Micro, Small and Medium Enterprises (MSMEs) in India: An Appraisal

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Abstract: The present article deals with micro, small and medium enterprises and their role in economic growth and employment generation in the Indian context. The article discusses how policy environment for promoting MSMEs changed from ‘protectionism’ during the pre-1990s to ‘export orientation’ during the post-1990s. The key constraints faced by the MSMEs including access to credit and technology, red tapism etc. are discussed.

Key words: MSME (micro, small and medium enterprises), MSE (micro and small enterprises), SME (small and medium enterprises), SSI (small scale industry), OSDD (Open Source Drug Discovery), Credit rating.

Definition of Micro, Small and Medium Enterprises in India

There exists several definitions of the term small and medium enterprises (SMEs), varying from country to country and varying between the sources reporting SME statistics. The commonly used criteria at the international level to define SMEs are the number of employees, total net assets, sales and investment level. If employment is the criterion to define, then there exists variation in defining the upper and lower size limit of a SME.

The European Union makes a general distinction between self-employment, micro, small and medium sized businesses based on the following criteria:

<table>
<thead>
<tr>
<th>Number of employees</th>
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<tbody>
<tr>
<td>0</td>
<td>Self-employed</td>
</tr>
<tr>
<td>2-9</td>
<td>Micro business</td>
</tr>
<tr>
<td>10-49</td>
<td>Small business</td>
</tr>
<tr>
<td>50-249</td>
<td>Medium-size business</td>
</tr>
</tbody>
</table>


In the Indian context, micro, small and medium enterprises as per the MSME Development Act, 2006 are defined based on their investment in plant and machinery.
(for manufacturing enterprise) and on equipments for enterprises providing or rendering services. According to the Micro, Small and Medium Enterprises (MSME) Development Act of 2006, (India) a micro enterprise is where the investment in plant and machinery does not exceed twenty five lakh rupees. A medium enterprise is where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees. A small enterprise is where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees. In the case of the enterprises engaged in providing or rendering of services, as

(a) a micro enterprise is where the investment in equipment does not exceed ten lakh rupees.
(b) a small enterprise is where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees.
(c) a medium enterprise is where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

According to the Ministry of Micro, Small and Medium Enterprises, recent ceilings on investment for enterprises to be classified as micro, small and medium enterprises are as follows:

<table>
<thead>
<tr>
<th>Classification</th>
<th>Manufacturing Enterprises*</th>
<th>Service Enterprises**</th>
</tr>
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<tbody>
<tr>
<td>Micro</td>
<td>Rs. 2.5 million/ Rs. 25 lakh (US$ 50,000)</td>
<td>Rs. 1 million/ Rs. 10 lakh (US$ 20,000)</td>
</tr>
<tr>
<td>Small</td>
<td>Rs. 50 million/ Rs. 5 crore (US$ 1 million)</td>
<td>Rs. 20 million/ Rs. 2 crore (US$ 40,000,000)</td>
</tr>
<tr>
<td>Medium</td>
<td>Rs. 100 million/ Rs. 10 crore (US$ 2 million)</td>
<td>Rs. 50 million/ Rs. 5 crore (US$ 1 million)</td>
</tr>
</tbody>
</table>

* Investment limit in Plant & Machinery
** Investment limit in equipments
*** Rs 50 = 1 USD

Before going further, it is important to mention some of the organisations that are associated with small-scale industry/ MSMEs:

Small Industries Development Organisation (SIDO), Small Scale Industries Board (SSIB), National Small Industries Corporation Ltd. (NSIC), Confederation of Indian Industry (CII), Federation of Indian Chamber of Commerce and Industry (FICCI), PHD Chamber of Commerce and Industry (PHDCCI), Associated Chamber of Commerce and Industry of India (ASSOCHAM), Federation of Indian Exporters Organisation (FIEO), World Association for Small and Medium Enterprises (WASME), Federation of Associations of Small Industries of India (FASII), Consortium of Women Entrepreneurs of India (CWEI), Laghu Udyog Bharti (LUB), Indian Council of Small Industries (ICSI), Indian Institute of Entrepreneurship (IIE), National Institute of Small-Industry Extension Training (NISIET), National Backward Caste Finance Development Corporation, National Institute for Entrepreneurship and Small Business Development (NIESBUD), Small Entrepreneurs Promotion and Training Institute (SEPTI), Small Industries Development Bank of India (SIDBI) etc.
Importance of the MSME sector

