#PaymentOntimeGrowthHarTime

Unlocking the full potential of India's MSMEs through prompt payments

Global Alliance for Mass Entrepreneurship (GAME) and Dun & Bradstreet (D&B)

WITH SUPPORT FROM OMIDYAR NETWORK INDIA (ONI)

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In the past, we have engaged several solution providers including **Recordent, Agami, Webnyay, M1Xchange, RXIL, Invoicemart, CredAble, Vayana Network,** and many more. We thank these organizations and their leadership teams for their continuous advocacy around dispute resolution, invoice financing, deep tier financing and more.

Finally, and most importantly, we thank the **MSMEs, from across the country, who lend their voices to this report.** Without their inputs, we would have failed to fully acknowledge the softer and unseen impacts of delayed payments and we hope we have sufficiently captured them in this report.

01

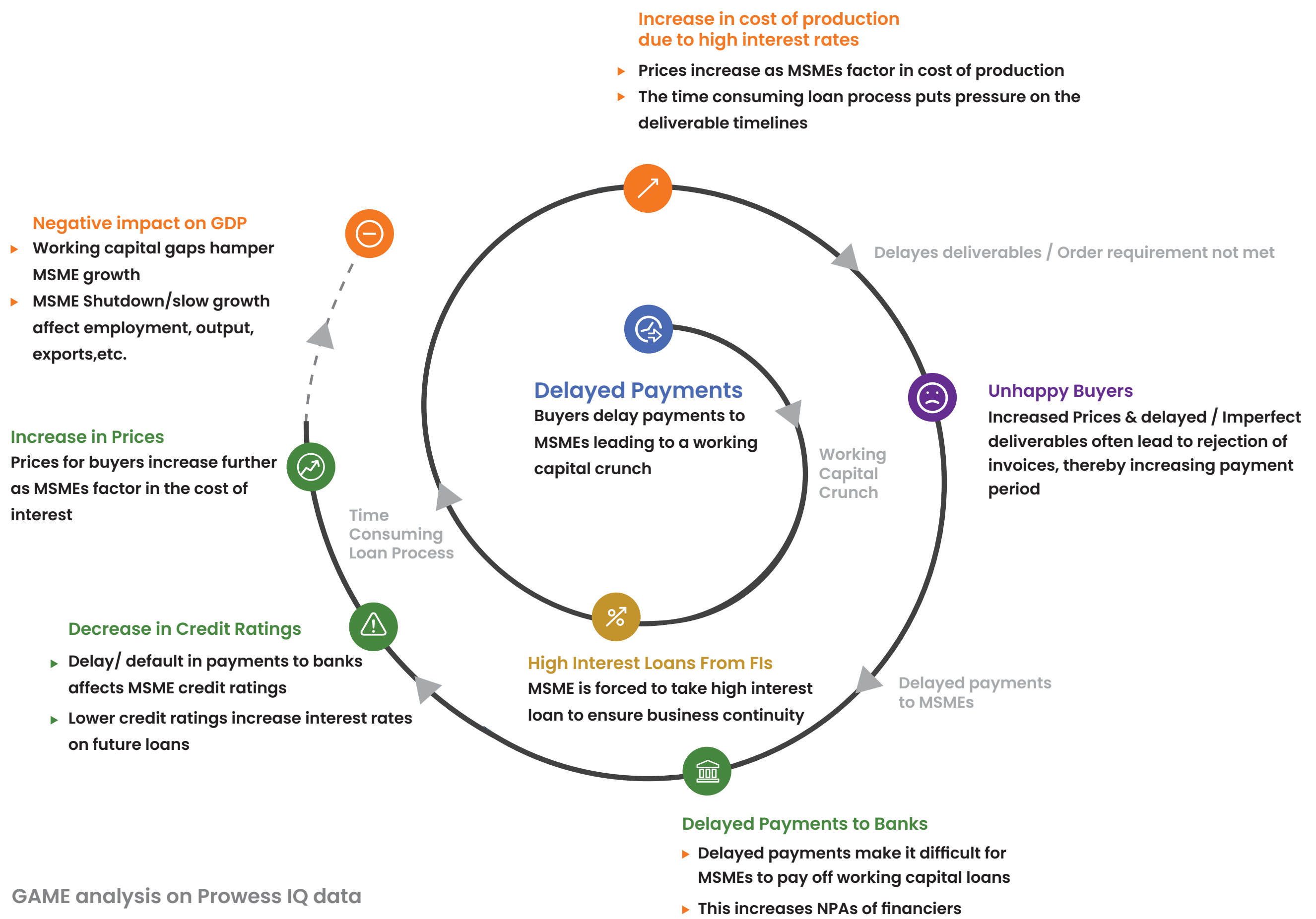
Executive Summary

Executive Summary

Payment delays to MSME suppliers remains an endemic and intractable problem in India. MSMEs contribute 33.5% of India's annual GVA[MSME Annual Report 2020-21, Ministry of Micro, Small, and Medium Enterprises], and the smallest of them - micro enterprises - employ 97% of all people employed by MSMEs, as well as an estimated 23% of India's total workforce *. Payments when delayed to MSME suppliers by their larger buyers hinders not just the viability and growth of MSMEs, but overall competitiveness of the Indian economy. **An estimated INR 10.7 Lakh Crore ie, 5.9% of the gross value added (GVA) of Indian businesses is locked up annually as delayed payments from buyers to MSME suppliers.**

The importance of prompt payments (and consequently, good cash flows) is captured well by the popular business adage, "revenue is vanity, profit is sanity, and cash is king." Cash flow is the lifeblood of any business. Positive cash flow allows MSMEs to invest in more production cycles, meet statutory payments on time, and even access credit. To manage cash flow mismatches, MSMEs borrow from financial institutions or local money lenders, a cost which ultimately prices up the of goods sold or services provided

Figure 1 **The vicious cycle of delayed payments for MSMEs, supply chains, and the economy**



GAME analysis on Prowess IQ data

* Data from Enterprise Survey 2015-16. No nationwide data on MSMEs/ businesses released by NSSO since the ES

Beyond hard numbers, the persistence of delayed payments reduces trust in the Indian economy. At a systems level, the balance of delinquency against diligence impacts the level of certainty and trust, both essential components of a well-functioning economy and society. Simply put, the absence of fear of being cheated along with predictability of outcomes help businesses make better, longer term, and more strategic decisions for their future. High-trust societies and systems have repeatedly proven to be better at achieving collective goals than low-trust counterparts[Fukuyama, (1995)],[Knack and Keefer (1997)].If India is to become a five or even ten trillion-dollar economy, it must ensure that its economic actors are reliable and trusted, and timely payments are made to MSMEs by buyers. This can go a long way towards reducing the transaction costs of conducting business in India and encouraging greater job creation by enabling a culture of considered risk-taking. At the moment, our economy seems a far way off from this reality.

A vast majority (~80%) of the annual delayed payments amount is owed to Micro and Small Enterprises (MSEs) in particular. In essence, the smaller you are as a business, the more you suffer at the hands of tardy buyers. Withholding these enormous sums of capital from India's smallest businesses deprives them of their opportunities to grow and return value to their owners, and consequently the millions of ordinary households that are supported by these businesses. This pattern does not augur well for the spirit of entrepreneurship that India's leadership seeks to promote, and makes the setting up of small business a risky and tumultuous experience.

Fundamentally, payments are delayed because of a power asymmetry between smaller suppliers and large buyers. By and large, the structure of supply chains mirrors the structure of biological food chains: lots of small suppliers supply to a smaller number of large buyers, who aggregate, assemble, and sell value-added goods and services to the end customer. This is even more true in an Indian context where many formal industries are dominated by a few established players, particularly in areas like healthcare, high-end manufacturing, and of course, the public sector (with ***Maharatna*** and ***Navratna*** PSUs often having near-monopolies in raw materials and industrial commodities). The great power (through size or frequency of orders) wielded by larger players in a supply chain comes with the responsibility of paying suppliers on time and negotiating payment terms that are reasonable and fair for the smaller parties. By withholding payments (or trade payables) beyond the agreed credit periods, buyers essentially get access to free cash to finance their own working capital cycles, at the cost of their deprived. If this happens repeatedly and across industries, then it indicates that delaying of payments is being deployed widely as a tactic by larger businesses to accumulate gains that should be distributed back to those who provide value to them.

For most MSMEs, delayed payments have become normalized and an attribute of India's business culture. MSMEs capable of differentiating themselves to win loyalty of buyers and incentivize good behavior from them do so, but often at the cost of their own profitability. These businesses include the probability of receiving delayed payments into their way of doing business, as an implicit and concealed cost of operations. Buyers, on their part, claim that delayed payments occur for reasons out of their control, although this claim must be held to a higher burden of proof and standards of accountability.

Executive Summary

India's Goods and Services Tax (GST) and non-performing (NPA classification) regime fail to account for delayed payments, further exacerbating MSMEs' cash crunch. Cash flows are further stretched by the fact that GST must be paid irrespective of whether payments are made to MSMEs or not. A 'one size fits all' NPA regime fails to account for the fact that a majority of receivables to micro-enterprises are delayed and they are delayed for much longer than larger enterprises in the country.

Government departments/PSUs have a long way to go in improving their payment performance. Data suggests high proportions of delinquencies by PSUs. In 2020, 69% of payments by public administration entities were delayed by 60 days beyond the due date.

Prominent solutions that exist to address delayed payments assume buyer's motivation to pay promptly. Wishing away the root cause of the problem makes it persistent and limits the effectiveness of its solutions. As the UK Sinha Committee on MSMEs succinctly put it, "timely payments to MSEs are of least priority to the buyers, the solution must be necessarily designed around the buyers." For example, the Trade Receivables Discounting System (TReDS) platform, addressing <5% of the total delayed payments problem as of today, requires buyers to onboard onto the platform, approve invoices uploaded for factoring, and further consent to pay the financier on the terms set.

