

# A Comparative Research Upon Influences and Policy Tendencies of Micro, Small and Medium Enterprise in India

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**Abstract –** The present article deals with micro, small and medium enterprises and their role in economic growth and employment generation in the Indian context. The article discusses how policy environment for promoting MSMEs changed from 'protectionism' during the pre-1990s to 'export orientation' during the post-1990s. The key constraints faced by the MSMEs including access to credit and technology, red tapism etc. are discussed.

While losses and layoffs at large firms are making headlines, many micro, small and medium-sized enterprises (MSMEs) are also severely affected by the global economic slump of 2008-09. Weak demand and tight credit are the chief pressures faced by these enterprises. Demand stimulus measures will assist all enterprises, whereas access to finance needs more specific targeting for small firms. Cooperatives (i.e. cooperative enterprises) appear to be the least affected by the crisis.

There is limited direct help for informal and micro-enterprises, which dominate the enterprise landscape in most developing countries. Micro-business startups are likely to increase as laid-off workers and returning migrant workers seek to make a living. Success for these new businesses and indeed many existing ones will be difficult to achieve, given weak demand and limited credit access. Entrepreneurs will need to be entrepreneurial in seeking out and exploiting new business opportunities.

## INTRODUCTION

The MSME sector plays a significant role in the Indian economy. A catalyst for socio-economic transformation of the country, the sector is critical in meeting the national objectives of generating employment, reducing poverty, and discouraging rural-urban migration. These enterprises help to build a thriving entrepreneurial eco-system, in addition to promoting the use of indigenous technologies. The sector has exhibited consistent growth over the last few years, but it has done so in a constrained environment often resulting in inefficient resource utilization. Of the many challenges impeding the growth and development of MSMEs, inadequate access to financial resources is one of the key bottlenecks that make these enterprises vulnerable, particularly in periods of economic downturn.

The term 'MSME' is widely used to describe small businesses in the private sector. Regulators and financial institutions across the world use parameters such as employee strength, annual sales, value of fixed assets, and

loan size proxies to define the sector in the context of finance. For instance, businesses with employee strength less than 500 are considered MSMEs in Mexico. According to the World Bank definition, a business is classified as MSME when it meets two of the three criteria – employee strength, size of assets, or annual sales (Table 1).

Enterprise Size	Employee	Assets	Annual Sales
Medium	<300	≤ USD 15 Million (≤ INR 750 Million)	≤ USD 15 Million (≤ INR 750 Million)
Small	<50	≤ USD 3 Million (≤ INR 150 Million)	≤ USD 3 Million (≤ INR 150 Million)
Micro	<10	≤ USD 10,000 (≤ INR 500,000)	≤ USD 10,000 (≤ INR 500,000)

Table 1: World Bank Definition of MSME.

The Micro, Small and Medium Enterprise Development Act 2006 (MSMED Act) of the Government of India provides the definition of the MSME sector. There exists several definitions of the term small and medium enterprises (SMEs), varying from country to country and varying between the sources reporting SME statistics. The commonly used criteria at the international level to define SMEs are the number of employees, total net assets, sales and investment level. If employment is the criterion to define, then there exists variation in defining the upper and lower size limit of a SME.

The European Union makes a general distinction between self-employment, micro, small and medium sized businesses based on the following criteria:

**Number of employees**

0	Self-employed
2-9	Micro business
10-49	Small business
50-249	Medium-size business

In the Indian context, micro, small and medium enterprises as per the MSME Development Act, 2006 are defined based on their investment in plant and machinery (for manufacturing enterprise) and on equipments for enterprises providing or rendering services. According to the Micro, Small and Medium Enterprises (MSME) Development Act of 2006, (India) a micro enterprise is where the investment in plant and machinery does not exceed twenty five lakh rupees. A medium enterprise is where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees. A small enterprise is where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees. In the case of the enterprises engaged in providing or rendering of services, as

- (a) a micro enterprise is where the investment in equipment does not exceed ten lakh rupees.
- (b) a small enterprise is where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees.
- (c) a medium enterprise is where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

According to the Ministry of Micro, Small and Medium Enterprises, recent ceilings on investment for enterprises to be classified as micro, small and medium enterprises are as follows:

Classification	Manufacturing Enterprises*	Service Enterprises**
Micro	Rs. 2.5 million/ Rs. 25 lakh (US\$ 50,000)	Rs. 1 million/ Rs. 10 lakh (US\$ 20,000)
Small	Rs. 50 million/ Rs. 5 crore (US\$ 1 million)	Rs. 20 million/ Rs. 2 crore (US\$ 40,00,000)
Medium	Rs. 100 million/ Rs. 10 crore (US\$ 2 million)	Rs. 50 million/ Rs. 5 crore (US\$ 1 million)

\* Investment limit in Plant & Machinery

\*\* Investment limit in equipments

\*\*\* Rs 50 = 1 USD

Before going further, it is important to mention some of the organisations that are associated with small-scale industry/ MSMEs:

Small Industries Development Organisation (SIDO), Small Scale Industries Board (SSIB), National Small Industries Corporation Ltd. (NSIC), Confederation of Indian Industry (CII), Federation of Indian Chamber of Commerce and Industry (FICCI), PHD Chamber of Commerce and Industry (PHDCCI), Associated Chamber of Commerce

and Industry of India (ASSOCHAM), Federation of Indian Exporters Organisation (FIEO), World Association for Small and Medium Enterprises (WASME), Federation of Associations of Small Industries of India (FASII), Consortium of Women Entrepreneurs of India (CWEI), Laghu Udyog Bharti (LUB), Indian Council of Small Industries (ICSI), Indian Institute of Entrepreneurship (IIE), National Institute of Small-Industry Extension Training (NISIET), National Backward Caste Finance Development Corporation, National Institute for Entrepreneurship and Small Business Development (NIESBUD), Small Entrepreneurs Promotion and Training Institute (SEPTI), Small Industries Development Bank of India (SIDBI) etc.

## ECONOMIC CONTRIBUTION OF MSME

It is important to note that in addition to helping catalyze the growth of the economy, MSMEs feed large local and international value chains as well as local consumer markets as suppliers, manufacturers, contractors, distributors, retailers and service providers. They account for a large share of industrial units, and contribute significantly to employment in the country (Table 2).

Key Metrics	
Share of	Value
Industrial units	95%
Industrial output	45%
Exports (in value)	40%
Gross Domestic Product (GDP)	-8%
Employment (in Millions)	69

**Table 2: Key Statistics on Economic Contribution of MSME.**

Growing at 11.5 percent a year, the MSME sector has been performing better than the overall GDP (8 percent growth per annum) and overall industrial output (measured by Index of Industrial Production-IIP). Current estimates of MSME contribution to GDP do not take into consideration the contribution made by unorganized private enterprises, for which asset and sales data is not tracked by government agencies.

MSMEs are also effective vehicles for employment generation. India's cities have been experiencing the burden of a consistently growing population, comprising an ever – increasing proportion of migrants in search of employment and livelihood. City infrastructure is already stretched, and policy makers are seeking solutions to mitigate issues arising from migrant population growth.

Rural MSMEs and those based outside of the large cities, offer a viable alternative for employment to local labor, hence presenting an opportunity for people to participate in productive, non-farm activities, without needing to migrate to urban areas. With adequate financial and non-financial resources, as well as capacity-building, the MSME sector can grow and contribute to economic development considerably higher than it is doing currently.

## THE EVOLVING CRISIS

The global economy is experiencing its greatest slowdown since the Second World War. Due to the increased integration of goods, services and financial markets, the crisis has spread from housing and credit sectors in the U.S. to other markets and countries around the world. There are few, if any, economies that have been left untouched by the crisis. The collapse of Wall Street investment banks and American mortgage lenders has had serious knock-on effects for commercial banks and non-financial companies around the world.

Credit everywhere is tight as lenders seek to shore up their financial positions and increase their precautionary reserves. Borrowers have become suspect as creditworthiness is difficult to assess. Businesses in the real economy have found it hard to survive, resulting in increased layoffs and closures. Retrenchment translates directly into a decline in the opportunities for women and men to engage in decent work. Thus, the credit crisis has developed, via weak demand, into a full-blown economic crisis. Many developed countries slipped into recession in the last quarter of 2008 and many developing countries have seen their growth rates plummet.

The crisis is affecting firms of all sizes. While large firms grab headlines when disclosing layoffs and dramatic declines in sales and earnings, many micro, small and medium sized enterprises (MSMEs) are also trying to cope with weak demand, tight credit and reduced orders from larger companies. Small businesses across a range of sectors and organizational types have been affected, although preliminary evidence suggests that the cooperative form of enterprise is managing particularly well and many are adding new members.

