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COVID ECONOMIC RELIEF PACKAGE OBJECTIVE

LIQUIDITY TO FINANCIAL INSTITUTIONS AND PROTECTION TO SMALLER COMPANIES

The economic relief package was released by the Ministry of Finance in five tranches, each covering a portion of the nation's needs. The measures introduced with respect to commercial enterprises mainly revolved around key regulatory changes and relaxations introduced to the MSME (*Micro, Small and Medium Enterprises*) and the banking sector. In addition to this package, the Reserve Bank of India made three press releases delineating its plan to stimulate businesses through regulatory tweaks to the financial sector.

The combined effort of the government and the RBI with respect to commercial businesses can be summed up as having the aim of facilitating credit to smaller enterprises in dire need of it. Contemporaneous to this period, the government also made certain changes to its FDI policy which will have its effect on companies adjusting to the times.

1. **Bringing more enterprises under the scope of the MSME Act to benefit from the special reliefs**

With its massive contribution to India's GDP, exports, and employment,[1] the relief package has rightfully prioritized the MSME sector. To assist this sector, which contributes so significantly to the health of the economy, the government amended the definition of 'micro', 'small' and 'medium' enterprises to bring more entities within the ambit of this special enactment and avail the benefits provided.

By way of a notification dated the 26th of June 2020,[2] the upper limits of investment in plant, machinery, or equipment were increased to enable more commercial enterprises to avail the benefits of being registered under the MSME Act.[3] Also, the distinction between a manufacturing and a service providing enterprise was done away with, bringing uniformity to the investment limits of micro, small and medium enterprises

[1] The Ministry of Statistics and Programme Implementation disclosed that the Gross Added Value of the MSME sector to the Indian economy was 31.80% in the year of 2016-17. Total export contribution was stated to be 48.10% and the employment in the sector to be an estimate of 110 million workers in the year 2018-19.

[2] Notification of the Ministry of Micro, Small and Medium Enterprises, 26th June 2020. It can be accessed at http://www.dcmsme.gov.in/IndianGazzate_0.pdf

[3] The MSME Act of 2006 was enacted to promote smaller enterprises in India. If a company falls within the investment/turnover limits, it may register itself under the Act and avail benefits of easier credit facility, subsidies on intellectual property applications and other government approvals, promotion efforts by the Ministry, deductions in electricity and other consumables, etc. The Act can be accessed at https://samadhaan.msme.gov.in/WriteReadData/DocumentFile/MSMED2006act.pdf

engaged in any of the two activities. Accordingly, investment limit in plant and machinery or equipment (for both manufacturing and service providing enterprises) has been increased to Rupees Ten Million (Approximately One Hundred and Twenty-Five Thousand Euros), Hundred Million (Approximately One Million Euros), and Five Hundred Million (Six Million Euros) for micro, small and medium enterprises respectively.[4] However, while increasing the limit, a new turnover limit has been introduced for the three types of enterprises which must also be fulfilled. This expansion helps to further widen the scope of this Act and strengthen smaller companies.

In addition to this expansion, the government acknowledged the financial difficulties due to the halt in manufacturing and reduction of demand and therefore released various measures for the inflow of government-guaranteed credit facilities.

The Ministry of Finance announced that it has allotted a fund of Rupees Three Trillion (Approximately Thirty Eight Billion Euros) to guarantee government-backed lending for MSMEs. Under this scheme, MSMEs may borrow an additional 20% of their outstanding credit on concessional interest rates, without having to provide any additional collateral. Only those enterprises with an outstanding credit liability of less than Rupees Two Fifty Million (Approximately Three Million Euros) are eligible to avail further credit under the scheme.[5]

Subordinate to the first credit facility scheme, the government allotted a second fund of Rupees Two Billion (Approximately 25 Million Euros) to partially guarantee loans to enterprises that have been classified as 'Stressed' or 'Non-Performing Assets'.[6] Under this scheme, the promoter may avail a loan amounting to a maximum of 15% of his/her stake in the 'Stressed' or 'Non-Performing Asset' classified enterprise. These totally/partially government-guaranteed credit facilities will encourage financial institutions to disburse more credit to MSMEs which are in dire need of it.