The contribution of micro, small and medium enterprises (MSME) sector to manufacturing output, employment and exports of the country is quite significant. According to estimates, in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 percent of the total exports of India. The MSME sector employs about 42 million persons in over 13 million units throughout the country. There are more than 6000 products, ranging from traditional to high-tech items, which are being manufactured by the Indian MSMEs.

Graph 1: Trends in the growth of Micro and Small Enterprises (MSEs) and the Employment Generated (in lakh)


It can be deciphered from the graph 1 that the number of MSEs has increased steadily in India from 67.87 lakhs in 1990-91 to 133.68 lakhs in 2007-08. This could be possible due to the conducive policy environment during the liberalization era (post 1991). Similarly, number of persons employed in MSEs has risen from 158.34 lakhs in 1990-91 to 322.28 lakhs in 2007-08. The yawning gap between the two lines over the years indicates that employment elasticity of the MSE sector has improved. However, much of the labour absorption has taken place in the unorganized/ informal enterprises.
Graph 2: Comparison of the growth rates in micro and small enterprises and the overall industrial sector


Graph 2 shows that the MSE sector observed better growth rates vis-à-vis the overall industrial sector in India.

Graph 3: Contribution of MSE (%) at 1999-2000 prices in total industrial production and GDP


It can be witnessed from the graph 3 that the contribution of the MSE sector to overall industrial production has declined marginally from 39.74% in 1999-2000 to 38.57% in 2006-07. The contribution of the MSE sector to the gross domestic product (GDP) has increased from 5.86% in 1999-2000 to 5.94% in 2006-07.
Graph 4: Exports from small scale industries (in Rs. Crore)

Source: Handbook of Statistics on Indian Economy (2009), Reserve Bank of India

Graph 4 shows that exports from the small scale industry has increased from Rs. 9,664 crore in 1990-91 to Rs. 1,50,242 crore in 2005-06. However, export-oriented SMEs are likely to be impacted from imminent global slowdown. Little progress has been made to diversify our export basket. Since the late 1980s, exports from SMEs continues to be dominated by just eight product groups, (namely, Readymade garments, Engineering goods, Electronic and computer software, Chemicals and allied products, Basic chemicals, pharmaceuticals and cosmetics, Processed foods, Finished leather and leather products and Plastic products) accounting for over 90 per cent of total value of exports.

The Final Results of the Third All India Census of Small Scale Industries (SSIs) conducted during 2001-2002 shows that the percentage of females employed in the SSI sector was 13.31 %. This shows that there exists a biasness towards men in getting employed in the SSIs. In Mizoram, Orissa, Karnataka, Goa, Lakshadweep, Kerala, Tamil Nadu and Puducherry, the percentage share of women employed was considerably higher (more than 20 %) as compared to the rest of the states and UTs.

Policy changes in the reforms era

The Prebisch-Singer thesis states that the terms-of-trade between primary products (exported by developing countries-'periphery' to developed countries-'core') and manufactured goods (imported from developed countries by developing countries) tend to deteriorate over time. This happens because the income elasticity of demand for manufactured goods is greater than that for primary products-especially food. Therefore, as incomes rise, the demand for manufactured goods increases more rapidly than demand for primary products, thus creating trade deficit in favour of the developing countries. The thesis calls for rapid industrialisation in the developing countries, which
would lead to import substitution and lesser dependence on developed countries for imports of manufactured goods. The infant industry argument too emanates from the Prebisch-Singer thesis. The infant industry argument demands protection for the domestic industry from the government in the form of tariffs, quotas, or subsidies in order to survive the lower prices and higher quality of the manufactured goods or services produced and exported by the advanced capitalist countries. Proponents of the infant industry argument theorize that protectionism will allow the infant industry to grow and develop to the point at which it can compete on the international market without protectionist measures.

