

## ROLE OF MSME'S IN ECONOMIC DEVELOPMENT OF INDIA

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### ABSTRACT

There is a growing and worldwide appreciation that the Micro, Small and Medium Enterprises play a catalytic role in the development process of most economies. This position gets reflected in the form of their increasing number and rising proportion in the overall product manufacturing, exports, manpower employment, technical innovations and promotion of entrepreneurial skills. This paper attempts to look at the changing definition of the Micro, Small and Medium Enterprises and the role these enterprises are playing in the growth story of our economy. In India, the MSME sector is the second largest manpower employer, after agriculture and the output from this sector alone constitutes 40 percent share of the value added in the manufacturing sector and one third of national exports. The importance of Micro, Small and Medium enterprises (MSME) for its contribution in the Indian economy growth is a matter of record and needs no further elaboration. However, with the changing focus from economic growth to inclusive growth, MSME sector's role in the socio economic development of India needs to be understood, explored and facilitated. The opportunity in MSMEs exists, however, the fact remains that most of the funding goes to the larger and more solvent MSMEs and to those who have business linkages with large corporate. The banks compete with each other to grant loans to the top rung MSMEs.

**KEY WORDS:** Economic Development of India, Micro, Small and Medium Enterprises, Funding needs of MSMEs, Future of MSMEs, Unorganized sector.

### INTRODUCTION

Since 1991, the Indian economy has been running under the mantra of "liberalization". While there has been almost unanimous approval amongst the more affluent sections of the population for liberating the consumer goods sector from the "License Raj" of the previous decades, external liberalization has been subject to far more scrutiny, and has generated considerable controversy and debate. The extent to which the economy should be decontrolled with respect to the international sector is not only of economic relevance but goes to the whole issue of national sovereignty and security i.e. the priority of food , clothing and shelter with security

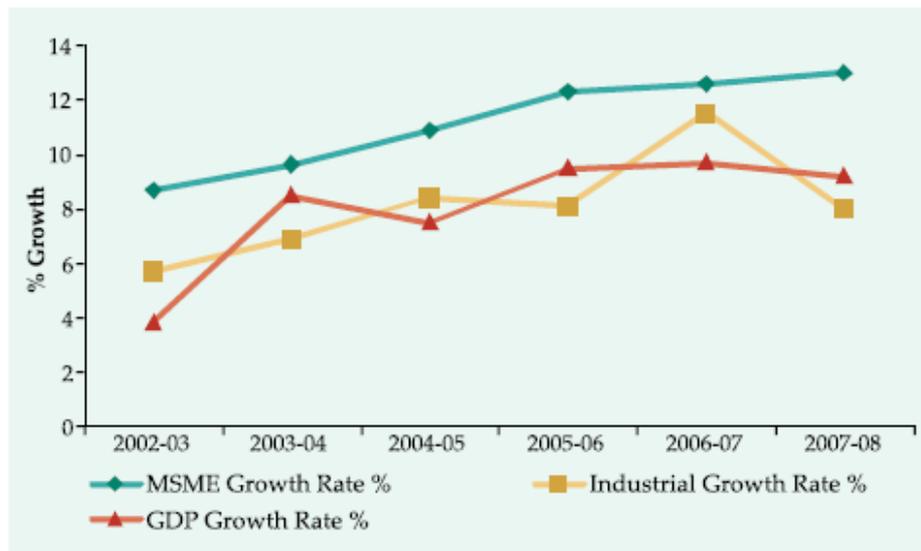
The progress of Indian economic development from 1947 to the present provides further evidence that individuals do respond to incentives in their pursuit of self-survival and accumulation of wealth. Further, the nature of this response depends on the economic climate, particularly the role of the government. India's economy struggled as long as it was based in a system of government regulation with little interaction with economic forces outside the country. The economic reforms of the early 1990s set the stage for substantial improvements in the Indian economy.

