Singh, Sumanjeet; Paliwal, Minakshi

Article
Unleashing the growth potential of Indian MSME sector

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Unleashing The Growth Potential Of Indian MSME Sector

Abstract

The MSME sector occupies a position of strategic significance in the Indian economic structure. This sector contributes nearly eight per cent to the country’s GDP, employing over 80 million people in nearly 36 million widely-dispersed enterprises across the country; accounting for 45 per cent of manufactured output, 40 per cent of the country’s total export, and producing more than 8000 value-added products ranging from traditional to high-tech. Furthermore, these enterprises are the nurseries for innovation and entrepreneurship, which will be key to the future growth of India. It is also an acknowledged fact that this sector can help realise the target of the proposed National Manufacturing Policy to enhance the share of manufacturing in GDP to 25 per cent and to create 100 million jobs by the end of 2022, as well as to foster growth and take India from its present two trillion dollar economy to a 20 trillion dollar economy. Despite the sector’s high enthusiasm and inherent capabilities to grow, its growth story still faces a number of challenges. In this light, the present paper examines the role of Indian MSMEs in India’s economic growth and explores various problems faced by the sector. The paper also attempts to discuss various policy measures undertaken by the Government to strengthen Indian MSMEs. Finally, the paper proposes strategies aimed at strengthening the sector to enable it to unleash its growth potential and help make India a 20 trillion dollar economy.

Keywords: MSMEs, Competitiveness, Growth, India

JEL: L25, L26, J2, M14, M48
1. Introduction

The importance and potential contribution of the Micro, Small, Medium and Small Enterprises Sector, or the MSME sector as it is called, are supported by both theoretical arguments and empirical evidence. It has been recognized all over the world that MSMEs are adept in distributing national income in a more efficient and equitable manner. This sector also helps the economy by promoting a balanced development of industries across all regions of the nation. The MSME sector stimulates economic growth by providing employment opportunities to those people who may not be employable in large-sized corporations/firms. Thus this sector acts as an essential medium for the efficient utilization of locally-available skills and resources. Consequently, MSMEs tend to attract the talent necessary to invent new products or implement new solutions for existing ideas. The larger businesses also often benefit from small businesses within the same local community, as many large corporations depend on small businesses for the completion of various business functions through outsourcing.

Added to this is the fact that small businesses do not always stay small. They also grow with the passage of time. Many modern day large corporations such as Nike and Microsoft started off as just small businesses, which grew to become major players in the international marketplace. Small businesses that grow into large ones often remain in the community in which their business was first established, thereby stimulating the local economy and providing employment opportunities. A strong MSME sector also promotes a country’s resilience to shocks by broadening and diversifying the domestic economy (UNDP 2013). By reducing the dependency on a few large firms or specific sectors, MSMEs protect a broad base of the labour force from sector-specific shocks and fluctuations in international markets (Dalberg 2011). In short, MSMEs are important for development because they can make a definite contribution to the realization of a country’s central economic purposes and to bring about an efficient utilization of natural, human and capital resources for the achievement of predetermined ends.

2. Role of MSMEs in ‘Make in India’

MSMEs have been globally considered as an engine of economic growth and as key instruments for promoting equitable development. The major advantage of the sector is its employment potential at a relatively low capital cost. The labour intensity of the MSME sector is much higher than that of large enterprises. The MSMEs constitute more than 90% of total enterprises in most economies and are credited with generating the highest rates of employment
growth, and they also account for a major share of industrial production and exports. The contributions made by MSMEs vary widely between countries and regions. In OECD economies, MSMEs account for over 95% of firms, 60–70% of total employment, 55% of GDP, and generate the lion’s share of new jobs. Nevertheless, although they play key roles, particularly in high-income countries, MSMEs are also important to low-income countries, by making significant contributions to both GDP and employment (Dalberg 2011). In this regard, China provides an excellent example, where over 70% of its export comes from MSMEs. In addition, MSMEs contribute 50% of tax collections, have a 60% share in GDP, and provide 80% of the urban job opportunities, 75% of new products, and 65% of patents and inventions. According to a CIDA report, as quoted by a national daily in its issue on August 1, 2010, in Bangladesh there are about 6.0 million MSMEs, which contribute about 50 percent of the country’s industrial output, employing about 80 percent of its industrial labour force. In Thailand, by the year 2010 MSMEs made up 99.5% of Thailand’s businesses (about 2,913,213 MSMEs) and 28.4% were involved in export activities. Their contribution to the national GDP stood at 42.35%.

The MSME sector also holds the key to economic prosperity, especially in the countries like India which are characterized by an abundant labour supply, unemployment and underemployment, capital scarcity, a growing modern large industrial sector providing scope for ancillarisation, and so on. In India, MSMEs constitute nearly 94% of industrial enterprises. There are more than 440 lakh (4.4 million) MSME units in India with a gross output of more than Rs. 18 lakh crore (Table 1).

