

EMPOWERING SMEs IN INDIA - A FRESH APPROACH

Amar Kumar Chaudhary*

KEY WORDS

Industrial Enterprises

Received on :

10.11.2009

Revision Accepted on :

12.05.2010

Accepted on :

22.08.2010

SME sector plays a dual role since the output produced by SMEs is not only about final consumption but also a source of capital goods in the form of input to heavy industries. The significance of SMEs in Indian economy is growing. The output of SMEs is not only increasing, but the productivity in terms of per unit is also growing at a higher rate in the past four years.

INTRODUCTION

Small and medium enterprises (SMEs) have played an important role in the growth of the economy as long and major contributors to employment generation in a country, regardless of geographical barriers. It helps to alleviate poverty and equal distribution of income that leads to sustainable development. India has nearly 13 millions SMEs, which account for almost 50% of industrial output and 40% of the country's total exports. SMEs, employ more than 42 million people in the country. Thus, SMEs form the lifeblood of any vibrant economy and have a significant socio-economic role in the balanced development of the country.

PRESENT SCENARIO OF SMEs IN INDIA

SMEs, particularly in developing countries are the backbone of the nation's economy. They constitute the bulk of the industrial base and also contribute significantly to their exports and their GDP. The total number of SME's in India were 13.3 million in 2008 in comparison to 11 million in 2003. So, there is a considerable increase in the SMEs in India. SMEs are functioning through out in the country. SMEs are growing and prospering in our country and in process it has a favourable impact on industrial output, employment and wealth creation.

SMEs in India, which constitute more than 80% of the total number of industrial enterprises, are still technologically backward. They suffer from problems of suboptimal scales of operations and technological obsolescence. While most of the large companies have financial as well as technical

* Faculty Member, University Dept. of Commerce & Business Management, Vinoba Bhave University, Hazaribag.

capacity to identify technological sources and evaluate alternative technologies that would suit their requirements, unfortunately, this capacity is missing in the case of most SMEs.

FUNDING OF SMEs

The funding patterns of small and medium enterprises (SMEs) in the country reveals that there is scope for banks to increase their lending to SMEs. Against the acceptable banking practice of financing 75% of an SMEs incremental working capital requirement, on an average, only around 60% was funded between 2006-07 and 2008-09. The SMEs met the bulk of their residual funding needs from their own funds.

The SMEs working capital funding patterns also debunks the long-held perception that these enterprises are overleveraged. Bank branches in urban areas have greater scope than their counterparts in the semi-urban and rural areas to increase funding support to SMEs; in from promoters and internal accruals.

Banks are permitted to fund up to 75% of the incremental working capital requirements - increase in current assets; less increase in current liabilities - of borrowers. Banks can fund 75% of increase in current assets (74%) less increase in current liabilities (21%). In other words, while banks can fund up to 40% of SMEs incremental working capital requirements, the actual funding provided by banks was only 25%. This reveals a significant incremental funding opportunity (IFO) - the difference between the actual bank funding and the maximum permissible levels - of 15% of SMEs incremental working capital requirements.

SMEs in urban areas have significantly higher IFO than those in semi-urban and rural areas. Funding opportunities for banks are still strong in the urban areas, where the IFO is 17% in the semi-urban and rural areas, the IFO is 13%. This is surprising given the general perception that SMEs in the urban areas have greater access to bank funding than those in other areas, where banking penetration is lower.

The reason for the urban-rural divide in bank funding the urban-rural divide in bank funding for SMEs may be that banks spread their funds over a wider basket of large, medium and small companies in the urban areas, whereas in the semi-urban or rural areas, the key customers are restricted mainly to SMEs.

A state-wise analysis reveals that SMEs in states such as Gujarat, Delhi and West Bengal have the highest IFOs. These states have the highest potential for incremental SME highest potential for incremental SME funding. In comparison, SMEs in states such as Tamil Nadu, Rajasthan and Punjab have low IFOs, and appear to be better funded.

Banks have the opportunity to increase funding support to SMEs across industry sectors. Also, most SMEs analysed have long track records, which rules out the possibility that working capital financing was adversely affected by concerns on management quality.

The small and fragmented structure makes these units more vulnerable. Despite their immense contribution, the sector is largely informal. According to the Third Census of Small Scale Industries (SSI), 90% of the units are not registered, and are not covered by annual formal data collection exercise like the Annual Survey of Industries. Around 97% of them are either proprietorship or partnership enterprises. The recent report of the Working Group on Rehabilitation of SMEs has pointed out that close to 95% of units do not have access to any kind of formal institutional credit from banks and other financial institutions.

