

Role of Micro, Small and Medium Enterprises in the Indian Economy

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Abstract- *The rise of India as a growing power not only in Asia but also at the global stage would require not only a macroeconomic uplift but also a thorough realization of innovation by the Micro, Small and Medium Enterprises (MSMEs). MSMEs contribute 45% in industrial output, 40% of exports, employing 60 million people and create 1.3 million jobs every year. Nationwide entrepreneurship development with appropriate scale, scope and innovation will make all the difference for Indian MSME segment considering the growing innovation in the competing countries including China, Japan, South Korea, Singapore etc. which are found high on Global Innovation index. MSMEs play a critical role in innovation, thanks to their nimbleness and their ability to experiment with new technologies on small scales. However, they often suffer from lack of funds, inability to take risks associated with technology developments and the difficulty of attracting skilled manpower. Accessing credit on easy terms has become difficult in the backdrop of current global financial crisis and the resultant liquidity constraints in the Indian financial sector, which has held back the growth of MSMEs and impeded overall growth and development. It has become difficult for lenders to be able to assess risk premiums properly, creating differences in the perceived versus real risk profiles of MSMEs. Government policies for MSMEs should therefore help them improve their technological capabilities by focusing on: providing access to risk capital, setting up of standards for the industry, improving industry/research institute/academia interaction, mostly in clusters, stimulating demand/providing scale through preferential treatment in government purchases.*

Keywords: Small Scale Industries, MSMED Act, Global Innovation Index, Industrial Clusters

“The poor cannot be helped by mass production but by production by the masses”

–Mahatma Gandhi, Father of the Nation

Introduction

The ongoing program of economic reform is based upon the principles of liberalization, globalization, and privatization. Changes in the international economic scene, including the emergence of the World Trade Organization (WTO), have brought certain challenges and several new opportunities to the Small Scale Industries sector. The most important challenge is that of increasing competition, both globally and domestically.

Micro, Small and Medium Enterprises (MSME) plays a critical role in Indian economy as reflected in their contribution to GDP (9%), manufacturing output (45%), exports (43%), fixed assets at Rs 689 billion & employment at

around 80 million. The scope and coverage of the MSME sector was broadened significantly under the Micro, Small and Medium Enterprises Development Act (MSMED) Act, 2006, which recognized the concept of “enterprise” and to include both manufacturing and services sector, besides defining the medium enterprises under MSME sector. Thus the entire non-agricultural sector of economy was brought under the coverage of MSME sector subject to the revised criteria prescribed for defining Micro, Small and Medium Enterprises separately for manufacturing and services sectors.

MSME Sector consists of any enterprise, whether proprietorship, Hindu undivided family, association of persons, co-operative society,

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partnership or undertaking or any other legal entity engaged in production of goods pertaining to any industry specified in the first schedule of Industries Development and Regulation Act, 1951 & other enterprises engaged in production and rendering services, subject to limiting factor of investment in plant and machinery and equipment respectively as noted below:

Definition of Micro, Small and Medium Enterprises in India:

Micro, small and medium enterprises as per MSMED Act, 2006 are defined based on their investment in plant and machinery (for manufacturing enterprise) and on equipment for enterprises providing services. The defined limit on investment for enterprises to be classified as micro, small and medium enterprises is as follows:

Classification	Manufacturing Enterprises*	Service Enterprises**
Micro	Rs. 2.5 million / Rs. 25 lakh	Rs. 1 million / Rs. 10 lakh
Small	Rs.50 million / Rs. 5 crore	Rs. 20 million / Rs 2 crore
Medium	Rs 100 million / Rs 10 crore	Rs. 50 million / Rs 5 crore

* Investment limit in Plant & Machinery ** Investment limit in equipment

The term "village industries" has been redefined in amended Khadi & Village Industries Commission (KVIC), Act, 1956 as "any industry located in a rural area which produces any goods or renders any service with or without the use of power and in which the fixed capital investment per head of artisan or worker does not exceed Rs. 1 lakh (Rs. 1 lakh and fifty thousand in case of village industry located in a hilly area) or such other sum as maybe specified by the Central Government"¹.