### Table 1. No. of MSME Units with Gross Output

<table>
<thead>
<tr>
<th>Year</th>
<th>Total MSME Units (In lakh)</th>
<th>Gross Output (in Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006–07</td>
<td>361.76</td>
<td>13,51,383.45</td>
</tr>
<tr>
<td>2007–08</td>
<td>377.37</td>
<td>14,35,179.26</td>
</tr>
<tr>
<td>2008–09</td>
<td>393.70</td>
<td>15,24,234.83</td>
</tr>
<tr>
<td>2009–10</td>
<td>410.82</td>
<td>16,19,355.53</td>
</tr>
<tr>
<td>2010–11</td>
<td>428.77</td>
<td>17,21,553.42</td>
</tr>
<tr>
<td>2011–12</td>
<td>447.73</td>
<td>18,34,332.05</td>
</tr>
</tbody>
</table>


In the year 2013 they contributed 8% of the country’s GDP, and their contribution to the country’s GDP is expected to increase to 22% by 2020, according to top officials of the Department of Science and Technology. This accounts for nearly 43% of India’s total export. MSME exports have expanded at an annual average growth rate of 11.0% during the period from 2007 to 2011.
For the period 2009–12 MSME exports were estimated at US $ 325 billion. The exports mainly consist of pearls, precious stones, metals, electrical and electronic equipment, pharmaceutical products, organic chemicals, articles of iron & steel etc. The main markets for the 20 most-exported MSME product groups, which accounted for more than 90 percent of MSME exports between 2009 and 2012, include the USA, European Union (EU), UAE, Turkey, Singapore, Hong Kong, Israel and Saudi Arabia. In this way the small-scale sector makes a very valuable contribution to the accumulation of the foreign exchange resources of the country. As per the information received from the Ministry of MSMEs, for the years 2011–12, the MSME exports are estimated at US $ 131 billion, constituting 43% of the total exports of the country. MSMEs are labour intensive and also need less capital. They are also significant contributors to backward linkages to heavy industries (MCCI, 2013).

MSMEs also contribute a sizeable amount to the industrial output of the country. Out of the total output of the manufacturing sector, as much as 45% comes from these units. And a major part of the total supplies of industrial consumer goods originate in the small-scale sector. Almost all the products of this sector are in the nature of consumer goods, with a significant part consisting of luxury goods. The adequate availability of consumer goods plays an important role in stabilizing and developing the economy. This sector produces more than 8,000 quality products for the Indian and international markets, ranging from traditional to high-tech items and with a high product diversification. Some of the major subsectors in terms of manufacturing output are food products (18.97%), textiles and readymade garments (14.05%), basic metals (8.81%), chemical and chemical products (7.55%), metal products (7.52%), machinery and equipment (6.35%), transport equipment (4.5%), rubber and plastic products (3.9%), furniture (2.62%), paper and paper products (2.03%) and leather and leather products (1.98%). The labour to capital ratio in MSMEs and the overall growth in the MSME sector is much higher than in the large industries. The geographic distribution of the MSMEs is also more even.

Indian MSMEs contribute significantly to employment generation. This sector employs close to 40% of India’s total workforce, generating one million jobs every year, especially at the low skill level, which is second highest in India, next only to agriculture. As per the information contained in the annual report of MSME 2012–13, MSMEs account for a large share of industrial units, which can be seen from the fact that in the year 2011–12, the total number of enterprises in the MSME Sector was 447.73 lakhs, with total employment of 1012.59 lakhs (Table 2).
Table 2. Employment Generation by Indian MSMEs

<table>
<thead>
<tr>
<th>Year</th>
<th>Employment (in Lakh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006–2007</td>
<td>805.23</td>
</tr>
<tr>
<td>2007–2008</td>
<td>842.23</td>
</tr>
<tr>
<td>2008–2009</td>
<td>881.14</td>
</tr>
<tr>
<td>2009–2010</td>
<td>922.19</td>
</tr>
<tr>
<td>2010–2011</td>
<td>965.69</td>
</tr>
<tr>
<td>2011–2012</td>
<td>1,012.59</td>
</tr>
</tbody>
</table>


It can be seen that MSMEs are also effective vehicles of employment generation. The estimated numbers of enterprises and employment numbers have increased at an annual compound growth rate of 28.02% and 26.42% respectively. MSMEs contribution to rural development can be observed from the fact that 200.19 lakhs of the working enterprises were located in rural areas, which accounted for 55.34% of the total working enterprises in the MSME sector; whereas 161.57 lakhs (44.66%) of the working enterprises were located in urban areas.