To address delayed payments at scale we need greater public discourse on the topic, raise the stakes for tardy buyers, and reduce the impact on MSMEs:

Build a public conversation on delayed payments

- Publish estimates of delayed payments and their trend in the Economic Survey (Ministry of Finance, Government of India), released annually before the budget, with quarterly estimates placed in the 'Monthly Economic Review' of the Department of Economic Affairs
- Leverage platforms such as 'Mann Ki Baat' to discuss Delayed Payments which have proven to drive large scale behavioral change campaigns. Placing it in the large conversation of India's business culture will be the starting point to counter the normalization of delayed payments
- Run a 'Prompt Payment Program', which brings together the 100 largest corporates in India to commit to becoming prompt payers by the beginning of FY 23-24; Also, encourage these corporates to engage in 'deep-tier' financing to unlock working capital for smaller MSMEs beyond their immediate supply chain
- Add delayed payments as an indicator within the EoDB 2.0 framework which is currently under development by the Department of Promotion of Industry and Internal Trade

Raise the stakes on tardy buyers

- Enable the entry of Online Dispute Startup (ODR) startups to ensure faster and more effective resolution of payment related disputes by reducing the burden on the state (i.e. the district level Micro & Small Enterprise Facilitation Councils). State legal service authorities may tie up with private ODR start-ups to create models similar to e-lok adalats to unlock the potential of ODR by leveraging data and technology.
- Allow MSMEs to opt-in to the services of an information utility, which will independently take action against tardy or delinquent buyers on behalf of the MSME. Currently leveraged by the insolvency and bankruptcy ecosystem of India, the UK Sinha Committee recommends that it be adopted across the MSME ecosystem as well.
- Create a clear formula for delayed payments to impact the borrowing costs of large buyers. Banks can work with data providers to evaluate the delayed payables of large corporates, increasing borrowing costs of tardy buyers.
- Mandate that all ***Miniratnas***, ***Maharatnas***, and ***Navratnas*** transact on TReDS.

Manage the unintended consequences on MSMEs

- Ensure a reasonable grace period for MSMEs for their GST dues caused by Delayed Payments
- Shift the Non-Performing Asset (NPA norms) for MSMEs to go up to 120 days to account for their unique cash flow challenges

02

Foreword

Foreword

Micro, Small and Medium Enterprises (MSMEs) are one of the important pillars of growth in India in terms of providing millions of job opportunities and export prospect. Recognising its potential, Government has taken various initiatives in this year's Budget including enhancing the Emergency Credit Line Guarantee Scheme, interlinking of Udyam, e-Shram, NCS and ASEEM portals among others, to make this sector more resilient, competitive and efficient. Despite its importance in the economy, the sector continues to face considerable challenges that prevent improvements in both its share in the Gross Value Added and the lives of people it employs

Globally, the MSME sector comprises of a very large number of small businesses that are marked by informality and low productivity. The World Bank has highlighted how access to financing remains one of the most significant constraints to the survival, growth and productivity of MSMEs for emerging economies. My own experience, in the context of MSME financing shows that the problem of fund availability is not just of accessing institutional credit, but also about working capital availability. However, what compounds the struggle of Indian MSMEs is the complex issue of delayed payments that leaves them wanting for both cash and bargaining power. The COVID-19 pandemic has only worsened this situation.

This report- ***'Unlocking the full potential of India's MSMEs through prompt payments',*** which is an outcome of the collaboration between GAME and Dun & Bradstreet, and supported by Omidyar Network India, addresses this very issue. Building on their bottom-up exercise of analysing impacts of delayed payments from the point of view of MSMEs, the authors have attempted a comprehensive study on the issue of delayed payments from the D&B's trade receivables experiences of more than 5 lakh entities and have thereby discussed practical suggestions to address the same. Using multiple datasets and from their own qualitative research they estimated that 5.9% of the gross value added in the Indian economy is locked up in delayed payments from buyers to MSME suppliers. As they write, a fundamental cause for this is the existence of a power asymmetry between small suppliers and large buyers. The formal mechanisms of recourse available to MSMEs are also riddled with low coverage and cumbersome processes.

The report further deliberates on the issue of raising the stakes on tardy buyers. This can be achieved by enabling the entry of Online Dispute Resolution start-ups to ensure faster and more effective resolution of payment related disputes. Banks can also work with data providers to evaluate the delayed payables of large buyers and consequently increase the borrowing costs of those buyers. Another approach is to link the working capital limits of large buyers to their participation in trade receivables platforms and acceptance of suppliers' invoices therein. The report is replete with case studies conducted by the participating organizations that substantiate the efficacy of these scalable solutions.

It is good that the report brings out the demonstration of the law of unintended consequences such as the mandatory payments of GST dues by MSMEs even if they are unable to collect their dues and the classification of dues from MSMEs as non-performing due to their inability to collect the monies owed to them from large buyers. Policymakers must pay particular attention to unintended consequences of their well-intentioned policies.

Foreword

I commend the authors and the institutions for their noble and sensible pursuit of unleashing the MSMEs to achieve their full potential resulting in job creations but also for providing an actionable agenda to policy makers. It is my sincere hope and wish that the report succeeds in achieving its **'desired objectives.'**

New Delhi, 3rd May 2022

By Dr. V. Anantha Nageswaran
Chief Economic Advisor - **Govt. Of India**

03

Concepts & Definitions

Concepts & Definitions

DPD – Days Past Due.

If a company pays its invoices, which are due in 30 days after purchase or delivery, in 35 days that's five days past due, so its DPD is five

GVA - Gross Value Added

GVA is the measure of the value of goods and services produced in an area, industry or sector of an economy

DSO – Day Sales Outstanding

Average number of days it takes for a company to collect payment for a sale. The formula we used for calculating DSO is Day sales outstanding = [Short term trade receivables/Total sales]*365

TReDS - The Trade Receivables Discounting System

It is an institutional mechanism set up in order to facilitate the discounting of invoices for MSMEs from corporate buyers through multiple financiers

ODR – Online Dispute Resolution

A branch of dispute resolution which uses technology to facilitate the resolution of disputes between parties

Receivables

Debts owed to a company by its customers for goods or services that have been delivered or used but not yet paid for

04

Context Setting

Context Setting

Micro, Small and Medium Enterprises (MSMEs) are the backbone of the Indian economy. Nearly 6 crore MSMEs employ approximately 11 crore people, i.e., approximately 40% of India's non-farm workforce. These organizations are also critical to the distribution and supply chains of larger companies, contributing nearly 25% towards India's services GDP and 33% towards total manufacturing output[Report on "Improving Economic Dynamism & Accelerating MSME Growth", June 2020, G.A.M.E.

Even pre-COVID-19, the sector was cost-uncompetitive with many small firms perennially stuck in a vicious cycle of informality, low productivity, and stuntedness. An astonishing 95% of all firms in India employ fewer than 5 people, while 98% employ fewer than 10 people So, India's entrepreneurial landscape comprises a very large number of small businesses and just a few large ones leaving the space for mid-size, growing businesses largely empty. This is India's 'Missing Middle'. For India's economy to grow at reasonable pace and create adequate employment and prosperity, we need millions of more enterprises that are both productive and able to grow.

Poor cash flow impacts MSME's ability to survive and thrive. Inadequate cash reserves reduce working/production cycles, investment, and predictability for MSMEs. A survey conducted by GAME – and LEAD at KREA University, after the first Covid lockdown, suggested that over 70% of micro-enterprises in India had cash reserves lasting less than a month, with a vast majority dipping into their personal savings to remain afloat.

Delayed payments from buyers to suppliers is a major contributor to the low resilience of MSMEs in India. Legally, delayed payments occur when buyers delay payables to their Micro & Small Enterprise (MSE) suppliers by 45 days [MSMED Act 2006]. For an MSME, delays occur when buyers go beyond the 'credit terms' set between the two parties. Our report suggests that from either of these goalposts, delayed payments are pervasive, longstanding, and normalized.

At a systems level, the balance of delinquency against diligence impacts the level of certainty and trust in a system, both essential components of a well-functioning economy and society. Simply put, the absence of fear of being cheated and having predictability of outcomes helps businesses make better, longer term, and more strategic decisions for their future. High-trust societies and systems have repeatedly been proven to be better at achieving collective goals than their low-trust counterparts

> "Low trust can also discourage innovation: if entrepreneurs must devote more time to monitoring possible malfeasance by partners, employees, and suppliers, they have less time to devote to innovation in new products or processes."
>
> - Stephen Knack, Trust, Associational Life and Economic Performance, 2001

Context Setting

India has a history of legal and regulatory safeguards to protect MSMEs from delayed payments. The Interest of Delayed Payments (IDP) to Small Scale and Ancillary Industrial Undertakings Act, 1993 was the first legal mandate to ensure timely payments by mandating buyers to pay interest to MSME if payments were due for more than 30 days. This was replaced by the MSMED Act, 2006, which was similar to the IDP Act, 1993 apart from changes to the interest rates and the number of days within which payments should be made. The threshold for making payments was increased to 45 days. Legally, buyers must file their delayed payables to the Ministry of Corporate Affairs. MSME Samadhaan is a platform introduced by the government for MSMEs to raise disputes over the non-payment of dues by buyers.

India has also had a history of market arrangements to ease the burden of delayed payments such as Trade Receivables Discount System (TReDS) which had its predecessor in SIDBI-NSE Trade Receivable E-discounting Engine (NTREES) that MSMEs could use to securitize their receivables, thus easing the working capital crunch due to delayed payments. This led to platforms such as M1xchange, Invoicemart and RXIL where MSMEs can get financing on the basis of their unpaid invoices. Solutions such as working capital loans and trade credit insurance have seen limited uptake due to the low penetration of formal finance in servicing MSMEs.

