AN OVERVIEW OF SMALL & MEDIUM ENTERPRISES

S. David Rajan
Dr. B. Madhavan

Abstract

Small and Medium Enterprises (SMEs) are clearly a major growth engine for the Indian economy. In recent times, the degree of availability and accessibility of resources have become key indicators to the health of SMEs in the economy. Amidst the current unprecedented financial crisis not only SMEs, but all stakeholders in the economy have been impacted adversely. In this process, SMEs are also facing an uphill task to manage operating profitability, access to adequate risk or debt capital and availability of professional help or advisory services to deal with the crisis. In this context this paper makes an attempt to give an overview of the functioning of SMEs in India, their problems and opportunities.

Key words: SME, SSI, MSMED Act

Definition of an SME

The definition of SMEs in India has changed with the passing of the Micro, Small and Medium Enterprises Development Act, 2006. The last two decades have seen the rise of the services sector, which now contributes 63% to the GDP as opposed to 49% in 1994-95. With this change, the term small and medium enterprises (SMEs) have become more relevant as opposed to 'small-scale industries' (SSIs). An SME is defined in different ways across the world. In India, a standard definition emerged only recently on October 2, 2006, when the Ministry of Micro, Small and Medium Enterprises, Government of India, enforced the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. The new 2006 Act, which was passed in response to the changing economic scenario, has separate definitions for SMEs in the manufacturing and services sector.

SME definition for manufacturing enterprises

The term "enterprise" in the manufacturing context means an industrial undertaking or a business concern or establishment engaged in the manufacture or production, processing or preservation of goods for the list of eligible industries in the First Schedule to the Industries (Development and Regulation) Act, 1951.

For the manufacturing sector, the MSMED Act 2006 defines micro, small and medium enterprises (MSMEs) as below:

- A micro enterprise is an enterprise where investment in plant and machinery does not exceed Rs 25 lakh
- A small enterprise is an enterprise where the investment in plant and machinery is more than Rs 25 lakh, but does not exceed Rs 5 crore
- A medium enterprise is one where the investment in plant and machinery is more than Rs 5 crore, but does not exceed Rs 10 crore

In all these, the cost excludes that of land, building and the items specified by the Ministry of Small Scale Industries in its notification No. SO 1722(E) dated October 5, 2006.

SME definition for service enterprises

A service sector enterprise is defined as one engaged in providing or rendering of services. This includes the following types:

- Small road and water transport operators that can own a fleet of vehicles not exceeding ten in number
- Small business whose original cost price of the equipment used for the purpose of business does not exceed Rs 20 lakhs
- Professional and self-employed persons, whose borrowing limits do not exceed Rs.10 lakhs of which not more than Rs. 2 lakhs should be for working capital requirements.
- Professionally qualified medical practitioners setting up practice in semi-urban and rural areas, whose borrowing limits should not exceed Rs.15 lakhs with a sub ceiling of Rs. 3 lakhs for working capital requirements.

The financial delimitation for the services sector as defined by MSME is as below:

- A micro enterprise is an enterprise where the investment in equipment does not exceed Rs 10 lakhs
- A small enterprise is an enterprise where the investment in equipment is more than Rs 10 lakhs but does not exceed Rs 2 crores.
- A medium enterprise is an enterprise where the investment in equipment is more than Rs 2 crores but does not exceed Rs 5 crores.

Source: Ministry of MSME, NewDelhi

SME definitions differ widely among Countries

Though the Indian definition hinges around the investment amount, most countries define small and medium enterprises (SMEs) in terms of number of employees and turnover.

In Malaysia, small enterprises have a turnover between Rs 250,000 to Rs 1 million and medium enterprises are those that have a turnover ranging between Rs 1 million and Rs 25 million also, the average employee strength for SME is 50 employees and 150 employees respectively.

In Hong Kong, the definition of SME is given by the Government of Hong Kong Special Administrative Region (HKSAR). According to the HKSAR, a manufacturing business that employs fewer than 100 persons or a non-manufacturing business that employs fewer than 50 persons is classified as an SME.

Similarly in China, small enterprises are defined as those that employ 50 to 100 people and medium enterprises employ 101 to 150 people. In the European Union, a business with a headcount of fewer than 250 is classified as medium sized, a business with a headcount of fewer than 50 is classified as small and a business with a headcount of fewer than 10, is considered a micro business.

In the United Kingdom, a small enterprise is defined as a unit that has a turnover of around 5.6 million pounds and employs around 50 people. A medium-sized enterprise has a turnover of not more than 22.8 million pounds and has 250 employees.

