

## 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**