Built into these solutions is the assumption of 'buyer intent' to address the problem. And consequently, as recently as 2019, the UK Sinha Committee on MSMEs highlighted the issue of delayed payments as a grave concern for MSMEs in the country calling out the 'lower bargaining power' among smaller suppliers as the core driver for the persistence of the issue. The committee report estimated typical delays to the MSME sector, charted its growth overtime, and offered solutions to end the problem once and for all. Another estimation exercise was conducted independently by Brickworks Ratings which pegged delayed payments from the largest 1000 corporates in India at **INR 3.3 lakh crore.**

In the wake of Covid-19, the Global Alliance for Mass Entrepreneurship's (GAME) National MSME Taskforce highlighted delayed payments as a longstanding malaise afflicting India's MSMEs. In its report 'Unlocking Credit for Job Creators', GAME conducted the first ever bottom-up exercise of understanding delayed payments from the point of view of MSMEs. The report went further to analyze the impact of delayed payments on the economy broadly.

However, deeper assessment of why the problem persists and where it is more pronounced remained elusive, which constrained a more concrete action. Consequently, **Omidyar Network India (ONI), Dun & Bradstreet (D&B), and GAME decided to join hands and publish the first ever comprehensive report on delayed payments to provide a deeper set of insights on 'why' and 'where' delayed payments persist. This ONI funded partnership leverages D&B's trade receivables experiences of over 500K entities, and GAME's prior qualitative research and understanding of other datasets to begin a nationwide conversation on a problem that has become indistinguishably normalized.**

Through this report and the partnership that made it possible, we hope to bring greater attention to the issue of delayed payments, offer insights on why it persists and where it is most pervasive, and share an actionable agenda that can help address this problem at scale.

Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.

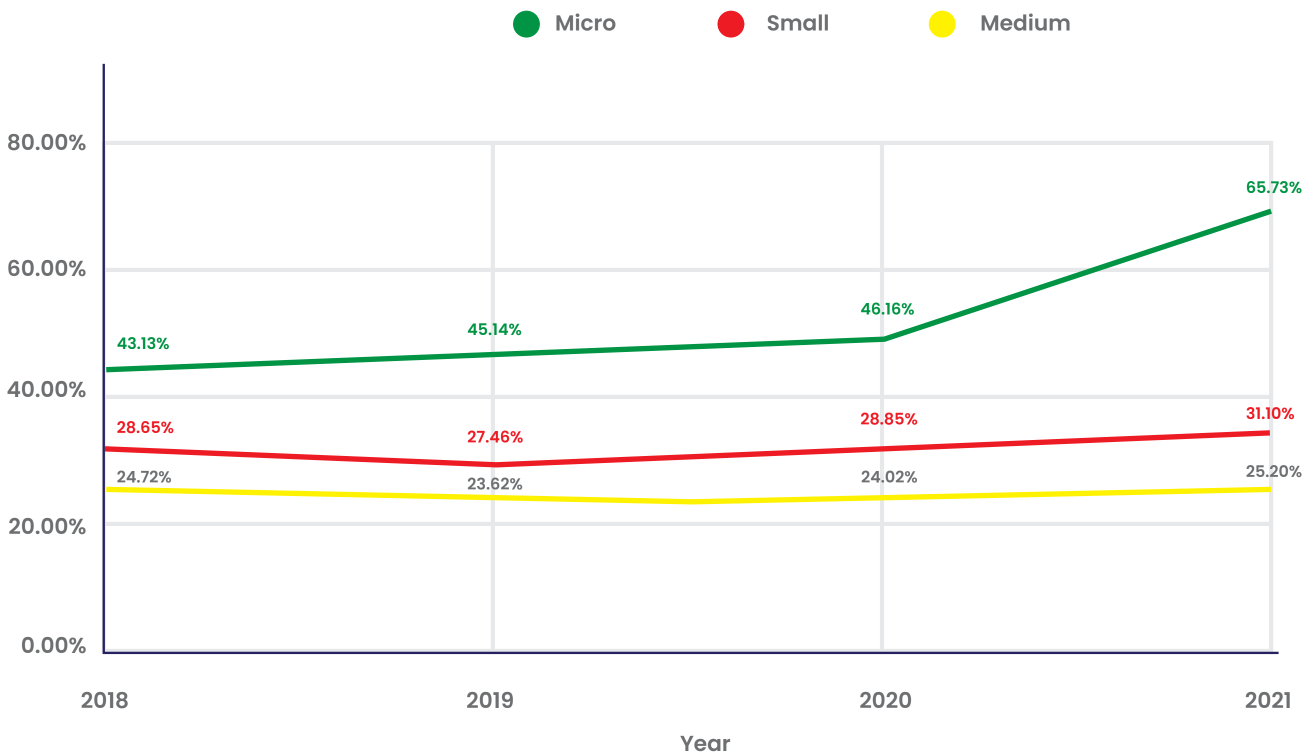
05

Our Findings

An estimated 5.9% of the gross value added (GVA) in the Indian economy - INR 10.7 lakh crores - is locked up in delayed payments from buyers to MSME suppliers

The issue is not new or the result of the pandemic. As the figure 2 demonstrates, the proportion of MSME sales stuck as delayed account receivables has been consistent and steady for years prior to the pandemic. Although the economic lockdowns during this period did intensify the problem, the numbers in the preceding five years were no less alarming. This is 16 years after the passing of a leading piece of legislation designed to curtail the problem – the MSMED Act of 2006 – meaning the law in itself has not achieved its intended purpose of rectifying this problem. Part of this reason is the acknowledged embeddedness – or normalization – of delayed payments by those on the receiving end of the problem, a pattern revealed in 3 out of 4 of all our interviews with MSMEs in early 2022.

Figure 2 **Delayed payments as % sales**



Common responses to the question of whether delayed payments were considered a significant business challenge for suppliers, included "Aisa hi to hota hai," (this is just how it is) that this is "part and parcel of doing business," and "business karna hai to yeh to hoga hi" (if you want to do business, then this will happen).[GAME Interviews with MSME suppliers across industries in India, 2022] How then do businesses justify normalizing this critical financial challenge? They prioritize predictability of payments over promptness of it i.e., they would rather be sure that they will get paid at a promised date, even if the date is beyond the 45-day credit period, than strictly enforce the agreed credit period and potentially lose future business with an important (even if delinquent) client.

This revelation is troubling on many fronts, not least of which is the acceptance of systemic economic injustice that it represents. If delayed payments are to be solved as a problem, it has to first be acknowledged and voiced out by those who are most affected by it. Improvements in legislation and institutional recourse mechanisms can only go so far if violations are not prioritized, reported, and followed through by suppliers in the country. This is not to say that change can happen through the individual action of suppliers – it cannot. But that change has to begin with universal raising of standards of fairness and be accompanied by the collective pursuit of justice by the aggrieved parties in this equation. The process of empowerment of the disempowered begins with sensitization about their rights, and the generation and dissemination of evidence that action can be net beneficial for them, not punitive.

80% of this estimated amount is owed to micro and small enterprises, totaling INR 8.55 lakh crores

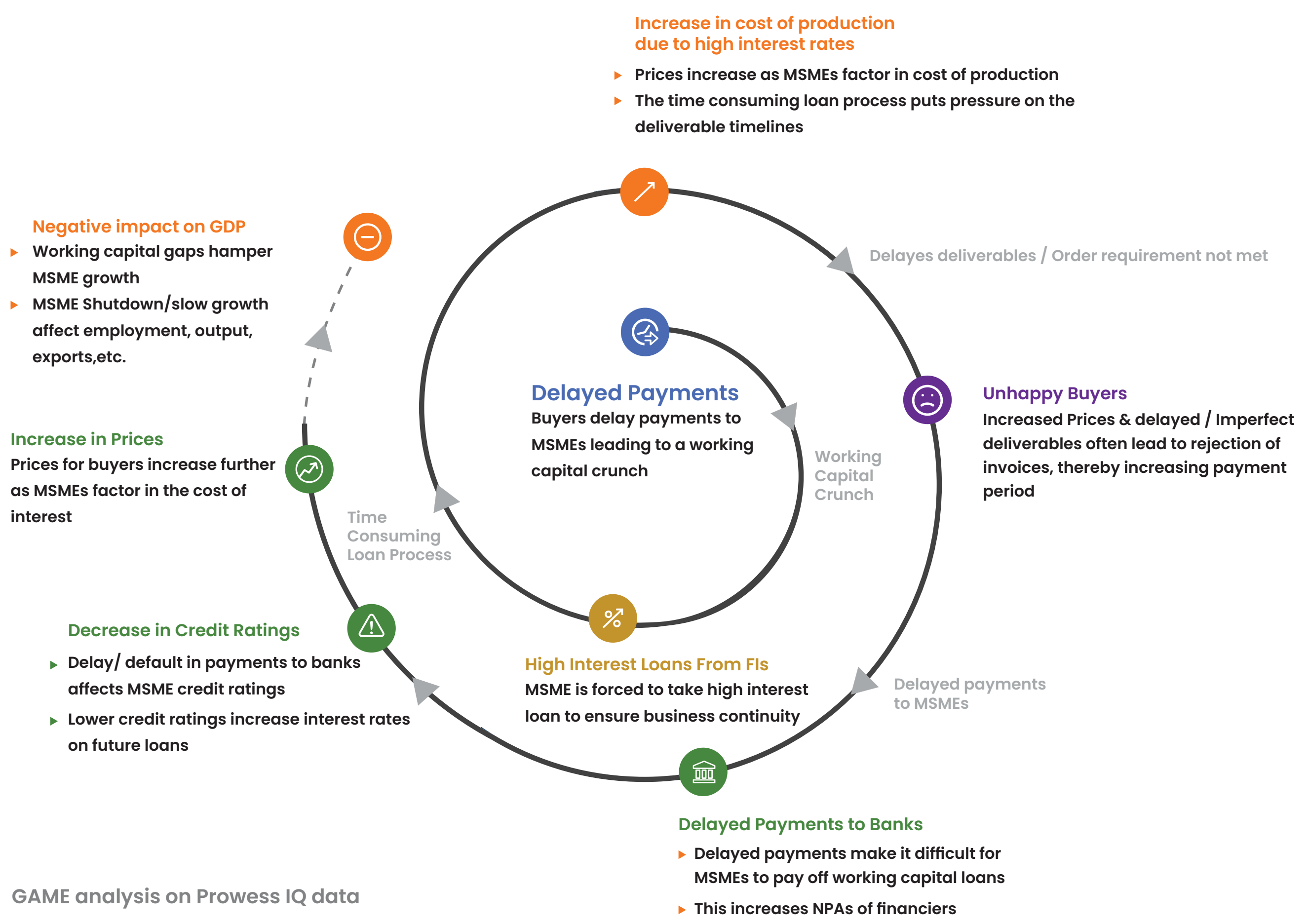
Small and micro enterprises - which collectively constitute the backbone of the nation's economy – shoulder most of the weight of the problem of delayed payments –INR 4.29 lakh crore and INR 4.44 lakh crore respectively. In addition, these enterprises both have a larger part of their total sales locked up in delayed account receivables and are also owed money for much longer periods than their larger counterparts. Delayed payments constitute a whopping 65.7% of all sales of microenterprises, 31.09% of small enterprises, and 25.19% of medium enterprises in 2020-21. Median debtor days beyond the legally recommended 45-day period for micro enterprises in 2020-21 was 6.5 months (195 days), compared to ~2 months (68 days) for small enterprises and 1.5 months (47 days) for medium enterprises.

