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**ROLE OF SMALL AND MEDIUM ENTERPRISES IN INDIA'S MANUFACTURING SECTOR**

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**ABSTRACT**

*The Small and Medium Enterprises (SMEs) are of key importance to the Indian Economy. They form the backbone of the Indian Manufacturing Sector. According to the Report of "The Working Group on Micro, Small & Medium Enterprises" (MSMEs), Growth for 12th Five Year Plan (2012-2017), the micro sector contributes significantly to manufacturing output, employment and exports of the country. It is estimated that in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 percent of total exports of the country. The sector is estimated to employ about 69 million persons in over 26 million units throughout the country. There are over 6000 products ranging from traditional to high- tech items, which are being manufactured by MSMEs in the country. It is well-known that MSME sector provides maximum opportunities for both self-employment and jobs and is considered the second largest workforce in the country after agriculture sector. The MSME units are growing swiftly and strengthening their role in the economic growth. The SME units are more concentrated in manufacturing sector compared to service sector (Archana & Disha, 2012).*

**KEYWORDS**

Employment, Exports, Indian Economy, Manufacturing Sector, MSMEs.

**1. INTRODUCTION**

The importance of SME's in manufacturing sector is mainly due to the quantum of units that fall in this category forming 90 per cent of the total industrial output and 40 per cent of the total exports. This significant contribution of SMEs to the economy is a result of increasing focus of industrial bodies, associations and policymakers towards the development of SMEs. Today SME units are flourishing in an organized way. Cluster-based operations have become a high growth channel among these units given the inherent advantages of such collective strategies. Some of the nation's manufacturing clusters have become leading producers in their respective industries; many others account for a large share in exports. With healthy growth and favorable, outlooks ahead, SMEs are being increasingly viewed by banks as important business destinations. Several Indian banks have joined hands for the formation of SME Rating Agency of India (SMERA) in August 2005, to facilitate the process of lending to SMEs. The rating is adding to the competitiveness of these units for business at national as well as international levels. Increasing awareness about their own ratings is fostering self-improvement among these units which will contribute to their development in the long- run. Apart from self- development, government is also encouraging the SMEs to innovate and grow through various schemes. These schemes are launched by National Manufacturing Competitiveness Council (NMCC) and are aiding overall development of the SMEs as it facilitates improvement at all the steps of value addition in the manufacturing activity.

**2. REVIEW OF LITERATURE**

The literature of SMEs emphasizes the small firms are not simply scaled down version of their larger counterparts. They are having their own complexities and uncertainties. Besides the severe peculiarity and diversity in its definition, there are certain characteristics that they are very specific among the SMEs (Curran and Blackburn, 2001) stresses that, "a small number of human beings engaged in a common endeavor create very complex subtle interactions" (Megginson, Nash and Randenborgh, 1994) explain that "individual freedom, risk taking initiative and hard work are just some features associated with this sector". Juneja (2000) demonstrates that small industry growth rates have increased rapidly compared to the growth rate of the total industrial sector of India since 1991. Global experiences show that an efficient SME sector is conducive to fast industrial growth (Hill, 2001). Lloyd (2002) analyzed the South African SME sector over the 1980 to 2000 period and found that expanded small businesses were playing an increasingly important role in the manufacturing, construction and trade sectors in South Africa, but their role was declining in the agriculture, transport and storage sectors. (Lee 2000) suggest that in South Korea the share of employment accounted for 70% of total employment and the product share for over 46%. In Malaysia SMEs accounted for about 48% of manufacturing establishment (Abdullah 2000b). There are about 118,648 SMEs in Thailand representing around 98% of total firms in manufacturing sector (Suthiphand 2000). China is fast becoming the largest economies in the world and SMEs are key element in China's economy accounting for 99% of total number of firms and about 70% of overall employment (Tang 2007).

**3. OBJECTIVES OF THE STUDY**

1. To assess the role of SMEs in India’s Manufacturing Sector.
2. To determine the growth opportunities of SMEs.
3. To highlight the Policy proposals for improving access to finance for SMEs in the manufacturing sector.
4. To sum up the Schemes launched by government for empowering SMEs to facilitate growth.

**4. METHODOLOGY**

The research design adopted in this study is descriptive research. The researcher has used the secondary source of data. The Secondary data were collected from Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, Ministry of MSME, official site of RBI. The data were analyzed using percentage analysis, ratios, tables, figures and charts.

