

## Small And Medium Enterprises Development Bill 2005 — Genesis Of SME Reforms

The Small and Medium Enterprises Development (SMED) Bill 2005 (The Bill), the draft of which was pending since 2002, has been finally introduced in the Parliament and is likely to be passed in the next session of the House. The Bill primarily aims to facilitate the promotion, development and enhancement of the competitiveness of Small and Medium Enterprises. Its other objectives are:

(a) Declaration as to expediency of control by the Union over certain industries as specified in First Schedule to Industries (Development and Regulation) Act 1951, by virtue of Section 2 of the said Act.

(b) To provide for other matters for facilitating the primary objective of promotion, development and enhancing the competitiveness of SMEs. The Bill, if passed in current form, will cut the bureaucratic tape and the multiplicity of laws applicable to SMEs and facilitate their global competitiveness.

### Overview

The Bill calls for the formation of a National Small and Medium Enterprises Board (NSMEB) and specifies several requirements ("sections") that include basis of classification of enterprises into SMEs (Section 7), providing of measures for promotion, development and enhancement of small and medium enterprises (Section 9), credit facilities to SMEs

(Section 10), preference policies in respect of procurement of goods or services produced or provided by small enterprises (Section 11) and inspection of SMEs (section 15).

The Bill also covers the financial aspects such as maintenance by SME of such records, filing of such returns as may be prescribed (Section 16), liability of buyer to make payment, interest on

policy based on the US model, where a minimum of one-third of Federal Departments' purchases come from tiny sector and the same is to be independently supported by reporting mechanism. The unnecessary documentation and complicated inspection system also need to be curtailed to promote healthy competitiveness among SMEs.

The Bill 2005 VII chapters

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This article assesses and analyses the pros and cons of Small and Medium Enterprises Development Bill, 2005 besides focusing on the importance of SMEs in India and the role of CII and SIDBI in this regard. An effort has also been made to correlate the presence of SMEs in various other sectors, including Information Technology.

delayed payment, recovery of amount due from buyer, appeal related provisions, reference to Industry Facilitation Council and additional disclosure requirements by the buyer in his financial statements (Section 17-24). The Bill also contains penal provisions for contravention of the provisions.

The Bill has largely concentrated on SMEs but there also exists a huge number of micro enterprises that too require a special focus and a separate criterion is needed for such micro enterprises apart from SMEs. Further, the credit facilities to SME also need to be made more liberal. There is a need to frame procurement

and 33 sections as shown in Table A. (*Facing Page*)

### Defining SMEs in Global Context

As recommended by the European Union Commission, an SME is an enterprise which: (a) has less than 250 employees, (b) has either an annual turnover not exceeding 50 million euros, or an annual balance sheet total not exceeding 43 million euros, and, (c) conforms to the criterion of independence (Independence would mean limitation of the ownership interest by a large entity).

In the Czech Republic, the parliament passed an Act as support for SME-sized enter-

Table A. SME Development Bill, 2005 - Listing of Chapters and Sections

Chapter	Topic	Section	Remarks
I	Preliminary	(1-2)	It covers short title, commencement and Definitions
II	National Small and Medium Enterprises Board	(3-6)	Constitution of NSMEB, removal of members from Board, functions of the Board. Power and functions of members-secretary of Board.
III	Classification of Enterprises, Formation of Advisory Committee and Filing of Memorandum of SMEs	(7-8)	It prescribes basis of classification of enterprises into small and medium enterprises; formation of advisory committee, its constitution and filing of memorandum of SMEs.
IV	Measures for promotion, development and enhancement of competitiveness of SMEs	(9-14)	It provides measures required for promoting, developing and enhancing the competitiveness of SMEs. Reference in connection to credit facilities, preference policies. Constitution of fund and its administration.
V	Inspection of SMEs and related matters.	(15-16)	Describes provisions in relation to inspection of SMEs, maintenance of records and filing of returns by SME.
VI	Delayed payments to Small Enterprises	(17-26)	It provides for liability of buyer for making payment of Principal, interest, reference to Industry Facilitation Council, filing of appeal by buyer and additional disclosure requirement of unpaid amount in Annual Statement of Accounts.
VII	Miscellaneous Provision	(27-33)	It prescribes about appointment of officers and employees, penal provisions and power of making rules etc.

prises in the year 2002. This Act harmonizes the definition of SMEs with the definition in the European Union Commission. Further, the SMEs Department of International Finance Corporations works with the following definitions:

#### Defining SMEs in Indian Context

In India, no specifications have ever been made for tiny sector or micro enterprise and the main concentration has been on SMEs.