Withholding these enormous sums of capital from India's smallest businesses is disadvantageous and deprives them of their opportunities to grow and return value to their owners. Delayed payments are a direct detriment to the working capital cycles and cash flows of a business, which are key components of business profitability. Legally, delayed payments are invoices not paid beyond the 45-days credit period mandated by the MSMED Act for micro and small enterprises.[MSMED Act, 2006] If collections from account receivables are delayed, a business will either have to delay purchases of or reduce its raw material inventory and therefore produce fewer goods (and hence make fewer sales in a cycle), or access short-term finance at high interest rates (e.g., through overdrafts) to maintain cash flows. The latter can lead to unexpected increases in the cost of production or an increase in the prices of goods and services sold (if the business can pass on costs to customers). Regardless of the path taken, delayed payments can reduce the net income and profitability of a business (and hence the source of income for its predominantly sole proprietor owners and their households). Added up, delayed payments can lead to supply chain disruptions all the way up to finished goods and make it difficult for end products to reach markets on time at a fair and reasonable price for end-consumers.

> **"I have a price card which I provide to all buyers. In case they want to purchase on credit, a higher price is mentioned because it includes the interest charged, the price is lower if they pay for the material in cash"**
>
> - plastic film mfg. - small enterprise

The big question that these numbers raise is this: how do India's growth engines – its micro and small enterprises - finance operations when so much of their cash is stuck in delayed payments for value already delivered to clients? The short answer is, they don't do very well. Formal debt financing can be pulled in to finance the gap left by delayed receivables, but its flow remains stifled to small businesses, instead being replaced by much more expensive informal sources of capital (by nearly 10-15 percentage points more). Reports such as IFC's 2018 landmark report on Financing India's MSMEs estimate the total addressable (by formal institutions) debt requirement of micro and small enterprises to be INR 24 lakh crore in 2018, an estimated 70% of it for the elevated working capital needs of these businesses that are not able to collect their payment and utilize them on time. Like with delayed payments, 95% of this unmet financing need is for micro and small enterprises, as medium enterprises report substantially improved financing and capitalization (through equity) than smaller counterparts. The impact of delayed payments combined with the quantum of unmet debt needs by micro and small businesses sheds light on the extremely grave and unfair operating environment of India's small entrepreneurs and their businesses, compared to conditions enjoyed by medium and large enterprises.

Figure 3 The vicious cycle of delayed payments for MSMEs, supply chains, and the economy



GAME analysis on Prowess IQ data

By withholding payments (or trade payables) beyond agreed credit periods, buyers essentially get access to free cash to finance their own working capital cycles, at the cost of their suppliers. If this happens repeatedly and across industries, then it indicates delaying payments is being deployed as a tactic by most larger businesses to accumulate gains that should be distributed back to those who provide value to them. Looking at it another way, buyers use MSMEs as an alternative to banks, who they should ideally apply to for formal finance (at rates far lower than those imposed on MSMEs who this burden is placed on). If we assume that MSMEs have to borrow credit for short-term financing of their working capital needs due to their receivables locked up in delays, then a notional interest burden of over 126,000 crore, or 1.8% of the total gross value added by MSMEs in India last year, is added as an additional cost to their business. This may not necessarily be additional/new interest incurred by enterprises but instead be amounts defaulted on due to unavailability of cash, leading to a fall in MSME credit ratings, higher future capital costs, and foregone future growth due to restricted financing.

However, the decision to withhold payments from vendors is short-term thinking on the part of buyers, as delaying payments to suppliers is harmful to everyone in the economy for reasons stated above, and because it leads to erosion of trust and risk-taking, which then diminishes the spirit of innovation and entrepreneurship in a society. It would be difficult for a large buyer to argue that improvements in quality and stabilization of prices of inputs purchased from suppliers are against their best interests. A MSME cannot improve year-on-year if the upgrade investments they need to make cannot be financed due to the misconduct of their own business partners. If this pervasive behavior is to be rectified, then individual businesses must be sensitized against this atomized and self-interested behavior, and collectively acknowledge their role in supporting small businesses grow and contribute to the value produced in an industry.

India's Goods and Services Tax (GST) and non-performing (NPA classification) regime fail to account for delayed payments, further impacting MSMEs

A sample walkthrough of the GST problem is as follows: currently, a business has to pay the government the GST amount invoiced to a buyer by the 20th day of the succeeding month, even if the actual payment has been delayed or defaulted by the buyer (or if the credit period is greater than the GST payment window, which is often the case). In essence, if a buyer does not settle its trade payables before the GST filing window closes, the vendor must foot the bill from their own accounts.

If we are to take an average 18% GST (state and central) and subtract it from the delayed payment figure of 10.7 lakh crores, a whopping ~2 lakh crores of taxes have to be paid for by MSMEs from revenue that has not hit their account. While in reality, the true number is likely higher (as only 1.3 crore of 6.3 crore enterprises have joined the GST network, and most of the missing ones are MSMEs), it provides a glimpse into the inadvertent punitive impacts of the current GST design on MSMEs when combined with the issue of delayed payments. The dizzying computation of potential risks emerging from the overlap of GST payment and account receivable collection can overwhelm even experienced accountants, let alone most micro and small enterprises which do not have formal, full-time accounting departments.

Figure 4 An illustrative example of how delayed payments & GST interact

Manufacturer →	Pharma Trading MSME →	Distributor →	Chemists/hospitals pharma chains →	Retail End User
MSME has to pay the supplier in 30 days	Products don't lie in inventory, no manufacturing process involved	MSME provides medicines to the distributors at 21-30 days of credit. 100% sales on credit		Pays in cash to the chemist/hospital
-30 days	15 - 30 day WCC*	+45 to +60 days		
Actual payment behaviour				
MSME asks for some time to make payments if they don't have cash	Has to pay GST on sales, although the cash from sales of ~15-30 days hasn't been realised yet Costs = (Supplier + marketing + employees)	No distributor pays on time, there is usually a 15-30 day delay, goes up to 50 delay is due to the distributors' facing a delayed payments	Hospitals delay their cash payments to distributors Chemists delay their payments due to a decline in sales	

The direct and indirect impact of the additional GST tax burden imposed on MSMEs facing delayed payments, can act as the proverbial straw that breaks the camel's back for small businesses in India.

Classification of Non-performing assets (NPAs) does not account for the unique burden of delayed payments that MSMEs face. The RBI defines Special Mention Accounts as (SMA) an account which is exhibiting signs of incipient stress resulting in the borrower defaulting in timely servicing of her debt obligations, though the account has not yet been classified as NPA[Master Circular- Income Recognition, Asset Classification, Provisioning and Other Related Matters - UCBs, RBI, Nov 2021, Available at: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12185&Mode=0#C3]. Currently banks are required to classify loan accounts of MSMEs into three subcategories under the Special Mention Accounts as follows: Source: RBI