**Table 1.1 : Total number and size of registered MSMEs (in thousands)**

	Micro	Small	Medium	Total registered MSMEs
Number of manufacturing enterprises	974.6	57.7	2.8	1,035.103
Number of service enterprises	501.1	15.9	0.4	517.389
Total	1,475.7	73.6	3.2	1,552.49

Source: Ministry of Micro, Small and Medium Enterprises, GoI

Economic development, achieved largely through productivity growth, is Very important to both developed and developing nations. However, even though we know that higher productivity leads to improved economic outcomes (for example, higher income, more choices to the consumers, better quality products, etc.), there has been no consensus among researchers about either the desired path of development or the role of state in economic development. At present major role is being played by the MSMEs. We can show it by a graph how MSMEs are growing and how it helps to increase the GDP?

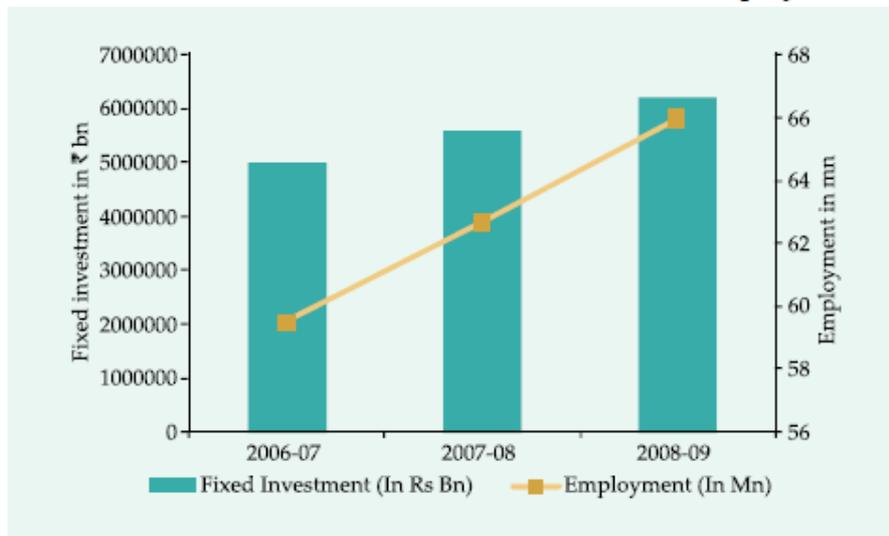


Source: Indiatat, D&B research

**Chart 1.1 : MSMEs performance**

Total production of MSMEs for the year 2008-09 was Rs. 8,808 bn (at 2001-02 prices). During 2006-07 and 2008-09, the sector's total production grew at a CAGR of 11.4%.

Fixed investment and employment in MSME on a growth trend MSMEs have experienced drastic improvement in productivity, which directly indicates the efforts in the sector to integrate the work force with technological enhancements to increase volumes. Annual Production per employee in 2008-09 was at 0.13 mn, compared with 0.12 mn in 2006-07. Moreover, fixed investment grew more than 11% y-o-y during FY08 and FY09. Employment on the other hand grew more than 5% y-o-y.



Source: Ministry of Micro, Small and Medium Enterprises, GoI

**Chart 1.2 : Increase in estimated fixed investment and employment in MSMEs**

MSME exports account for nearly one third of the country's total exports. MSME exports have managed to keep up with the growth rate of total exports of the country. The period of FY00-03 saw moderate growth in the economy, during which SSI exports grew in tandem with total exports at around 16% CAGR. Even during the boom phase (FY04-07), SSI exports kept pace with the CAGR of India's exports. However, during FY08, overall exports experienced much slower growth due to rupee appreciation, recording y-o-y growth of 15% in FY08, as against 25% in FY07. SSI exports also saw sluggish growth at 11% (versus 21% in FY07). Notably, since FY00, the share of SSI exports has been above 30% and stood at 31% during FY08.