Section 7 of the Bill contains

the provisions regarding the classification of any class or classes of enterprises whether proprietorship, HUF, association of persons, cooperative-society, partnership firm, engaged in manufacturing and production of goods or rendering of services into SMEs. It also requires formation of an Advisory Committee, which will give recommendations to the Centre and accordingly the classification will be done.

Section 7 has an overriding effect on Section 11B of the Industries (Development and Regulation) Act, 1951. Section 11B empowers the Centre to specify

Enterprise	Criteria (up to basis)		
	Employees	Total Assets	Total Annual Sales
Micro enterprise	10	USD 100000	USD 100000
Small enterprise	50	USD 3 million	USD 3 million
Medium enterprise	300	USD 15 million	USD 15 million

the requirements which shall be complied with by the ancillary and small-scale Industrial undertakings so as to maintain their viability and strength. An analysis chart showing the classification of enterprises into SMEs is given in Table B.

- (c) Advisory function to the Centre for use of fund constituted under section 12. The ex-officio chairman and vice chairman of the Board shall be the minister in-charge of the ministry or department of the Centre having administrative control of

**Removal of members from Board:**

- The Centre has power to remove a member if he:
- (a) Is adjudged as insolvent
  - (b) Is declared unsound by a competent court
  - (c) Refuses or is incapable to act as member

Table B

Particulars	Enterprises	
	Small Enterprise	Medium Enterprise
In relation to industry specified in First Schedule to Industries (Development and Regulation) Act, 1951	Investment in Plant and Machinery is less than or equal to Rs 5 crore	Investment in Plant and Machinery is more than Rs 5 crore but less than or equal to Rs 10 crore.
(a) In case enterprise engaged in the manufacture or production of goods		
(b) In case enterprise engaged in providing or rendering of services	Investment in Equipment is less than or equal to Rs 2 crore	Investment in Equipment is more than Rs 2 crore but less than or equal to Rs 5 crore.
<i>Note: It may be noted that while arriving at the investment in plant and machinery or equipment as the case may be, the investment in land and building shall not be considered.</i>		

**National Small and Medium Enterprise Board**  
Section 3-6 of the Bill provides for establishment of a new body, the National Small and Medium Enterprises Board, to perform the following functions:

- (a) Examining the factors affecting the promotion and development of SMEs and to make recommendation on the same (if any).
- (b) Preview the policies and programmes of the central Government in regard to facilitating the promotion, development and enhancing the competitiveness of small and medium enterprises and to make recommendation on the same (if any).

the SME and the minister of state or a deputy minister respectively. The Centre will appoint five ministers of state governments, having administrative control of SSIs. Besides, it also requires persons from various reputed institutions of India viz, NABARD, SIDBI, RBI. Further, a few persons of eminence from the field of economics and industry can also be the part of the Board. The Board will also be empowered to associate any other member whom it deems fit to provide assistance, advice in compliance of the Bill. In such a case, the associate member has the right to take part in discussions of the Board but will have no power to vote.

**The credit facilities to SMEs need to be made more liberal. There is a need to frame procurement policy based on the US model, where a minimum of one-third of Federal Departments' purchases come from a tiny sector and the same is to be independently supported by a reporting mechanism**

- (d) Is convicted of an offence, which, in the opinion of the Centre involves moral turpitude.
  - (e) Has so abused, in the opinion of the Centre, as a member his continuance is detrimental to the interest of general public.
- Note: In case of removal due to reasons specified in point c to e, reasonable opportunity of being heard to be given to the member.*

**Basis of Classification into SMEs**

There can be numerous criteria on which classification of an enterprise into small or medium can be done. Mostly, number of employees, total annual turnover, total assets investment in plant and machinery, nature of ownership i.e., extent of independence

are some of the examples. Section 7 of the Bill, which has an overriding effect on Section 11B of Industries (Development and Regulation) Act, 1951 requires that the Centre, after considering the recommendations from Advisory Committee, shall make the classification. Under the Bill, the Advisory Committee is also required to consider certain matters before communicating its recommendation to the Centre. The comparative analysis of Section 7 of the Bill and Section 11B of Industries (Regulation & Development) Act, 1951 are as under:

It may be noted that section 11B of Industries (Development and Regulation) Act 1951, deals with the power of the Centre to notify certain conditions, which need to be complied with by an Industrial Undertaking to enable it to be regarded for the purpose of the said Act as an ancillary or a Small Scale industrial undertaking.

