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MSMEs in India: Problem and Prospects

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ABSTRACT

With the introduction of reform measures in India since 1991, the Govt. has withdrawn many protective policies for the Micro, Small and Medium Enterprise (MSMEs) and introduced promotional policies to increase competitiveness of the sector. Though globalization process has expanded the market facilitating supply of superior technology, this has also forced the MSMEs to face ruthless competition from large domestic firms and the MNCs. The sector has undergone several changes regarding definition. The Small Scale Industries (SSI) has been renamed as Micro, Small and Medium Enterprises (MSMEs) with the introduction of MSMED Act, 2006. The current paper is an attempt to critically analyse the definitional aspect of MSMEs and explore the opportunities enjoyed and the constraints faced by them in the era of globalization. Annual Average Growth rate (AAGR) has been used as the major statistical tool to compare the performances of MSMEs during pre and post-liberalization period with the help of four economic parameters namely No. of units, production, employment and export. The study results show that except marginal increase in growth rate in employment generation, the growth rate in other parameters is not encouraging during the liberalization period.

Keywords: Micro, Small and Medium Enterprise (MSMEs), Globalization, Liberalization, Annual Average Growth rate (AAGR), Employment, Export.

INTRODUCTION

In Indian economy, micro, small and medium enterprises has been because the most brightest and emotional sectors. The important of micro, small and medium enterprises (MSMEs) is able to make relation to its capacity of the employment generation, low capital and technology requirement, use of cultural and inherited skill, use of local resources, mobilization of resources and exportability of products.

REVIEW OF LITERATURE

Sandesara (1993) studied the performance of SSIs producing reserved items collecting data from the second census conducted by the Ministry of SSIs. The study examined the null hypothesis that the SSI firms producing reserved category items should perform better than the SSIs producing non-reserved items. The study result revealed that capacity utilization in 1987-88 and aggregate change in production in 1987-88 were both lower for reserved than for unreserved items. This below par performance of the SSI firms producing reserved items was surprising as those firms did not have to face competition from the large firms. The author observed that this could be due to the entrance of excess SSI firms into the protected areas.

Sonia and Kansai Rajeev (2009) studied the effects of globalization on Micro, Small and Medium Enterprises (MSMEs) during pre and post liberalization from 1973-74 to 2008-09. They used four economic parameters namely number of units, production, employment and export and

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interpreted study results based on Annual Average Growth Rate (AAGR) calculation. AAGR in pre liberalization period (1973-74 to 1989-90) was higher in all selected parameters than that of post liberalization period (1991-92 to 2007-08). They concluded that MSMEs failed to put up an impressive performance in post reform era.

Bhavani T.A. (2010) highlights the issue of quality employment generation by the SSIs and negates the short term attitude of increasing the volume of employment generation compromising with quality. The author argues that employment generation by the SSIs may be high in quantitative term but very low in quality. Technological up gradation would enable the small firms to create quality employment improving remuneration, duration and skill. This structural shift may reduce the rate of employment generation in the short run but would ensure high-income employment generation in the long run.

Subramanian Bala (2011) has probed the impact of globalization on the exports potentials of the small enterprises. The study shows that share of SSI export in total export has increased in protection period but remain more or less stagnated during the liberalization period. However, the correlation co-efficient in liberalization period is higher than that of protection period suggesting that the relationship between the total export and SSI export has become stronger in liberalization period. This may be due to the drastic change in composition of SSI export items from traditional to non-traditional and growth in its contribution to total export through trading houses, export houses and subcontracting relation with large enterprises. Thus, the current policy of increasing competitiveness through infusion of improved technology, finance, and marketingtechniques should be emphasized.

OBJECTIVE OF THE STUDY

The major objectives of the study are as follows:

1. To examine the changing pattern of definition of the Micro, Small and Medium Enterprises in India and critically analyse the impact of Micro, Small and Medium Enterprise Development (MSMED) Act, 2006.
2. To analyse the opportunities and threats of MSMEs in India during the liberalization period

RESEARCH METHODOLOGY

On the basis of the above mentioned objectives, the following methodology has been adopted in this study.