**5. SME AND INDIAN ECONOMY (AN OVERVIEW)**

The small and medium enterprises today constitute a very important segment of the Indian economy. The development of this sector came about primarily due to the vision of our late Prime Minister Jawaharlal Nehru who sought to develop core industry and have a supporting sector in the form of small scale enterprises. SMEs sector has emerged as a dynamic and vibrant sector of the economy. The Indian economy is expected to grow by over 8 per cent per annum until 2020 and can become the second largest in the world, ahead of the United States, by 2050, and the third largest after China and the United States by 2032. The turnaround in manufacturing and other sectors, which has occurred in the face of increased global competition, is due to improved efficiency following the various policy reforms in recent years (Ruchika Jeswal, 2012).

The units in India are classified under the MSME (Micro, Small and Medium Enterprises) category and on the basis of their investment size. Manufacturing enterprises are classified with respect to their investment in Plant and Machinery, while the classification of service enterprises is based on investment in equipment.

**DEFINITION OF MSMES IN INDIA**

<b>Manufacturing Enterprises – Investment in Plant &amp; Machinery</b>		
Description	INR	USD(\$)
Micro Enterprises	upto Rs. 25Lakhs	upto \$ 62,500
Small Enterprises	above Rs. 25 Lakhs & upto Rs. 5 Crores	above \$ 62,500 & upto \$ 1.25 million
Medium Enterprises	above Rs. 5 Crores & upto Rs. 10 Crores	above \$ 1.25 million & upto \$ 2.5 million
<b>Service Enterprises – Investment in Equipments</b>		
Description	INR	USD(\$)
Micro Enterprises	upto Rs. 10Lakhs	upto \$ 25,000
Small Enterprises	above Rs. 10 Lakhs & upto Rs. 2 Crores	above \$ 25,000 & upto \$ 0.5 million
Medium Enterprises	above Rs. 2 Crores & upto Rs. 5 Crores	above \$ 0.5 million & upto \$ 1.5 million

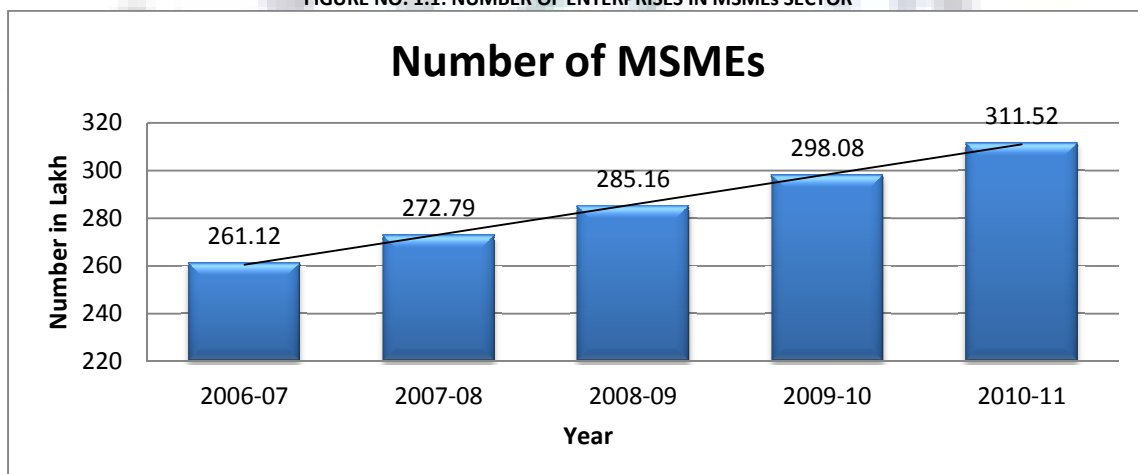
*Source: Ministry of Micro, Small and Medium Enterprises, Government of India.*

Indian SMEs represent the model of socio-economic policies of Government which emphasized job creation at all levels of income stratum and diffusion of economic power in the hands of few, discouraging monopolistic practices of production and marketing; and contributing to growth of economy and foreign exchange earning with low import-intensive operations. Indian SMEs also play a significant role for Nation development through high contribution to Domestic Production, Significant Export Earnings, Low Investment Requirements, Operational Flexibility, Location Wise Mobility, Low Intensive Imports, Capacities to Develop Appropriate Indigenous Technology, Import Substitution, Contribution towards Defense Production, Technology – Oriented Industries, Competitiveness in Domestic and Export Markets and Generate new entrepreneurs by providing knowledge and training. SMEs that have strong technological base, innovative, inventive, international business outlook, competitive spirit and willingness to restructure them can withstand the Present challenges and come out successfully to contribute 22% to GDP.