### Measures for SME Development

The Bill provides for the following measures to attain the objective of promoting, developing and enhancing the competitiveness of SME:

#### (1) Certain measures for promotion and development

The Centre shall take initiatives for promotion, development and enhancement of competitiveness of SME, especially the former by:

- (a) Developing employee management skills and entrepreneurs
- (b) Providing marketing assistance/infrastructure facilities
- (c) Cluster development to

Criteria of Classification as per Section 7	Criteria of Classification as per Section 11B
(a) The level of employment in a class or classes of enterprise	(a) The investment by the industrial undertaking in (i) Plant & machinery or (ii) Land & building, Plant & machinery
(b) The level of investment in Plant machinery or Equipment, excluding the investment in land and building, in class or classes of enterprises	(a) The nature of ownership of the industrial undertaking
(c) The need of higher investment in Plant & machinery or equipment excluding the investment in land and building, for technological upgradation, employment generation and enhanced competitiveness of the class or classes of enterprises.	(b) The smallness of the number of workers employed in the industrial undertaking
(d) The possibility of promoting and diffusing entrepreneurship in small and medium enterprises.	(c) The nature, cost and quality of the product of the industrial undertaking
(e) The international standards for classification of small and medium enterprises	(d) Foreign exchange, if any, required for the import of any plant and machinery by the industrial undertaking
(f) Such other matter as the Advisory committee may think fit	(e) Such other relevant factors as may be prescribed.

strengthen backward and forward linkage.

#### (2) Credit Facilities

To ensure timely and smooth flow of credit to SMEs, to minimise the incidence of sickness among them and to enhance the competitiveness, necessary guidelines / instructions shall be issued by RBI. The Credit facilities shall be progressive in nature.

#### (3) Preference policies in procurement of goods/ services from Small Enterprises

Preference policies in respect of procurement of good / services, produced or provided by small enterprises shall be provided to encourage their

promotion and development. It may be noted that in United States, under the procurement policies, minimum of 1/3 of federal departments' purchases must come from tiny sector, even as an independent authority directly reporting to the US President monitored the compliances.

#### (4) Creation of Funds, Grants by the Centre

A Fund shall be constituted for the benefit of SMEs. The grant from the Centre shall be credited to the fund.

The fund shall only be (exclusively) used for the following purposes:

1. Developing employee management skills and entrepreneurs



2. Providing marketing assistance/infrastructure facilities
3. Cluster development to strengthen backward and forward linkage.

### Inspection of SMEs

The Bill has admitted and even addressed the quintessential problem of labour laws and regulations. Thus, by providing an overriding clause over various Acts viz, Payment of Wages Act 1936, the Employees State Insurance Act 1948, the Factories Act, 1948, Employees Provident Funds and Miscellaneous Provisions Act, 1952, the Maternity Benefit Act, 1961, the Payment of Bonus Act, 1965 and the Payment of Gratuity Act 1972, the emphasis has been made on self-regulation and self-certification.

Even though the concept of self-certification and self-regulation was great on road, the Bill 2005 requires SMEs to maintain such records, and

file such returns with authority in such forms as may be prescribed.

### Additional shelf to Small Enterprises

Under the Bill, every small enterprise which has filed a memorandum under Section 8(1) (a), National Small Industries Corporation being registered under Companies Act 1956 and the Small Industries Development Corporation of State or Union being a company registered under the Companies Act 1956 will be called "Supplier".

It requires from every buyer for goods received or services availed to make the payment to the supplier within 30 days from the date of actual delivery of goods or rendering of services. In case the buyer has raised objections in writing regarding acceptance of goods/services, within 30 days of delivery of goods / rendering of services, then the day on which such objection was

removed by the supplier, the buyer has to make the payment. It also provides that in no case the period agreed between supplier and buyer, in writing, shall exceed 75 days from the date of actual delivery of goods and services. Further, in case the payment is not made on time, the interest @ 9% plus bank rate as notified by RBI to be paid from the date of payment due to the date of actual payment made. The amount due from buyer, including interest, shall be recoverable by way of suit or proceedings under law.

