includes a INR3,000-billion (about $40.6 billion) scheme for collateral-free automatic loans to 4.5 million businesses, INR500 billion (about $6.8 billion) for equity funding, and INR200 billion (about $2.7 billion) for distressed MSMEs through subordinate debt and equity infusion.

In October and November 2020, additional stimulus measures were announced under the relief package to boost job creation, consumer spending, and incentivize selected sectors. Other regulatory measures included (i) insulating MSMEs from insolvency proceedings by increasing the threshold from INR100,000 million to INR10 million, (ii) expeditiously issuing pending income tax refunds of small businesses, and (iii) permitting restructuring of MSME loans. The minister of finance also announced that a special framework for MSME debt resolution will be introduced to ensure faster disposal of cases in 2021–2022.
Challenges

MSMEs in India faced difficulties even before the COVID-19 pandemic. Dominated by micro enterprises, the sector lacks the scale, experience, and resources to stay abreast of latest technology, manufacturing processes, and business management practices. Insufficient local support for incubation of MSMEs, lack of guidance on entering new markets, and policies that disincentivized scaling up have prevented businesses from attaining their full potential.

Limited access to finance

The Reserve Bank of India identified three key barriers to MSME lending:

- The high risk perception makes banks reluctant to lend to MSMEs without collateral. [1]
- Information asymmetry and poor accounting practices make assessment of MSME credit risk worthiness difficult.
- Several MSME clusters lack access to formal credit channels and technology and have low awareness of government schemes.

These barriers are amplified for women-led enterprises, for whom access to finance is severely constrained.

Skills mismatch

Skills training institutes in India do not always have courses relevant for local MSMEs. At the same time, a study by the Ministry of Statistical Office and Programme Implementation reported that only 3.5% men and 2.9% of women received formal skills training while only 9% of the female workforce received vocational training as against 18.8% of the male workforce. The gap is wider in nonformal training, with 15.2% men getting hereditary, on-the-job, or other forms of informal training compared to only 6.1% women.

Inability to diversify and innovate

Indian MSMEs manufacture more than 8,000 products—from handmade, traditional, machine-made items to more recently, automation-technology-made goods. However, they find it difficult to diversify into new product and service lines due to lack of awareness of market trends, lack of technical knowledge, and high investment cost.

Low adoption of technology and digital marketing

Almost 51% of Indian MSMEs are based in rural areas and have limited internet connectivity and computer access. Of those with access to personal computers, less than 6% advertise online. Common constraints to adoption of digital marketing include lack of direct access to consumers and dependence on local traders and distributors to reach markets, inability to access marketing experts, and lack of awareness of digital marketing tools.
Complicated regulatory requirements

The MSMEs find it challenging to utilize the full benefits of government schemes designed for them due to lack of awareness and cumbersome and complicated processes. Increased online processes and shorter timelines, multiple visits to government offices, manual interface in automated systems and numerous compliance processes impede efficient transactions.

Policy Recommendations

The Reserve Bank of India Expert Committee on MSMEs has recommended policy measures for developing an enabling ecosystem for enhancing competitiveness and sustainability of MSMEs. These initiatives require a medium-term reforms agenda based on seven pillars.

Integrated cluster infrastructure development

Integrated cluster development focuses on reducing the isolation of individual MSMEs and achieving economies of scale, thereby improving cluster competitiveness. It can be implemented using a holistic approach that entails developing connectivity and sustainable utility infrastructure, promoting cleaner manufacturing practices, and establishing institutional and governance systems to ensure the financial sustainability and maintenance of the infrastructure. Specific initiatives can include support for MSME co-location in industrial parks, regular training sessions on waste minimization and recycling, and last mile connectivity and logistics infrastructure improvements.

Access to finance

The COVID-19 pandemic has highlighted the need for adequate risk mitigation instruments, credit appraisal techniques, and innovative financial products, such as cluster financing. Under a cluster financing model, MSMEs can group together to form a special purpose vehicle, which then borrows from banks under a single transaction and on-lends to its members. This reduces the cost of borrowing for MSMEs and transaction costs for the bank.