Data Source: This study is depended on the secondary data source. The secondary data is collected from the Annual Reports published by the Ministry of Micro, Small and Medium Enterprises. The study covers a period from 2001 to 2010.

ANALYSIS

Government policies regarding Micro, Small and Medium Enterprises (MSMEs) After independence, the Govt. took up the policy of accelerating industrialization since Second Five Year Plan. The Policy resolution 1948 emphasized that cottage and small-scale industries can ensure best utilization of local resources, achieve 'local-self-sufficiency' in production, increase employment generation through rehabilitation of displaced persons and ensure balanced economic growth. Industrial Policy Statement [illegible] introduced the concept of District Industries Centres (DICs) for SSIs to ensure supply of raw materials and machinery, market survey of the district, generating new business ideas, arrangement of credit facility, maintenance of quality of products etc. The Industrial Policy Statement 1980 took some path breaking measures likeincrease in Investment limit for tiny, small, and ancillary units, withdrawal of industrial location restriction, elimination of provisions regarding expansion, increase in private participation.

The New Industrial Policy in 1991 emphasized on raising the investment ceiling for the purpose of definition of a small unit to 6 million (Rs 7.5 million if the unit concerned undertakes to export 30 % of its output or if it is an ancillary unit i.e. a firm supplying at least 50 % of its output to large scale industries), allowing other investors (including large-scale enterprises and foreign investors) 24 % equity participation in a small-scale unit, introduction of the Act on delayed payment to small and ancillary enterprises, encouraging banks to open specialized SSI Branches and giving better priority to the sector in their annual credit budgets. Comprehensive Policy Package for SSIs and Tiny Sector 2000 increased the exemption for excise duty limit from 50 lakhs to Rs One crore to increase competitiveness, conducted the third census of small-scale industries and motivated the SSI associations to develop and operate testing laboratories. As per the Policy Package for SME 2005-06 Small and Medium Enterprises were recognized in the services sector, and treated at par with SSIs in the manufacturing sector and emphasized on Cluster Development Model.

DEFINITIONAL ASPECT OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES)

The definition of Small Scale Industries has undergone changes for many times. The main criterion for definition was mainly the investment level and number of employees. The chart below shows the changing pattern of SSI definition.

Changing pattern of Investments in Small Scale Industries

Year	Investment Limit in Rupees
1950	Up to 0.5 Million in Fixed Assets
1966	Up to 0.75 Million in Plant and Machinery
1975	Up to 1 Million in Plant and Machinery
1980	Up to 2 Million in Plant and Machinery
1985	Up to 3.5 Million in Plant and Machinery
1991	Up to 6 Million in Plant and Machinery
1997	Up to 10 Million in Plant and Machinery
1999	Up to 30 Million in Plant and Machinery

(Source: Ministry of Small Scale Industries, Govt. of India**)**

A major change took place in 2006 with the enactment of MSME Development Act, 2006. In accordance with the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified into two categories.

a. **Manufacturing Enterprises**- The enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the industries (Development and regulation) Act, 1951. The Manufacturing Enterprise is defined in terms of investment level in plant & machinery.

b. **Service Enterprises**: The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment. The limit for investment in plant and machinery / equipment for manufacturing / service enterprises, as notified are as under:

DEFINITION OF MSMES

Manufacturing Enterprises	**Criteria**
Classification	**Investment in plant & machinery**
Micro Enterprises	Investment up to 25 lakh
Small Enterprises	Investment up to 5 Cr
Medium Enterprises	Investment up to 10 Cr
Service Enterprises	Investment in plant & machinery
Micro Enterprises	Investment up to 10 Lakh
Small Enterprises	Investment up to 2 Cr
Medium Enterprises	Investment up to 5 Cr

(**Source:** MSME Development Act 2006, Ministry of the District Industry Centres (DIC)

IMPORTANCE OF MSME DEVELOPMENT ACT, 2006

With the introduction of new MSME Act 2006, the Govt. has tried to resolve some major issues related to the MSMEs like complicated bureaucratic registration procedures, lack of finance, lack of managerial skills etc. The most important thing the Act has done is to increase the significance of the sector and to offer a clear definition of MSMEs. Further, the act mandated the composition of the National Board of MSME8 with clear long run objective of overseeing and regulating the development of micro, small and medium enterprises in India. The broad functions of this board are to manage cluster development, train entrepreneurs, develop infrastructure and promote financial access to this sector.