To resolve the dispute, any party can refer to the Industry Facilitation Council to act as arbitrator or conciliator. Further, to make an appeal to Industry Facilitation Council, only the buyer is required to deposit up to 75% of amount under dispute.

**Additional Disclosure Requirement from Buyers in Annual Statement of Accounts**

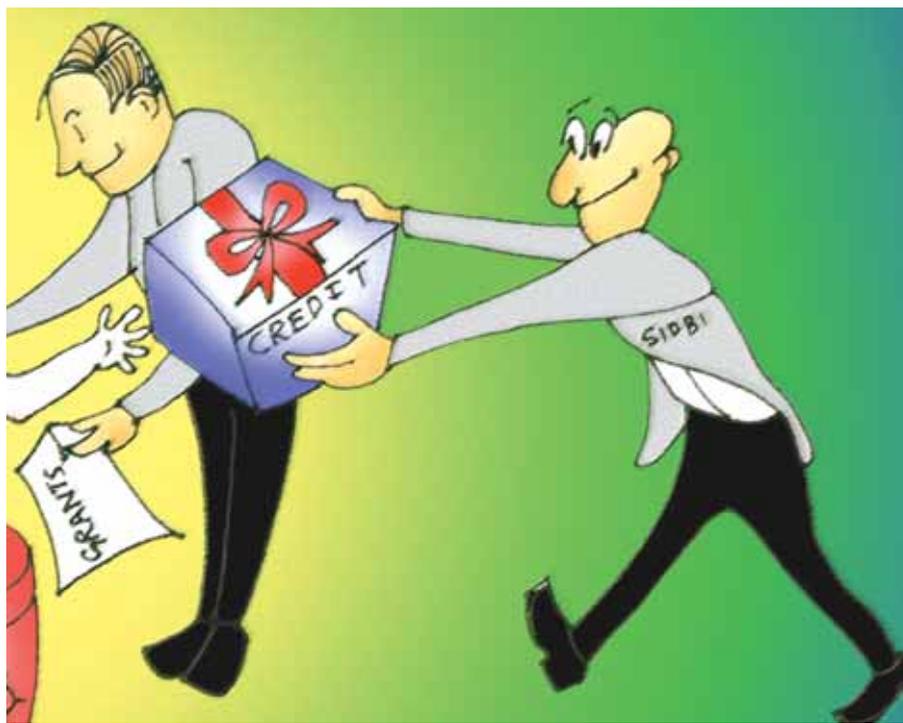
Section 24 of the Bill requires every buyer to get his annual accounts audited and an additional duty has been cast for furnishing certain additional information in his annual statement of accounts. The given case would be the perfect example of "substance over form" where besides the disclosure requirement as prescribed in relevant law, additional disclosure is provided under Bill 2005.

Auditors of every buyer shall now be required to verify whether this statutory requirement of the Bill is complied with or not, even though

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duty has been cast on the auditee in the upper front. The additional disclosures are as follows: -

- (i) As at the end of each accounting year,
  - (a) The principal amount and interest due and remain unpaid to supplier
  - (b) The amount of interest accrued and remains unpaid to supplier.
  - (c) The amount of interest paid by buyer on delayed or non-payment to supplier within 30 days of delivery of goods or rendering of services. In case objection regarding goods or services is made by buyer then within 30 days from the date of such removal of objection and the payment of principal beyond the due date.
- (ii) The amount of interest due and paid beyond the due date during the year.



(iii) The amount of any interest remaining due and payable in the succeeding years, until such date when the same is actually paid to small enterprises.

*Note: It may be noted that amount of interest paid or payable by buyer on delayed or late payment to small enterprise*

*shall not be allowed under the Income Tax Act, 1961.*

#### IFAC's initiatives

International Federation of Accountants (IFAC) has issued International Auditing Practice Statement (IAPS) 1005 "The Special Consideration in the Audit of Small

#### Penalty Provisions

Nature of penalty	Section	Penalty
Contravention of provisions regarding filing of memorandum of small and medium enterprise	Section 8	* First conviction – fine up to Rs 1000/-* Second and subsequent conviction– fine up to Rs 10000/- (subject to minimum Rs 1000).
Non-maintenance of record, non-filing of returns by SMEs.	Section 16	* First conviction – fine up to Rs. 1000/-* Second and subsequent conviction - fine up to Rs 10000/- (subject to minimum Rs 1000).
Non-furnishing of information to the officers appointed u/s 27 (1)	Section 27 (2)	* First conviction – fine up to Rs 1000/-* Second and subsequent conviction– fine up to Rs 10000/- (subject to minimum Rs 1000).
Non-disclosure of additional information by buyer in his annual statement of accounts.	Section 24	Fine Rs 10,000/- or above

Entities". It was issued in the year 1999 and revised in the year 2003.