MSME sector spans the entire non-agriculture segment of the Indian economy. Implementation of MSMED Act, 2006 brought different components of the economy hitherto classified under Small Scale Industries (SSIs), Small Scale Business Sector Enterprises (SSBSEs), Village & Cottage industries together and expanded the scope of MSME sector.

The Khadi & Village Industries (KVI) Sector not only serves the basic needs of processed goods of the vast rural sector of the country, but also provides sustainable employment to rural artisans. KVI today represent an exquisite, heritage product, which is 'ethnic' and has a strong clientele among the middle and upper sections of the society.

Output, Employment & Investment of MSME Sector

MSMEs account for more than 90.0% of total industrial units in India. The MSME sector has

registered an impressive growth over the years; total number of units increased at an annual rate of 20.3% to 31.2 million during 2006–11. MSMEs contribute 45.0% to manufacturing output, 40.0% to exports and 8.0% to the country's GDP.

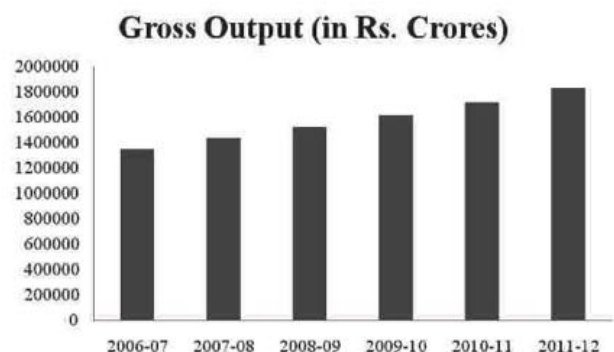


Figure 1 : Gross Output
Source: Annual Report of MSMEs 2012-13

Growth Rates in India

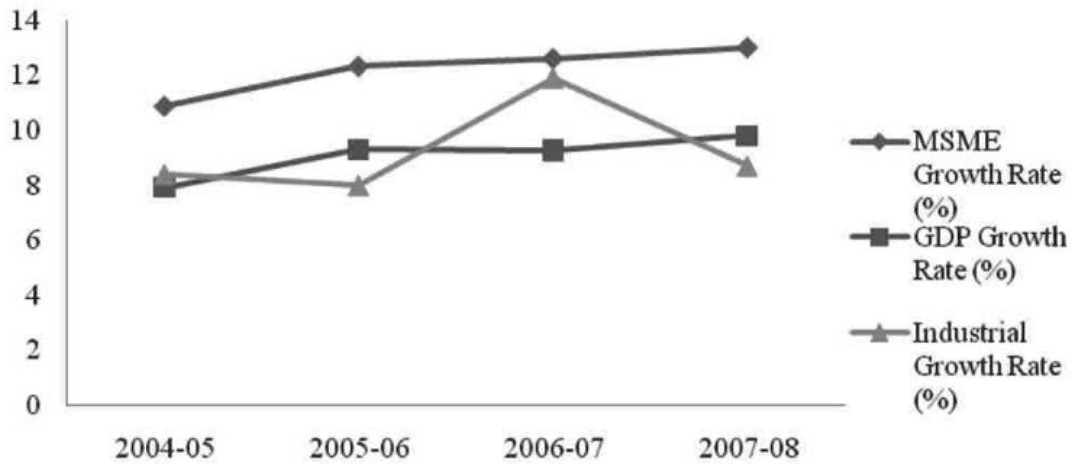


Figure 2 : GDP Growth Rate & MSME Sector Growth Rate compared with Industrial Growth Rate
Source: Annual Report of MSMEs 2011-12