The relief package also includes the creation of a corpus of Rupees Five Hundred Billion (Approximately Six Billion Euros) for promotion and strengthening of the sector. In the attempt to create more opportunities for MSMEs, foreign entities have been restricted from bidding for tenders for the procurement of goods and services of a value of less than Rupees Two Billion (Approximately Twenty Five Million Euros).

While credit facilities will significantly take away long term concerns, there is an absence of any immediate cash facilities and that may impact wages and short term capital requirements.

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[4] Prior to the 26th of June 2020, the investment limits for enterprises engaged in manufacturing was rupees 2.5 million, 50 million and 100 million for micro, small and medium enterprises respectively. In case of enterprises engaged in providing services, the limits were rupees 1 million, 20 million and 50 million for the three enterprises respectively. Now the difference between manufacturing and services has been done away with and the new limits have been introduced.

[5] This limit of Rupees 250 million is fixed to be calculated on the 29th of February 2020 to ensure that additional working capital credit availed to keep businesses running in the COVID period does not penalize enterprises.

[6] Where a borrower has failed to pay installments for 90 days, the collaterals are classified as '*Non-Performing Assets*'. While where such NPAs are restructured or loans based on them have been written off, they are termed as '*Stressed*'.

2. Increase of liquidity within financial institutions to ensure steady flow of liquidity to companies

The Reserve Bank of India through its three press releases made key regulatory tweaks, and provided its strategy to combat this turbulent period. The top priorities were to ensure flow of liquidity and postpone repayments where required.

In a bid to improve liquidity, the RBI announced in its first press release on the 27th of March 2020,[7] that it was going to organize two auctions for Targeted Long Term Repos (long term borrowings from the reserve with low interest rates and to be utilized for specified needs) worth Rupees One Trillion (Approximately Twelve Billion Euros), which would be open to all financial institutions. Furthermore, the RBI reduced the required cash reserve ratio and even allowed financial institution to dip up to 3% into their statutory liquidity ratio through the marginal standing facility (before, this facility allowed financial institutions to dip up to 2% into their statutory liquidity ratio).

With liquidity covered, the RBI acknowledged short term difficulties of companies to pay loan installments, thereby allowing financial institutions to place moratorium on loan repayments and working capital facilities, from the 1st of March 2020 till the 31st of August 2020. It also clarified that if a company opted to avail the moratorium facility, its assets would not be classified as 'Stressed' or 'Non-Performing'.

3. Simultaneous changes to FDI policy and its effect on Indian companies

The outbreak and ensuing difficulties might have caused panic to some investors. With collapse of share prices and companies desperate for an infuse of capital, the government of India was wary of opportunistic takeovers and acquisitions from neighboring countries. Having this concern in mind, the new FDI regulations require prior government approval for FDI emanating from any of the border sharing countries in any of the sector for which FDI is open through the automatic route for other countries.[8] While it may impact foreign investment, especially from China, the government has further opened FDI in the insurance sector, aviation and certain defense projects. Companies reliant on investment from those countries upon which additional requirements have been imposed will have to bear additional scrutiny and delays.

The long term implications remain to be seen, but markets were encouraged by these reliefs. Companies, especially MSMEs, were reassured that liquidity was available to get through this turbulent period. However, analysts raised differing opinions on the lack of immediate cash relief.

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[7] RBI press release dated 27th of March 2020, Statement on Developmental and Regulatory Policies. The press release can be accessed at https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR21302E204AFFBB614305B56DD6B843A520DB.PDF

[8] Ministry of Commerce and Industry, press note No. 3 of 2020, 'FDI Policy'. The same can be accessed at https://dipp.gov.in/sites/default/files/pn3_2020.pdf

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