**5.1 SMALL AND MEDIUM ENTERPRISE TRENDS**

According to Ministry of Micro, Small and Medium Enterprises, the number of MSME units are steadily increasing. The number of MSME units has increased from 261.12 (lakhs) to 311.52 (lakhs) from 2006-2007 to 2010-2011 period (see figure 1.1).

**FIGURE NO. 1.1: NUMBER OF ENTERPRISES IN MSMES SECTOR**



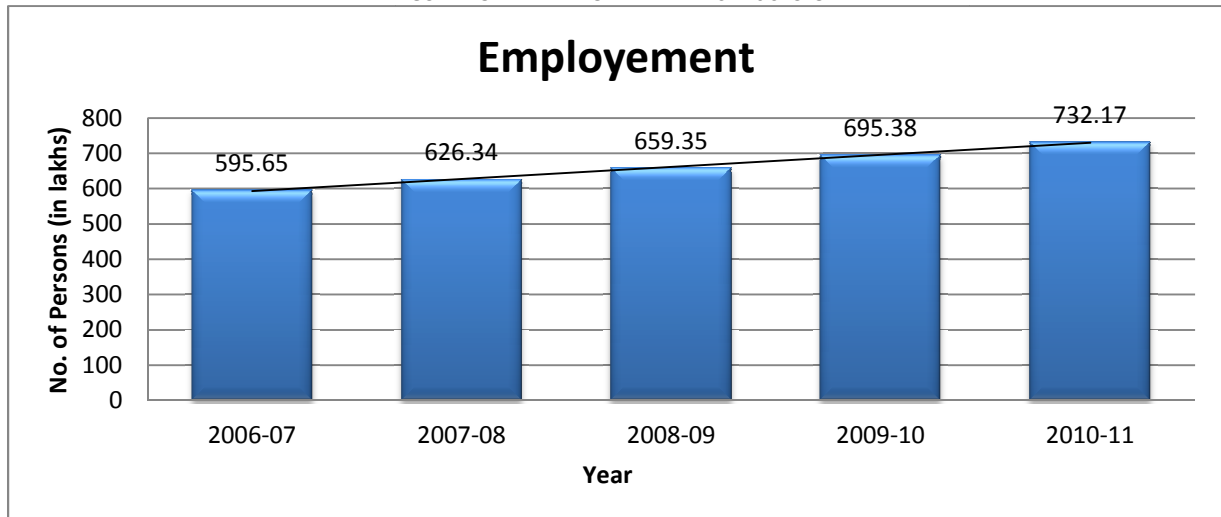
\*Projected data for the year 2009-10 to 2010-11.

*Source: Annual Report MSME 2011-2012 (Government of India).*



The total employment in the MSMEs sector in the country as per the Final Report of the Fourth Census of MSMEs in 2006-07(Registered Sector) was 93.09 lakh persons and the same stands 732.17 lakh persons in the year 2010-2011(see figure 1.2).