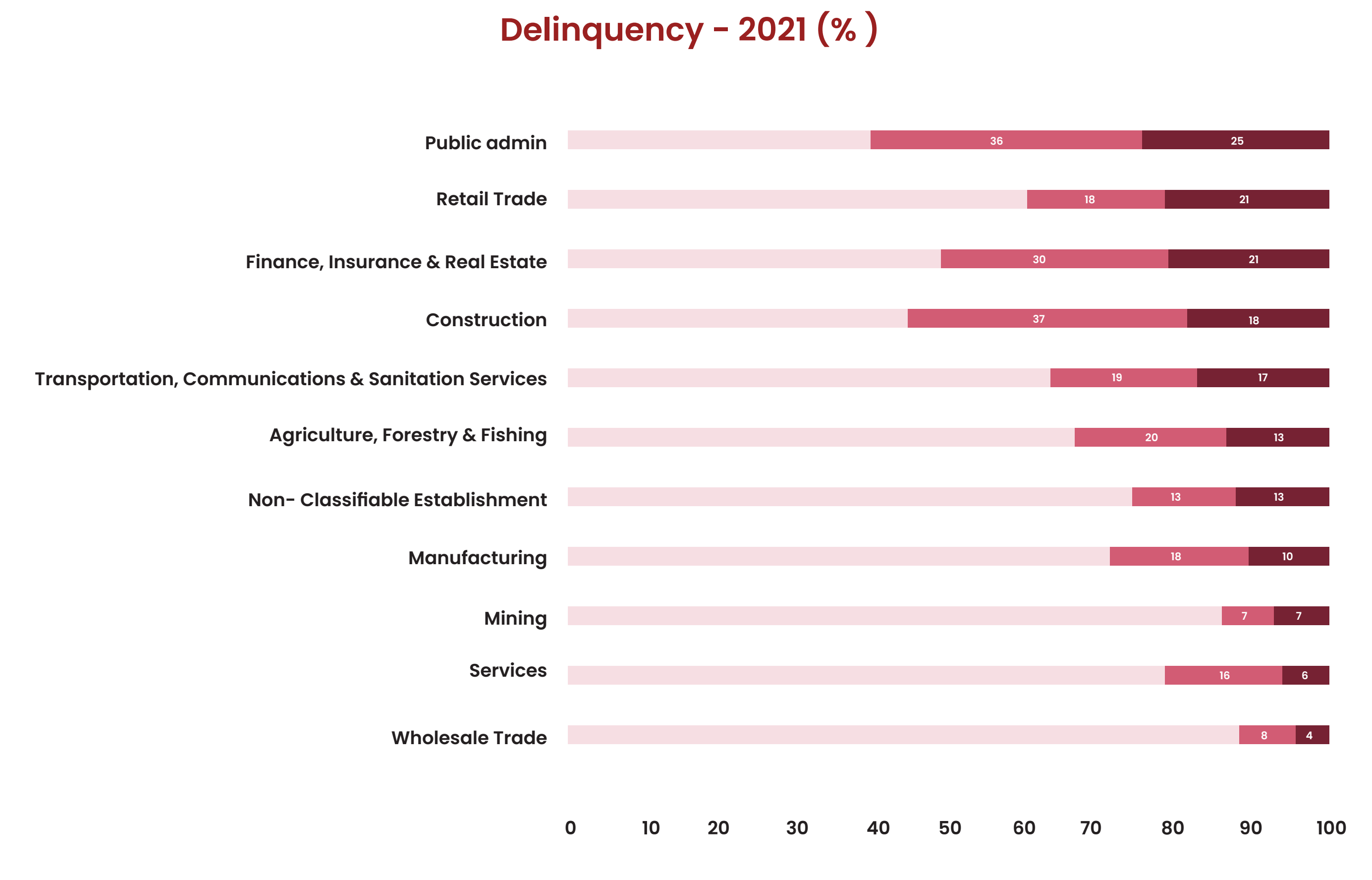
A hasty categorization into SMA-2, quickly advances to NPA classification without accounting for an MSMEs own delayed dues. Our analysis on days outstanding by sector suggests that in many sectors over 10% of receivables are delayed by 60 days or more. This means that even if credit terms are set at 30 days, 10% of MSMEs revenue remains unrealized for 90 days, making it hard for them to cover debt obligations without trading off payments or dues elsewhere.

Our Findings

Government Organizations/Public Sector Undertakings (PSUs) are delaying payments to MSMEs too

As figure 5 shows, public administration [Public administration definition to be added from D&B definitions] has the highest proportion of delinquencies of all industries in India – in 2020, 69% of payments by public administration entities were delayed by 60 days beyond the due date[D&B analysis]. This is even more concerning if we consider that nearly half of all invoices in this industry had lenient credit periods of more than 45 days[Ibid]. While it must be recognized that the industry made significant strides in improving its payment performance a year later in 2021, public administration still remains the worst performing of all. Data on ***Maharatnas*** and ***Navaratnas*** also indicate delayed payments to MSMEs. 73% of invoices paid by ***Maharatnas*** and 54% of those paid by ***Navratnas*** were delayed beyond the credit period, compared to 31% by private sector companies that make up NIFTY50[Ibid]. These PSUs wield considerable economic power in supply chains. ***Maharatnas***, for example, have an average annual turnover of INR 20,000 crores and source from hundreds, if not thousands, of vendors collectively in their supply chains.

Figure 5 **Delayed payments by sector**



Source : Dun & Bradstreet

06

Causes of Delays in Payments

Causes of Delays in Payments

To explore the underlying reasons for and impacts of delays in payments among MSMEs in India, GAME conducted interviews with proprietors and management of MSME businesses in early 2022, focused on the micro and small enterprises that bear most of the burden of the problem of delayed payments. Our objective was to deepen perspectives and add nuance to the (underreported) quantitative data already in circulation on the topic. Respondents were picked from across industries, and included representation from manufacturing, trading and retail, and services.

Fundamentally, payments are delayed because of a power asymmetry between smaller suppliers and large buyers

As established earlier in the findings, the smaller the enterprise, the higher the incidence and period of delayed payments suffered by them. To understand why, we must first look at the predominant reason given by businesses for payments being received after the legally mandated 45 days – mutual agreement to credit terms beyond 45 days. 44% of respondents in the MCA dataset provided this reason as the reason for delays. However, the term "mutual" here must be taken with a grain of salt. Given the disparity between the size of a buyer and supplier in most supply chains, acceding to a more lenient credit period is less a matter of choice, and more a matter of circumstance for smaller suppliers. What indeed is the point of a strict 45-day credit period if the likelihood of delay is almost certain, and enforcement or legal recourse out of reach for most small enterprises? These businesses would rather set a more lenient term and have some certainty of payment within this period than enforce something rigid and certain to be violated. Given the frequency and value of orders placed by larger buyers, the potential loss of business due to an unfriendly credit term negotiation can be too much to bear for small vendors looking for lucrative business partners. Acquiescence and flexibility seem like logical concessions in this context.

Businesses capable of differentiating themselves to win loyalty of and incentivize good behavior from buyers do so, but often at the cost of their own profitability.

An optimal form of leverage would be related to innovations in product and process that make a supplier stand out from its competitors, and lead to such quality of supply that buyers are incentivized to invest in their loyalty by agreeing to fair and reasonable credit terms with them, and to adhere to these consistently. This is indeed one of the strategies employed by enterprises we spoke to with the wherewithal (and expertise) to do so. Innovations here included improving the design and quality of product and reducing defects, building better information management systems, and offering better customer service.

Causes of Delays in Payments

"I was the first in the market to create a website where the retailers can track what products are available. The traditional process was that retailers would call up the suppliers to check for product availability and placing an order required a lot of going back and forth. Now retailers can just see what products are available on the platform and can place orders. It reduced the time it took for them to place an order. My grandfather always used to say 'Create experiences which get your buyers hooked to the convenience"

- small enterprise into laptop servicing and spare parts manufacture

However, other businesses used forms of leverage that were neither in their own long-term best interest nor that of the industry at large. This includes leverage induced by maintaining inflated inventories, where suppliers keep large amounts of stock in order to cater to buyers' needs quickly, and faster than their competitors (but lock up their own working capital in the process). Others engage in predatory pricing to out-compete other suppliers, at the cost of their profitability. Optimal forms of leverage, such as through innovation in products and processes, are also available more to those operating in markets where they offer unique and differentiated products that are critical for the next stage of production to begin with (e.g., in automobile parts), rather than in markets with lots of businesses producing homogeneous, commoditized goods (e.g., low and mid-range hospitality and food)

"We offer longer credit terms to the bigger hotels, we work on narrow margins, so we have to play on volume. They give steady business and monthly billing cycle"

- Small enterprise - food distributorship

"The person who started this practice (of long credit terms) started doing this years ago to capture the market and now buyers expect it from all the players in the market. I have to provide it too to remain competitive"

- Small enterprise - automobile sector

There is evidence of mitigation actions taken by MSMEs to reduce their exposure to risk, but these are not always optimal solutions to the problem. Sound methods used by business owners to hedge themselves against payment hazards included conducting background checks on buyers through social networks before transactions; diversifying sales to a portfolio of buyers and balancing the delinquency rates of some against the timeliness of others; and offering credit periods to only those buyers who prove trustworthiness after a few cycles of orders. These actions make sense and can be replicated by younger entrepreneurs entering into a new trade who are uncertain of how to navigate the tricky power dynamics with larger, more established buyers. Others, are less fruitful and must be stemmed, for example where owners downward adjust their production plans or reduce their net take home income to compensate for lost working capital.

> "I have divided my buyers on the basis of how many days they usually pay in, smaller buyers typically pay in 7 days, larger buyers take more time. Knowing when a buyer usually pays helps me manage my cash flows"
>
> ***- small enterprise, laptop spare parts and servicing***

> When our buyer did not pay us during the first wave of COVID, me and my partners only used to take the amount required for sustenance from our business, and used the rest of the money to pay our suppliers, we made 100% payments to all our suppliers"
>
> ***– small enterprise, solar power plant manufacturer***

For suppliers to make system-wide gains in their bargaining position with buyers, they must step outside of the zero-sum game (undercutting one another to bid for buyer loyalty) and the fatalistic mentality ("this is just how it is, and we must suffer") that currently guides decision making. This is no easy task and requires equal measures of confidence building and collective action from supplier associations. Disseminating data on the true size of delayed payments faced by MSMEs, and sensitizing groups to the financial impacts of this problem on their own businesses and broader supply chain ecosystems can go a long way in stimulating cooperation that is currently stifled, in large parts, by ignorance. Other longer-term, more strategic solutions are discussed in the way forward section of this report.

Institutional recourse mechanisms have low coverage and rely heavily on buyer-intent

Our report in 2020 outlines some of the key challenges faced by formal mechanisms of recourse available to MSMEs. First, it must be noted that these are only available to MSMEs that are registered under the Udhyam Aadhar, which are a tiny 13% of total estimated MSMEs in the country. Hence a majority of Indian MSMEs cannot, at the moment, access institutional support. For those who can, businesses can invoke the penalty clause of MSMED Act (that empowers enterprises to charge interest penalties on delinquent suppliers), by approaching the MSE Facilitation Council (MSFE) through the Samadhaan portal. However as per Samadhaan portal's own data, less than 1% of all registered MSMEs have filed delayed payment applications, which amounts to only ~1.3% of the estimated outstanding payments due to registered MSMEs[Secondary Data Analysis based on amount involved in applications on Samadhaan portal as of 27 Feb 21 and CMIE data analysis]. Three clear drivers of this underutilization emerge: lack of awareness of SAMADHAAN, the supplier's fear of reprisal or loss of business from buyers, and the cumbersome recourse process itself which has a low percentage of successfully resolved cases, and hence limits trust in the system[GAME interviews with MSMEs 2022].