Following these arguments, India went for rapid industrilisation during the 2nd and 3rd Five Year Plans, which was capital intensive in nature and thus could not solve the problem of unemployment. Moreover, it created regional disparity in development outcomes. The Karve Committee Report (1955) was one of the earliest of the exercises, which recommended a protective environment for the growth of small industries in India. Reservation of items for exclusive manufacture in SSI sector statutorily provided for in the Industries (Development and Regulation) Act, 1951, has been one of the important policy measures for promoting this sector.

After the liberalisation of the economy, government’s attitude towards the MSME sector changed and many of the products exclusively manufactured by these units earlier, got dereserved. No more the MSME sector continued to be treated as 'infant industry'. Presently, only 21 items are reserved for exclusive manufacturing in the MSE sector. These include bread, pickles, wooden furniture, wax candles, exercise books and registers, safety matches, incense sticks, fireworks, and stainless steel and aluminium utensils. The phased deletion of products from the list of items reserved for the exclusive manufacture by micro and small enterprises is being continued. In October 2008, the government deleted 14 items from this list.

The MSME sector today faces competitive environment owing to: (a) liberalisation of the investment regime during the 1990s, favouring foreign direct investment (FDI); (b) the formation of the World Trade Organisation (WTO) in 1995, forcing its member-countries (including India) to drastically scale down quantitative and non-quantitative restrictions on imports, and (c) domestic economic reforms. Under the current paradigm of neo-liberalism, labour market rigidity is considered as a barrier to the overall growth of the economy. Labour market flexibility (a cost cutting strategy) is often prescribed to enhance productivity.

There existed three historical models of corporate governance in India: a) the managing agency model in the colonial period; b) the business house model that emerged after Independence, and; c) the Anglo-American model which has recently been adopted. The reforms in the Indian Company Law under the Anglo-American model now include: a strengthening of disclosure norms, the establishment of an Investor Education and Protection Fund, the establishment of a National Advisory Committee on Accounting Standards, etc. Deregulation of share prices led to a huge securities scam in 1992,
following which the Securities and Exchange Board of India (SEBI) came into being through the Securities and Exchange Board of India Act (1992).

The Foreign Exchange Regulation Act (FERA) has been repealed, being replaced now by Foreign Exchange Mechanism Act (FEMA). Steps have been taken to bring forth the Prevention of Money Laundering Bill, and the two together are expected to facilitate the liberalization of the capital account.

The MSME Development Act 2006, came into being with effect from 2nd October, 2006, subsequent to which, both the Central and State Governments took effective measures towards implementation of the Act. In order to increase the competitive edge of the MSMEs vis-à-vis the multinational corporations (MNCs), the Government of India announced the National Manufacturing Competitiveness Programme (NMCP) during the budget speech 2005-06. One of the objectives of NMCP is to ensure healthy growth of the MSME sector. Under the National Manufacturing Competitiveness Programme (NMCP), five components have been made operational, which include quality management systems and quality technology tools, building awareness on intellectual property rights, support for entrepreneurial and managerial development through incubators, setting up of new mini tool rooms and marketing assistance/support to MSEs.

An important component of the NMCP is “Building Awareness on Intellectual Property Rights (IPRs)” for the MSMEs. The objective here is to create and enhance awareness about Intellectual Property Rights (IPRs) among the MSME units so as to enable them to take appropriate measures for protecting their ideas and business strategies and also avoiding infringement of the intellectual property belonging to others. This has been deemed important since India is a signatory of the Trade related Intellectual Property Rights (TRIPs) under the World Trade Organisation (WTO) pact. However, it would have been better had the government taken steps towards open research, collaborative knowledge creation as well as innovation and adopted the idea of ‘scientific commons’. IPR protection and standards are required but it should not be based on: (i) frivolous patents; (ii) monopolistic practices; (iii) beating the system by incrementally modifying patents and getting extensions on the IPR, etc.
**Box 1: Open Source Drug Discovery**