FIGURE NO. 1.2: EMPLOYMENT IN MSMEs SECTOR

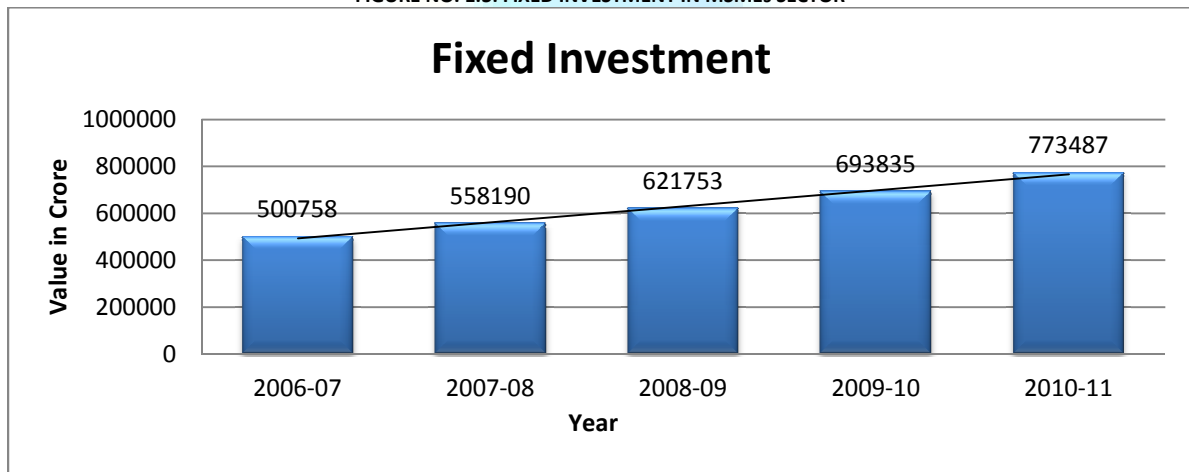


\*Projected data for the year 2009-10 to 2010-11.

Source: Annual Report MSME 2011-2012 (Government of India).

The fixed investments (shown in figure 1.3) rose during the period of 2006-07 to 2010-11 from Rs 500758 (Crore) to Rs 773487 (Crore).

FIGURE NO. 1.3: FIXED INVESTMENT IN MSMEs SECTOR

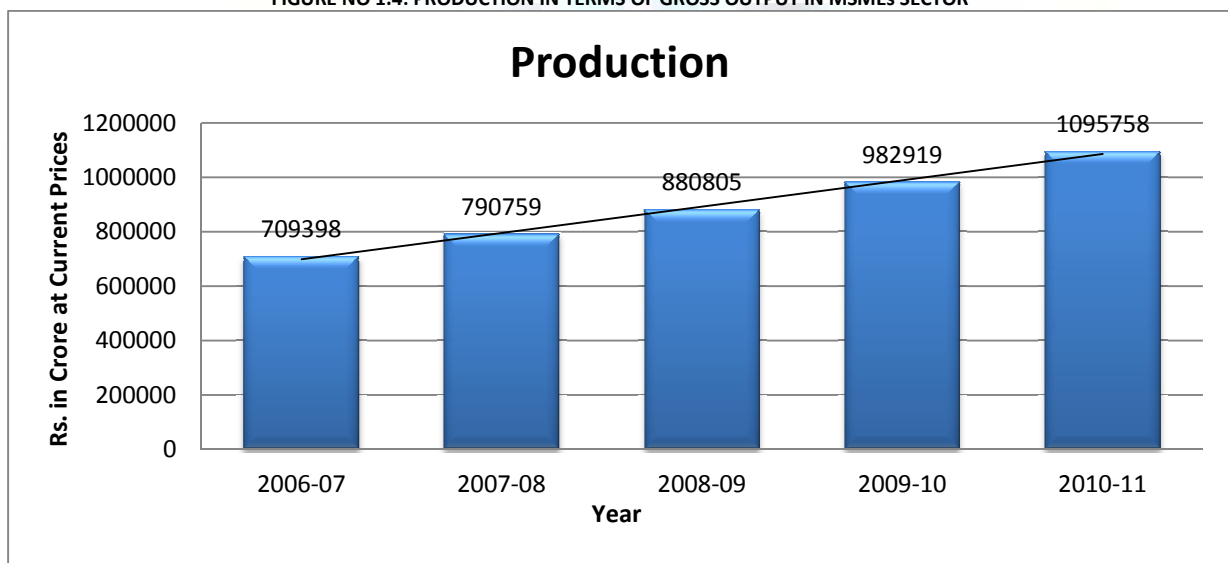


\*Projected data for the year 2009-10 to 2010-11.

Source: Annual Report MSME 2011-2012 (Government of India).

