

Small and medium enterprises in India

Small and medium enterprises (SMEs) form an integral and indispensable segment of any economy, the world over. They make considerable contributions to national economies in terms of employment, income and exports, among others. Overall, the SME segment is characterized by a relatively 'free entry and free exit' criterion and therefore, has high rates of births and demises. In between, they are constantly threatened by various constraints with respect to obtaining finance, accessing markets, recruiting human resources and operating production activities with a constant need for updating technologies. This is so, despite national governments forming exclusive SME policies and extending financial and fiscal benefits, on the one hand, and administrative and technical support, on the other, on a continuous basis.

In the global economy, India occupies a unique position, as it has a long standing policy (extending up to three fourths of a century now) for the promotion of SMEs, since independence. To begin with, India adopted a formal definition of small scale industries (SSI) in the early 1950s, in terms of investment and employment (limits) criteria, to exclusively identify and promote the segment. However, the employment criterion was given up in 1960. Since then, SSI definition comprised only investment criterion, which was raised periodically, on three grounds: (i) to take account of inflation, (ii) to facilitate technology upgradation and modernization, and (iii) to enable expansion of scale of operations. The definitions of SSI were protected by the Industries Development & Regulation (IDR) Act 1951.

Along with the periodic definition changes, India pursued a dual strategy for the protection and promotion of SSI: (i) Developing institutional infrastructure from national to state to district levels, and (ii) Policies and programmes, both to facilitate prospective as well as functional SSI entrepreneurs. The nation-wide institutional network ranged from a Development Commission for SSI (also known as Small Industries Development Organization (SIDO)) at the national level to Directorate of Industries (with exclusive Small Scale Industries Development Corporation (SSIDC), Small Scale Industries Marketing Corporation (SSIMC), State Financial Corporation (SFC), etc.) at the state level, and to District Industries Centres at the district level.

An exclusive Entrepreneurship Development Institute of India (EDII) was set up by the then Development Finance

Institutions and State Bank of India. The launching of Industrial Estates Programme in the early 1960s provided the much needed integrated physical infrastructure for the growth of SSI. The notable protective policies comprised: (i) reservation of product lines exclusively for SSI production, (ii) reservation of SSI products for government and public sector purchases, (iii) price preferences to SSI products (to the extent of 15% over non-SSI products) by government and public sector agencies, (iv) fiscal and financial concessions, (v) preferential access to imported raw materials, intermediates and machinery, and (vi) exemption from industrial licensing, among others. To ensure better financial access to the sector, SSI was brought under the 'priority sector' which obligated the banking sector (comprising both domestic and foreign banks) to lend 40% of their Net Bank Credit to the constituents of priority sector comprising agriculturists, small transport operators, artisans and SSI. Till 1991, SSI policy formed a part and parcel of general industrial policy.

The era from 1991 has been distinctly different from the pre-1991 era, for Indian SSI. For the first time, an exclusive Small Scale Industry Policy was introduced soon after the New Industrial Policy 1991. The exclusive policy laid emphasis on imparting more vitality and growth impetus to the sector to enable it to contribute its mite fully to the economy in terms of employment, output and exports. Industrial delicensing and dilution of Foreign Direct Investment and foreign trade restrictions introduced since 1991 gradually exposed SSI to a competitive environment internally as well as externally. At the same time, the process of dilution of SSI-specific protective measures began and gradually gained momentum. Simultaneously, SSI-specific promotional measures gained a steady progress with an increasing involvement of the private sector including SSI associations in technology diffusion, technical training and promoting linkages with large enterprises, among others. An exclusive financial institution – Small Industries Development Bank of India (SIDBI) – with state level and SSI cluster level branches, was created (in 1990). The setting up of exclusive SSI branches by Public Sector Banks was initiated in 1993.

The Micro, Small and Medium Enterprises Development (MSMED) Act 2006 marked another major milestone in India's SME history. For the first time, medium scale enterprises were clubbed with small scale enterprises, covering not only the manufacturing sector but also the services

sector. Thus India adopted the international practice of promoting SMEs as an exclusive segment within the economy. The MSMED Act 2006 created a new and easier process of registration for SMEs. Since 2014, Small Finance Banks have been introduced (with the objective of achieving financial inclusion) which exceeded 4300 branches by March 2020. They are expected to benefit primarily informal enterprises, among others. The revision of SME definition in May 2020 added another new dimension: (i) investment limit was raised, (ii) additional criterion of turnover was added, and (iii) distinction between manufacturing and services sectors was eliminated. The latest SME definition revision (in May 2020) was introduced as part of the *Atmanirbhar Bharat* scheme as one of the policy measures to address the concerns of the MSME sector to mitigate the impact of COVID-19 pandemic.