OSDD is a CSIR Team India Consortium with Global Partnership with a vision to provide affordable healthcare to the developing world by providing a global platform where the best minds can collaborate & collectively endeavor to solve the complex problems associated with discovering novel therapies for neglected tropical diseases like Malaria, Tuberculosis, Leshmaniasis, etc. It is a concept to collaboratively aggregate the biological and genetic information available to scientists in order to use it to hasten the discovery of drugs. This will provide a unique opportunity for scientists, doctors, technocrats, students and others with diverse expertise to work for a common cause.

The success of Open Source models in Information Technology (For e.g., Web Technology, The Linux Operating System) and Biotechnology (For e.g., Human Genome Sequencing) sectors highlights the urgent need to initiate a similar model in healthcare, i.e., an Open Source model for Drug Discovery.

**Funding source** - The Government of India has committed Rs. 150 crores (US $38 million) towards this project. An equivalent amount of funding would be raised from international agencies and philanthropists. About 46 crores (US $12 million) has been already released by the Government of India.

The ‘open source drug discovery’ programme takes inspiration from the success of the open source movements in software (including wikipedia) and the Human Genome Sequencing Project, which happened in the West. The website is based on the popular Wiki-based model and is designed to enable anyone to contribute or modify content in a collaborative mode. The ideas are reviewed by experts and the contributors get certificates and even monetary rewards if their contributions prove useful. The initiative makes use of the recent developments in bioinformatics, which has enabled research to identify potential drugs by comparing on computer, potential disease targets against large chemical databases. The website now hosts different types of data on the pathogens and the various tools needed for data analysis. There is a discussion forum for members to share ideas. A core committee of expert scientists monitor the process closely. The website is open to all—scientists, researchers, academicians, doctors, software professionals, traditional healers, and industry. Even lay persons, who have some useful idea or the other to contribute could share them on the website.

No major advancement in treatment of tuberculosis (TB) has emerged over the past half a century, particularly because market forces discourage big pharma firms from developing drugs for such diseases as they are subject to long gestation period, heavy research and development costs and lower returns. It can be recalled here that TB is an infectious disease that is not confined to HIV+ individuals only. However, those infected with HIV are at high risk of developing active TB because of low level of immunity. Although TB is curable, poor case detection and patients’ lack of adherence to treatment make it the leading cause of death among HIV+ people particularly in Africa. Intensive TB case finding must take place in areas severely affected by HIV through coordination of TB and HIV services. According to the data released by the World Health Organisation (WHO), 1/3rd of the world’s population is currently infected by TB.

**Source:** CSIR, [http://www.osdd.net/publications](http://www.osdd.net/publications);

Cluster formation has been considered important for MSME development. A cluster may be defined as a local agglomeration of enterprises (mainly SMEs, but often also including some large enterprises), which are producing and selling a range of related and complementary products and services. Generally, SME clusters can be categorized in terms of
(i) Whether it is located in the rural, semi-urban or urban areas (villages/ towns/ cities/ metros)

(ii) Whether it is induced cluster (due to the initiative of the government) or natural cluster (which has come up due to the private entrepreneurs)

(iii) Whether it is traditional (art and craft), traditional consumer goods or modern SSI

(iv) Whether it is resource-based, market based or infrastructure based.

(v) Industry group: machinery and parts except electrical, cotton textiles, chemical and chemical products, metal products, hosiery and garments, food products, non-metallic mineral products, electrical machinery and parts, wool, silk and synthetic fibre textiles, transport equipment and parts, etc.

(vi) Phase of development--'Initial phase', 'Growth phase', 'Maturity phase' and 'Extinction phase'.

The close proximity of raw material suppliers, equipment suppliers, component producers, sub-contractors and final goods producers, together with a combination of both intense rivalry among firms and cooperation in producers' associations drive the whole cluster forward. Clusters are also classified as: Marshallian cluster, hub-and-spoke cluster and state-anchored cluster.