Source: DGFT, MSME AR 09

**Chart 1.3 : SSI and India's total exports**

### Statistical Data on MSME Sector

Parameters	Distribution			Percentage distribution		
	Regd.	Unregd.	Total	Regd.	Unregd.	Total
<b>1. Total number of working enterprises</b>						
Manufacturing	1035102	6418294	7453396	66.67	26.15	28.56
Services	517390	18130011	18647401	33.33	73.85	71.44
<b>Total</b>	<b>1552492</b>	<b>24548305</b>	<b>26100797</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>
<b>2. Number of rural enterprises</b>	704551	12808326	13512877	45.38	52.18	51.77
<b>3. Employment</b>						
Manufacturing	8731254	22422264	31153518	86.75	44.62	51.65
Services	1333906	27834775	29168681	13.25	55.38	48.35
<b>Total</b>	<b>10065160</b>	<b>50257039</b>	<b>60322199</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>
<b>4. Enterprises by type of organization</b>						
Proprietary	1415422	23247043	24662465	91.17	94.70	94.49
Partnership	57832	120662	178494	3.73	0.49	0.68
Private Company	41373	95478	136851	2.66	0.39	0.52
Public Ltd. Company	8216	65209	73425	0.53	0.27	0.28
Co-operatives	4623	128912	133535	0.30	0.53	0.51
Others	25016	891011	916027	1.61	3.63	3.51
<b>Total</b>	<b>1552482</b>	<b>24548315</b>	<b>26100797</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: Report of Prime Minister's Task Force on MSME, Government of India, January 2010

### ADVANCES TO MSMES

Small and medium enterprises play a very constructive role in an economy. This is very much evident by looking at the economic and socio economic benefits achieved by the developed and the developing world.

The Bank advances to small enterprises on an upswing The MSME sector has been accorded high priority in the industrial policy owing to its vital role in the economy. During FY09, total priority sector advances by public sector banks (PSBs) grew 24% y-o-y to ` 16,934.37 bn, as against ` 13,642.68 bn in FY08. The total advances provided by public sector banks to MSME sector for the year ended Mar 2009 stood at ` 1,913.07 bn, a y-o-y growth of 27%. The advances to SME constituted around 11.3% of the total priority sector advances made by PSBs, which saw marginal growth versus the 11.1% share during FY08. Total advances provided by private sector banks to MSMEs was ` 479.16 bn as of Mar 2009, constituting 25.2% of the total priority sector advances.

The micro, small and medium enterprises (MSME) sector has a key role cut out in shaping India's GDP growth in the 12<sup>th</sup> Plan period. Stating this in his inaugural address at the two-day 'India Global Summit on MSMEs 2011' organized in New Delhi, Mr Virbhadra Singh, Minister of Micro, Small and Medium Enterprises, Government of India, said that innovations and the adoption of appropriate technologies will shape the sector's growth and development in the coming years.

Underlining the criticality of both industries and services in determining the MSME growth story, Mr Singh said the summit, organised by the MSME Ministry and Confederation of Indian Industry (CII),

has provided a singular opportunity for Indian MSMEs to demonstrate their capabilities to a global audience as well as open up new opportunities for partnerships.

As per the Planning Commission the key sectoral challenges like access to easy finance, technology and markets for MSMEs are being addressed. The 12<sup>th</sup> Plan will focus on building MSMEs global competitiveness. MSMEs will continue to account for 40-50% of the GDP growth.

With a growth rate of above 8%, India is expected to be the second largest economy in the world by 2013. However, India's incredible growth story contains certain confounding facts. For instance, on the Human Development Index, it ranks 132 out of 179 countries. Thus graduating to a new problem --- growing economic disparity.

### KEY FACTORS REGARDING MSMES

- ✚ *There are more than 100 lakh MSME units in India with an investment of more of more than Rs 1 lakh crore.*
- ✚ *The sector has recorded double digit growth in the last four years.*
- ✚ *The contribution of the MSME sector to total output of the country is 40% and to the GDP 6%.*
- ✚ *Currently there are over 11 million MSME units in India that produce more than 8000 products.*
- ✚ *Ninety percent of the industrial units in India belong to the MSME Sector*
- ✚ *These MSMEs units contribute 35% to Indian industrial exports.*

These bold statistics are seen at the top of the continuous incremental growth curve of India's small sector with MSMEs constituting the growth engine of the country's economy.

