



# Key reforms to support Micro, Small and Medium Enterprises as a response to Covid-19 and the economic crisis

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## 1 Background

The Micro, Small and Medium Enterprises Development Act, 2006 (MSME Act) provides a raft of protections and incentives for micro, small and medium enterprises (MSMEs).

MSMEs have been disproportionately impacted by the Covid-19 pandemic and ensuing economic crises. A large number of them face dire operational and financial constraints including a shortage of working capital, difficulty in recovery of amounts from debtors, limited availability of raw material and a labour crunch, leading to an existential crisis for some of them. To support MSMEs

and help them survive and turnaround from the pandemic, the Indian Government has introduced a host of measures under the 'Atma Nirbhar Bharat Scheme' (Scheme). This update summarises and analyses the key changes introduced under the Scheme and specifically looks at their implications for MSMEs.

The Government of India has introduced a slew of legislative, regulatory and financial measures to support the MSME sector amidst the financial crisis created by the COVID-19 pandemic.

## 2 Key Changes

### 2.1 Revised Definition of MSME

Eligibility criteria and threshold: An enterprise qualifies as a micro, small or a medium enterprise depending upon the amount of investment made with respect to (i) plant and machinery in case it undertakes manufacturing; or (ii) equipment in case it provides services. In addition to this existing investment conditionality, a new criterion for turnover has been introduced. Further, the prescribed investment thresholds for being included within the definition of MSME have also been increased. Additionally, the distinction between manufacturing and services industries has been done away with.

The table below shows a comparison of the previous position under the MSME Act against the new categorisation.

Category	Previous Categorisation		New Categorisation	
	Manufacturing <i>(investment towards plant and machinery)</i>	Services <i>(investment in equipment)</i>	Capital/ Investment <i>(both plant and machinery and equipment)</i>	Turnover <i>(both plant and machinery and equipment)</i>
Micro	Upto Rs. 25 lakhs	Upto Rs. 10 lakhs	Less than Rs. 1 crore	Less than Rs. 5 crores
Small	Above Rs. 25 lakhs and upto Rs. 5 crores	Above Rs. 10 lakhs and upto Rs. 2 crores	Less than Rs. 10 crores	Less than Rs. 50 crores

Category	Previous Categorisation		New Categorisation	
	Manufacturing <i>(investment towards plant and machinery)</i>	Services <i>(investment in equipment)</i>	Capital/ Investment <i>(both plant and machinery and equipment)</i>	Turnover <i>(both plant and machinery and equipment)</i>
Medium	Above Rs. 5 crores and upto Rs. 10 crores	Above Rs. 2 crores and upto Rs. 10 crores	Less than Rs. 50 crores	Less than Rs. 250 crores

The above revisions to the threshold limits of MSMEs help alleviate fears of outgrowing or missing out on the benefits extended to MSMEs by the Government under the Scheme as well as the MSME Act. The new definition has widened the scope of MSMEs thereby allowing more entities to qualify themselves as MSMEs and avail the benefits under the Scheme and the MSME Act.

## 2.2 Financing Measures

The Government has announced several financial measures to help bring additional liquidity and stimulus to MSMEs. Key measures include:

- Emergency Credit Line Guarantee Scheme

To help MSMEs with additional funding requirements during the Covid-19 crisis, particularly to meet their operational liabilities, purchase raw materials, and restart their business, the Government has announced the Emergency Credit Line Guarantee Scheme (ECLG Scheme). This scheme is being operationalised through the National Credit Guarantee Trustee Company Limited (NCGTC).

The guaranteed emergency credit line under the ECLG Scheme is a loan to be made available by Member Lending Institutions (MLIs) to MSMEs, for which 100% guarantee would be provided by NCGTC to the MLIs. All scheduled commercial banks, as well as NBFCs and financial institutions that meet the prescribed criteria, are eligible to be MLIs. This loan will be extended by MLIs to MSMEs as either additional working capital or term loans (as applicable). The total amount of credit available per borrower will be 20% of the borrower's total outstanding credit up to Rs. 25 crores (excluding off-balance sheet and non-fund based exposures) as on a cut-off date of 29 February 2020. This implies that MSMEs will be eligible to receive additional credit of upto Rs. 5 crores (i.e. 20% of their total borrowings upto Rs. 25 crores).

The ECLG Scheme would apply to all loans sanctioned or made available to MSMEs between 23 May 2020 and 31 October 2020 and the Government has presently imposed an overall cap of Rs. 3 lakh crores for all loans disbursed under the ECLG Scheme.

- Rs. 20,000 crores as subordinate debt to provide equity support to stressed MSMEs

Acknowledging that MSMEs will require financing assistance in the form of both equity and debt, the Government has proposed a scheme for providing subordinate debt to promoters of MSMEs which will, in turn, have to be infused by the promoter as equity in the MSME ensuring that a prescribed debt-equity ratio continues to be maintained.