The MSME Act 2006 has frame worked a strict rule regarding payment of dues by increasing penalties substantially for delay in payment. For example, the Act mandates that all payments be made within 45 days failing which the creditor must pay compound Interest which is higher than he bank rate notified by the RBI. As noted in section 2.1, registration in the MSME sector is voluntary and unregistered firms constitute a significant proportion of the total firms constitute a significant proportion of the total. As a result, proper maintenance of records becomes extremely difficult. The new MSME Development Act 2006 has made the registration procedure much simple and less time taking.

DEBATABLE ISSUES INITIATED BY THE MSME DEVELOPMENT ACT, 2006

Two policies introduced by the MSMED Act, 2006 have initiated much debate. One is proposed Procurement Preference Policy and the other is Exit Policy or a Close of Business (COB) policy. The first policy will determine how much supplies should be purchased by the Govt. agencies from the MSMEs and the second policy will determine when and how to close a sick MSME unit. The first policy tends to create a cold war between the small and medium enterprises. The Federation of Associations of Cottage and Small Industries (FACSI) have placed a demand for a separate policy exclusively for the small units regarding the purchase of supplies. Many women run small and cottage industries have asked for separate quota for themselves. Thus, the issue has taken a complicated shape. Regarding the Close of Business (COB) two major issues remain unsettled. The first one is at what level The Govt. should intervene to close a sick MSME unit. The second issue is about the relative priorities of different parties associated with the MSME units like owners, shareholders and employees, in case of conflict.The Act has expanded the investment range and has clubbed small and medium enterprises. In the process of doing so, it does not consider the 'crowding out' effect of smaller firms within the sector.

MSME sector falls into the Priority Sector where the banks and many other financialinstitutions have to extend at least 40% of their total portfolio. As the investment level have beenincreased many bigger firms fall into MSME category. The banks prefer to extend theirstipulated percentage of loan to those comparatively bigger firms effectively crowding outsmaller firms. Thus the small units again get back to their original position of lack of workingcapital and some financially strong firms get benefited. One possible solution that can be offeredis to create own priority package for different sectors to negate the crowding off effect of thelarge firms.

Another major problem for MSMEs is their less capacity of collective bargaining in the creditmarket. MSMEs with net worth less than Rs.100 million cannot raise capital through stockmarket. Thus they became fully dependent on banks and have to take loans at a higher rate thanthe Prime Lending Rate (PLR).The larger businesses can bargain with the banks and often canget loans at a lower rate. One possible solution may be to regulate the banks more effectively andestablish a uniform rate of lending.Out of the total counts of MSMEs, a significant portion is run by the women entrepreneurs andthey must be provided sufficient encouragement. The Act is not very specific about this area. This gap can be fulfilled by allowing some reservation of procurement preference policies inwomen-run small units, creation of shared facilities for female employees like day care servicesand single window interfaces to reduce the information gap etc.

FLOW OF FOREIGN INVESTMENT AND TECHNOLOGY

The MSMEs in India suffer from out dated technology and sub-optimal scale of operation. Many foreign companies have tied up with Indian MSMEs and helped them to use better technology and managerial skill etc. Thus, a proper collaboration between the small and large companies can help small firms to develop technology base through Research & Development activities, contribution from the technological institutes, universities etc.

Emerging areas of business

MSMEs have been able to identify many uncommon but highly promising business areas like outsourcing, medical transcription, clinical research trials, sub-contracting and many new technologies like biotechnology, nanotechnology etc which are attractive for the new generation MSME entrepreneurs.

Less Govt. Intervention

As the economy is mainly market driven; there is less Govt. intervention, red tapes, less control on import and export etc. The MSMEs would be allowed to work in a free environment.

Employment generation

Being labour-intensive in nature, the MSMEs make significant contribution in employment generation and expanding industrial network in rural areas. This sector nurtures the traditional skills and knowledge based small and cottage industries. The workers inherit and transfer skills from generation to generation. The handicrafts and other products produced by this sector have good demand in market. The MSMEs have been a good source of employment generation and can be even more if the sector gets support in terms of infusion of technology, capital and innovative marketing techniques etc.