Other measures include creating a digital platform to collect credit information and develop credit ratings for MSMEs, promoting the Small Investments Development Bank of India (SIDBI) as a market maker that could offer low-cost credit lines for state government-led MSME schemes, and supporting MSME-focused financial technology firms, including those that developed online marketplaces and peer-to-peer lending platforms.

Skills training

India’s public vocational education and training systems require greater scale, better quality, and more relevance to prepare young workers for emerging skill demands. Vocational training programs need to provide (i) refresher courses for base level jobs, (ii) upskilling for those seeking advanced training, and (iii) reskilling for workers transitioning across sectors and jobs. These will require increased support for apprenticeship schemes, introduction of online industry-relevant courses that can be done through the e-
skilling portal of the National Skill Development Corporation and virtual skill training centers run by industry associations, tailored entrepreneurship training from micro-businesses, and vocational training at the higher secondary level.

To address the gender gap, skills training institutes should provide requisite infrastructure for women, while central and state governments need to prioritize sector-specific training and certification for industries with higher participation of women.

Product diversification

The significant and rapid shifts of consumer preferences during the health crisis have underscored the need to diversify into new products. Measures to help MSMEs learn more about the market and ease into product diversification include (i) promoting use of digital platforms, (ii) encouraging partnerships between leading and nascent clusters, and (iii) introducing short-term training programs that can be offered by state skills development missions, sector skills councils, and industry associations.

Also, the government can incentivize production of personal protective equipment (PPE) for global markets during the pandemic. India has become the second-largest PPE manufacturer in the world (Government of India, Ministry of Textiles 2020) and has manufacturing capacity for alcohol-based sanitizers (Government of India, Ministry of Commerce and Industry 2020).

Marketing and branding

Government can assist MSMEs to go beyond traditional marketing methods by (i) repurposing its support to include digital marketing, including hiring marketing experts and purchasing digital and social media marketing solutions; (ii) promoting digital trade fairs and exhibitions; (iii) providing financial support for eco-friendly packaging; (iv) creating awareness of and establishing links with online marketplaces, including international business-to-business and business-to-consumer platforms; and (v) decentralizing product testing and quality management to enter export markets.

Access to technology and digital tools

Accelerated adoption of automation, artificial intelligence, and machine learning can help MSMEs improve the quality, precision, and productivity of their goods and services. Digitalization can be promoted across the value chain, such as offering incentives to private firms to develop tailored digital servicing platforms and products for MSMEs, as provided for under the government’s Digital MSME scheme.

Investment into research and development can be increased to promote sustainable manufacturing technologies in high-priority sectors, and a dedicated public–private development fund may be established. Also, programs can facilitate cluster-level partnerships among MSMEs, large enterprises, and educational and research institutions (KPMG and Confederation of Indian Industry 2015 and Government of India, Ministry of MSME 2019).
Institutional and regulatory support

To facilitate the access of MSMEs to government programs, processes should be simplified and online governance initiatives for enterprises promoted. A survey of MSMEs and industry associations should be conducted to understand their needs in the post-pandemic market, and schemes need to be designed or converged accordingly. At the same time, one-stop MSME accelerator cells at district level can be created. These units will provide various knowledge and advisory services, such as an employment portal, information on government schemes, technology upgrade, and market entry strategies.

Conclusion

The COVID-19 crisis has prompted India’s MSMEs to repurpose production lines, diversify supply chains, and borrow to meet working capital requirements. Pandemic recovery requires reforms toward an efficient manufacturing ecosystem that will enable greater digital service delivery, connect MSMEs with global value chains, and minimize market failures associated with digital transactions.

Robust institutional support at district and block levels is key to delivering on this reform agenda, so that the intended policies can enable growth of MSMEs located not only in large cities but also in semi-urban and rural areas.

[1] The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) of the Government of India is one of the few risk mitigation instruments available.

Resources

A. Biswas. 2015. Impact of Technology on MSME Sector in India. EPRA International Journal of Economic and Business Review. 3 (2).


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