MSMEs not only generate the highest employment per capita investment, they also go a long way in toward checking rural-urban migration by providing people living in villages and isolated areas with a sustainable source of employment. MSMEs are key to the transition of agriculture-led economies into industrial ones, as they provide ample opportunities for processing activities which can generate sustainable livelihoods. In this context, the predominant role of women is of particular importance. This sector also supports the building up of systemic productive capacities. They help to absorb productive resources at all levels of the economy and contribute to the creation of resilient economic systems in which small and large firms are interlinked. Such linkages are of importance also in attracting foreign investment. Investing transnational corporations seek reliable domestic suppliers for their supply chains. Thus, in the competition for foreign investors there is a premium on the existence of domestic supporting industries (UNIDO 2012). There is ample empirical evidence that countries with a high share of small industrial enterprises have succeeded in making the income distribution (both regionally and functionally) more equitable. This in turn is a key contribution to ensuring long-term social stability by reducing ex-post re-distributional pressure and by reducing economic disparities between urban and rural areas. Also, the Indian SMEs embody the sort of innovation entrepreneurialism which will be the key to the future growth of the economy. Thus, MSMEs are important for the national objectives of growth with equity and inclusion.
3. Issues and Challenges Faced by Indian MSMEs

Despite the sector’s high enthusiasm and inherent capabilities for growth, its growth story faces a number of challenges in. The major hindrance to the survival and the growth of MSMEs is the unavailability of sufficient and timely funds to finance their operational as well as growth plans. Various estimates on the availability of credit to the MSME sector indicate a considerable credit gap, which is a matter of serious concern. In India, the MSME credit gap is estimated at approximately around 56 per cent. While there is an estimated demand of 2,803,628 crore, the supply of finance through banks stands at 1,038,948 crore, as revealed by a study conducted by the US-based Entrepreneurial Finance Lab (EFL). Public sector banks accounts for over 70 per cent of debt financing to the MSMEs, while private and foreign banks account for over 20 per cent of their credit flow. While the Reserve Bank of India (RBI) has directed banks to provide 60 per cent of the total loans to be extended to MSME units, the figure currently stands at 47 per cent. It is argued that financial institutions are hesitant to lend to MSMEs as this segment has high NPAs (Non Performing Assets), although only about 15 per cent of the total NPAs in the country are on account of the MSME sector.

While large industries have access to various sources of finance, the MSME sector depends primarily on finance from banks and other financial institutions. But due to a lack of transparency in their financial conditions, the poor reliability of data, lack of financial discipline, high administrative costs of small-scale lending, high risk perception and lack of collateral, banks are reluctant to provide loans to MSMEs. Despite their intrinsic strengths, MSMEs have low market credibility. Due to their small size and inherent vulnerability to market fluctuations, the mortality rates of MSMEs are relatively high. According to the new definition of sickness by the Reserve Bank of India, of the 3.62 crore MSMEs in the country, over 12.2 lakhs are sick units. Alarming statistics show that around 29,000 units are being added to the sick list every year. These sick MSMEs amount to an astounding outstanding bank credit of over 7,000 crore. Consequently, due to doubts about the possibility of survival and growth in these enterprises, financial institutions are inclined to be more stringent in approving a loan and may seek a lot of information while making their investment. Innovative and knowledge-driven firms are generally more information opaque, and as a result they fall into the credit rationing trap, facing a greater degree of difficulty in obtaining finance. Combined with the small amount of loans, the market becomes unappealing and the sector remains under-financed. So, banks generally lend only the amount prescribed to this sector under priority sector lending obligations.
Constraints in accessing bank credit force MSMEs to tap alternative sources of finance. According to a survey by Assocham and Resurgent India, only about 33 per cent of MSMEs have access to banks and institutional financing channels, while the rest raise money through personal and family savings and even borrow money from friends and relatives at higher rates of interest to ensure their survival. Added to this, trade credit is also a popular form of alternative financing for the Indian MSMEs. Alternative financing typically involves higher transaction costs as well as higher interest costs compared to bank finance. Poor access to finance limits the ability of Indian MSMEs to survive and grow (Peter and Jasmina 2011). A study on the MSME sector suggests that its multiple growth constraints (like poor infrastructure, obsolete technology, inadequate market linkages etc.) can be largely linked to inadequate access to finance.

MSMEs are also constrained by substantial non-financial barriers. A leading issue that is of major concern to MSMEs from the point of view of their growth and development is the non-availability of infrastructure support, according to a report of the Small Industries Development Bank of India (SIDBI) on the MSME Sector, 2010. According to a PHDCCI Survey, the Indian MSME sector listed lack of infrastructure, archaic labour laws, multiple taxes and the “intransigent attitude” of Government officials as the key impediments to the growth of business in the region. Many MSMEs in rural and semi-urban areas are still deprived of infrastructural facilities like power, roads, and communication services. This has hampered their proper and efficient working conditions, thereby retarding their development. Often individual units lack packaging facilities. As a result, markets are shrinking and workers are experiencing a dip in wages, especially in traditional industries.