The production segment of MSME sector also shows the healthy growth which stands Rs 709398(Rs in crore at current Prices) in 2006-07 and comes upto Rs 1095758 (Rs in crore at current Prices) in 2010-2011. (See figure No. 1.4)

FIGURE NO 1.4: PRODUCTION IN TERMS OF GROSS OUTPUT IN MSMEs SECTOR

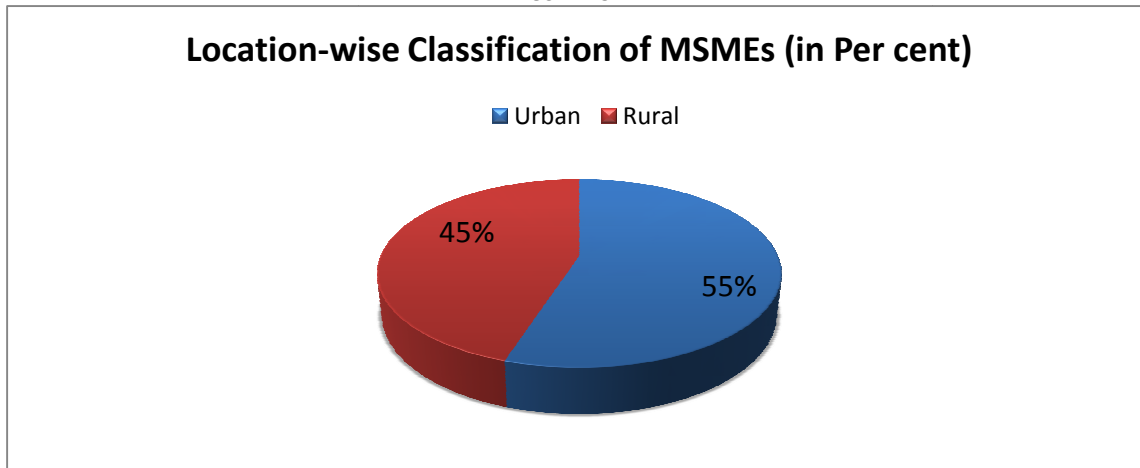


\*Projected data for the year 2009-10 to 2010-11.

Source: Annual Report MSME 2011-2012 (Government of India).

As per the fourth All-India Census of MSMEs (2006-07), 94 per cent of the enterprises are in the unorganized sector. The MSMEs are not concentrated in terms of rural versus urban origin. Rural areas account for 45 per cent of all MSMEs, while the remaining 55 per cent are located in urban areas. (See Figure No.2.1)

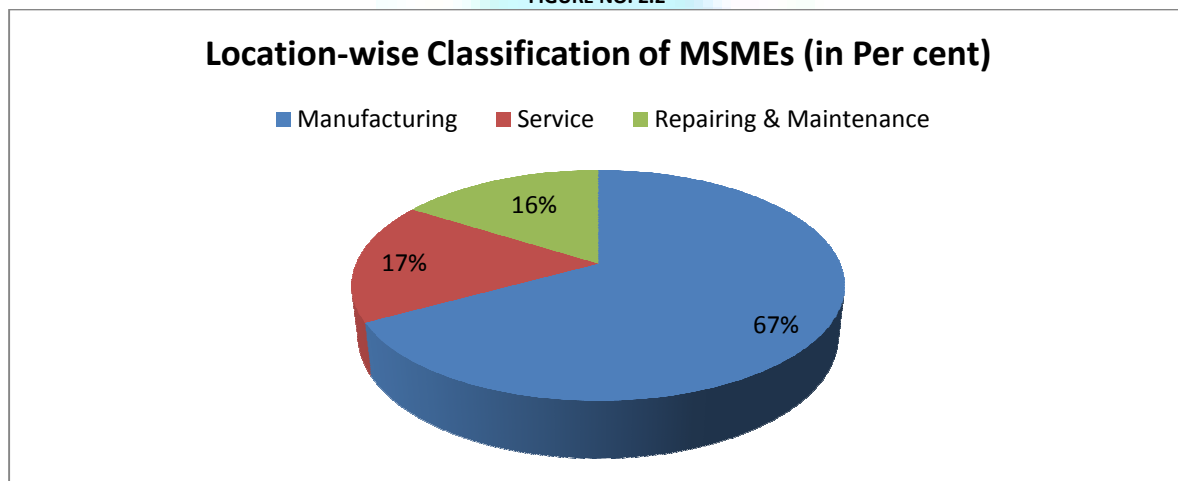
FIGURE NO.2.1



*Source: Annual Report MSME 2011-2012 (Government of India).*

On the other hand if classified with respect to sector of operation, 67 per cent are involved in manufacturing activities and the remaining 33 per cent units are distributed in the service sector (17 per cent) and repairing and maintenance sector (16 per cent). (See Figure No.2.2)

FIGURE NO. 2.2



*Source: Annual Report MSME 2011-2012 (Government of India)*

## 6. SMEs AND INDIAN MANUFACTURING SECTOR

The burgeoning importance of SMEs in the manufacturing sector is due to their significant contribution to the key factors of the growing Indian economy. According to Small & Medium Business Development Chamber of India, SMEs currently contribute 45 per cent of the nation's industrial output as well as 40 per cent of the total exports. SMEs form 95 per cent of the total industrial units in the country and manufacture around 8,000 quality products for the Indian as well as international markets (SME Annual Report, 2012).