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Under the Scheme, the Government had announced an initial outlay of Rs. 20,000 crores towards provisioning of subordinate debt to stressed MSMEs. On 25 June 2020, the Ministry of MSMEs introduced the Credit Guarantee Scheme for Subordinate Debt (CGSSD) which is also called 'Distressed Assets Fund–Subordinate Debt for MSMEs'. This scheme will be operationalised through Credit Guarantee Fund Trust for Micro and Small Enterprises.

This scheme seeks to extend support to promoters of operational MSMEs which are stressed and have become non-performing assets as on 30 April 2020. The salient features of CGSSD are as set out below:

- Promoters of MSMEs will be given credit equal to 15% of their stake (equity plus debt) or Rs. 75 lakhs, whichever is lower.
- 90% guarantee coverage for this subordinate debt will be given under the scheme/trust and 10% would come from the concerned promoters.
- there will be a moratorium of 7 years on payment of principal whereas maximum tenor for repayment will be 10 years.
- Equity infusion of Rs. 50,000 crores for MSMEs through a Fund of Funds

The Government has also announced the proposed establishment of a Fund of Funds that will directly invest in MSMEs and encourage them to list on the Indian stock exchanges. According to the Government's announcement, the Fund of Funds is proposed to be set up with a corpus of Rs. 10,000 crores and provide equity funding to MSMEs with growth potential and viability. The Fund of Funds will be operated through a 'Mother Fund' and a few daughter funds, through which it intends to leverage Rs. 50,000 crores of funds. This decision has received the approval of Cabinet Committee on Economic Affairs on 1 June 2020 and further details on operationalisation are awaited.

### 2.3 Amendment to Government Procurement Policies

In line with the Government of India's stated aim of encouraging domestic self-reliance and independence, the Government has issued a notification dated 15 May 2020 amending the General Financial Rules 2017 to mandate that there will be no 'global tenders enquiry' for government procurements of a value of upto Rs. 200 crores. A waiver from this condition is only permitted in exceptional cases and after obtaining requisite approval. The procurement threshold of Rs. 200 crores has been specifically introduced to primarily benefit MSMEs who would now be eligible to bid for such procurements without having to compete with global counterparts.

### 2.4 Measures relating to the Insolvency and Bankruptcy Code

The Government on 24 March 2020 increased the minimum threshold for default from Rs.1 lakh to Rs.1 crore to initiate corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 (IBC). This amendment will likely benefit MSMEs which are under financial distress on account of the economic crisis caused by COVID-19.

The Government has also on 5 June 2020 introduced further changes to the IBC to prevent corporate debtors from being dragged into insolvency resolution process during the COVID-19 pandemic. For our detailed analysis on the changes introduced, please [click here](#).

Additionally, the Scheme mentions that a special insolvency resolution regime is also being considered by the Government for MSMEs under the IBC.

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### 2.5 Directions to Public Sector Undertakings to make timely payments

While the MSME Act provides for a 45-day timeframe for payments to be made by buyers to MSMEs, the Government had received representations from stakeholders that Government-owned companies or public sector undertakings (PSUs) themselves have not made payments to MSMEs in compliance with the MSME Act. In response, directions have been issued by the Cabinet Secretary, Expenditure Secretary and Secretary, MSME to all PSUs to pay outstanding dues to MSMEs within the prescribed timeframe of 45 days.

## 3 Conclusion

The change in the definition of MSME is one of the most significant changes made to the legal regime governing MSMEs since the enactment of the MSME Act as it brings numerous companies within the ambit of the MSME Act and allows them to avail of the benefits of the reforms introduced by the Government for the MSME sector during the pandemic.

While the liquidity measures put in place for MSMEs in the form of the ECLG Scheme and the equity and debt investments to be made by the Government have the potential to alleviate liquidity constraints, operationalising these reforms and facilities to the MSMEs remains a challenge. For instance, given that Fund of Funds will provide equity funding to MSMEs with growth potential and viability and in such case, if the determinative criteria for 'growth and viability' are difficult to prove or the covenants and undertakings required to be provided by MSMEs are too onerous, the practical efficacy of the Fund of Funds programme or other funding programmes for MSMEs may be called into question. Similarly, if the directions from the Government on timely payment to MSMEs as well as other incentives extended to help MSMEs survive the crisis are not strictly implemented or facilitated, the efforts of the Government may not yield the desired results and it may then be too late to rescue MSMEs.

The relaxation to Government Procurement Policies would also bring a much-needed boost to domestic manufacturing and reliance and consequently increase chances of survival of MSMEs during this pandemic. However, adequate safeguards should be put in place to make sure that such relaxations and consequent lack of competition from global companies do not affect the long-term competitiveness of MSMEs in India.

In India's fight against Covid-19 and its attempt to revive its economy, the Government has specifically focused on providing relief to the MSME sector which is a welcome move. The much-needed panacea for MSMEs should be swiftly implemented in spirit and the Government should ensure that it reinforces investor confidence and the dynamic growth of the MSME industry in the long run.

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