The MSMEs in India are at a particular disadvantage on another count. They lack the knowledge, expertise, and resources necessary to manage their IP and to prevent the theft of their ideas and products. Many Indian MSMEs generally do not apply for IP protection, due to high capital requirements. For example, in case of acquiring of patent rights, businesses not only have to cover application fees, publication costs, and maintenance charges, but also the costs with respect to legal advice and translation costs. In addition, the patent process is long, drawn-out, and complex. Not only this, most Indian MSMEs are even unaware of the concept of IP, infringement protections, and legislation to protect IP. Some MSMEs find it difficult even to identify and describe their IP assets. In order to protect and appraise an IP, the first step is to identify and understand its origin, nature, current and future uses and the potential to generate profits. Moreover, the Indian business sector in general, and especially MSMEs, usually lack an understanding of how IP constitutes a competitive advantage. As a result they face the threat of losing their standing in the national and international markets.
Rising competition from Chinese imports is also an issue of concern. As per information compiled from Director General of Commercial Intelligence & Statistics with respect to eight major product groups¹ largely manufactured by the Small Scale Industries (SSIs) in India, imports from China grew at a rate higher than their respective imports from all countries combined during 2008–09 through 2011–12. As these eight product groups accounted for 54 percent of India’s total imports from China in 2011–12, a large number of Indian MSMEs are seen to be facing greater competition from that country as compared to rest of the world (PTI, 2014). According to Government sources, Chinese imports leapt from $32.45 billion (Rs 146,005 crore) in 2008–09 to $52.25 billion (Rs 3,13,500 crore) in 2012–13. A report (2009) by the industry body FICCI, based on a survey of over 100 small and medium companies, listed 22 product categories imported from China which were from 10 to 70 percent cheaper. In addition, in recent years the imports from China have changed from low-value, low-cost products like toys and crackers to high-value items like electronic devices and machinery. Machinery imports, such as textile machinery, are one of the biggest threats to small domestic manufacturers. India has about 1,500 such manufacturers, whose range extends from spinning and weaving machines to knitting or processing machines. According to the Textile Machinery Manufacturers Association (TMMA), imports of low-cost and low-tech textile machines from China have increased in the past few years because they are between 30 and 50 percent cheaper. The value of textile machinery imports from China grew from Rs 1,636 crore in 2007–08 to Rs 4,300 crore in 2012–13 (Khan 2014).

Indian MSMEs also face many marketing-related problems of which are generally not faced by large scale businesses. A large-scale business can buy an item in bulk, which saves money, while a small-scale business may not have the money or sufficient demand to order a bulk quantity, which raises the item cost. This creates a marketing issue: how can a small company sell the same item as its competition at a higher price and remain competitive? This is why many small-scale industries focus upon selling a higher-quality item than its mass-marketed competition. Other marketing-related problems arise from factors such as small scale production, lack of knowledge about marketing strategies, lack of standardization, competition from technically more efficient units, the high cost of product certification,² etc. A further problem facing small-scale marketing

¹ These product groups pertain to Electrical and Electronics products; Mechanical and Metallurgical products; Chemical and Glass and Ceramics-based products.
² One particular problem of marketing for a small-scale business is the issue of certification. Whatever the product is, it is subject to laws and regulations regarding consistency, purity and the like. Vegetables and milk, for example, are not permitted to be sold in certain areas unless certified as either organic or disease-free. Acquiring these certifications is often costly for a small-scale business. However, without them sales will be more limited.
efforts is the cost of advertising. Running a full-page newspaper advertisement or TV commercial is no financial hardship for certain large businesses, but such costs are obviously prohibitive for small-scale businesses. Thus, many will circumvent this dilemma through forming co-ops to split advertising costs or using local advertising and word-of-mouth.

Furthermore, many second-generation MSME entrepreneurs do not want to step into their parents’ shoes. Some of them have settled abroad, while some others are not interested because they are educated enough to pursue well-paying jobs. In addition, some do not want to run the factory or business as the efforts of running the business are not rewarded with adequate profitability. For example, grocery stores in Mumbai are finding it difficult to get their next generation into the same business. Some of them do not have the entrepreneurial zeal of their parents and are not willing to work in a non-air-conditioned shop floor level. In absence of the next generation’s commitment, the further investments needed to take the MSME business to the next level are not being invested. Neutral gear versus top gear comes into play due to the non-commitment of the next generation (Shah 2012).

Indeed, lack of information on how to access markets and foreign business opportunities, lack of trained and skilled manpower, lack of reliable and stable infrastructure, lack of knowledge about IP protection and exploitation, inefficient marketing networks, inadequate and irregular supplies of raw materials, and obsolete technology are the major barriers to the growth of Indian MSMEs. All these constraints have resulted in a high cost structure, thus placing this sector at a disadvantage vis-à-vis large industries.