An analysis of Indian clusters shows that 72 clusters have high potential for exports, 47 have medium potential and only 19 clusters seem to have low export potential. Clusters need to look particularly to expand export markets and network with both domestic and overseas clusters in order to become strong and global. The National Commission for Enterprises in the Unorganized Sector (NCEUS, www.nceus.gov.in) too had proposed establishment of “Growth Poles” in different parts of India with a view to integrating, within a geographical location, a number of clusters of production units engaged in manufacturing, services and non-farm activities and facilitating the expansion of production and employment in micro and small enterprises.
Box 2: Limited Liability Partnership Bill, 2006

**Highlights of the Bill**

- The Limited Liability Partnership Bill, 2006, permits the creation of a new type of corporate entity, the limited liability partnership (LLP).

- An LLP shall have a minimum of two partners. At least two will be designated partners, one of whom is resident in India.

- Unlike in partnerships, the liability of partners of an LLP is limited to their share in the LLP. In the case of deliberate fraud, the limited liability shield may be removed.

- The concept of whistleblower has been introduced. The penalties against a partner or employee may be reduced or waived if he provides information that is useful during investigation, or leads to conviction.

- Partnerships, private limited companies and unlisted public limited companies may convert into LLPs. The Bill also permits foreign LLPs to function in India.

**Key Issues and Analysis**

- Limited companies are taxed on their incomes, and the income they distribute to their shareholders is also taxed. In partnerships and proprietorships only the income attributed to the partners is taxed. It is not specified how LLPs will be taxed.

- The maximum number of partners in a partnership is limited to 20 by the Companies Act, 1956. It is unclear if this limit will also apply to LLPs.

- The Bill does not specify whether capital gains tax or stamp duty will be payable when a partnership or a company converts into an LLP.

- For companies, partnerships and proposed LLPs, the minimum number of members or partners is two. Even after this Bill there is no legislation under which a single-member entity can function with limited liability in India.

- If a person ceases to be a designated partner, the LLP has to appoint another person, resident in India, as a designated partner. This seems to apply even if the LLP has the minimum required two designated partners, one of whom is resident in India.

*Source: PRS Legislative Research, Chanakyapuri, New Delhi*
State of the Micro and Small Enterprises (MSEs)


- The NSS 55th Round reported an estimated 44.1 million non-farm unorganized enterprises in 1999-2000. However, the Economic Census of 2005 reported a total count of 41.83 million enterprises that comes under the NCEUS' definition of informal/ unorganized enterprises

- A large number of micro-enterprises are engaged in traditional activities. It is estimated that about 6.5 million enterprises are in handloom sector and 0.5 million in Khadi and village industries sector. About 8.2 million enterprises are engaged in agro-processing activities like dairy, poultry, fishery, etc. and the remaining 19.3 million cover handicrafts, coir, sericulture, wool, retail trade, small business, etc.

- In several countries including India, industrial policy has incorporated elements that promoted subcontracting between large and small enterprises. The data suggests that the overall incidence of subcontracting has increased, albeit marginally, from 31 percent in 2000-01 to 32 percent in 2005-06.

- Nearly 27.3 per cent of rural, and 31.5 per cent of urban enterprises, work under sub-contracting system. The incidence of subcontracting is much higher in West Bengal (54 per cent), followed by Tamil Nadu (52 per cent), Karnataka (39 per cent), UP (35 per cent) and Kerala (27%). At the other extremes are Himachal Pradesh, Haryana and Madhya Pradesh where the enterprises are the least subcontracted (less than 10 percent).

- While urban India accounted for only 22.9 per cent of total employment, in the services sector, urban enterprises accounted for about 47 per cent of total MSEs. Besides the smaller city states such as Delhi and Chandigarh, larger states such as Maharashtra, Karnataka, Tamil Nadu, Punjab and Haryana, had a proportionately larger number of urban than rural micro enterprises. The geographical spread of the micro enterprises shows that the relatively poorer states such as Uttar Pradesh, West Bengal, Bihar and Orissa were having relatively larger density of enterprises.