PRODUCTION OF SMEs

In fact the SME sector plays a dual role since the output produced by SMEs is not only about final consumption but also a source of capital goods in the form of input to heavy industries. The significance of SMEs in Indian economy is growing. The output of SMEs is not only increasing, but the productivity in terms of per unit is also growing at a higher rate in the past four years.

The relative advantage of SMEs is well recognized by the resurgence of the manufacturing sectors in India during recent years. The production was 3,14,850 crores in 2003 which has increased to 6,95,100 crores in 2008 (120.77%). The highly heterogeneous Indian SME sector, produces 8,000 odd items which contributes 40% of the industrial output.

EMPLOYMENT IN SMEs

SMEs have a major role in providing employment. This sector does not only provide direct employment but also indirect employment. There has been increasing employment in this sector.

The employment was 2.6 crores in 2003 and it has increased to 3.2 crores in 2008. The growth being 23.07%.

EXPORT FROM SMEs

Exports from SME sector has also increased substantially. Fig. 4 shows the exports from SME sector. The export was 17.8\$ million in 2003 & it has been increased to 37.8\$ million in 2007. SME sectors contribute over 65% of their production to the export market. Moreover, factors like low export oriented, high import and diversification of Indian SMEs have contributed to restraining their downward spiral during the current global meltdown. The sluggish growth in the credit flow to the SME sector can be attributed to the macro environment. Exports are down to 33% in March 2009 from the last year. The performance of SME is interlinked to the performance of economy at large. In this global crisis & slowdown the overseas product market has been adversely affected, thereby taking a toll on production and employment in SMEs that are heavily dependent on the export market.

CREDIT FLOW TO SMEs

The biggest problem plaguing small scale industries is inadequate demand along with technological, financial & marketing weaknesses all of which lead to a shortage of working capital. In fact, lack of adequate and timely finance is the root cause of sickness in the small scale sector.

Moreover, credit flow to the sector from the banking channel has been restricted following rising delinquencies, bank credit to the SME sector grew by only 35.4% till Feb. 2009 against a rise of 67.4% till the same period of the last year.

Also growth in bank credit moderated to 17.2% as in March 2009 compared to 24.3% in May 2008. Besides, till Feb. 2009, the borrowing rate for SMEs was as high as 14%. This has altered the overall funding patterns of SMEs, which are forced to rely more on interval accruals and non institutional credit. Moreover the share of micro and small enterprises in bank's total credit flow has declined to 10.9% for 2008 against 14.2% in 2001.

Although liquidity conditions in the banking system have improved significantly in the past few months, credit growth has remained moderate due to sustainable slowdown in overall economic activity and increased risk aversion on the part of banks. These factors may continue to weigh on credit growth for the near future. The reduced credit availability has particularly impacted SMEs. Small enterprises (both small industrial and service enterprises) absorbed 15.4% of the total incremental non food credit up to Feb 2009 compared with 19.2% in Feb 2008.

In March 2009, the CFSA (Committee on Financial Sector Assessment) brought out two points, one is decline in the share of credit to small scale industries (SSIs) and other is widening of credit gap to an unreasonable level. According to the third All India Census of small scale industries out of 2.3 million registered units surveyed in 2001 – 2002, only 0.13 million (17.9%) have availed of credit. Out of these only, 0.11 million units (14.9%) could have access to institutional credit. The survey also showed that though inadequate demand was the biggest problem causing sickness in the small scale sector, the lack of credit was next in line, with almost half (48%) of the sick and incipient sick units complaining about a shortage of working capital.

GOVT. APPROACH TOWARDS SMEs IN INDIA

The Govt. of India and the Reserve Bank of India (RBI) have initiated timely and corrective measures by announcing stimulus packages & schemes in 2008-09 to cope up with the effect of slowdown in the global economy and liquidity crunch in the financial system.

The Govt. of India and RBI have given special emphasis to SMEs units for their sustainable growth. Banks are in the process of framing new SME focused policies following the RBIs directive to review existing policies for leading to SMEs. They have also instructed to step-up restructuring of sick units that are potentially viable. As per RBIs recommendation, banks are expected to frame new loan policies for extension of credit facilities and non discretionary any time settlement schemes, which would enable to overview commercial judgment relating to SME finance.