4. Policy Measures/Initiatives to Strengthen Indian MSMEs

The government of India increasingly recognizes the growing role of MSMEs as a driver of economic growth and job creation. In view of its importance, identifying and implementing policies that can protect, support and promote Indian MSMEs has become a priority objective for the government. In order to protect, support and promote the MSME sector, and also to help MSME units become self-supporting, a number of protective and promotional measures have been undertaken by the Government (Pooja 2009), which notably include:

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3 According to the Third All India Census of Small Scale Industries 2001–02, 85.38 percent of the total registered MSME units do not have any access to technical know-how. Further, the unorganised sector enterprises are hampered by obsolete technology which further reduces their productivity and income. The most important barrier to the adoption of improved technology is the lack of availability of financial resources to obtain these units. In several instances, the cost of technology makes it difficult to adopt it.
promulgation of the MSMED Act, 2006; the Prime Minister’s Employment Generation Programme and promotional packages; the Task force on MSMEs; Credit Guarantee Scheme; the National Manufacturing Competitiveness Programme; the MSE-Cluster Development Programme (MSE-CDP); Public Procurement Policy for goods produced and services rendered by Micro & Small Enterprises (MSEs); Credit Linked Capital Subsidy Scheme (Table 3); Scheme of Funds for the Regeneration of Traditional Industries (SFURTI); Rajiv Gandhi Udyami Mitra Yojana (RGUMY) Marketing Assistance Scheme (Implemented through the NSIC); a Performance and Credit Rating Scheme (Implemented through the NSIC); Product Development, Design Intervention and Packaging (PRODIP) (Implemented through the KVIC); Khadi Karigar Janashree Bima Yojana for Khadi Artisans (Implemented through the KVIC); Interest Subsidy Eligibility Certification (ISEC); Prime Minister’s National Council on Skill Development, Performance and Credit Rating Scheme; Financial Assistance on Bar Code; National Small Industries Corporation (NSIC); National Board for MSMEs; SIDBI Venture Capital Fund Ltd (SVCL); Indian MSE Asset Reconstruction Company Ltd (ISARC); the Micro Finance Programme. Etc.

In order to improve the flow of credit to this sector, certain measures have been taken by the Government in the recent past. An outlay of 24,124 crore has been allocated for the MSME sector for the 12th Five Year Plan period (2012–17). This 12th Plan allocation represents an increase of 133.53 per cent over the 11th Five Year Plan (2007-12) allocation of Rs 10,330 crore. The government has also implemented various schemes like the Credit Guarantee Scheme, Credit Linked Capital Subsidy Scheme (CLCSS), Rajiv Gandhi Udyami Mitra Yojana (RGUMY) Performance and Credit Rating Scheme, Prime Minister Employment Generation Programme (PMEGP), Micro Finance Programme, Bills Discounting Scheme, and others to facilitate the flow of credit to this sector. For the implementation of various schemes for the growth of this sector, the government has allocated 3,327 crore in 2014–2015. An allocation of 10,000 crore to this sector in

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4 While there are no specific reservations for women, there are some concessions/incentives available under these programmes for the benefit of women entrepreneurs. With respect to entrepreneurship/skill development training programmes, under the National Awards for Entrepreneurial Development (Quality Products) and Trade Related Entrepreneurship Assistance and Development (TREAD) Programme for women, the necessary guidelines have been issued and specific reservations provided for women. The MSME Development Organisation (MSME-DO), the various State Small Industries Development Corporations (SSIDCs), the nationalised banks and even NGOs are also conducting various programmes including Entrepreneurship Development Programmes (EDPs). To cater to the needs of potential women entrepreneurs, who may not have an adequate educational background and/or skills, MSME-DO has introduced process/product oriented EDPs in areas like TV repairing, printed circuit boards, leather goods, screen printing etc. A special prize to the “Outstanding Women Entrepreneur” of the year is being given to recognize achievements made by and to provide incentives to women entrepreneurs (FICCI, 2013).
the 2014–15 Budget will act as a catalyst to private capital by quasi-equity, soft loan, and other risky capital for start-up enterprises. The recent 2015–16 Budget proposes a MUDRA (Micro Unit Development Refinance Agency) bank with a corpus of 20,000 crore for this sector. This move is expected to enhance credit facilities for small businesses and manufacturing units. The 1000 crore Self Employment and Talent Utilisation (SETU) fund is designed to support start-up businesses and self-employment for those who are mostly working in this sector. In a recent move by the RBI, banks are advised to achieve a 20 per cent year-on-year growth in credit to MSMEs and 10 per cent annual growth in the number of micro enterprises financed. Banks are also instructed not to accept collateral security for loans up to 10 Lakh extended to MSMEs.

Table 3. Progress of Capital Linked Subsidy Scheme (CLCSS)

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Units Assisted</th>
<th>Amount of Subsidy Sanctioned (in lakh Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001–2002</td>
<td>9</td>
<td>21.36</td>
</tr>
<tr>
<td>2002–2003</td>
<td>47</td>
<td>93.97</td>
</tr>
<tr>
<td>2003–2004</td>
<td>150</td>
<td>363.06</td>
</tr>
<tr>
<td>2004–2005</td>
<td>526</td>
<td>1,312.08</td>
</tr>
<tr>
<td>2005–2006</td>
<td>699</td>
<td>1,767.82</td>
</tr>
<tr>
<td>2006–2007</td>
<td>1,880</td>
<td>6,579.74</td>
</tr>
<tr>
<td>2007–2008</td>
<td>1,407</td>
<td>6,374.30</td>
</tr>
<tr>
<td>2008–2009</td>
<td>1,790</td>
<td>9,734.60</td>
</tr>
<tr>
<td>2009–2010</td>
<td>2,551</td>
<td>13,971.72</td>
</tr>
<tr>
<td>2010–2011</td>
<td>2,055</td>
<td>12,127.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11,114</strong></td>
<td><strong>52,345.65</strong></td>
</tr>
</tbody>
</table>


To date, the government’s development strategy for this sector has primarily evolved around ‘protective discrimination’ (industrial reservations), ‘integration with large scale industries’ (ancillarisation) and ‘institutional support’.