Better performance by the MSMEs

Before globalization, the MSME sector was a highly protected sector. Suddenly, after globalization they discover that many of such protective measures were withdrawn and they have to fight for their existence. This competitiveness in domestic and global market may bring out superior performance.

Better Customer Satisfaction

As the domestic market gets competitive, small and medium firms try to satisfy the consumers in every possible way. They try to produce products as per the needs and preferences of the consumers and satisfy the customers in best possible way.

Short and long term capital

In a liberalized economy, banks would try to find out new avenues of giving credits to increase their profitability. Thus, supply of funds may be easier. Development in money market would initiate development in capital market.

Export contribution

The products produced by MSME sector (like sports goods, readymade garments, woollen garments and knitwear, plastic products, processed food and leather products, handicrafts etc) have an excellent foreign market. As per the results of fourth MSME census (2006-07), this sector has registered an export earning of Rs 202017 crores in 2007-08.

Removal of Regional disparity

People from remote areas have the tendency to migrate to urban areas in search of jobs. This creates excessive pressure on urban areas and initiates social and personal problems. This problem can be addressed by setting up a network of micro, small and medium enterprises in economically backward areas. MSME sector can take care of local needs, improve economic condition of the area and most importantly, can bring a qualitative change in the economy of the country.

Better industrial relations-The MSMEs are less prone to industrial disputes. However, the truth behind the scene is the workers in small sectors are mostly from unorganized sector and cannot raise their voice collectively. Thus, apparently, they share harmonious relation with the firm owners.

Financing Problems

Financing has always been a major problem for the small and medium industries in India. The MSMEs mostly depend on internal sources of finance (personal savings, loan from relatives, and loan from local money lenders) than that of institutional financing by banks and other financing institutions.

Flow of credit from commercial banks to MSME sectors

(Amount in Cr)

Year	Net Bank Credit	Annual Growth (%)	Credit to MSMEs	Annual Growth (%)	MSME as Per cent of Net Bank Credit
2001	767206	17.33	60141	5.43	12.86
2002	535063	14.56	67107	11.65	12.53
2003	668576	25.04	64707	-3.60	09.67
2004	763855	14.20	71209	10.04	09.32
2005	971809	27.22	83498	16.71	08.55
2006	1350467	38.96	101285	21.30	07.50
2007	1768376	30.95	127323	25.71	07.20
2008	1840853	04.09	213539	67.72	11.60
2009	22666111	23.13	256127	19.90	11.30
2010	2716507	19.85	364012	42.10	13.40

(Source:Annual Report 2010-11 Govt. of India, Ministry of Micro, Small and Medium Enterprises)

As the charts show, the annual growth rate in terms of Net Bank Credit, Credit to MSMEs and Percentage of Net Bank Credit offered to MSMEs show fluctuating trend. In 2002-03, the annual growth rate of credit to MSMEs showed a negative result. All the Scheduled banks offered credit to SSI sector to the tune of Rs 64707 Cr. which was less than that of the last year (2002-03) by Rs 400 Cr. Another noteworthy year is 2007-08 which witnessed high annual growth rate in terms of credit to MSME Sector (67.7%). The annual growth rate of credit offered by Public Sector Banks in 2008 over 2007 is 47.4 %, for Private Banks 257.1 % and for foreign banks 67.7 %. This abnormally high growth rate was due to re-classification of MSEs as per MSMED Act, 2006. However, annual growth rate in terms of Net Bank Credit is extremely low (4.09 %). The annual growth rate of percentage of Net Bank Credit offered as credit to MSMEs has not shown sufficient increase even after re-classification of MSEs as per MSMED Act, 2006

The Scheduled banks do not consider the MSMEs preferred area of investment. Traditionally, banking sector considers Small industries a risky field of investment due to reasonably low growth rate of the small firms, firms following informal business practices, inability of the MSME entrepreneurs to maintain collateral securities, lack of creditworthiness, relatively high processing cost, and poor flow of information. Moreover, incidence of Non-Performing Assets (NPA) in Small and Medium Sector is about 15 % compared to about 9 5 in large business houses.