Canada defines a small business as one that has around 50 to 100 employees depending on service and manufacturing respectively. A firm that has around 500 employees is classified as a medium-sized business. A micro business is defined as a business with fewer than five employees.

In Japan, for the manufacturing sector, SMEs are those that employ less than 300 people or have an invested capital of less than 100 million yen. In the service sector, SME in Japan are defined as those units that employ less than 50 people or have an invested capital of around 10 million yen.

In the United States of America, SME means a unit consisting of 1,500 employees and has a turnover of $0.75 to 29 million, depending upon the type of business. In the US, a government department called Small Business Administration (SBA) sets the definition of small businesses.

History of SMEs in India

The History of SME in India can be traced back to the Gandhian model of economic self - reliance. However the real growth started with the liberalisation policies of the government starting 1991. Small and medium enterprises (SME) are a critical engine of growth for India's economy. The emphasis on small - scale manufacturing setups in India is born out of the Gandhian model of economic self - reliance that envisaged the village as a self - sufficient economic unit that could produce everything it needed to consume. Mahatma Gandhi's Vision for this economic model was aimed at providing employment to large number of people to address the prevalent issue of poverty.

Policy Measures

Post - independence, India adopted the Industrial policy Resolution of 1948 that defined the role of the State in industrial development for the first time. At this time, the role of the government was dual - that of the entrepreneur and also the regulatory authority. Centralized planning was a strong feature of the first few decades and several controls were kept on private trade, investment, land ownership and foreign exchange.

In 1956, during the second five year plan, the Indian government announced the Second Industrial policy that clearly placed small industries in an important position by stating that "small - scale industries (SSI) provide immediate large - scale employment, offer a method of ensuing a more equitable distribution of National Income and facilitate effective mobilisation of resources of capital and skill, which might otherwise remain unutilised."

The sector was defined as enterprises with investment in plant and machinery of up to Rs. 1 lakh and located in towns and villages with a population of less than 50,000 people. The policy statement put in place special legislation to recognise and protect self-employed people in cottage and home industries. District Industries Centres (DICs) were set up and made the focal point of SSI Development, bypassing large cities and state capitals. Also the government started providing special services like product standardisation, quality control and marketing surveys to help SSI market their products in an under developed market.

In the First Five Year Plan (1951-56), village industries got government attention. In second Plan (1956-61), small industries policy statement was made which emphasized small industrial capital and employment. In third Plan (1961-66) and Fourth plan (1967-74), Industrial policy resolutions began and SSI based welfare oriented employment programme of Keynesian model was introduced. In Fifth plan (1974-79), promotion of wider dispersal of village and cottage industries in rural areas, and tiny sector concept were introduced.

Time Line

In 1967, the manufacturing of several products was limited to small industries by law in a move to boost the sector. In 1977, the concept of protection of small industries was given a thrust comprehensively by the government. The number of products re-served for SSIs increased from 180 to 504 in 1977 and subsequently to 836 in 1996. In a policy statement issued in 1980, the Government recognised the importance of ancillary industries and ramped up the development of rural and backward areas through the propagation of SSI. The

Industrial Policy Statement of 1985 accounted for inflation and raised the investment ceiling to Rs 35 lakh for SSI and Rs 45 lakh for ancillary industries.

Liberalisation

The scenario for the small scale sector changed with the Industrial Policy of July 1991, when for the first time in India's development history the Government spoke of liberalisation. What this meant was that medium and large enterprises would no longer need licenses to run. Export oriented enterprises could be wholly foreign-owned and foreign equity participation was selectively allowed. Industries could import capital goods with much fewer restrictions.

In 1996, the government set up a high level committee, known as the Abid Hussain Committee, to review policies for small industries and recommend measures to help formulate a strong and innovative policy package for rapid development of SMEs. With liberalisation, rapid changes were being seen in the Indian economy. Indian companies were no longer insulated from the global economy. In fact, there was an urgent need to make them - especially SMEs, more competitive and resilient.

In Sixth and Seventh Five Year Plans (1980-89), Industrial Policy Statement and project planning were introduced and efforts were made as to promote industrial growth in backward districts. In Eight, Ninth and Tenth Plans (1992-2007), efforts such as Labour Law relationship, Vision to create employment for 50 million people and Formulation of National Competitiveness Programme to support SME were defined. But in Eleventh Plan (2007-2012), recognising the continuous need to facilitate the graduation of SMEs to higher levels and Stress on enhancing competitiveness of SME is planned.