### 6.1 MSMEs GROWTH OPPORTUNITIES

According to the United Nations Industrial Development organization (UNIDO), clusters are agglomerations of interconnected companies and associated institutions. Enterprises operating as part of the cluster manufacture related or similar products and are located in spatial proximity.

These enterprises enjoy benefits such as:

- External economies that might be related to specialized raw material supplier, sector-specific labour skills.
- Emergence of customized services for the enterprises; for instance, financial services.
- A platform for building cooperation at the inter-firm level, and local public and private institutions that eventually fosters production and innovation.
- Support from related business associations and technical assistance providers.

Indian manufacturer's clusters have positioned themselves with a strong footprint in the economy. These clusters account for 40 per cent of the nation's industrial output and 35 per cent of direct exports. Some of the prominent clusters in the manufacturing activity are:

- Panipat cluster, which produces 75 per cent of the country's blankets.
- Tirpur cluster, which produces cotton hosiery and account for 80 per cent of product's exports.
- Agra footwear cluster, which includes 800 registered and 6000 unregistered enterprises with a cumulative capacity of approximately 150000 pairs of shoes per day, contributing USD 60 million of exports.
- Ludhiana cluster, which has developed multiple product clusters and produces 95 per cent of the country's woolen knitwear, 60 per cent of the total bicycle and bicycle parts and 85 percent of the sewing machines (Report, UNIDO).

### 6.2 CREDIT RATING FOSTERING BUSINESS GROWTH IN MSMEs

SME Rating Agency of India Limited (SMERA) is India's first and the only rating agency focused on the MSMEs. SMERA is a joint project of Small Industries Development Bank of India (SIDBI), Dun & Bradstreet Information Services India Private Limited (D&B), and nation's many leading banks. The main objective of SMERA's establishment was to design a system to facilitate the banking sector in providing credit to these units. Thus, MSMEs with rating from SMERA are able to seek easy and timely credit on favorable terms. MSMEs are also witnessing growth in business due to the following benefits of credit rating –

1. The business units that avail SMERA rating are assigned a unique 9 digit D&B D-U-N-S® number which acts as an international identification for these units. The D&B D-U-N-S® number is recognized, recommended and sometimes required by more than 500 global trade associations for internal purpose and thus supports growth in export business.
2. Enables large corporate units build confidence in the MSMSE units when the latter is seeking to form part of vendor base of the former.
3. Strengthens the position of MSME among peers for the one bearing credit rating and also allows easy comparison.
4. Allows MSMEs to explore opportunities internationally as rating provides a platform for trade partnerships with global players.

### 6.3 FACTORS ENABLING SMEs TO CONTRIBUTE MORE TO THE ECONOMIC GROWTH

The key to ensure that SMEs are able to grow in tandem with the economy in this age of increasing globalization is to reckon the issues faced by most of them. The government recognizes the importance of SMEs for the overall development of the country, and already has measures in place to harness the erupting issues associated with them. Some of these factors are as follows:

#### FINANCING

The major hindrance in the expansion of SMEs is the unavailability of sufficient and timely funds to finance their growth plans. Measures proposed by the government would ensure availability of adequate funds to MSMEs to power their growth. Small Industries Development Bank of India (SIDBI), the country's apex development bank, has targeted 18–20 per cent YoY growth in disbursement of credit to microfinance institutions (MFIs); with this, the total credit disbursed during FY11 would total INR10 billion. In order to garner more funds for MSMEs, the government is drawing the attention of private equity (PE) firms and venture capitalists (VC) towards these units. The Ministry of Micro, Small and Medium Enterprises (MSME) has plans to network major PEs through informal meetings to invest in MSMEs. Furthermore, in July 2011, the secretary of Department of Industrial Policy and Promotion (DIPP) announced plans to offer incentives to VCs on their investments in SMEs.