**Accounting for almost 45% of the manufacturing output, 95% of the number of the industrial units, 40% of exports and providing employment to almost 60 million people people make MSMEs the largest source of employment after the agriculture sector.**

A holistic and strategic approach in developing India's micro, small and medium enterprises (MSME's) is the most effective way for addressing disparity making growth more inclusive

In India, small business sectors is next only to agriculture. Today's, India's small sector is divided in to three types i) micro enterprises (village and cottage industrial units) (ii) small enterprises and (iii) the Medium enterprises. In accordance with (MSMED) Act, 2006 the micro, small and medium enterprises have been classified :

Manufacturing sector		Service Sector	
Enterprise	Investment in P&M	Enterprise	Investment in equipment
Micro	Does not exceed Rs 25 lakh	Micro	Does not exceed Rs 10 lakh
Small	More than 25 lakh but Does not exceed	Small	More than 2 lakh but Does not exceed

	Rs 5 Crore		Rs 2 Crore
Medium	More than 5 crore but Does not exceed Rs 10 Crore	Medium	More than 2 crore but Does not exceed Rs 5 Crore

MSME lead to entrepreneurial development and the diversification of industrial sector. They also provide depth to the industrial base of the economy. The contribution of the MSMSE sector to the entire output of the country is 40% and to the GDP 6%.

90% of the industrial units in India belong to MSME sector. These MSME units contribute 35% to industrial exports. In the current situation, MSME's are the biggest generators of employment in the country.

### FINANCING OF MSME'S

Finance is the lifeline of any enterprise; India has one of the most extensive banking infrastructure in the world. A large no. of MSMS's run only on the promoters investment which severely limits their growth .In India ,the preferred mode of finance is either self and other private sources. But now-a-days MSME's have started looking beyond traditional lending institutions like banks, state financial institutions for supporting innovation and commercialization of indigenously developed technologies. MSMEs have also started some innovate finance options which include.

- a) **Factoring Services** : This combines sales –linked finance, bad debt protection, payment collection and transmission services that helps business complete with local suppliers on equal trading terms.
- b) **Micro credit** : Provision of thrift, credit and other financial services and products of a very small amount to the poor in rural ,semi urban and urban areas.
- c) **Angel Investors**: Angel investors are typically high-net-worth individuals (HNIs) who have often been successful entrepreneurs themselves. They re-deploy their wealth in next-generation businesses. They invest in new-idea enterprises (that do not yet have external validation), help bring these ideas to market, take significant risks and invest a lot of time and energy in mentoring, management guidance and networking. Angel investors are also governed by considerations other than finance alone, such as belief in Entrepreneurship itself. Their time horizons are limited and aimed at ensuring the availability of larger institutional funding, mainly from VCs. In recent years, institutional seed funds that perform the roles of sophisticated angel investors have also emerged in India. Where access to early-stage capital is a serious issue, angel investors have the potential to become one of the most important catalysts for increasing the number of new entrepreneurial ventures in India.
- d) **Venture Capital**: Venture capital funding provides funds for early stage companies once they have passed the seed stage and report some returns. VC investments are traditionally made for scaling up operations (i.e., developing, launching and expanding new products or services). VCs

take lesser degrees of risk and invest more money than angel investors. However, a VC is about more than financial based value-addition, often in the form of providing financial advice, human resources, establishing networks with customers and overall guidance in company strategy. In return, VCs also retain a degree of control over decisions governing the company's functioning (e.g., through board seats and legal covenants etc.), and usually look at fixed time horizons for predetermined exit, usually via a private equity fund.

- e) **Private Equity:** Private Equity (PE) funds are among the largest sources of funding for enterprises that are relatively secure with an established track record, requiring significantly large funds for expansion and growth. PEs make capital investments in companies not yet quoted on a stock exchange in exchange for equity and management participation. As such, they take reasonably well-defined risks and their exit strategy is usually up to the stage when the company goes public or gets acquired at high value.

In recent years, India has witnessed an increase flow of capital in the form of primary and secondary securities markets, venture capital, private equity external commercial borrowings, factoring services and others.

The Prime Minister's task force set up in February 2010 has recommended steps to encourage many MSMEs.

- ✚ **The credit has asked for a target to 60% for micro enterprise under priority sector lending. The panel also recommended that in case there is a shortfall by banks in lending to SMEs, that deficits should with SIDBI to ensure assistance to MSEs in one way or the other.**
- ✚ **Interest subvention will help MSMEs avail the required credit at a better rate than what has been available till now.**
- ✚ **The SMEs exchange will allow MSMEs to acquire equity or risk capital. The sector has been relying heavily on debt capital so far.**

## **OPPORTUNITIES AND CHALLENGES FOR MSME'S IN INDIA**

The MSME'S segment has been in the focus from several govt.institutions, corporate bodies and banks. Apart from the policy focus and the govt. Thrust on promoting this segment, globalization and India's robust economic growth have opened several latent business opportunities for it. This section of the paper tries to highlight some of the opportunities and challenges which Indian MSME's face in the present scenario.