The domestic MSME sector has outpaced industrial and GDP growth. MSME sector plays a key role in supporting employment and skill upgrading. The MSME sector is the second largest employment generator in India after agriculture. It generated employment for 73.2 million people in 2011-12 and is projected to increase. While MSMEs are a key source of employment for low-skilled and semi-skilled workers, the sector has been working hard towards upgrading the skill base and attracting more talent. In line with this, the government and various private players are heavily investing in training centres. MSMEs have been coordinating with private sector players in upgrading skills and delivering quality. Large industrial firms

(such as those in automotive sector) often tend to be the end-customer for MSMEs. To ensure product quality, these firms often coordinate with smaller suppliers to impart the requisite skills and ensure adherence to standardised processes. The government as well as NGOs have been actively involved in this endeavour. With improving skills, better coordination with bigger firms and greater technological access, MSMEs in India have moved into a league of their own. The sector currently produces more than 6,000 quality products, ranging from handloom saris, carpets and soaps to pickles and machine parts, for large industries targeting domestic and international markets².

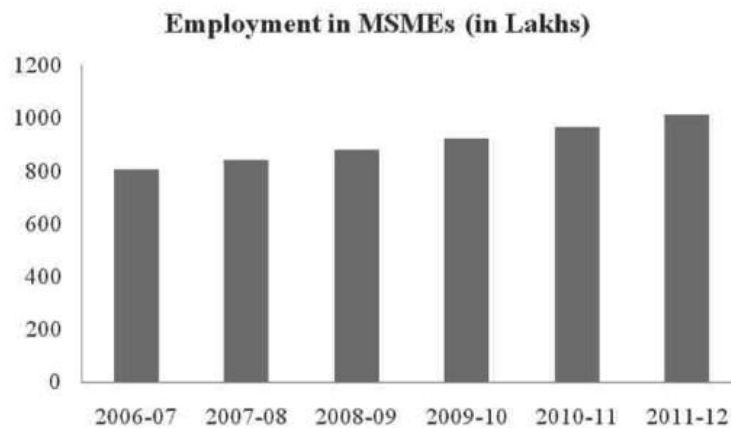


Figure 3 : Employment in MSMEs
Source: Annual Report of MSMEs 2012-13

The MSME sector in India is heterogeneous, dispersed and mostly unorganized. A key feature of MSMEs in India is that a majority of them are unregistered. Micro enterprises dominate the sector with a 94.9% share, followed by small

enterprises (4.9%) and medium enterprises (0.2%). Uttar Pradesh leads with the largest number of enterprises and highest employment followed by West Bengal.

States	Number of Enterprises (Lakhs)	Employment (Lakhs)
Uttar Pradesh	44.03	92.36
West Bengal	34.64	85.78
Tamil Nadu	33.13	80.98
Maharashtra	30.63	70.04
Andhra Pradesh	25.96	70.69
Kerala	22.13	49.62
Gujarat	21.78	47.73
Karnataka	20.19	46.72
Madhya Pradesh	19.33	33.66
Rajasthan	16.64	30.79
All India	361.76	805.24

Table 1 : State-wise distribution in MSME Sector
Source: Annual Report of MSMEs 2012-13

Given strong growth and rising potential, the MSME sector experienced a significant increase in investment flows.