Also, SMEs will now have greater exposure to public funds given the recent launch of an SME exchange at the Bombay Stock Exchange (BSE). The BSE SME Exchange commenced operations in March 2012 and senior BSE officials expect about 100 companies on its trading platform by mid-FY13. The exchange is set to be a key source of low cost equity capital for SMEs to aid their growth and expansion plans.

#### INFRASTRUCTURE ISSUES

Policy focus on infrastructure will be instrumental in boosting growth in SMEs manufacturing activities as it brings markets closer. Government infrastructure spending is set to touch USD1 trillion under the 12th Five-Year Plan (2012–17), up from USD514 billion in 11th Five-Year Plan (2007–12). Much of this investment will be directed at the development of roads, bridges, ports, power, railways, airports and urban infrastructure, among others. Apart from spending from its own coffers, the government is keen to engage the private sector as well. Successful implementation of numerous infrastructure projects through the Public-Private Partnership (PPP) model has encouraged the government.

### 6.4 EMPOWERING SMEs TO FACILITATE GROWTH

The main barrier in the growth of SMEs is the lack of resources. SMEs require support from government and industry bodies to overcome the limitations. In line with this, the National Manufacturing Competitiveness Council (NMCC) has announced 10 schemes for developing global competitiveness of the Indian MSMEs in the sector. These schemes cover most of the key areas related to the manufacturing activity –

1. *Lean Manufacturing Competitiveness Scheme*: Implemented under the Public Private Partnership (PPP) mode with 42 Lean Consultants, the project aims to reduce manufacturing waste, and increase productivity and competitiveness.
2. *Design Clinic Scheme*: This is a platform to enable MSMEs to avail expert advice and cost-effective solutions for real-time design issues. The scheme includes two projects, namely Design Awareness and Design Project Funding.
3. *Marketing Assistance and Technology Up-gradation*: The scheme focuses on upgrading technology for increasing competitiveness in marketing. Activities include technology up-gradation for packaging, competition studies and development of marketing techniques.
4. *Technology and Quality Up-gradation*: The scheme aims to encourage MSMEs to adopt global standards for improving the quality of goods.
5. *Promotion of Information and Communication Tools (ICT)*: The scheme focuses on encouraging the adoption of ICT technology by SME clusters, which have been delivering world-class products and, therefore, have potential for growth in exports. The scheme covers building E-readiness infrastructure<sup>3</sup> and web portals and linking it to national level portals for reaching global markets, training MSME personnel for ICT applications, and the development of software solutions for efficient management of production at clusters, among other measures.
6. *Tolling and Training Centers*: This includes incorporation of tool rooms and training centers as a facility to MSMEs.
7. *Improving Quality in Products*: In order to improve the product quality of the MSE (Micro and Small Enterprise) sector, this scheme covers various activities such as: 1) Introduction of appropriate modules for technical institutions, 2) Organizing awareness campaigns, 3) Organizing competition watch (C Watch), 4) Implementing quality management standards and quality technology tools in selected MSEs, 5) Monitoring international study missions, and 6) Impact studies of the initiatives.
8. *Awareness on Intellectual Property Rights (IPR)*: The scheme aims to foster Indian MSMEs to attain leading positions globally, and seeks to empower these units with the IPR tools to protect their innovations.
9. *Barcode Certification*: The certification enables higher export price realization. The adoption of Barcode certification is being encouraged among MSMEs under this scheme by reimbursing 75 per cent of the annual certification fee (recurring) in the initial three years.
10. *Nurturing Innovative Business Ideas*: The Support for Entrepreneurial and Managerial Development of MSMEs through Incubators scheme is aimed at nurturing the innovative idea of an entrepreneur by providing technical assistance through various institutions. Funds up to INR 625,000 are offered per idea as assistance to commercialize the innovation and establish the enterprise through guidance by relevant associations. Currently, 76 business incubators have enabled the approval of 190 business ideas.