### **OPPORTUNITIES**

- a) **Food Processing :** The Indian Food processing industry is estimated to cross the \$300 Billion mark by 2015. MSME's currently contribute 90% of the industrial units and 40% of the revenue to the sector. With the current policy of SSI reservation ,this sector has been predominant growth of regional enterprise.

MSME's can further advance into Geographical areas and new product markets.

- b) **Biotech and pharma:** The Indian pharmaceutical market is the 4<sup>TH</sup> largest in the world in terms of volume and 14<sup>th</sup> largest in terms of value. India is expected to be one of the top 10 markets by 2020. The collaborative initiative between the AIMS and Stanford University aims to provide a forum for the development of new medical technologies to solve some of India's healthcare challenges.
- c) **Defense and homeland security :** India's first defense production policy aimed to enhance the capabilities and growth trajectory of SME's in the security domain .The defense ministry is looking to achieve 70% indigenization and 30% imports in defense acquisition.

## CHALLENGES

- a) **Strategic:** IPR the effective implementation of IPR's in India has always remained a contentious issue. Weak implementation, ineffective legislation and implementation drastically ( and illegally) cut down lead time, thereby negating the ability of MSME's to effectively monetize their innovation.
- b) **High cost of credit :** In the current Indian economic scenario ,cheap funds are difficult to come by, with the RBI reiterating that cost of funds will remain high. For a while to curb inflation, this will continue to remain a challenge for the sector.
- c) **Lack of Technology:** One of the crucial factors that prompts in the success or failure of enterprise is technology. The best use of technology no doubt enables enterprise in reducing cost of production, maintain consistency in quality, improve productivity and finally develop the competitiveness of the enterprise.
- d) **Insufficient Infrastructure :** The state of infrastructure ,including power, water, roads, etc. is poor and unreliable. While these act as threat to MSME's, the biggest impact is felt by their research arm as they don't have the firework to be able to innovate.
- e) **Lack of skilled labour :** Although India has a large pool of human resource ,the industry continues to lack skilled manpower required for manufacturing ,marketing ,servicing ,etc.
- f) **Delays in settlement:** Large –scale buyers usually have a long settlement lead times when they deal with MSME's owing to their limited bargaining power in the market. This hurt the ability of MSME's to divert funds to other cape req.and to R&D.

## CONCLUSIONS

The Indian economy provides a revealing contrast between the manner individuals react under a government-controlled environment and how they respond to a market-based environment. The evidence presented here suggests that recent market reforms encouraging individual enterprise have led to higher economic growth in the country and can yield a wide range of economic benefits. In India these benefits include increased economic growth, reduced inflation, a smaller fiscal deficit, and higher inflows of the foreign capital needed for investment.

We further conclude that India can generate additional economic growth by fostering entrepreneurial activities within its borders, particularly within its burgeoning middle class. Not only has entrepreneurship been found to yield significant economic benefits in a wide variety of nations, but India specifically has reached a point in its development where it can achieve similar results through entrepreneurial efforts. Among other things, India is poised to generate new business startups in the high technology area that can help it become a major competitor in the world economy. For example, it has a strong education base suited to entrepreneurial activities, increased inflows of foreign capital aimed at its growing information technology services sector, and a host of successful new business startups. To pursue further the entrepreneurial approach to economic growth, India must now provide opportunities for (1) education directed specifically at developing entrepreneurial skills, (2) financing of entrepreneurial efforts, and (3) networking among potential entrepreneurs and their experienced counterparts.

Despite the MSME's Strategic importance in overall industrialization strategy and employment generation, Indian landscape presents the small sector due to its large scale dependency on credit. The performance of developed economies and confidence index of the manufacturing sector and many other factors determine the fate of small sector in the country ,as MSME's form an integral part of almost every value chain.

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