The RBI, through its various measures, pumped in about Rs 5,00,000 crore into the system, allowed banks to take up restructuring of SME accounts, and also consider, as a one-time measure, the second restructuring of exposures to the sector up to 30 June 2009. In order to ensure continued flow of credit to SMEs, SIDBI was also extended a special refinance facility of Rs 7,000 crore by the RBI.

SIDBI, as the principal financial institution for SMEs, introduced several schemes for SMEs, especially for micro enterprises. It formulated a special refinance scheme to augment the credit to micro enterprises. Under the scheme, an amount of about Rs 4,400 crore was sanctioned to public sector banks, with the condition that they will grant credit to the extent of double the amount (Rs 8,800 crore) to micro enterprises with a base date of 30 September 2008. Thus, through this scheme, further credit has flowed to micro enterprises.

The bank recorded its highest-ever credit disbursement of Rs 28,273 crore - an increase of more than 87 per cent. The outstanding portfolio grew by 50% which would probably be the highest in percentage terms achieved by any bank/financial institution during the financial year 2008-09. The number of branches also grew by 27 during FY09, taking the total network to 100 branches.

Under SIDBI's micro credit scheme, disbursements made during FY09 were Rs 1,721 crore, which were more than the cumulative figure for the preceding nine years of operation of the scheme. The total portfolio under micro credit rose to Rs 2,137 crore as of end of FY09, from Rs 950 crore as of end of FY08, i.e. a growth of over 125 per cent. Its subsidiaries and associates also performed very well.

The enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act 2006 was a landmark initiative taken by the Govt. of India to enable the SMEs have competitive strength to reap the competitive advantage & to meet the challenges of the global market. SME policy initiatives at the national and the state level are aimed at strengthening the role of SMEs at the base as well as at higher levels.

Credit Guarantee Trust for Small and Medium Enterprises (CGTSME) which was established in August 2000 with the objective to provide guarantee support to banks and lending institutions for their exposure to SME sector, the eligible loan amount for collateral -free leading their the CGTSEME was increased to Rs. 100 lakh, the lock in period was brought down from 24 months to 18 months & the guarantee cover was increased to 85% for loans up to Rs. 5 lakh.

During 2008-2009, the trust extended 53,708 credit guarantee approvals aggregating Rs. 2200 crore, registering a 77% growth in number and 108% growth in amount of guarantee approved over 2007-08. Cumulatively, the trust had, as on 31st March 2009, approved 1,50,034 guarantee amounting to Rs. 4,824 crore. The trend is expected to continue with 10983 guarantees worth Rs 552 crore being approved during the first two months of the current financial year. As many as 21 banks/ leading institutions during 2009-2010 and the number base of the trust has increased to 96 banks/ lending institutes so far.

In order to facilitate credit growth further, SBI has cut its lending rates on loans for SMEs. The country's largest public sector bank has slashed the interest rate for all new SME customers with loan requirements of up to Rs 5 lakh to 8 per cent, and for loan requirements above Rs 5 lakh but below Rs 25 lakh to 10 per cent. The reduced rate will be available for the next two years and will be applicable for working capital as well as term loans, provided they are covered under the CGTSME scheme.

PROBLEMS FACED BY SMEs

SMEs form the lifeblood of any vibrant economy. In an emerging economy like India SMEs have a significant socio-economic role as they are estimated to employ more than 42 million people in the country. As the process of globalization and liberalization gathers momentum across the globe, SMEs are facing tremendous challenges to survive and sustain. Some of the major challenges faced by SMEs are

1. Lack of access to finance
2. Low R & D investment
3. Lack of access to technology.
4. Lack of product innovation
5. Inadequate marketing support in an increasingly competitive environment.

However, the biggest problem plaguing small scale industries is inadequate demand, along with technological, financial and marketing weaknesses, all of which lead to shortage of working capital. In fact lack of adequate and timely finance is the root cause of sickness in the small scale sector.

Moreover, factors like low export orientation, high import substitution and diversification of Indian SMEs have contributed to restraining their downward spiral in the current global meltdown.

Despite several positive features, SMEs are not able to exploit their full potential. One reason for this may be the low credit penetration into the segment due to sub-optimal delivery of credit and services to the sector. Most of them are not registered and do not take any kind of advantage from formal institutional credit.