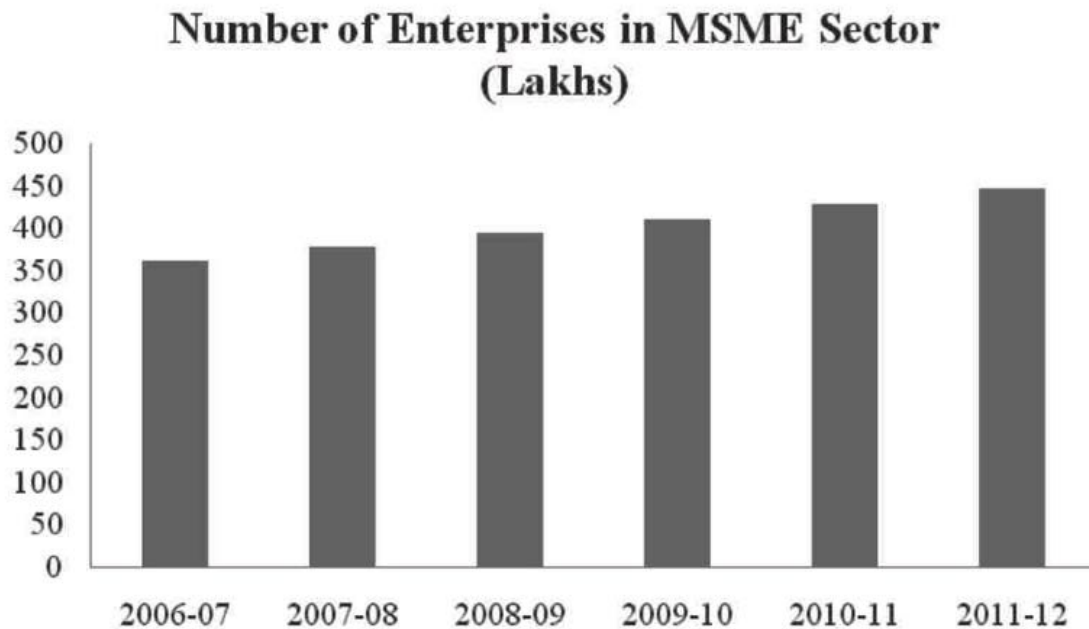


Figure 4 : Number of Enterprises in MSME Sector
Source: Annual Report of MSMEs 2012-13

Market Value of Fixed Assets (Rs. Crores)

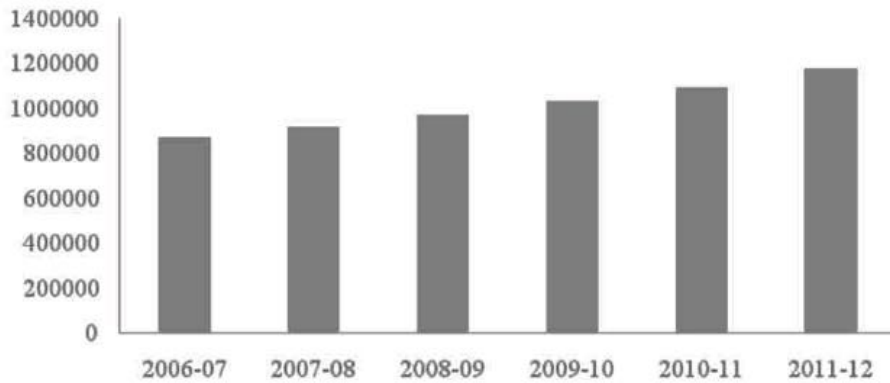


Figure 5 : Market Value of Fixed Assets
Source: Annual Report of MSMEs 2012-13

A major portion of investments has been directed towards technological developments, resulting in an improvement in volume and quality.

I. No.	Year	Total Working Enterprise (In Lakh)	Employment (In Lakh)	Market Value of Fixed Assets (In Crore)	Gross Output (In Crore)
1	2001-02	105.21	249.33	154349.00	282270.00
2	2002-03	109.49	260.21	162317.00	314850.00
3	2003-04	113.95	271.42	170219.00	364547.00
4	2004-05	118.59	282.57	178699.00	429796.00
5	2005-06	123.42	294.91	188113.00	497842.00
6	2006-07	361.76 ³	805.23	868543.79 ⁴	1351383.45
7	2007-08	377.37	842.23	917437.46	1435179.26
8	2008-09	393.70	881.14	971407.49	1524234.83
9	2009-10	410.82	922.19	1029331.46	1619355.53
10	2010-11	428.77	965.69	1094893.42	1721553.42
11	2011-12	447.73	1012.59	1176939.36	1834332.05

Table 2 : Performance of MSME Units, Employment, Investments and Gross Output
Source: Annual Report of MSMEs 2012-13

There are over 6000 products ranging from traditional to high-tech items, which are being manufactured by the MSME sector in addition to provide wide range of services⁵. The leading industries with their respective shares are as depicted below:



Figure 6 : Sector Shares in MSME Sector
Source: Annual Report of MSMEs 2012-13

Around 45.2% of MSME enterprises operate in rural regions and 31.79% of the enterprises in the MSME sector were engaged in manufacturing, whereas 68.21% were engaged in services.