- The manufacturing segment of the microenterprises sector in India consisted of almost 17 million enterprises in 2005-06, this having increased drastically by about 4.5 million enterprises in slightly over a decade. This sector is located mostly in rural areas (71%), but with the rural preponderance having reduced in the period 1994-95 to 2005-06, signaling a sharp growth in the urban informal manufacturing sector between the mid-nineties and the first five years of the twenty first century.
The manufacturing segment of the microenterprises sector employed more than 32 million people in 2005-06, this having gone up by more than five million from 1994-95. The rural domination is true of employment in the sector as well although to a smaller extent than the share of microenterprises. The urban informal sector thus employs a larger share of the workforce (34%) than its share of enterprises (29%).

The Third Census of Small Scale Industries (2001-02) (Government of India, 2004) revealed that over 99 per cent of small scale industries (SSIs) exist in the form of micro (tiny) enterprises whose average per unit fixed investment was a meager Rs.1.47 lakh. Further, over 94 per cent of all small enterprises are unorganised sector enterprises as per the NCEUS definition and they belong to the lower segment of micro-enterprises i.e. with an investment below 5 lakh.

Credit flows to Micro and Small Enterprises

The Challenge of Employment in India: An Informal Economy Perspective (NCEUS, 2009) shows that between August 2007 and 2008, credit for credit cards increased by 86.3 per cent, all services sectors by 35.3 per cent, construction by 48.3 per cent, and real estate by 46.3 per cent. However, the increase to credit agriculture and allied activities has been 18.5 percent and for small-scale industries (including micro enterprises) just 9.7 per cent.

The overall availability of credit to small and micro enterprises as percentage of net bank credit (NBC) of the Scheduled Commercial Banks (SCB) has declined from 15.5 per cent in 1996-97 to 6.6 per cent in 2007-08. Banks’ credit to micro enterprises (investment up to Rs 25 lakh in plant and machinery) declined from 4.2 percent in 2002-03 to 2.8 percent in 2007-08. The lower segment of micro enterprises (with investment up to Rs 5 lakh in plant and machinery) has experienced a decline from 2.2 per cent to 1.6 percent in the same period. The proportion of net bank credit flows to the small scale sector has been falling in recent years (from 16 per cent in early 1990s to 8 per cent in 2006–2007).

Banks show their reluctance to extend credit to small enterprises because of the following reasons:
• High administrative costs of small-scale lending;
• Asymmetric information;
• High risk perception; and
• Lack of collateral.

Credit guarantee schemes diminishes the risk incurred by lenders and are mainly a reaction to small firms’ lack of collateral. Such schemes do have the potential to reduce the costs of small-scale lending and to improve the information available on borrowers. They enable small firms to access formal credit and also improve the terms of a loan. Such schemes assist small enterprises to obtain finance for working capital, investment
and/or leasing purposes at reasonable conditions. This enables SMEs to improve their competitiveness and to extend their economic activity. Weaknesses of credit guarantee schemes can be avoided through proper design and private sector involvement.

**Factors affecting MSMEs**

Some of the key constraints that are being faced by the Indian MSMEs are:

a. Accessing adequate and timely financing on competitive terms, particularly longer tenure loans.

b. 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 SMEs and impeded overall growth and development.

c. The financing constraints faced by Indian SMEs are attributable to a combination of factors that include policy, legal/regulatory framework (in terms of recovery, bankruptcy and contract enforcement), institutional weaknesses (absence of good credit appraisal and risk management/monitoring tools), and lack of reliable credit information on SMEs.

d. It has become difficult for lenders to be able to assess risk premiums properly, creating differences in the perceived versus real risk profiles of SMEs.

e. Access to skilled manpower, R&D facilities and marketing channels is limited.

f. Availability of finance at cheaper rates, skills about decision-making and good management and accounting practices, and access to modern technology.

Bribery and corruption emanates from red-tapism and high-handedness of the bureaucracy. Many economists believe that the License-Permit Raj prevailing in India before the 1990s, affected the growth of businesses and industry. Hence, lesser intervention by the government in the functioning of the market is being demanded.