MSMEs, which account for over 90% of enterprises in all countries, are an important source of output and employment.

They employ 33% of formal sector workers in low-income countries and 62% of such workers in high-income countries.

2 Because poor countries have large informal economies, dominated by micro-businesses, the MSME portion of total employment is much higher. In India, for example, 86% of the labour force is employed in the informal sector, including farming. The crisis has not only hit Wall Street and Main Street, but it has affected the side streets, the dirt streets and the markets where many small retailers and producers thrive.

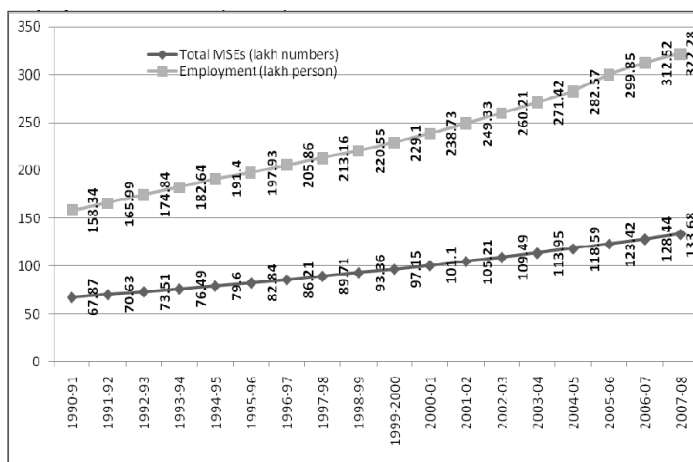
Many, if not most, of the stimulus packages announced by governments in late 2008 and early 2009 include measures for the MSME sector. This is true of both developed and developing countries. For example, an announcement by Indian Prime Minister Manmohan Singh on the country's first stimulus package, stressed that "The Government attaches the highest priority to supporting the medium, small and micro enterprises (MSMEs) sector which is critical for employment generation".

The MSME sector is highly varied, both within a country and between richer and poorer countries. Formal sector firms, working within the framework of formal credit institutions, tax regulations and social security programs

can benefit from changes to the policy environment that are designed to assist enterprises during the downturn.

### IMPORTANCE OF THE MSME SECTOR

The contribution of micro, small and medium enterprises (MSME) sector to manufacturing output, employment and exports of the country is quite significant. According to estimates, in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 percent of the total exports of India. The MSME sector employs about 42 million persons in over 13 million units throughout the country. There are more than 6000 products, ranging from traditional to high-tech items, which are being manufactured by the Indian MSMEs.



**Figure 2: Trends in the growth of Micro and Small Enterprises (MSEs) and the Employment Generated (in lakh).**

It can be deciphered from the *figure 2* that the number of MSEs has increased steadily in India from 67.87 lakhs in 1990-91 to 133.68 lakhs in 2007-08. This could be possible due to the conducive policy environment during the liberalization era (post 1991).

Similarly, number of persons employed in MSEs has risen from 158.34 lakhs in 1990-91 to 322.28 lakhs in 2007-08. The yawning gap between the two lines over the years indicates that employment elasticity of the MSE sector has improved. However, much of the labour absorption has taken place in the unorganized/ informal enterprises.

### MSME LANDSCAPE IN INDIA

In 2009-10, the Indian MSME sector was estimated to include 29.8 Million enterprises. In order to encourage these unorganized units to register, the Ministry of MSME has simplified the registration process (replacing the earlier

two-stage registration process with a one-step filling of memorandum). Table 3 The sector has been growing at an effective rate of 4 percent annually over the last three years from 2008-10. The share of registered enterprises in the sector is estimated to be only around 6 percent, which goes to show that the sector is dominated by unregistered enterprises that do not file business information with District Industry Centers (DICs) of the State/ Union Territory. In order to encourage these unorganized units to register, the Ministry of MSME has simplified the registration process (replacing the earlier two-stage registration process with a one-step filling of memorandum).

Year	Registered	Unregistered	Total units
2006-07	1.5 (-6%)	24.6 (-94%)	26.1
2009-10	1.8 (-6%)	28.0 (-94%)	29.8

**Table 3: Size of the MSME Sector in India (in Millions)**

In addition to the registered and unregistered enterprises covered by the MSME census, the sector has an additional 30 million enterprises

### POLICY CHANGES IN THE REFORMS ERA

The Prebisch-Singer thesis states that the terms-of-trade between primary products (exported by developing countries-'periphery' to developed countries-'core') and manufactured goods (imported from developed countries by developing countries) tend to deteriorate over time. This happens because the income elasticity of demand for manufactured goods is greater than that for primary products-especially food.