Urban-Rural spread of MSMEs

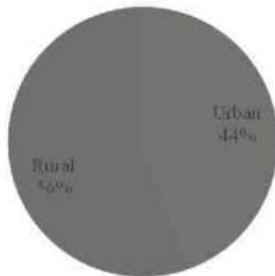


Figure 7 : Urban-Rural Spread of MSMEs
Source: Annual Report of MSMEs 2012-13

Activity-wise MSME



Figure 8 : Activity-wise MSMEs
Source: Annual Report of MSMEs 2012-13

MSME Sector & Industrial Clusters

The MSME landscape has matured over time and moved up the value chain. The MSME sector has evolved from the manufacturing of traditional products to much more hybrid products. Firms in the MSME sector that were earlier facing difficulties in achieving economies of scale, specialisation and innovation due to their small size are now increasingly benefiting from the advent of industrial clusters. Clusters and associated networks enable small firms to combine the advantages of running a small unit with the benefits of scale and specialisation provided by large units. Currently, there are more than 600 industrial SMEs clusters and over 7,000 artisan/micro enterprise clusters operating in India. The networking approach has helped

MSMEs to overcome barriers such as technological obsolescence, supply chain incompetence, global competition and investment shortages. Furthermore, to capitalise on the benefits from specific target customer base, clusters are classified as export-oriented and domestic. Tirupur textile and Vizag marine processing clusters focus mostly on exports while the requirements of large domestic firms are supplied by MSMEs in specialised domestic clusters such as Jamshedpur's engineering cluster and Pune's auto cluster.

The inter-firm linkages stimulated by these clusters and networks have aided MSMEs to move up the value chain and gain competitiveness. Firms within a specific cluster have been able to better utilise the available infrastructure by sharing the same transport mechanism. These clusters even helped the journey of rural artisans with innate skills to self-sufficiency by overcoming their funding and technology-based constraints. Many success stories showcasing the potential of MSMEs have been recorded in India. Many industrial zones across sectors adopted the participatory approach by coming together to reap the benefits of clustering. The textile industry, largely operated within industrial clusters, in India is home to more than 70 clusters, accounting for around 80% of the total country's production. There are several successful natural clusters across the country. Panipat is home to 75% of total blankets produced in the country, Tirupur contributes 80% to total cotton hosiery export and Agra exports shoes worth \$60 million annually. Similarly, Ludhiana has become the hub for production of woollen knitwear, sewing machines and bicycles and bicycle parts in India. The auto component industry at Gurgaon is an induced cluster. Setting up of Maruti Udyog Ltd's public sector car manufacturing unit laid the foundation for the cluster formation. Moreover, petrochemical-based cluster at Vadodara was driven by the establishment of Indian Petrochemical Industries Ltd. Additionally, majority of the gems and jewellery exports come from Surat (Gujarat) and Mumbai (Maharashtra). Chennai, Agra and Kolkata are hubs for leather and leather-based products⁶.

Policy Initiatives during Economic Reforms period

The MSME Development Act, 2006 came into effect on October 2, 2006. Subsequently both the Central and State Governments have taken effective steps towards implementation of the Act.