*Doing Business 2010: Reforming Through Difficult Times* presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies. According to the same report:

- India is ranked 133 out of 183 economies. Singapore is the top ranked economy in the Ease of Doing Business.
- It requires 13 procedures, takes 30 days, and costs 66.06 % GNI per capita to start a business in India.
- India is ranked 169 overall for Starting a Business.
- It requires 37 procedures, takes 195 days, and costs 2,394.86 % GNI per capita to build a warehouse in India.
- India is ranked 175 overall for Dealing with Construction Permits.
- India is ranked 104 overall for Employing Workers.
- It requires 5 procedures, takes 44 days, and costs 7.43 % of property value to register the property in India.
- India is ranked 93 overall for Registering Property.
- India is ranked 30 overall for Getting Credit.
• India is ranked 41 overall for Protecting Investors.
• India is ranked 169 overall for Paying Taxes.
• India is ranked 94 overall for Trading Across Borders.
• India is ranked 182 overall for Enforcing Contracts.
• India is ranked 138 overall for Closing a Business.

In India procedures under the 2002 Securitization Act have become more effective, easing the process and reducing the time required to close a business.

Corporate governance has become a buzz term before the Indian industrial sector, particularly after the outbreak of Satyam scam. According to the *Global Corruption Barometer 2009* that has been prepared by Transparency International, the private sector is perceived to be corrupt by half of those interviewed: a notable increase of eight percentage points compared to five years ago. The public in general is critical of the private sector’s role in their countries’ policy making processes. More than half of respondents held the view that bribery is often used to shape policies and regulations in companies’ favour. Firms from India, China and Brazil are regarded by their peers as among the most corrupt when doing business abroad. Two major securities scams have already taken place in India: the Harshad Mehta securities fraud and the Ketan Parekh scam.
Box 3: Impact of global financial meltdown on employment in MSMEs

A survey was conducted by the Ministry of Labour and Employment, Government of India to assess the impact of economic slowdown on employment during October-December, 2008. The sample was drawn from 20 centres covering 11 States/UT. Important sectors, viz. Mining, Textiles, Metals, Gems & Jewellery, Automobile, Transport and IT/BPO were covered in the survey. These sectors contributed more than 60% to the GDP in the year 2007-08. A sample of 2581 units was covered in the survey.

The survey found that about half a million workers lost their jobs during October-December, 2008. The total estimated employment in all the sectors covered by the survey went down from 16.2 million during September, 2008 to 15.7 million during December, 2008 resulting in job loss of about half a million. It is seen that the employment declined every month during this period. It has also been observed that the employment in all the sectors/industries studied went up significantly over the period from March, 2008 to September, 2008. Beyond September, 2008, it however, decelerated at all industries/sectors level at an average rate of 1.01 per cent per month. The major impact of the slowdown is noticed in the export-oriented units. Though India’s export sector accounts for less than 20 percent of the its gross domestic product (GDP), decline in exports would affect the employment in this sector. A comparison of employment data of export and non-export units indicates that employment declined at an average monthly rate of 1.13 per cent in case of former whereas in case of latter, it declined by 0.81 per cent. The reason for decline in employment in export units of textile sector at Chennai was that the workers left these units due to declining wages and insecurity and seeking better employment avenues in other sectors. In Tiruppur (Tamil Nadu), many of the units informed that the orders from foreign buyers were either not coming or their value had declined. The decrease in employment has been experienced in all the sectors, except the IT/BPO sectors, wherein it has gone up marginally during the October-December, 2008 period. The average monthly decline in employment was highest (8.58 percent) in Gems & Jewellery followed by Transport (4.03 percent), Automobiles (2.42 percent), Metals (1.91 percent), Textiles (0.91 percent) and Mining (0.33 percent). Under the contract category, the most affected sector is Automobiles where the employment has decreased by 12.37 per cent followed by 9.93 per cent in Transport sector. For the direct category of workers the most affected sector is Gems & Jewellery-9.27 percent followed by Textiles-1.11 per cent. The overall decline in the direct and contract category of workers is 0.63 percent and 3.88 percent respectively. The average earnings have declined at the rate of 3.45 per cent per month during the period of study.