Therefore, as incomes rise, the demand for manufactured goods increases more rapidly than demand for primary products, thus creating trade deficit in favor of the developing countries. The research calls for rapid industrialization in the developing countries, which would lead to import substitution and lesser dependence on developed countries for imports of manufactured goods. The infant industry argument too emanates from the Prebisch-Singer thesis. The infant industry argument demands protection for the domestic industry from the government in the form of tariffs, quotas, or subsidies in order to survive the lower prices and higher quality of the manufactured goods or services produced and exported by



the advanced capitalist countries. Proponents of the infant industry argument theorize that protectionism will allow the infant industry to grow and develop to the point at which it can compete on the international market without protectionist measures.

Following these arguments, India went for rapid industrialization during the 2<sup>nd</sup> and 3<sup>rd</sup> Five Year Plans, which was capital intensive in nature and thus could not solve the problem of unemployment. Moreover, it created regional disparity in development outcomes. The Karve Committee Report (1955) was one of the earliest of the exercises, which recommended a protective environment for the growth of small industries in India.

Reservation of items for exclusive manufacture in SSI sector statutorily provided for in the Industries (Development and Regulation) Act, 1951, has been one of the important policy measures for promoting this sector.

After the liberalization of the economy, government's attitude towards the MSME sector changed and many of the products exclusively manufactured by these units earlier got deserved. No more the MSME sector continued to be treated as 'infant industry'.

Presently, only 21 items are reserved for exclusive manufacturing in the MSE sector. These include bread, pickles, wooden furniture, wax candles, exercise books and registers, safety matches, incense sticks, fireworks, and stainless steel and aluminum utensils. The phased deletion of products from the list of items reserved for the exclusive manufacture by micro and small enterprises is being continued. In October 2008, the government deleted 14 items from this list.

The MSME sector today faces competitive environment owing to: (a) liberalization of the investment regime during the 1990s, favoring foreign direct investment (FDI); (b) the formation of the World Trade Organisation (WTO) in 1995, forcing its member-countries (including India) to drastically scale down quantitative and non-quantitative restrictions on imports, and (c) domestic economic reforms. Under the current paradigm of neoliberalism, labour market rigidity is considered as a barrier to the overall growth of the economy. Labour market flexibility (a cost cutting strategy) is often prescribed to enhance productivity.

There existed three historical models of corporate governance in India: a) the managing agency model in the colonial period; b) the business house model that emerged after Independence, and; c) the Anglo-American model which has recently been adopted.

The reforms in the Indian Company Law under the Anglo-American model now include: a strengthening of disclosure norms, the establishment of an Investor Education and Protection Fund, the establishment of a National Advisory Committee on Accounting Standards, etc. Deregulation of share prices led to a huge securities scam in 1992, following which the Securities and Exchange Board of India (SEBI) came into being through the Securities and Exchange Board of India Act (1992).

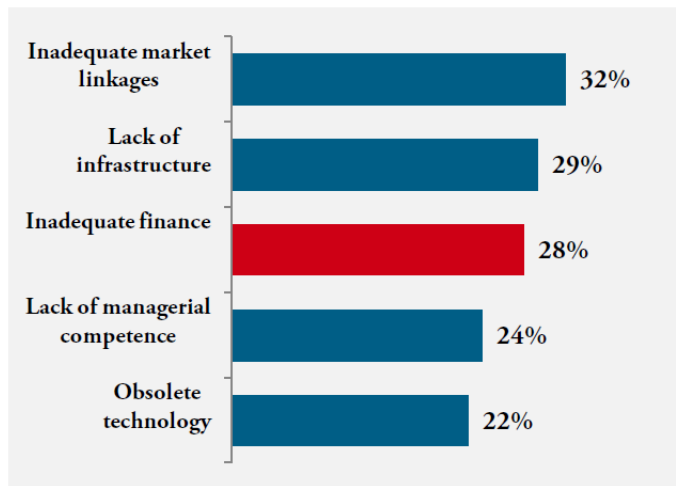
The Foreign Exchange Regulation Act (FERA) has been repealed, being replaced now by Foreign Exchange Mechanism Act (FEMA). Steps have been taken to bring forth the

Prevention of Money Laundering Bill, and the two together are expected to facilitate the liberalization of the capital account.