5. Policy Options for Strengthening Indian MSMEs

Despite the various incentives and facilities being provided to Indian MSMEs, they are losing their economic strength and there are signals of large scale sicknesses. According to a study of ASSOCHAM, most MSMEs are running at close to 70% capacity utilization, due to paucity of funds arising from unduly delayed payment of their funds, resulting in serious suffocation and anaemic...
conditions for them. Consequently, most of the Indian MSMEs nowadays fall under the category of a sick unit. The number of sick micro, small and medium enterprises (MSMEs) in March 2013 was 248,890. This number increased from 88,635 in March 2012 on account of the revision of the definition of ‘sickness’ made by the RBI. These loss-making MSMEs have constituted about 16% of total bank NPAs.

The Fourth All India Census of MSMEs reported eight major reasons for their sickness: (a) lack of demand (41.94%); (b) shortage of working capital (20.49%); (c) non-availability of raw materials (5.11%); (d) power shortages (5.71%); (e) labour problems (5.64%); (f) marketing problems (11.48%); (g) equipment problems (3.17%); and (h) management problems (6.64%). Added to these, high-cost loans severely impact the industry. For every 1 percent increase in the interest rate, the net profit of a micro, small or medium unit is reduced by 20 percent.

Whatever the reason, the sickness of MSMEs directly affects the workforce. In addition, it impacts the small investor who has put in their hard earned money in setting up the industrial unit. Such a situation calls for urgent remedial measures which would not only aim at restoring viable sick units back to health, but would also support industries on the verge of sickness. Added to this, policymakers need to consider the full range of issues confronting MSMEs, including MSME financing, entrepreneurship and skills development, innovation and technology, market access, and the overall appropriate public policy framework for MSME development. To address the above-mentioned problems and issues, following policy options and measures are critical.

First, in order to address the issue of timely and low cost availability of credit to the MSMEs, the RBI may create a group along with the Indian Banks Association and the credit rating agencies. This group should work out a uniform credit rating format and processes to bring about transparency and speed to this important issue. The ability of MSMEs (especially those involving innovations and new technologies) to access alternative sources of capital like angel funds/risk capital needs to be enhanced considerably in order to encourage and develop entrepreneurship. For this purpose, removing fiscal/regulatory impediments to the use of such funds by the MSMEs should be considered as a priority.

In addition, there is a demand for a dedicated Exchange for MSMEs (Chakrabarty 2012). In the Union Budget 2012–13, the Finance Minister announced the setting up of a Rs.50 billion India Opportunities Venture Fund with SIDBI, to enhance the availability of equity to the MSME sector. Based on the recommendations of the PM’s Task Force on MSMEs, the Bombay Stock Exchange and the National Stock Exchange have also set up a separate dedicated exchange/platform for listing and trading shares of SMEs, making it easier for them to raise equity capital. Furthermore, the Banking Codes and Standards Board of India (BCSBI) has set out two Codes – The Code of Bank’s Commitment to
Customers (2006, revised in 2014) and The Code of Bank’s Commitment to Micro and Small Enterprises (2008, revised in 2012). All industrial units should acquaint themselves with these Codes so that they are aware of the Charter of Rights for bank customers. Small units which are unable to get a satisfactory redress of grievances from banks can, within a month, approach the Banking Ombudsman. Furthermore, redress can be sought from the Consumer District Forum (for amounts up to Rs 2 million), the State Consumer Commission (for amounts above Rs 2 million and up to Rs 10 million), and the National Consumer Commission (for amounts over Rs 10 million). Indian MSMEs also need to realize that when large industrial units move from bank to non-bank sources, such as commercial paper, they are able to reduce their overall costs of finance. In contrast, when small units take recourse to non-bank sources of financing, they end up facing a steep increase in interest costs. There is reliable anecdotal evidence of small units availing of non-bank finance at very steep interest rates which can reach as high as 3 percent per month (36 percent per annum), or even higher if there is inadequate collateral. MSMEs must realise that the availability and timeliness of bank credit is much more important than cost. The agitation by borrowers for lower interest rates is often misplaced.

Second, attracting and retaining the right talent becomes a critical bottleneck for many MSMEs in their future growth. It is indeed ironic that in a nation of more than one billion individuals, skilled labour is cited as scarce. India needs to capitalize on its unique demographic dividend (it has a very large and young workforce). Vocational training is critical. In this context, useful lessons can be drawn from Germany, which has been particularly successful in building a national culture where vocational training is seen as a natural and much-valued career path. Vocational training can be provided by a range of institutions, such as government entities, business training by academic and professional bodies and chambers of commerce, and SMEs who themselves focus on this market opportunity. Governments can help underwrite training and research and development through voucher programs and targeted grants. Investment needs to be made on a large scale into skill and entrepreneurship development.