> “It has been one and a half years since I filed a case, it only got converted into a court case a couple of weeks ago. Ideally there should be a time limit, like 6 months, after a case should automatically be converted. The local MSEFC called us for our first meeting 4 months after we had filed the case” small enterprises manufacturing components for solar power plants
>
> ***– small enterprises manufacturing components for solar power plants***

Then there is TReDS, a platform introduced by RBI that facilitates financing of trade receivables by MSMEs through multiple financiers. Although well intentioned with the right objectives, buyers retain control of the process in the system by being required to validate an invoice submitted by a supplier. We estimate that less than 1% of registered MSMEs are onboarded to TReDS, only 20% of corporates with a turnover above INR 500 crores (who are mandated by the government to join the platform) have signed up, and only 22% of these reported transaction on the platform. Respondents in our interviews confirmed the lack of response from buyers, stating the futility of participation given low buyer engagement, as well as the lack of response to their invoices already submitted on the portal.

> “I had completed all the formalities to upload my invoice for discounting on TReDS, but no one was willing to finance it”
>
> ***- agro-trading co, small enterprise***

Buyers on their part claim that delayed payments occur for reasons out of their control, although this claim must be held to a higher burden of proof and standards of accountability

According to the MCA dataset (fig: SEQ), ~44% buyers have listed mutual agreement of payment terms longer than the stipulated 45 days, as the most common reason for delay. While buyers say they have negotiated higher than 45 days credit terms from MSMEs, D&B's DPD (days past due) data from states across India suggest that even mutually agreed longer credit durations remain unmet in a vast majority of geographies. This ranges from Jharkhand (fig: xx) which is the highest at 48% of the outstanding amount due for over 60 days to Tamil Nadu (fig: yy) which is the lowest at 4% of the outstanding amount due for over 60 days. In some states such as Madhya Pradesh, Bihar, Odisha, West Bengal, and Chattisgarh, buyers are delaying more than one fifth of MSME payables by over 60 days.

> “I discovered MSME Samadhan by chance when I was doing research on what to do about a payment that I did not receive from my buyer. I was not aware of it, even CAs and lawyers did not know about Samadhan, so I had to study it on my own and file a case. My buyer could not pay me because their buyer did not pay them, even they got to know about Samadhaan through me. ”
>
> **mfg. Solar power plants - small enterprise**

Causes of Delays in Payments

Insufficient funds at buyers end' and 'delay in submission of invoice' are the second and third most reported reasons for delay in payments in the MCA dataset. Both must be studied carefully. Insufficient funds at the buyer's end should not be a permissible reason for delaying payments to suppliers, for the simple reason that buyers should know better (and have visibility into their cash flows), and delay placing an order until they have cash to pay vendors. This is of course more challenging in long supply chains where a buyer may not be at the pinnacle but rather somewhere in the middle, themselves a victim of delayed payments from other buyers. But this does not preclude them from the responsibility of communication and transparency to vendors down the line, and from pausing further purchases until issues with creditors are resolved. In interviews with MSMEs, it was reported that buyers at times reneged on this basic responsibility, claiming that delays to them could rightfully be passed on down the chain.

> **"I try to understand how good the accounting team is, it is important to understand that because otherwise bills and other documents get lost and a lot of resources go into ensuring our payments get cleared"**
>
> ***– small enterprise into food distribution company***

Figure 6 **Reasons for delay according to buyers (MCA data)**

Reasons for Delay	Counts	Percentage
Mutually Agreed to payment terms > 45 days	51,873	44.0 %
Insufficient funds at buyer's end	19,678	16.7 %
Delay in submission of invoice	16,616	14.1 %
Buyer dissatisfied with quality	9,428	8.0 %
Reconcilation in progress	4,278	3.6 %
Incomplete GST Complisnce by seller	4,210	3.6 %
MSME status unknown to buyer	3,124	2.7 %

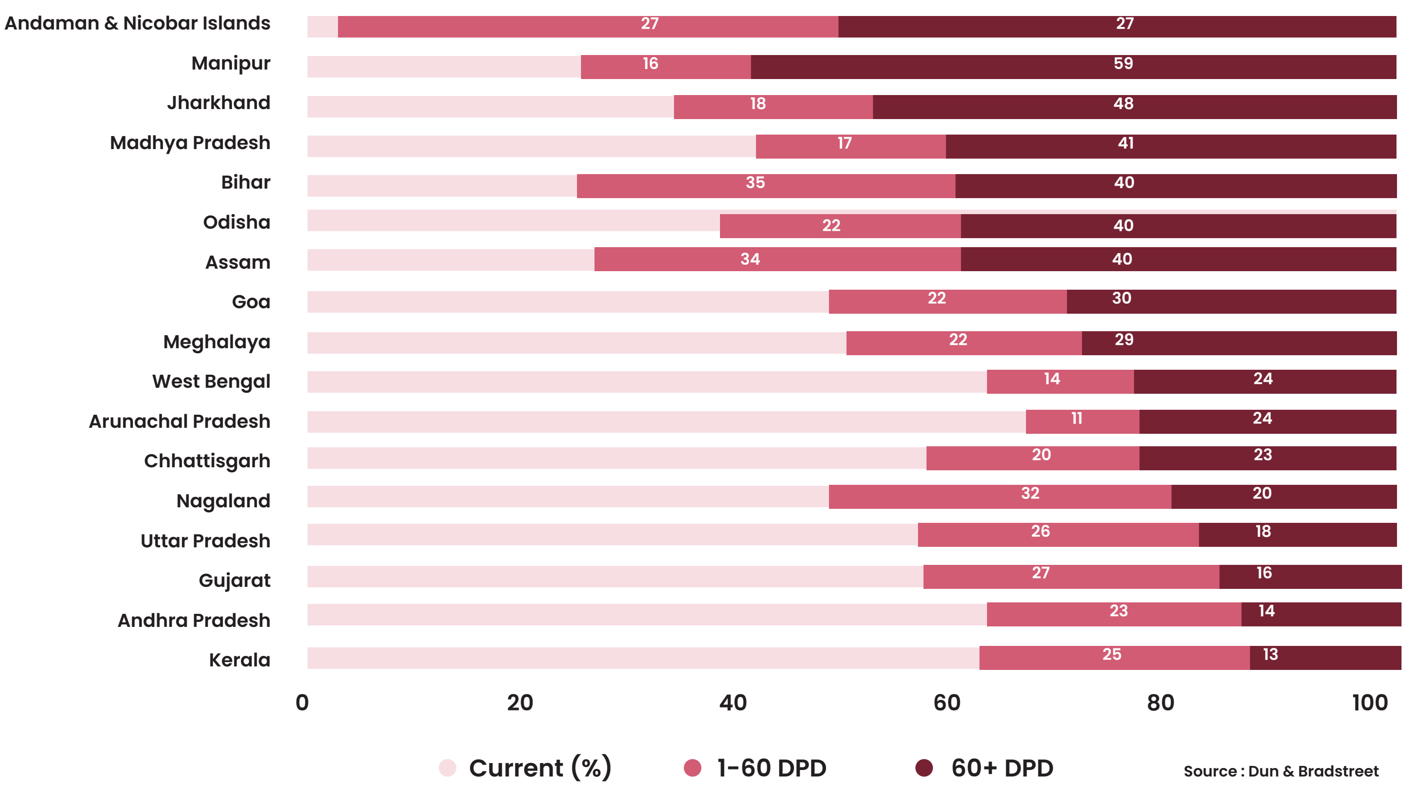
In case of 'delays in submitting invoices,' this is presumably a genuine reason for buyers to delay payments to suppliers. Formal record keeping and accounting is not as prevalent in MSMEs as it is amongst large corporate entities, and it is very likely, although hard empirical evidence of this is absent, that most MSMEs are unable to furnish 'pakka' invoices in the format required by accounting departments in time.

Causes of Delays in Payments

In addition, many small businesses are burdened by the compliances of GST and may resist registering under the system and furnishing GST compliant bills required by large buyers when first transacting with them. That a wide range of modern-day bookkeeping and neo-banking start-ups like Udaan, RazorpayX, Jupiter, and Nupay are targeting MSMEs customers is evidence to the reality of this problem, and the consequent opportunity in formalizing the accounting processes of small businesses. While this is indeed true, questions remain on whether the furnishing of an acceptable invoice (or rectification of mistakes) truly takes more than 45 days from the point of intimation to the vendor. It is worth considering if because delays in invoicing is advantageous for the buyer, then flagging problems late is used as a convenient delay tactic by them. In many cases, the standards and formats of invoicing can be communicated to suppliers well in advance of the payment period (or templates of invoices provided to them to replicate) at the very start of a business relationship, if parties paying were truly committed to avoiding future delays.

