

How Govt. Policies inadvertently discriminates MSMEs

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Importance of MSME

We all know that MSME is the backbone of any economy. Often rightly termed as “the engine of growth” for India, MSME has played a prominent role in the development of the country in terms of creating employment opportunities. This sector has employed more than 111 million people¹. In addition, MSME enables scaling manufacturing capabilities, curtailing regional disparities, balancing the distribution of wealth, and contributing significantly to the GDP with almost 30%¹ contribution.

Realising the importance of MSME in employment creation, inclusive growth creation, and contribution to GDP, government of India has various schemes to promote them. However, there are instances where in the process of supporting some other activity or sector, inadvertently, MSME is discriminated which results in Make in India policy also getting affected.

Let's discuss both issues created out of practice as well as policy issues.

Taking work away from MSME

First, issues created out of practice. Govt. institutions and PSUs are known to be wary of tenders and the associated checks and balances especially when it has to be awarded to private firms. Because of this they are always ready to find another Govt. institution or PSU who can take the work from them and execute the project.

This means that in many cases, projects are given to PSUs who are not supposed to be doing such work because of their size. For example, a large shipyard like Cochin Shipyard (CSL) with ₹ 3000 crores turnover and over ₹ 1000 crores assets are not mean to build small boats under ₹ 5 crores. Such projects are supposed to be done by MSME yards.

¹ MSME Annual Report 2018-19 <https://msme.gov.in/sites/default/files/Annualrprt.pdf>

However, in the recent past many projects have been given to CSL on nomination basis only because of this “convenience” of Govt. departments. Two RO-ROs for Cochin Corporation, three Marine Ambulance boat for Kerala fisheries department, sixteen Fishing boats under Blue Water scheme (Ministry of Shipping), eight RO-Pax for IWAI (Inland Water Authority of India)² are just some of the examples of this irresponsible behaviour.

Another category is where the tender is gamed to ensure that MSME yards cannot participate. A good example of this is Kochi Metro (KMRL) water metro project for 23 electric ferries of 100 passenger capacity. These are small boats, again, suitable for MSME yards. However, the tender criteria were kept by KMRL to ensure that MSME yards with relevant electric boat experience does not qualify for this project but large shipyard like CSL with no electric boat experience qualify based on balance sheet criteria. Here again CSL was given the work on nomination since it was a single tender and not re-tendered.

There must be clear guidelines from Ministry of Shipping to prevent large shipyards operating under their them to bid in projects that are suitable for MSME yards, maybe based on value or size of the boat.

Import duty exemption for shipyards discriminates MSME

Ministry of Shipping has an interesting policy to support shipbuilding in India. The policy is to exempt customs duty on items imported. It makes logical sense when the final ship is for export. However, when the same facility is extended to ships and boats built for Indian market and for the items that are already available in Indian manufacturing sector this affects domestic manufacturers.

Imagine a scenario where with this customs duty exemption in place, the shipyard has two choices - an Indian MSME that make the product and a foreign supplier. The shipyard will be ready to pay the foreign supplier in foreign currency and give a Letter of Credit (LC) one month before the item is shipped from the foreign country.

Let's see what terms the same shipyard keeps for Indian MSME. The shipyard will make the payment in Indian rupees (quoting some RBI guidelines). The payment terms will be full payment one month after delivery of the product. Interestingly in the recent KMRL project, CSL claims that it gets part of the payment from KMRL in Euro and that is the reason why they favour payment to foreign vendors in Euro. When receiving money, they will find ways

² Annual report 2018-19

<https://cochinshipyard.com/uploads/annualreport/a4afe0fcfdda16d637132ce8a18bd2d1.pdf>

to get in Euro whereas when giving money to Indian MSME they have only one option of payment in Indian rupees.

Let's see the obvious discrimination.

1. The currency exchange risk is completely transferred to the Indian MSME. In case the MSME has some components coming from foreign country, then the exchange rate risk is real. The shipyard offers to pay the part which is imported in foreign currency using a high sea sale process. This works if the value addition is limited and the parts can be assembled independently. It does not work if most of the activity is done in India using some components from abroad.
2. The difference in payment terms is obvious and the increase in finance cost associated with it.

Let's see what is not obvious.

1. Given that the shipyard expects the vendor to finance the product - to some extent by foreign players and completely by Indian MSME, the finance cost becomes critical. We all know that MSME borrows from banks at 12-16% in India whereas the foreign suppliers get at 1-3%. That spread alone is over 10%.
2. The shipyard is incentivised to find foreign players even when MSME based in India can offer a solution since it is simpler for them.

The current policy promoted by Ministry of Shipping discriminates MSME based out of India. It must be amended to allow custom duty exemption for boats build for Indian market only when Indian MSME/firms cannot offer the solution. Else it works against Make in India policy and cause slow death of MSME sector.