The MSME Development Act 2006, came into being with effect from 2<sup>nd</sup> October, 2006, subsequent to which, both the Central and State Governments took effective measures towards implementation of the Act. In order to increase the competitive edge of the MSMEs vis-à-vis the multinational corporations (MNCs), the Government of India announced the National Manufacturing Competitiveness Programme (NMCP) during the budget speech 2005-06. One of the objectives of NMCP is to ensure healthy growth of the MSME sector. Under the National Manufacturing Competitiveness Programme (NMCP), five components have been made operational, which include quality management systems and quality technology tools, building awareness on intellectual property rights, support for entrepreneurial and managerial development through incubators, setting up of new mini tool rooms and marketing assistance/ support to MSEs.

## **MSME GROWTH IMPACTED BY MULTIPLE CONSTRAINTS**

Although the MSME sector has been growing at a faster rate than the overall industrial sector, MSMEs experience multiple constraints that threaten to derail the sector's growth trajectory. Some of key hindrances that MSMEs face are highlighted in Figure 1.



**Figure 1: Key Growth Constraints for MSMEs.**

- **Inadequate market linkages:** Except in the case of cluster-linked and ancillary MSMEs that have natural linkages with large enterprises, MSMEs tend to have poor market access. The non-cluster MSMEs are fragmented, and as a result, are unable to organize themselves in order to reduce procurement cost from large enterprises or streamline the output supply chain. What is worse, in the absence of adequate market linkages, any demand disruption in the supply chain can severely impact operations because the enterprise capital of these businesses tends to be locked in illiquid inventory and receivables.
- **Lack of infrastructure:** Limited access to infrastructure such as power, water and roads increases operational costs for MSMEs and makes their businesses uncompetitive. Inadequate access to support infrastructure discourages these units from adopting newer technologies, where available. In addition, poor infrastructure forces small and medium businesses to operate in select geographies, increasing the demand for natural resources in that region.
- **Inadequate finance:** MSMEs consider challenges in access to finance as one of the biggest constraints in growth. A study on the MSME sector also suggests that the multiple growth constraints (like those mentioned above) can be largely linked to inadequate access to finance. The Report of Working Group on Rehabilitation of Sick MSMEs by RBI also finds lack of adequate and timely access to working capital finance is one of the key reasons for sickness in the sector.

- **Lack of managerial competence:** Micro and small enterprises in particular largely comprise first-generation entrepreneurs, who have had a limited structured training on resource planning, capital management and labor management. As a result, lack of managerial competence often shows in poor book-keeping and a limited knowledge of formal financial institutions, which further inhibits the growth of these enterprises.
- **Obsolete technology:** While industries such as automotive, forging, software development sector require advanced technologies in operations, the majority of the small and medium enterprises do not have that kind of technological edge. A low technology base results in low productivity, which makes these enterprises uncompetitive. Financial institutions associate lack of technology with uncompetitive businesses and therefore are wary of financing enterprises which are not technologically up-to-date in operations. These enterprises too have limited awareness about new technologies, or the technology financing schemes.

The 2007 MSME Census indicated that only 5 percent of enterprises in the sector had access to some form of formal finance, while over 92 percent of the units lacked access to any form of institutional finance. Studies on financing pattern in the sector and the MSME census suggest that MSMEs prefer self-financing, which not just includes the savings of the entrepreneurs, but also the finance availed from friends, family and relatives..

## CONCLUSION

Information technology or Internet-enabled environment helps in fast and accurate decision-making by the SMEs due to increased mobility. The critical components before SMEs are speed of services, access to information, empowering employees in terms of skill and delivering highest valued services at competitive cost. SMEs need IT-based

solutions in terms of multi-tasking, expanding customer base, raising productivity, controlling cost, working remotely, fast and accurate decision-making and facilitating collaboration. SMEs have various needs to function in an aggregative manner in order to reach out for value addition by keeping in mind the variable cost model. IT usage by the SMEs raises productivity of the sector in particular and the economy in general.

More support is needed for MSMEs from the government in the form of priority sector lending, government

procurement programme, credit and performance ratings and marketing support. Technology transfers (such as green technology) and networking can revive the growth of MSMEs.

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