Extreme competition

The MSMEs face ruthless competition from the large domestic firms and multinationals armed with improved technology, managerial ability, skilled workers, marketing skills, better product quality, and wide range of products. The small firms find it difficult to maintain their existence as the cases of merger and acquisition are continuously increasing.

Poor Technology Base

There exist considerable heterogeneity among the MSMEs in India. A small percentage of firms operate with sophisticated technology base whereas majority of firms use outdated technology.

They suffer from low productivity and poor product quality. Due to their small size, they cannot enjoy large-scale production economies.

Lack of infrastructure

Infrastructural lacking includes inadequate power supply, transportation, water supply etc. Small firms cannot bear the cost of setting up independent power supply unit. They have to depend on irregular power supply from the electricity boards. Inadequate transportation system increases cost of production. The MSMEs producing beverages, tobacco products, medicines etc. face the problem of inadequate water supply.

Lack of Skilled workers

Though India has no shortage of human resources, most of them are unskilled workers. Large firms pay higher remuneration and employ skilled workers. The MSMEs have to operate with unskilled or semi-skilled workers. Thus, the MSMEs suffer from low managerial capabilities.

Marketing and Distribution Problems

Marketing is probably the most neglected and less explored problem for Micro and Small firms. Most of them do not have any well formulated marketing strategy, market research programmes, innovative advertisement techniques etc. Most of the MSMEs do not have adequate monetary support to develop marketing section and many are not aware of modern low-cost marketing techniques (by using sending mails, developing website for the company).

Delayed payments

The small firms find it difficult to recover their dues from the large firms and even from Govt. departments due to complex payment procedure and corruption. Due to lack of funds, they cannot employ credit collection machineries (like factoring services). The large firms force them to offer long credit period and even pay advance to ensure timely supply of materials.

Gradual withdrawal of Reservation Policy

Reservation Policy, introduced in 1967 emphasized that some products would be earmarked for exclusive production by the small enterprises and Non-MSME units can undertake manufacture of reserved items only if they undertake 50 % export obligations. Withdrawal of reservation policy allowed MNCs and large domestic firms to produce reserved items without any restrictions and increased the degree of competition for the small firms. However, Several Expert Committees like Abid Hussain (1995), Shri T.S. Vijayaraghavan (1997), Confederation of Indian Industries (CII) (1997) etc. concluded that reservation policy is no longer helpful for MSMEs as MSME units with no reservation facility have performed better than those units with reservation support. Moreover many MSMEs do not produce the reserved items and many MSMEEntrepreneurs do not consider it a relevant policy.

Mind-set Problems

The mind-set of the many MSME entrepreneurs has not yet changed. They still expect protection policies and preferential treatment for the MSMEs. Fortunately, this tendency is low in the new generation entrepreneurs. Workshops, success story based approach may help reduce this tendency even more

Outflow of wealth

Globalization process seems to favour the developed countries and the multinationals more than that of developing countries and the MSMEs. The MNCs use domestic wealth, infrastructure, and local unskilled workers at a lower cost and repatriate huge profits to their own countries

More prone to global fluctuations

A well liberalized economy reacts more sharply with the changes in global market. The demand and supply would be determined by global fluctuations and not by the needs of the consumers.

Social welfare areas neglected

The MNCs are more willing to produce consumer goods to maximize their profit. The qualitative services like health, education etc. which require huge investment but generate less and time taking return on investment, would be neglected.

CONCLUSION

The MSMEs in India face a tough situation due to extreme competition from large industries due to withdrawal of subsidy, lack of infrastructure, antidumping policy, challenges on product standardization, total quality management etc. Though Globalization has increased competitiveness in Indian MSMEs to certain extent, still Indian MSMEs are not adequately prepared to compete with the global players. There has been a definite change in attitude of the Govt. from protection to promotion of the MSMEs. The Govt. has taken several policy initiatives but needs to ensure proper co-ordination and implementation of such schemes. The MSMEs must convert the threats of globalization into opportunities through increased productivity, product diversification, supply chain management, Research and Development activities.

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