Third, the extent of technological sophistication and knowledge intensity of a company is a sine qua non for commercial success. This makes it imperative for MSMEs to pay special attention to upgrading technology and adopting new technologies through innovative approaches. A research study undertaken by software giant Microsoft revealed that nearly 90 percent of SMEs (Small and Medium Enterprises) in India have no access to the Internet, compared with only 22 percent of SMEs in China and 5 percent in the US. The report further concluded that adopting the latest IT tools and techniques can help India’s small and medium businesses boost revenues by $56 billion, while also creating over a million jobs.
Inasmuch as many Indian MSMEs use obsolete technology, many buyers have cited the upgrading of technology as one effective solution to turn SMEs into good vendors. By upgrading technology they can develop substitutes for imported products in a cost-effective manner. Furthermore, Indian MSMEs rely heavily on imported technology, with its attendant high costs.

There is also a need to generate awareness about intellectual property rights in order to enable Indian MSMEs to attain a global leadership position and to empower them to effectively use the tools of IPR of innovative projects. In addition, in order to enhance energy self-reliance and also be responsible towards the environment, it is important to promote climate-friendly energy technologies. There is a need to create a fund like Central Climate Friendly Technology Fund to help MSMEs to adopt such technologies.

Fourth, although there has been an encouraging upturn in women running businesses in the past decade or so, much more needs to be done to overcome the specific factors which discourage women in particular from starting or taking over small firms. Promoting female entrepreneurship and enhancing sustainable energy finance is crucial for India. Experience across different developed markets has shown that women have a better repayment record and yield a higher cross sell ratio for financial institutions. The Women Entrepreneur Package by Garanti Bank in Turkey and the M-Power Package by Access Bank in Nigeria are good examples of how outreach was extended to women in business. In addition, sustainable energy finance provides opportunities for MSMEs to reduce costs as well as increase environmentally friendly operations. Erste in the Czech Republic and eight banks in Russia (in particular the Bank-Center Invest) have successfully built profitable portfolios in this sector.

Fifth, Indian MSMEs continue to face the problem of infrastructure bottlenecks in terms of a lack of adequate transportation facilities like railways, waterways, roadways and airways, low/no access to a reliable power supply, lack of proper communication channels, inadequate marketing facilities, lack of funds, etc. Hence the key demand of the Indian MSME sector is the availability of adequate infrastructure at reasonable rates. One of the major reasons why Indian MSMEs, despite being so competitive, fail to compete effectively in the global market is the unavailability of adequate infrastructure and power, which are key to running business operations successfully. Policy makers need to create an enabling environment by providing adequate infrastructure to attract investments in India, most importantly in the MSME sector. The state governments, along with the industry associations, should involve the private sector in the development of infrastructure in existing industrial estates and clusters and permit the provision of infrastructural services on payment. Similarly, private sector investment should be
encouraged for the development and management of existing as well as new industrial parks/estates/clusters.

Sixth, the weak corporate governance of small firms, burdened further by the poor availability of crucial inputs, has made these firms extremely vulnerable. Good governance practices in MSMEs will help them grow and/or attract additional investors. The absence of good corporate governance practices makes it difficult for them to access finance from banks or investors. The adoption of sound corporate governance by MSMEs is indispensable for setting this sector on a higher growth trajectory. The lack of corporate governance is attributable to a lack of awareness about corporate governance practices and its impact on corporate performance. There is a need to educate MSMEs about the benefits of adopting sound corporate governance practices, and industry associations have a key role to play in this respect (Chakrabarty 2012).

Seventh, the process of liberalization and market reforms since 1991 has brought about intense competition for MSMEs in both domestic and overseas markets. This has made it imperative for Indian MSMEs to overcome the challenges that they face and maintain, improve and sustain their competitiveness through lower costs, improved quality, making available wider choice by initiating various measures, including innovation and the upgrading of technology. Indian MSMEs need to equip themselves with updated information and to conduct market intelligence on a real-time basis. Sharing of knowledge, experience and technical expertise would not only enhance the growth potential of MSMEs, but also help businesses to remain relevant in the changing times.