Apart from above schemes few important schemes have been designed to boost the growth of MSMEs which includes:

- a) *Cluster Development Programme for Enhancing Productivity*: The Ministry of MSMEs announced this programme, which aims at increasing the productivity, competitiveness and capacity of MSMEs. Clusters are provided financial assistance for the preparation of Diagnostic Study Report and infrastructure development of the Common Facility Centre. This programme has proved beneficial for the clusters. For instance, the Brass and German Silver Utensils Cluster registered a three-fold growth in revenues.
- b) *Prime Minister's Employment Generation Programme (PMEGP)*: Considering the importance of MSMEs in the nation's employment generation, a national level credit-linked subsidy scheme was announced by the Khadi and Village Industries Commission (KVIC). The programme had a total outlay of INR44.85 billion during the last four years (2008–09 to 2011–12) of the 11th Five-Year plan. This scheme covers financial assistance for setting up of microenterprises. The Ministry of MSME is also contributing to this initiative of the KVIC. The programme is estimated to have enabled the generation of 442,000 jobs.

## 7. POLICY PROPOSALS FOR IMPROVING ACCESS TO FINANCES FOR SMEs IN THE MANUFACTURING SECTOR

The Government of India has announced a national manufacturing policy with the objective of enhancing the share of manufacturing in GDP to 25% within a decade and creating 100 million jobs. It also seeks to empower rural youth by imparting necessary skill sets to make them employable. Sustainable development is integral to the spirit of the policy and technological value addition in manufacturing has received special focus, (National Manufacturing Policy, 2011).

- i. Rollover relief from long term Capital Gains Tax to individuals on sale of a residential property (house or plot of land) in case of re-investment of sale consideration in the equity of a new start-up SME company in the manufacturing sector for the purchase of new plant and machinery. This would enable a large number of entrepreneurs to raise equity by selling of ancestral properties and to raise the level of investments in the SMEs in the manufacturing sector, apart from boosting employment.

- II. Tax pass-through status for Venture Capital Funds with a focus on SMEs in the manufacturing sector. These VCFs will be required to be registered under the Securities and Exchange Board of India (Venture Capital Funds) Regulations 1996 and appropriately notified under the Income Tax Act.
- III. Liberalization of RBI norms for banks investing in Venture Capital Funds with a focus on SMEs in the manufacturing sector will be taken up in consultation with RBI.
- IV. Liberalization of IRDA guidelines to provide for investments by insurance companies in Venture Capital Funds with a focus on SMEs in the manufacturing sector will be taken up in consultation with IRDA.
- V. Setting up of a stock exchange for SMEs and implementation of SEBI's 'framework for recognition and supervision of stock exchanges/ platforms of stock exchanges for SMEs', which is expected to boost the access of VC funds to small and medium enterprises.
- VI. Implementation of the recommendations made by the 'Task Force on Micro Small and Medium Enterprises (MSME)', presented to the Prime Minister on 31 January, 2010, including:
  - the creation of a separate fund with the Small Industries Development Bank of India (SIDBI) using the shortfalls against MSE credit targets for commercial banks
  - Strengthening of the National Small Industries Corporation (NSIC) equity base, to give the demand side impetus to MSME enterprises.
- VII. Easier access to bank finance through appropriate bank lending norms, to be arrived at in consultation with RBI, to cater specifically to the MSME sector and early stage business units. This would involve a shift of lending focus from tangible assets to other kinds of assets.
- VIII. Inclusion of lending to SMEs engaged in manufacturing as part of 'priority sector' lending will be considered depending on the recommendations of the Committee set up to look into priority sector lending .

## 8. CONCLUSION

The growing importance of SMEs, which account for about one-sixth of India's total GDP, is manifesting itself in various quarters of the economy. Government is trying to push it forward with a number of plans to foster technology, innovation and quality in SMEs. Banks have joined hands with private players to create a rating agency focused on SMEs in order to improve the credit disbursal to them. Indian SMEs are increasingly organizing themselves in clusters, which improve their access to business associations and technical assistance providers. It also helps in building inter-firm cooperation that adds to productivity and innovation. The clusters already account for 40 per cent of the nation's industrial output and 35 per cent of direct exports. The efficacy of clustering in SME space will further increase in future as clusters continue to leverage benefits of spatial proximity. Globally, successful instances of SMEs have been witnessed in Germany and Italy. Germany's SME units, called Mittelstand companies, emerged as the key contributor to the economy due to the government initiative of bringing together the companies and education institutions. This policy worked as a win-win situation for both companies who adopted concepts towards lean manufacturing and also the students enabling them to improve their technical skills from hands-on experience.

India's manufacturing SME sector is well equipped to grow, and the fundamental drivers are in the right place. Continued empowerment of SMEs will enable them to attain high and sustainable growth in the long-run which in turn lead our nation to sustainable economic development.

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