Till 2006, the SME segment saw a lot more development and support from the government sector. SMEs led to entrepreneurial development and diversification of the industrial sector by providing ample employment opportunities for the youth. Also, with the services sector dominating SMEs, who were thriving on outsourced work given by various multi - national companies (MNCs), the scope for SME finance increased enormously. Besides this, the Kochi based Institute of Small Enterprises and Development (ISED) had put forth the idea of setting up an SME Innovation Fund with a corpus of Rs 500 crore, to be administered by the Small Industries Development Bank of India (SIDBI). The fund was to be used for training, exposure programmes, support to innovative professional agencies and awards for successful entrepreneurs.

A fresh start for the sector

A concerted effort to support and promote SMEs in the context of a globalised competitive world began with the implementation of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. It came into effect from October 2, 2006. It aims to remove several bottlenecks faced by the SME sector such as:

- Competition from domestic companies and MNCs
- Inadequate access to finance due to lack of financial information and non-formal business practices.
- Lack of access to private equity and venture capital
- Lack of access to inter-state and international markets
- Limited access to secondary market instruments
- Fragmented markets in respect of inputs as well as final products
- Vulnerability to market fluctuations

- Limited access to technology and product innovations
- Lack of awareness of global best practices
- Considerable delays in the settlement of dues / payment of bills by large-scale buyers

Salient Features of the Act

- Creation of a National Board for SMEs
- Proper classification of enterprises
- Advisory committee to support SMEs
- Measures for promotion, development and enhancement of SMEs
- Scheme to control delayed payments to SMEs
- Scheme for closure of businesses of SMEs
- State governments are required to make rules to carry out the MSMED 2006 Act in their respective states properly.

Economic Importance

With the services sector adding more and more to the GDP of the Country, the importance of SMEs to the economy is also increasing. As per various estimates, there are more than 12 million small and medium enterprises (SMEs) in India, out of which about 55% are in rural India and the balance 45% in cities and urban areas.

According to figures from the Ministry of Micro, Small and Medium Enterprises and the Central Statistical Organisation, the contribution of SMEs to India's GDP has increased from 13.1% in 2000-01 to a projected 15.5% in 2007-08. In the same time period, the total SME units have increased from 9.7 million to 12.8 million, with production per unit increasing from Rs 240500 to Rs 457300. The exports from the SME sector increased from US$ 17.8 billion in 2003-04 to $33.9 billion in 2006- 07.

Estimates vary widely as Government sources report only registered SMEs. Research organisation Zinnov estimates that the number of SMEs in India in 2006-07 was 35 million, the second highest after China. This number is slated to become 48 million by 2015. Zinnov's research also says that SMEs contribute over 60% to the Nation's GDP and have been growing at a compound annual growth rate (CAGR) of 12% for the past seven years.

The growth rate for SMEs has been consistently higher than that of the overall industrial sector. Over the last two years, the SME sector was growing at 35%. However, SMEs are slated to grow at 40 per cent on the back of increased technology adoption.

An Important Link in the Economic Value Chain

SMEs are critical because they offer specific socio-economic benefits for the National economy. There are several benefits that SMEs give to the economy, some of which are :

- Driving industrial growth by adding capacities.
- Supplying cost effective quality goods and services to meet local market demands.
- Leveraging and retaining the Indian advantage to sell goods and service in international markets.
- Influencing social transformation -SMEs play a catalytic role in offering affordable and innovative goods and services to meet the changing needs of society- be it in education, medical care, transportation, entertainment or local infrastructure development.

- As SMEs consume only low capital investment per unit of output, they have really high ratio of cost Vs output.
- They generate opportunities for direct and indirect employment. As per a Dun & Bradstreet (D&B) report, emerging SMEs of India 2008, in 2006-07 every ten million rupees invested by the SME sector generated employment for over 150 people, while for the overall economy, the same amount of investment generated employment for 37.4 people. Government statistics show that in 2007-08, SMEs provided employment to 31.25 million people.
- SMEs use natural resources and local skills and meet the needs of a local or "limited" market for consumer goods and services.
- The growth of the SMEs also brings about socio-economic uplift in the region and more employment opportunities to the untapped rural and urban workforce across geographic regions.

Merits of SMEs

SMEs encourage entrepreneurship because setting up an SME is a smaller risk. With employment and livelihood opportunities available in rural and semi-urban areas, the migration to urban areas is stemmed to an extent. Whereas the above reasons are more applicable in a manufacturing context, SMEs are critical to India in achieving the transition from a predominantly agricultural economy to a service-oriented one. Inter-sectoral shifts from agriculture to industry and to the services sector are part of the natural growth of an economy.

For example, in Japan the share of agriculture in the labour force has gone down from 68% to 4.9%, in the United States from 44% to 9% on an average (including the migrants).