> **"Some of them are flush with cash and personal assets, but don't even pay their employees because their business isn't making money, they don't have their skin in the game. I asked one of my buyers to invest personal resources because the industry is facing a difficult time, he stopped doing business with me"**
>
> **- food distribution company - small/ medium enterprise**

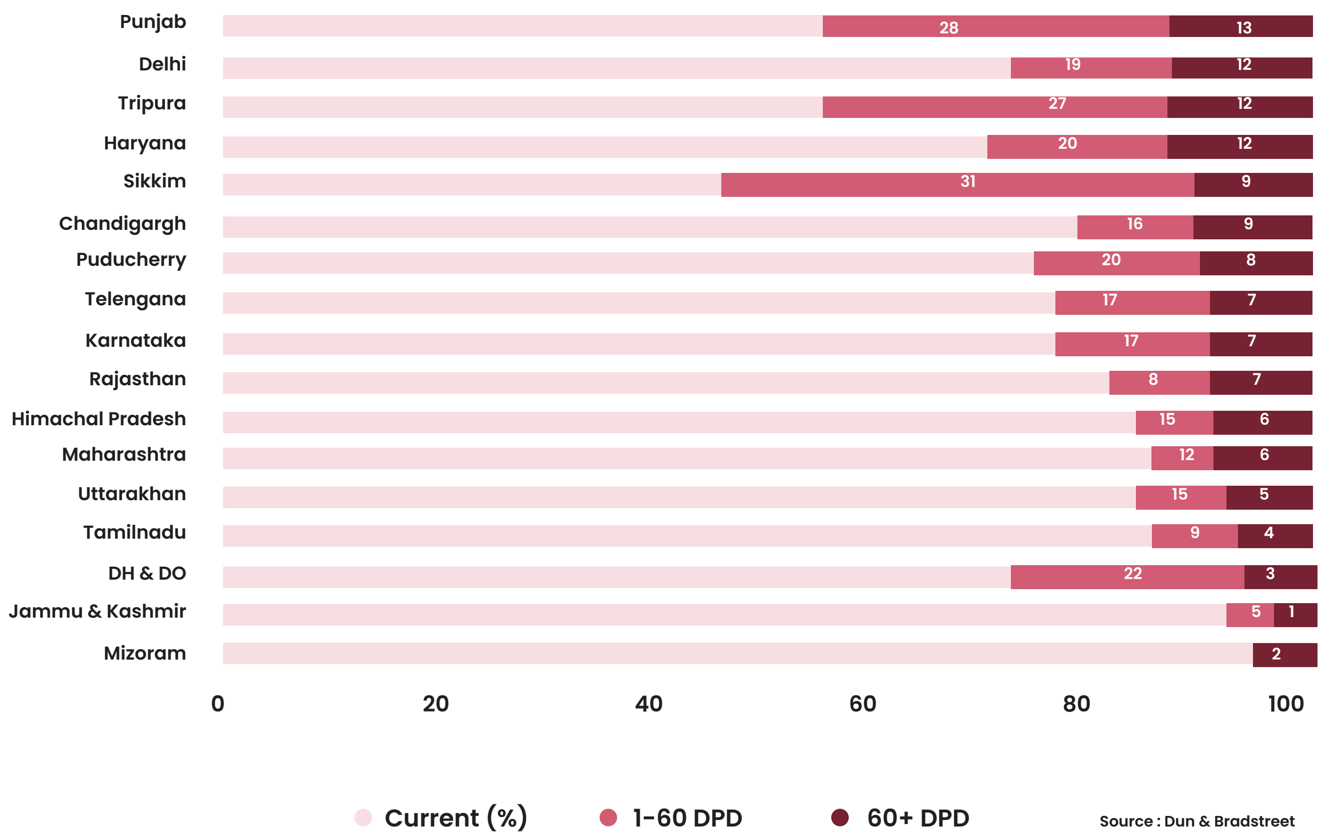
Figure 7 **Delinquency amount and Days Past Due analysis by Indian states in 2021**



Source : Dun & Bradstreet

Disclaimer: DPD data from the Northeastern states and smaller states in India may not be representat...

Delinquency amount and Days Past Due analysis by Indian states in 2021



Source : Dun & Bradstreet

Disclaimer: DPD data from the Northeastern states and smaller states in India may not be representative given a relatively small sample

07

Solutions and Way Forward

Solutions and Way Forward

Delayed payments have become normalized in the lives of MSMEs in India. Many MSMEs that do recognize the problem reach this point after getting their fingers burned several times. Existing penalties on buyers do not seem effective and it's essential to raise the stakes for them to pay on time. To address delayed payments at scale we need greater public discourse on the topic, raise the stakes for tardy buyers, and reduce the impact on MSMEs.

Build a public conversation on delayed payments

- **Publish estimates of delayed payments and their trend in the Economic Survey (Ministry of Finance, Government of India), released annually before the budget, with quarterly estimates placed in the 'Monthly Economic Review' of the Department of Economic Affairs. The quarterly estimates should be placed in the 'Monthly Economic Review' of the Department of Economic Affairs.** The frequency of publishing this data, serves as a reminder of the central government's continued focus on delayed payments and allows the problem to remain in public attention, subtly urging large buyers to keep up their end of the bargain. It also equips MSMEs with greater knowledge into the payment behavior of a potential large buyer, allowing them to make better informed business decisions

- **Leverage platforms such as 'Mann Ki Baat' to discuss Delayed Payments which have proven to drive large scale behavioral change campaigns so that we may begin the process of breaking through the normalization of delayed payments.** For example, since its inception in October 2014, there have been 87 'Mann Ki Baat' episodes with a cumulative reach estimated to range from approximately 6 crore to 14.35 crore during 2018 to 2020. Such programmes are the perfect platform owing to its wide reach and may serve to inspire many MSMEs to reconsider their business models and long-standing relationships with delinquent buyers.

- **Run a 'Prompt Payment Program', Bring together the 100 largest corporates in India who commit to becoming prompt payers by the beginning of FY 23-24; in particular, encourage these corporates to engage in 'deep-tier' financing to unlock working capital for smaller MSMEs beyond their immediate supply chain. which Brings together India's 100 largest corporates who commit to become prompt payers by the beginning of financial year 2023-24.** As incentives to participate, the corporates who make the public commitment will have preferential access to empaneled solution providers of factoring, MSME digitization services, Supply Chain Finance, Online Dispute Resolution, etc.

- **Case Study:** The Obama administration on July 11, 2014, set a great precedent by announcing Supplier Pay, a new partnership bringing together 26 companies - large and small, who commit to pay their small suppliers faster or enable a financing solution that helps them access working capital at a lower cost. Among its many benefits, this initiative strengthens small businesses by increasing their working capital, so they can grow and hire more workers. After taking the pledge - software company Intuit offered 10-day payment terms to 320 small businesses, impacting $40 million in payments in 2014. Siemens began offering small business suppliers a supply chain finance program which includes several supplier benefits such as cash flow improvement, working capital optimization, cost reduction, and cash flow transparency, benefitting 1,300 of its North America suppliers

- Deep-tier financing unlocks the value of business relationships, offering finance access to every supplier, not just the tier one. In other words, banks and other lenders assess risk not just on the relationship a small business might hold with a supplier a little further up the chain, but as a part of the wider ecosystem that rolls up to a large buyer. It also allows the large buyer to optimize its working capital. As per the MCA dataset, 14-17% buyers have cited delays in invoice submission, missing supporting documents and the lack of GST compliance at the end of the suppliers as the reason for delay in payment beyond the stipulated 45 days. Large buyers with wherewithal may take up this ecosystem building task (through the alignment of its internal departments) supporting small suppliers in the task of raising a satisfactory invoice, the documentation requirements of its accounting team and educating them on the intricacies of GST compliances

Add delayed payments as an indicator within the EoDB 2.0 framework under development by the Department of Promotion of Industry and Internal Trade

- Listing it as a specific line item will give due importance to the problem nationally and draw the much-needed attention and focus on brainstorming, creating and implementing solutions. The Union Finance Minister Nirmala Sitharaman while presenting the Union Budget 2022-23, announced that the government is crowd-sourcing suggestions from citizens and businesses and will be launching the next of reforms under the label of Ease of Doing Business 2.0

Raise the stakes on tardy buyers

- **Enable the entry of Online Dispute Resolution (ODR) service providers to ensure faster and thereby effective resolution of payment related disputes. This will reduce the burden on the state (i.e. the district level Micro & Small Enterprise Facilitation Councils)**

    - With INR 10.7 lakh crores of MSME funds locked in delayed payments, the state of MSEFC assisted by the Samadhaan portal is far from ideal. The use of ODR will play a tremendous role in easing the burden faced by the MSEFCs. Only about 20% of all applications filed on Samadhaan have either been disposed of, or mutually settled with buyers, while nearly 39% applications were yet to be seen by the government officials. Another 27% of total applications are currently under consideration. The Facilitation Councils are overburdened and under-resourced. The investigation by the Tamil Nadu government has revealed inefficiencies of the MSEFC system. For example, medium enterprises and traders are not automatically excluded even though the Act does not extend such protection to them, several disputed invoices between the same parties require separate cases, sensitive matters are handled and shared via unsecure word documents, excel sheets etc.

    - In 2021, Niti Ayog's report on Designing the Future of Dispute Resolution in India highlighted the huge potential for ODR in the MSME sector. Unlocking ODR by leveraging data and technology is integral to addressing a part of the concern relating to delayed payments for suppliers in the MSME ecosystem. ODR providers use a combination of technology and tools of mediation, conciliation, negotiation and arbitration to re-engineer the dispute resolution process. ODR is also being explored by sophisticated ecosystems that are data and technology driven, such as Account Aggregators (Sehamati), Open Network for Digital Commerce (ONDC) and United Payment Interface (UPI). Many such ecosystems are connected to multiple ODR service providers through the use of an Application Programming Interface (API).

    - In the past, ODR service providers have frequently collaborated with government agencies such as state Legal Service Authorities (LSAs) and state Real Estate Regulatory Authorities (RERA) to customise ODR solutions. The ODR Public Private Partnership model has been very successful with e-Lok Adalats. Several state LSAs tied up with private ODR firms to conduct online Lok Adalats. Thus far 24 states have successfully conducted e-Lok Adalats and have disposed of 4.44 lakh cases. For instance, Delhi State Legal Services Authority witnessed a total settlement crossing 46.2 crores and Rajasthan witnessed settlements crossing 270 crore. In September 2021, Maharashtra State Legal Services Authority adopted ODR and witnessed 2 lakh cases worth 7.5+ crore be settled out of a total of 6 lakh cases that were filed.

- **Allow MSMEs to opt-in to the services of an information utility to independently take action against tardy or delinquent buyers on behalf of the MSME.** An IU is a repository of electronic legal evidence pertaining to any debt/claim as submitted by a financial or operational creditor that is verified and authenticated by parties thereby making the information non-refutable or prima facie evidence . IUs are currently set up under the name of National e-Governance Services Limited (NeSL) and constitute a key pillar of the insolvency and bankruptcy ecosystem of India. This recommendation was first put forth by the UK Sinha Committee on MSMEs.