- ❖ With a view to build the capacity of the Indian micro, small and medium manufacturing enterprises for overcoming competition in the global markets and facing challenges being posed by multi-nationals in the domestic markets, the Ministry of MSME is implementing the National Manufacturing Competitiveness Programme (NMCP). The objective of NMCP is to ensure healthy growth of the MSME Manufacturing Sector. The ten components of the Programme dealing with the firm level competitiveness are being implemented in the Public-Private-Partnership (PPP) mode.
- ❖ The objective of Rajiv Gandhi Udyami Mitra Yojana (RGUMY) is to provide support and assistance to the potential first generation entrepreneurs, who have already successfully completed Entrepreneurship Development Training Programme (EDP) in the establishment and management of the new enterprise, in dealing with various procedural and legal hurdles and completion of various formalities required for setting up and running of the enterprise. An 'Udyami Helpline' (a Call Centre for MSMEs) with a toll free number is functioning under the Scheme which provides information, support, guidance and assistance to first generation entrepreneurs as well as other existing entrepreneurs. The Udyami Helpline provides information about various promotional schemes of the Government, procedural formalities required for setting up

and running the enterprise and how to access credit from Banks etc.

- ❖ The Government of India has notified Public Procurement Policy for goods produced and services rendered by Micro & Small Enterprises (MSEs) Order, 2012 which is applicable for Central Ministries/ Departments and PSUs for effective implementation. With effect from 2015, overall procurement goal of minimum 20% are to be made mandatory by every Central Ministry/Departments/PSU⁷.

Financing for MSME Sector

MSMEs funding gap needs to be bridged to capture sectors promising growth. Availability of funds at competitive rates is considered to be an important factor to fund long-term growth plans and short-term working capital needs of MSMEs. Small Industries Development Bank of India (SIDBI)'s contribution to the sector so far has been remarkable. SIDBI, in collaboration with various major public and private sector banks in India, launched a dedicated rating agency called SME Rating Agency of India in 2005. The rating agency provides a third-party rating for the overall condition of a specific SME before granting loans. The need for such committed financing institutions is consistently being felt mainly due to the sector's increasing demand for credit. This offers immense scope for other private and public sector banks in India to formulate innovative financing models. Total advances from various public sector banks to micro and small sized firms have been growing at a fast pace; it expanded at 23.8 % to reach \$106.2 billion over 2000–11. As part of an RBI initiative, all banks were instructed to boost credit to micro and small units to 60% of total SME lending by 2013⁸.

<i>Name of the Products reserved for Exclusive Manufacture under MSME Act, 2008</i>
FOOD AND ALLIED INDUSTRIES
WOOD AND WOOD PRODUCTS
PAPER PRODUCTS
INJECTION MOULDING THERMO-PLASTIC PRODUCT
OTHER CHEMICALS AND CHEMICAL PRODUCTS
GLASS AND CERAMICS
MECHANICAL ENGINEERING EXCLUDING TRANSPORT EQUIPMENT



Figure 9 : Financing of MSMEs
Source: Annual Report of MSMEs 2012-13

Export Promotion of MSMEs

The MSME sector also plays an important role in India's exports. MSME exports have expanded at 19% during 2002–08. The MSME sector accounts for around 40% of total exports in India. With the opening up of foreign direct investment (FDI) in multi-brand retail, small and medium enterprises (SMEs) have sought the government's help in setting up a branding and export marketing fund. The primary objective of such a fund would be to promote and create awareness of Indian SME labels in markets overseas and within India. The proposed fund could enable positioning of Indian MSME products and services and help create new market opportunities, as foreign retailers that invest in India are required to source at least 30% of their goods from Indian SMEs. The key strategy to enhance the exports of MSMEs is to improve the manufacturing ability, which in turn is expected to improve the competitiveness of their products, higher value addition, skill development and training, thrust on standardisation and quality, access to affordable credit, impetus to technology upgradation and innovation, support for marketing and brand-building and infrastructure development.

Adequate provision of pre- and post-shipment foreign currency credit to the MSME sector; a uniform credit rating format, tackling the problem of delayed payments by customers will go a long way to improve their liquidity problems and bring about an overall improvement in efficiency in the sector⁹.