In India as well, agriculture can no longer absorb the employment needs of a growing population. SMEs are vital as they help create self employment opportunities in all three sectors. The service sector has shown tremendous growth. In 1980, it contributed 36% to the GDP and as per revised estimates for 2007-08 the service sector contributed 62.9% to the real GDP.

The experiences of several developed nations like USA, Japan and many European countries have shown that conscious and articulated policies to promote SMEs can create greater employment than focus on large enterprises alone. In the US, firms that employ 100 or fewer employees create approximately 80% of new jobs. SMEs and large enterprises are inter-linked strongly, in both backward and forward directions. SMEs are often spin-offs frorn large manufacturing and service firms. For instance, the auto ancillary and pharmaceutical sectors in India have become important SME areas and have grown in the wake of the growth of large companies in these verticals. Conversely, vertical growth in SMEs can also result in formation of big groups through mergers.

Take for example, the Aurangabad-based Huchii Engineers joint venture (JV) with US based precision sheet metal and integrated assembly player “Craftsman Custom Metals” (CCM) in 2006. With an investment of around $10 million, the JV caters to companies in sectors like computing, networking, hardware and telecom among others. The JV has also employed over 200 people. It will set up an ultra-modern plant in India to meet the emerging business needs. Thus the JV gives both the companies an opportunity to explore various markets and cater to more clients with international expertise.

Barriers and Opportunities

In recent times, the degree of availability and accessibility of resources have become key indicators to the health of small and medium enterprises (SMEs) in the economy. Amidst the current unprecedented financial crisis, not only SMEs, but all stakeholders in the economy have been impacted adversely. In this process, SMEs are also facing an uphill task to manage operating profitability, access to adequate capital and availability of professional help or advisory services to deal with the crisis.

Barriers to growth

Access to markets: Small businesses do not have adequate resources to link to markets beyond their immediate context. This is a limiting factor for profitability as well as growth. The economic slowdown has meant shrinking demand for export-oriented SMEs

Customer retention: SMEs depend on the quality and competitive advantages of their goods and services to get and retain customers. Compared to large enterprises, they do not make overt moves to retain customers. This can be a challenge and so SMEs are also adopting tools like customer resource management and focusing on branding, visibility and corporate communication to ensure that customers keep coming back.

Access to finance and high cost of capital: In the absence of adequate means for financing, SMEs have restricted access to funds. Banks and financial institutions have not been forthcoming in the past to lend to SMEs. In the past five years, Angel investors, Venture capitalists and Private Equity Players have started investing in the SME sector. Even so, SMEs reckon lack of finance as their biggest problem. Besides unwillingness of lenders to look at SMEs and lack of collateral security are common barriers to get finance. Plus, the cost of compliance is often prohibitive. A simplified structure for SME lending is required, with simpler conditions for eligibility, corporate governance norms and disclosure standards. On the other hand, SMEs also need to improve accounting practices and increase transparency to make themselves more attractive to lenders and investors. Delayed payment from customers is another common problem faced by SMEs. These results in cash flow problems and SMEs are unable to sustain themselves.

Access to business development services: SMEs are usually inward-looking and do not use latest management tools to enhance their businesses. For instance, benchmarking and best practices are rarely used by SMEs. Small businesses particularly face the problem of being unable to forecast demand because they do not use market or business intelligence. Often, affordability for business services, tools and software is a barrier. However, the availability of tools suited to small businesses has also been a problem in the past.

Human resources: According to the UPS Asia Business Monitor 2008 (UPS ABM) survey, which studied the competitiveness of Asia's SMEs, 48% of the businesses stated that the major business issue keeping them awake at night is retention of quality employees. SMEs are unable to match large enterprises in terms of remuneration and work environment.

Infrastructure and logistics: SMEs along with the industry in general, suffer from an underdeveloped supply chain and lack of logistics infrastructure in the country. It is far more critical for an SME to ensure that its product reaches the market on time and in good condition because their margins are usually lower. An efficient supply chain ensures that losses are minimised.

Legal and regulatory system: Special laws and provision for SMEs are needed as the mode of functioning and problems faced are very different from those of larger enterprises. Plus, SME's are adversely impacted by complicated mechanism for approvals and permits. Lengthy processes often result in SMEs losing their window of opportunity. About 54% of the respondents to the UPS ABM 2008 survey felt that bureaucracy and red tape in processing applications is a big issue.

WTO compliance: Since India signed the WTO agreement, SMEs have had to deal with a set of regulations that aim to move towards a free market and remove barriers to trade. SMEs are vulnerable to the impact of WTO as they are now in direct competition with companies in East Asia and China that can manufacture goods at lower cost. Large companies in India now have the option of procuring their supplies from overseas suppliers and the market for SMEs could go down. Tighter patent laws are also putting SMEs at a disadvantage, as they often cannot afford the compliance. Moreover, Indian SMEs are unable to implement anti-dumping measures and counter other unfair practices such as moves by competitors to patent traditional Indian products and brands.