IFAC has formed the Small and Medium Practices Permanent Task Force to provide necessary inputs to International Auditing and Assurance Standards Board (IAASB) projects. Within the task force, small teams named Rapid Response Teams have been formed to monitor projects of IAASB. The team monitors the IAASB project from the proposal stage to the final approval of the pronouncement.

Federation des Experts Comptables Europeens (FEE) has publicly stated that "FEE recommends the small and medium enterprise issues should be at the heart of the standard setting process, not an afterthought." This criticism relates to the way the standards are developed. The critics argue that standards are developed with the audit of large entities in mind. As a result, there is a tilt of the standards towards large entities' considerations.

#### SIDBI and SME

Small Industries Development Bank of India (SIDBI) has launched SME Growth Fund, a new venture capital fund of Rs 500 crore dedicated to the small and medium enterprise sector. The 8-year life fund aims at supporting the risk capital requirements of the innovative and technology oriented small and medium units. Further, the SIDBI has taken following initiatives to expand the growth of the SME sector:

- (a) Setting up of a Credit Rating Agency (CRA) for the SME sector. CRA would provide credit rating services, which would

enable the SME sector to access the diverse risk-oriented funds.

- (b) Operationalisation of "small and medium enterprise fund" of Rs 10000 crore, being given to SME at concessional rates i.e. presently 9.5% per annum.
- (c) To act as a channel for World Bank to route long-term credit to the SME segment.

#### IT Sector and SME

Most of the successful Information Technology companies started their business journeys as a small or medium enterprise. There were various reasons behind their success

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viz, good leadership, good investment, effective marketing strategy and consumer satisfaction and so on.

As many as 80 per cent of NASSCOM's 900 members are SMEs. Human resource is one of the most important resources for SME. NASSCOM is continuously working towards the availability of quality manpower in sufficient number to meet the ever-growing demands of the IT sector. Various other problems faced by SME in IT Sector are:

- (i) Lack of infrastructure facilities
- (ii) Huge cost of training and development of human resource



Business Volume	No. Of SMEs
Rs 500 crore	10
Rs 200-500 crore	14
Rs 50-200 crore	74
Rs 10-50 crore	132
Rs 1-10 crore	228
Rs 10 lakh to Rs 1 crore	249
Rs 5-10 lakh	65
	(Source: NASSCOM)

- (iii) Lack of skilled manpower
  - (iv) Lack of latest technology, etc.
- The volume-wise classification of SME is as under:

#### CII and SME

The confederation of Indian Industry has conducted a snap poll, based on the Bill to gauge the mood of the SMEs. As per the poll, a majority of the respondents favoured the Bill, which aims at streamlin-

Table C

Provisions of the Bill	Response (%wise)		Remarks
	Positive	Negative	
1. Inspection of SMEs and related matters	70	30	The respondent further requires the liberalisation of self-regulation and self-certification process.
2. Formation of National Small and Medium Enterprises Board (NSMEB)	87	13	The respondents are happy as with the establishment of NSMEB as periodic overseeing of SME sector can be assured.
3. Classification of small and medium enterprises	74	26	Respondent requires considering the "Tiny sector", phenomenon.
4. Measures for promotion, development and enhancement of competitiveness of SMEs such as credit facilities, procurement preference policy, fund, grant by the Centre, etc.	74	26	The provision was welcomed in general.
5. Provisions relating to delayed payment to small enterprises	61	39	Most require that provisions are much more similar to current law and it again lacks the effective implementation. Thus, repeal of Interest on Delayed Payments to Small Scale and Ancillary Undertaking Act, 1993 would not affect the current problem.

ing the day-to-day operations of SMEs. The overall analysis of the Poll is explained in Table C.

#### Conclusion

At the outset, industry at large has favoured the Bill 2005 as it gives great impetus to the growth of SMEs and cuts the bureaucratic red tape and procedural complexities to a great extent. □