Eighth, Indian MSMEs are at a particular disadvantage because they lack the knowledge, expertise, and/or resources necessary to manage their IP and prevent the theft of their ideas and products. This situation calls for strong policy intervention and support programmes that help to fully exploit the innovative and creative capacity of Indian MSMEs. On the policy front, there is a need to introduce an ‘awareness and training program for Indian MSMEs’ to enable them to make informed decisions about protecting their ideas, effective utilization of intellectual property rights (IPR) tools for upgrading technology, enhancing competitiveness through the use of IP, and providing access to technical facilities and expertise for value addition to their businesses. To encourage MSMEs to enhance their IP protection, the Government should increase the speed and efficiency in checking and approving applications by optimizing the examination processes and recruiting more examiners (Vohra and Sumanjeet 2015). To promote better services on consultancy about IP polices and affairs, government should set up information or service centres, providing free service to MSMEs through telephone, e-mail, or other means.
Last but not the least, because the MSME sector in itself is so large, the Government alone cannot do all the things needed and it needs the support of the apex bodies/associations in helping it implementing its policies. MSME associations are normally best placed to appreciate or identify the common problems of their members. Such associations/bodies can provide solutions to problems common to a large number of MSMEs in a specific industrial sector or segment.

6. Concluding Remarks

Owing to its potential for generating innovative entrepreneurship and massive employment, hence fuelling social and economic development in India, the MSME sector is of strategic importance to the country. While the growth in the sector has brought into view the front runners who have successfully translated their pioneering ideas into sustainable business models, it has also starkly revealed the many challenges confronting Indian MSME’s and obstructing them in the realisation of their true potential. Limited access to finance continues to be the most crucial factor undermining the capacity of this sector. Banks have shown a reluctance to extend credit to the MSME sector on account of high administrative costs, inflated risk perception, inadequate and inaccurate borrowing information, and lack of collateral. However, lack of access to finance is only part of the problem. MSMEs are also constrained by substantial nonfinancial barriers. Lack of information to access markets and take advantage of foreign business opportunities, lack of trained and skilled manpower, lack of a reliable and stable infrastructure, lack of knowledge about IP protection and its exploitation, inefficient marketing networks and obsolete technology are other major barriers to the growth of Indian MSMEs. All these constraints have resulted in a high cost structure, thus placing this sector at great disadvantage vis-à-vis the large industries.

Undoubtedly, the MSME sector has the huge potential to contribute in the course of time to making India a 20 trillion dollar economy. But in order to unleash the growth potential of this sector, there are some stark issues and challenges which need to be resolved first. Despite various incentives and facilities being provided to Indian MSMEs, they are losing their economic strength and emanating signals of large-scale sickness. Thus, more efforts are needed for reviving and promoting the Indian MSME sector. The efficiency and competitiveness of this sector can be improved through continuous technology innovation; quality improvement; easy access to finance; diversification into new markets; better infrastructural facilities; and upgrading skills. Thus, addressing only the financing constraints in isolation is not enough. There is an urgent need to build the capacity of MSMEs through associations or cooperatives to enable the bulk purchasing of material inputs and
outputs. It is also necessary to encourage and promote market linkages between large and small producers and between markets, thus expanding both local and foreign opportunities for MSMEs. Most importantly, facilitation from the Government is required to minimise the transaction costs of technology upgrades, market penetration, modernisation of infrastructure etc. History shows that only with persistent and effective Government support in these areas were the MSMEs of countries like Japan, Korea etc. able to emerge as global players.

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**Sreszczenie**

**UWOLNIENIE POTENCJAŁU WZROSTU INDYJSKIEGO SEKTORA MMSP**

Sektor MMSP zajmuje strategiczną pozycję w strukturze gospodarki indyjskiej. Sektor ten generuje prawie 8% PKB kraju, zatrudniając ponad 80 milionów ludzi w blisko 36 milionach przedsiębiorstw rozproszonych na terenie całego kraju, co stanowi 45 procent produkcji wytworzonych i 40 procent całkowitego eksportu tego kraju a także wytwarza ponad 8000 produktów o wysokiej wartości dodanej, od produktów tradycyjnych aż do produktów wysokich technologii. Ponadto przedsiębiorstwa te są inkubatorem innowacji i przedsiębiorczości, co będzie miało kluczowe znaczenie dla prędkości wzrostu gospodarczego Indii. Powszechnie uznańie się również, że sektor ten może pomóc zrealizować cel postulowany Krajowej Polityki Produkcji, polegający na zwiększeniu udziału produkcji w PKB do 25% i stworzeniu 100 mln miejsc pracy do końca 2022 roku, a także pobudzeniu wzrostu i zwiększeniu wartości gospodarki Indii z obecnych dwóch bilionów dolarów do 20 bilionów dolarów. Pomimo dużego entuzjazmu sektora i jego możliwości wzrostu, wciąż stoi przed nim wiele wyzwani. W tym świetle, niniejszy artykuł analizuje znaczenie indyjskich MMSP dla wzrostu gospodarczego Indii i bada różne problemy stojące przed tym sektorem. W artykule podjęto również próbę omówienia różnych narzędzi polityki stosowanych przez rząd w celu wzmocnienia indyjskich MMSP. Wreszcie, artykuł ten proponuje strategie mające na celu wzmocnienie sektora, co powinno umożliwić mu uwolnienie jego potencjału wzrostu i uczynić Indie gospodarką o wartości 20 bilionów dolarów.

**Słowa kluczowe:** MMSP, konkurencyjność, wzrost, Indie