Opportunities for SMEs

Owing to their size, SMEs can tap specific opportunities that larger enterprises cannot. They are self-reliant, with the ability to carry out most of their processes in-house, as opposed to larger companies, where a number of processes are outsourced. This accords SMEs greater control as well as a shorter production time. At times, this also allows them to be more flexible, an asset for design-based products in several verticals. SMEs can function in remote areas and therefore, have access to cheaper labour.

At this time, SMEs can take advantage of India's growing economy and substantial domestic demand. In fact, recent studies show that Asian companies should look at domestic demand rather than focus only on exports. In India, domestic market opportunities are high. India has a total population of 1.1 billion growing at 1.3% a year. Of this, about 350 million Indians have disposable income. Though India's per capita income is low, it has more than doubled in the past seven years. According to a report on big countries (Brazil, Russia, India & China) India's per capita disposable income currently stands at US$ 556 per annum, which will rise to $1150 by 2015.

And with the end of the quota regime and a more responsive policy framework in place, SMEs have a better future of addressing issues like financing, infrastructure and marketing. For example, the permission of foreign direct investment (FDI) into many vertical sectors has opened up a number of opportunities and benefited SME players.

Future Outlook

SMEs are clearly a major growth engine for the Indian economy. Despite the global slowdown, the mood in the industry is upbeat (Allen Mukerjee R.L. 2008). According to the HSBC Asia-Pacific Small Business Confidence Survey for 2007, conducted by the Neilson Group, Indian SMEs are the 'most optimistic' about the economy and their growth, with 79% of the Indian small business surveyed expecting a faster economic growth this year. While about 30% of the SMEs expect moderate growth, 43% expect a significant growth in their business. Around 36% of the respondents have investment plans this year. With reference to cross-border trade, about 73% of the SMEs across the regions see a growth in trade with mainland China. 76% of the SMEs see an increase in the trade growth by about 30%. The outlook for Indian SMEs has been positive from a global perspective as well. The UPS ABM 2008 survey shows that 41% of the SME respondents from outside India rated Indian SMEs to be more competitive than them.

References:

1. Allen mukerjee, Survey on Indian MSMEs, 2008
2. Asia Pacific Small Business Confidence Survey, HSBC, 2007
3. Reports of Central Statistical Organization, Chennai
4. Reports of Department of Industries Development, Govt of Tamil Nadu,
5. Reports of Directorate of Small Scale Industries, Guindy, Chennai
6. Emerging Auto Components' SMEs of India, Dun & Bradstreet, 2006
7. Emerging SMEs of India, Dun & Bradstreet, 2008
8. General Review of Small & Medium Enterprises Clusters in India, United Nations Industrial Development Organization
9. India Micro, Small and Medium Enterprises Report, Institute of Small Enterprises and Development, 2008
10. IT opportunity in Indian SME sector, Zinnov LLC, February 2008
11. Sickness & Rehabilitation of MSMEs in India, Milagrow Business & Knowledge Solutions
12. Third All India Census of Small Scale Industries 2001-2002
13. The MSME White book, Business World, 2009-2010

QUOTABLE QUOTES (on Teaching)

1. Teaching is the only job which does not have a financial relationship with the beneficiary/ customers. In all other walks of life, say in any trade or business, such a relationship is present.
2. Teaching is the only profession on 24 hours duty. A Teacher has to behave a Teacher whether on duty or off duty
3. A Teacher must be high on intellect but low on ambition. If he is low on intellect he won't be able to teach; if he is high on ambition he won't be interested in Teaching; he will be an executive or business man .
4. Only a Teacher is in a unique position to groom people (students) better than himself!!
5. Great Teachers play down their role strategically, to boost the confidence level of a meek student.
6. Teachers are like Potential Energy, students- kinetic Energy; they are complementary part of a whole.
7. A Teacher is down with fever in the Staff room; push him into the class - lo and behold, he is alright.
8. A Teacher is a person who knows the road - but does not drive himself.
9. A Teacher is a showman too ! As part of the showmanship, he has to have a smart turnout, a cheerful countenance and must be well groomed.
10. An ordinary Teacher narrates, the good Teacher explains, the better Teacher demonstrates and the best Teacher inspires.

About the Authors:

S. David Rajan is a Research scholar on Small & Medium Industries, with Sathyabama University. davidrajan@gmail.com

Dr. B. Madhavan is the Research Supervisor of S. David Rajan.