- **Create a clear formula for delayed payments to impact the borrowing costs of large buyers.** The MSMED Act requires buyers to pay 'three times the interest rate set by the RBI' in case of delayed payments to their MSME suppliers. Our interactions with suppliers show that this is rarely enforced. Banks, on the other hand, can work with data providers to evaluate the delayed payables of a large corporate and consequently increase the borrowing costs of tardy buyers. This is also prudent since delayed payables act as a useful proxy for poor governance or supply chain risks.

- **Mandate that all *Miniratnas, Maharatnas, and Navratnas* transact on TReDS.** As detailed in the section on our findings, government-run businesses are major defaulters – in 2020, 69% of payments by public administration entities were delayed 60 days beyond the due date . TReDS adoption by the state would allow the following benefits to percolate to PSUs - extended payment terms of up to 180 days, competitive interest rates by financiers through a bidding mechanism, increased accountability through automatic repayments triggered on due dates, etc.

    - **Case Study:** The Goa government is leading the way to such a change, having executed its first transaction as a buyer on Receivables Exchange of India Limited (RXIL) platform in October 2020. Since, its onboarding over 575 crores of MSME funds have been cleared via the TReDS platform, helping over 250 MSMEs and delivering a valuable additional source of working capital to the MSMEs that need it the most

    - **Case Study:** Professors Ramana Nanda and Jean-Noël Barrot studied the impact of the US Defense Department paying its small suppliers 15 days earlier than normal under the Quickpay reform of 2011. They made the following observations - it improved corporate liquidity to a greater consistency in paying their own suppliers, a fall in loan delinquencies, a lower likelihood of firm failure and greater employment growth relative to firms that did not benefit from the reform. For treated firms, the reform permanently reduced the working capital needed to sustain a dollar of sales with the government. A total of $70 billion in annual contract value was accelerated, with small businesses impacted across virtually every industry sector

If India's ***Navratnas*** and ***Maharatnas*** could commit to participating in a similar experiment, we might study the ripple effects of such a 15-day early payment concession across the whole country. India's PSUs can serve a higher purpose in the Indian economy by aiding the survival and growth of small businesses through small revisions in their payment behavior

Manage the unintended consequences on MSMEs

- **Ensure that GST is due with a greater grace period for MSMEs.** Usually, large companies (the kind of client a small vendor must not lose) delay paying smaller vendors forcing them to pay GST from their own pocket. This consumes a lot of working capital (even if temporarily) of the supplying vendors, and reduces the amount of working capital needed by the buying companies. But that would cost the small vendor interest on additional working capital. This is one of the ways in which GST compliances are a burden to the small businesses. The GST Act could be amended to increase the minimum threshold limits to an annual turnover of Rs. 50 Lakhs per annum for both manufacturing and service entities. Further, GST compliances may be simplified, making quarterly filings mandatory. The power to make such amendments rests with the Parliament

- **Shift the Non-Performing Asset (NPA norms) for MSMEs to go up to 120 days to account for their unique cash flow challenges.** For an entity to meet its interest or principal payments as per the tight schedule defined by the bank makes undue demands on its limited cash flows. MSMEs are constantly threatened by the burdenof mismatched cash inflows and outflows, but in this case the repercussions are far too severe. RBI could amend this by taking DSO into account to prevent hasty NPA classifications of potentially viable businesses.

08

Methodology

Methodology

The report leverages data from three distinct sources: (i) The quantitative insights in the report originate from Dun & Bradstreet's Global Trade Exchange program dataset and (ii) GAME's analysis of the CMIE's Prowess IQ dataset, lastly (iii)the qualitative insights are sourced from GAME's qualitative interviews with 20 entrepreneurs across sectors and geographies in India.

Quantitative Analysis

D&B Methodology

- The report leverages Dun & Bradstreet's Global Trade Exchange program dataset to analyze the trends in delays in trade payments by businesses. **"Slow pay" is the designation used for companies that pay their bills past terms of trade (credit period).** This can also be referred to as "delayed payments," "delinquent payments," or "late payments"
- **Dun & Bradstreet's Global Trade Exchange program is a 'shared information network' that works in a fairly simple manner.** After entering into an agreement, each Trade Partner provides their accounts receivables data to Dun & Bradstreet on a monthly basis - this information collected from multiple sources is then used to provide an overview of a customer's payment habits. Thousands of companies around the world report their trade payment information to Dun & Bradstreet. With the world's largest commercial trade database, D&B annually processes more than 2 billion trade experiences. In return for this data, the Trade Partner receives free of charge data that focuses on reducing Days Sales Outstanding (DSO) and receivables risk. Dun & Bradstreet assures confidentiality of the data and its source. A written guarantee of confidentiality is signed by Dun & Bradstreet and issued to each Trade Participant
- **To calculate the notional interest burden of delayed payments to MSMEs, we use data from the Dun & Bradstreet trade exchange programme to arrive at the percentage share of trade experiences that fall under each bucket of DPD i.e., 1 to 7 days, 8 to 15 days, ...,91-120 days, and above 120 days.** We then derive at a weighted average interest cost by multiplying these shares with the average number of days outstanding, average nominal interest rate of a working capital loan for MSMEs, and the contribution of MSMEs in annual India's Gross Value Added

GAME's Methodology

Overview:

GAME's method to estimate the size of delayed payments uses CMIEs Prowess dataset. The Prowess dataset is a database of the financial performance of companies. The primary sources of data for Prowess are Annual Reports and financial statements submitted to the Ministry of Corporate Affairs, stock exchanges and regulators. The database has information on 52,163 companies

Methodology:

This analysis was done for the companies that had reported their data to any of the sources mentioned above for the financial year 2020-21, and fulfilled the MSME criterion. The criterion that was used for filtering enterprises is given below:

Classification criteria

Details	Micro	Small	Medium
Annual turnover (Rupees)	Not more than Rs, 5 Crore	Not more than Rs, 50 Crore	Not more than Rs, 250 Crore
Investment in plant and machinery	Not more than Rs, 1 Crore	Not more than Rs, 10 Crore	Not more than Rs, 50 Crore

	MSME Criterial	Prowess Analysis
Included	Manufacturing Services	Manufacturing Services Retail
Partially included	Retail	
Excluded*	Agriculture	Agriculture Construction Financial Services Mining

- **We wanted to use the following metrics to estimate the quantum of delayed payments in India**
  - **Short term trade receivables**
    - Short term trade receivables as a proportion of sales
  - **Day sales outstanding (DSO): We calculated the day sales outstanding to find enterprises that have a DSO greater than 45 days. The 45 day limit was decided upon because that is the duration beyond which a payment should be made to a MSME seller according to the MSMED Act, 2006. The day sales outstanding is calculated from the short term trade receivables using the following formula:**
    - Day sales outstanding=[Short term trade receivables/Total sales]*365

- **The final set of enterprises from Prowess that we used to estimate number for delayed payments have therefore been filtered using the following criteria:**
  - Companies that do not satisfy the revenue/ turnover criteria or the investment in plant and machinery in India described in Table 1 were excluded
  - Only companies which belonged to manufacturing, services and retail were included. Companies from financial services, mining, construction and agriculture sectors were excluded
  - Companies with a DSO of 45 days or less were excluded from the analysis, since we have assumed that a payment after 45 days of providing a good or a service is considered a delayed payment

- **We computed the following estimates for the filtered list of companies, after they were classified as micro, small or medium enterprises according to the MSME criteria:**
  - Median short term trade receivables: We computed the median of the short term trade receivables for the enterprises
  - Median short term trade receivables to sales ratio: We calculated the ratio of short term trade receivables to sales for each enterprise, and then computed the median
  - Median day sales outstanding: Computed the median of the day sales outstanding

- **To compute the size of delayed payments in India, we used the number of MSMEs from Udyam Aadhaar registrations. An exploratory analysis of data from Prowess indicated that it has a weak representation of micro enterprises because it includes enterprises that belong to a higher revenue and investment bucket than , but is fairly representative for small and medium enterprises**

Methodology

- **To estimate the quantum of delayed payments, we assumed that a proportion of enterprises registered on Udyam were facing the problem of delayed payments. The following weights were used:**

MSME Classification	Weight
Micro	10 %
Small	25 %
Medium	25 %

- **The above weights were then used to arrive at the estimated number of enterprises facing the problem. These were then multiplied by the median short term trade receivables that we computed from Prowess to arrive at the estimate of delayed payments for micro, small and medium enterprises**

- A similar methodology was adopted by RBI in its report of the Expert Committee on Micro, Small and Medium Enterprises. 'Debtor days' was used to estimate the duration of delay in payments to MSMEs. 'Debtor days' is the equivalent of 'Day Sales Outstanding' used in our analysis and is computed using the same formula

- **Definitions**

  - **Day sales outstanding:**
    Average number of days it takes for a company to collect payment for a sale. The formula we used for calculating DSO is
  - **Day sales outstanding=**[Short term trade receivables/Total sales]*365
  - **Short term trade receivables:**
    This data field captures the value of a company's trade receivables that are current in nature, i.e. which are expected to be converted into cash within the normal operating cycle or within one year from the balance sheet date

Methodology

Qualitative Analysis

- **In an endeavor to understand the problem of delayed payments in India, we spoke with 19 micro and small entrepreneurs spanning sectors and geographies.** These were hour-long conversations that took place online owing to covid and gave us great insights into the psyche of the average Indian entrepreneur. Questions that guided our discussions were centered around their business model, relationship with buyers, experience with delayed payments, coping mechanisms and mitigation strategies they employ (if any)

- **Basic details of the 19 entrepreneurs:**

Size	Number
Micro (Turnover up to Rs. 5 Cr)	8
Small (Turnover between Rs. 5 and 50 Cr)	11

Age of Enterprise	Number
1-3 Years	2
3-10 Years	6
more than 10 Years	11

Age of Enterprise	Number
Manufacturing	8
Trading and retail	6
Services	4
MAnufacturing and trading	1

Region	Number
Kolkata, West Bengal	6
Mumbai, Maharashtra	5
Chennai, Tamilnadu	2
Ahmedabad, Gujarat	1
Palakad, Kerala	1
Bangalore, Karnataka	3
Bihar	1

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Thank You

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