The global liquidity crisis has also taken its toll on SMEs. Downsizing of orders by large corporates due to less demand by user industries has led to lower off-take of goods from the SME sector. This

has led to a pile-up of inventory, which coupled with delayed payments from customers, has put severe pressure on the working capital management of SMEs. In addition to higher working capital requirements, lower lending by banks to this sector has made it difficult for SMEs to manage their finances, resulting in a decline in their cash reserves. “Slowdown in the global economy is adversely affecting the overseas demand for Indian products, thereby taking a toll on production and employment in SMEs that are heavily dependent on the export market.

CONCLUSION

Nearly 42 million people are working in SME sector that is more than the population of many countries. 40% of our economical growth comes from this sector and 40% of the country’s total exports. SMEs account for over 60% of the GDP. To meet the challenges of threats and avail the opportunities from global competition, there is an urgent need of strategic management to well equip the SMEs to take the competitive advantages.

As regards suggestions for SMEs, there is a need to reduce cost and to improve quality, improve the inventory management and adopt lean manufacturing processes. Incorporating the latest technology into their production processes would enable SMEs to achieve a competitive edge. Energy efficiency is another area where SMEs need to focus on. The SME exporters may also attempt to diversify their export destinations and explore new markets, including the untapped domestic markets, which by themselves, may be very large. SMEs must also widen their information and knowledge base.

In view of the unorganized nature of the sector, where proper information and documentation is a major challenge, banks will have to adopt different models of credit delivery mechanisms for SMEs, like centralized processing and credit appraisal, inspection and sanction functions. Banks need to develop a special category of officers to strengthen the expertise in credit appraisal and credit counseling to SMEs. According to the RBI’s latest recommendations, there is a need to define suitable indicators for different industries in the SME sector and benchmark efficiency parameters for more professional appraisal and rating of SME proposals.

Going forward, to ensure better accessibility of credit by SMEs, banks’ ability to quickly evaluate the credit worthiness of small and medium enterprises will be critical. Due to limiting factors of financial statement lending and asset-based lending, credit scoring lending, long used in consumer lending, may be considered by banks in the case of SMEs. To make this a more effective option, it may be combined with relationship lending, universally the most popular lending technique for SMEs, where information and documentation are quite adequate. Under relationship lending, a lender’s decision in a substantial part is based on the proprietary information about the firm and its owner, acquired by the loan officer through a variety of sources. However, for micro enterprises in general and small enterprises in vulnerable sectors, particularly for start-up units, the interest rate needs to be moderated. There is a need to sensitize the schemes at branch level.

SMEs can significantly increase their competitive advantage through material co-operation with emerging business development service providers for cost reduction, capacity building, technological up gradation and common facility creation through cluster approach. Some work has already been done by the National Resource Centre for Cluster Development.

Thus, the government needs to help them by approving stamp duty exemptions, enhancing their image globally through trade fairs, seminars and development programs. Entrepreneurs should be provided infrastructure facilities.

References

- Govt. of India (2003) Report on All India Census of Small Scale Industry in India, GOI, New Delhi
- Govt. of India (2009) Economic Survey, Ministry of Finance, GOI, New Delhi
- Mohan Rakesh (2001) Small Scale Industry Policy in India. A Critical Evaluation, NCAER, New Delhi
- K. R. G. Nair (2004): "Economic Reforms and Regional Disparities in Economic and Social Development in India", (Report of a Research Project Funded by the SER Division of the Planning Commission of the Government of India), *Centre for Policy Research*, Delhi: August 2004.
- Kanakalatha Mukund (2003): "Regional Disparities", *EPW Book Review* February 22.
- Kaplinsky Raphael (1998): *India's Industrial Development- an Interpretative Survey*, Institute of Development Studies, Brighton, Sussex, U. K. June.

JOURNAL OF ECONOMIC & SOCIAL DEVELOPMENT

(A Bi-annual Research Journal of Economics)

Advertisement Rates

Outside Back Cover	:	Rs. 50,000/-
Inside Front Cover	:	Rs. 35,000/-
Inside Back Cover	:	Rs. 25,000/-
Inside Late Back Page	:	Rs. 15,000/-
Inner Full Page	:	Rs. 10,000/-
Inner Half Page	:	Rs. 5,000/-

All payments should be made in favour of 'Journal of Economic & Social Development' through DD or Local Cheques payable at Ranchi, Jharkhand.