Constraints facing MSME and Policy Implications

The inclusiveness of the MSME sector is highlighted by the fact that around 50% of MSMEs in India are owned by underprivileged groups. Due to its low capital structure, coupled with high labour absorbing power, the sector has played a noteworthy role in achieving rural industrialisation as well. The MSME sector remains a key driving force for India's complete transition from an agrarian economy to an industrialised one. MSMEs have been awarded a host of incentives by government and number of other organisations in the private and non-profit domain have also been aiding MSMEs to remain competitive in a more globalised economic order. This is set to continue in the coming decade as well, with MSMEs requiring access to credit, technological know-how and training centres for bridging the skill gap¹⁰.

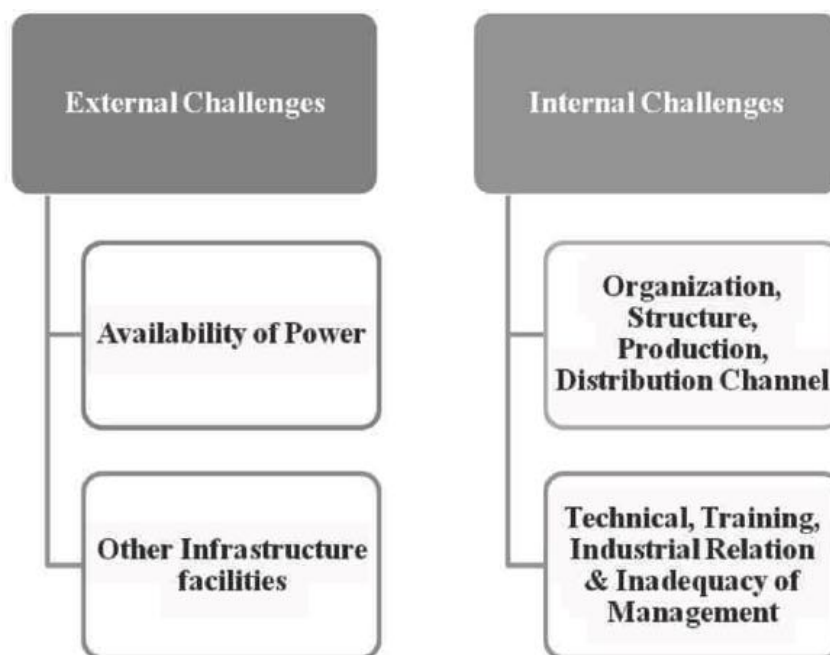


Figure 10 : Challenges facing MSMEs
Source: Annual Report of MSMEs 2012-13

The requirements of large domestic MSMEs play a critical role in innovation due to their ability to experiment with new technologies on small scales. However, they often suffer from lack of funds, inability to take risks associated with technology developments and the difficulty of attracting skilled manpower. Policy interventions for MSMEs must be tailored to their conditions. Government policies for MSMEs should therefore help them improve their technological capabilities by focusing on¹¹:

- i. Providing access to risk capital
- ii. Setting up of standards for the industry
- iii. Improving Industry/research institute/academia interaction, mostly in clusters
- iv. Stimulating demand/providing scale through preferential treatment in government purchases

Future Landscape for MSME Sector

MSMEs are likely to experience a more conducive landscape with the government committed to provide momentum to the sector by including it as an integral part of industrial policy. MSMEs' contribution to the country's GDP is expected to increase to 22 % by 2020. The anticipated rise can be attributed to policymakers'

focus on boosting the country's manufacturing sector and promoting greater role of entrepreneurial activity across sectors. This could lead to a wide range of lucrative opportunities for domestic and international investors. An appropriate strategy in supporting MSMEs is important for financial institutions also. In recent times, while banks' dependence on large corporates and infrastructure funding resulted in a mismatch of funds, MSMEs have provided better opportunities for working capital and short-term loans.

Notes and References:

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