The growth performance and challenges of SSI/SME segment in India need to be elaborated against the backdrop of these policy developments. In the pre-liberalization era (prior to 1991), SSI grew steadily in terms of number of units, employment, investment, production and exports, rather on a steady basis. The overall growth performance of SSI, contrary to expectations, continued unabatedly in the liberalization era (1991–2006). The addition of service sector enterprises and medium scale sector to SSI (after the MSMED Act 2006) augmented the contribution of SME segment to gain more prominence in the Indian economy. Prior to the onslaught of COVID-19 pandemic, the SME sector accounted for more than 63 million enterprises, employed more than 120 million persons, and thus it was the second largest employer (first being agriculture). It accounted for 45% of the manufacturing output, more than 30% of the national income, and about 48% of the total exports. Of late, its ability to contribute in terms of innovations has been recognized, but hardly assessed at the national level, and therefore, goes unnoticed largely. This sums up the significance of the SME segment in the Indian economy.

However, this does not mean that the SME sector in India has been growing smoothly, without constraints. The constraints known in the international context have been hampering the birth, operations and growth of Indian SMEs in a more pronounced way all through. Precisely for this reason, policy makers have been strengthening institutional infrastructure and introducing more and more conducive policies progressively ever since the Industrial Policy Resolution, 1956. The introduction of an exclusive SSI policy in 1991 followed by the promulgation of MSMED Act 2006, are reflections on the increasing importance that policymakers attach to this vital segment in the era of liberalization. Even the *Atmanirbhar Bharat* scheme attached due importance to SMEs to enable them to cope with the COVID-19 crisis. The fiscal and monetary policy stimuli extended are expected to lend strength to the sector for its resurgence.

To revitalize the SME sector, its core challenges need to be identified and addressed vehemently. First of all, while there is a mechanism to count SME birth rate periodically through a registration process, at what rate the enterprises exit from the sector due to (i) graduation and (ii) closure, is not known. Therefore, a periodic and comprehensive database (akin to *Annual Survey of Industries* available for the registered factory sector) is urgently needed, to aid effective policy making for SMEs. Secondly, the extent of inter-firm relationships that SMEs have with large firms or with other SMEs is not captured periodically. Dated data reveal that such a relationship was prevailing far below the potential. It is imperative to promote inter-firm relationships between SMEs and large scale enterprises (including MNCs), because such relationships prove to be mutually beneficial, particularly for SMEs, to overcome many of the resource constraints they have (with respect to technology upgradation and innovation, finance, marketing and development of human resources, among others).

Thirdly, empirical research has revealed, time and again, the decisive role of technological innovation in enhancing SME competitiveness. But, we are ignorant on the extent and intensity of technological innovations carried out by the SMEs, on an annual basis. It is crucial to enable an increasing number of SMEs to undertake technological (product and process) innovations, as innovations enable generation of Intellectual Property (IP) and wider market penetration including international markets. Fourthly, though SMEs account for nearly one-half of the total exports of our country, only a negligible proportion of SMEs has been able to enter the export market, intermittently or continuously. That is why, we have a negligible presence of Indian SMEs in the Global Value Chains (GVCs) of MNCs. Of late, the GVCs are estimated to account for anywhere between 3/4 and 4/5 of the global trade. Most of the emerging economies have been increasing their SME footprints in the GVCs for their gain. Indian SMEs can ill afford to ignore the steadily growing dominance of GVCs in the global arena.

Given the above, if an increasing proportion of SMEs has to enter the international market to join the GVCs, they need to be competitive; if they have to be competitive, they need to be innovative; if they have to be innovative, they need to overcome their resource constraints; if they have to overcome their resource constraints, they need to develop inter-firm relationships with large scale enterprises or network with similar other SMEs. Therefore, inter-firm linkages, innovation and internationalization should form the 'watchwords' of Indian policy makers in their strategy for SME development in the immediate future.

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