The situation of Indian SMEs is better as compared to their counterparts in Bangladesh and Pakistan. Almost 36% of Pakistani SMEs have a bank account, while only 7 percent had at least one loan outstanding in the previous three years (2002-05). In comparison, in 2006, 43% of SMEs in Bangladesh, and 95% in India, had a bank account. About 32% SMEs in Bangladesh and 33% SMEs in India had a loan from a bank. A smaller fraction of SMEs in Pakistan borrow from banks as compared with SMEs in other countries of South Asia region including India and Bangladesh.
Some new initiatives to promote MSMEs

In the recent years, Indian authorities have taken several steps to address factors that constrain SME financing and developments, and the World Bank has provided support through an SME Financing and Development Project.

The Government of India and the Small Industries Development Bank of India (SIDBI, www.sidbi.com, which is the apex bank for SMEs in India) requested the World Bank to support efforts to remove constraints to SME access to finance (including term financing), and to foster SME development. A Bank project involving funding of US$120 million for SME financing and development was subsequently developed. The Project was approved on November 30, 2004, and became effective on April 4, 2005 and is currently scheduled to close on June 30, 2009. The objective of the Project was to improve SME access to finance and business development services, thereby fostering SME growth, competitiveness and employment. The Small and Medium Enterprises Financing and Development Project has been designed to improve access to finance for SMEs. The lending from the original project covered 927 SMEs spread across 10 Indian states.

A US$ 400 million additional financing loan to the SIDBI was signed on 5 June, 2009 by representatives from the Government of India, SIDBI and the World Bank.

The Securities and Exchange Board of India (SEBI, http://www.sebi.gov.in/) issued norms on separate stock exchanges for SMEs during November, 2009 so as to give them more options to raise capital. At present, around 90% of the 2.61 crore MSMEs depend on either banks or informal sources to finance their business. Setting up of a separate stock exchange for SMEs is not so simple. Two requirements are to be fulfilled. One is to reduce the cost of compliance and the second is to safeguard the investors from any undue risk. The SEBI has laid the groundwork to allow SMEs to list on SME Exchanges. SMEs have always complained of difficulty in accessing to both debt and equity capital. It is perceived that registration of companies from the SME sector is essential so as to raise capital from the stock exchange.

SMERA (www.smera.in) is India’s premier credit rating agency in the micro, small, & medium enterprise segment. It focuses primarily on the Indian SME segment. The primary objective is to provide ratings that are comprehensive, transparent and reliable. It takes into account the financial condition and several qualitative factors that have bearing on credit worthiness of the SME.

The credit guaranty fund and credit linked capital subsidy scheme has been built in order to support the SMEs. Credit rating helps in cost efficiency and innovation to be undertaken by SMEs, and helps the bank to go for less riskier lending venture, provided the credit rating is done in a scientific way. The Exim Bank of India in India has also provided financial solutions to the SMEs.
A few suggestions

Information technology or Internet-enabled environment helps in fast and accurate decision-making by the SMEs due to increased mobility. The critical components before SMEs are speed of services, access to information, empowering employees in terms of skill and delivering highest valued services at competitive cost. SMEs need IT-based solutions in terms of multi-tasking, expanding customer base, raising productivity, controlling cost, working remotely, fast and accurate decision-making and facilitating collaboration. SMEs have various needs to function in an aggregative manner in order to reach out for value addition by keeping in mind the variable cost model. IT usage by the SMEs raises productivity of the sector in particular and the economy in general.

An all-India survey across 8 cities was conducted among 1000 B2B sell-side suppliers to see how MSMEs are adopting online B2B market places in a study titled ICT adoption among MSMEs in India: A survey with special focus on Online B2B marketplaces by Internet and Mobile Association of India (IAMAI) and eStasIndia.com. The study shows:

- Internet application usage among B2B suppliers across India showed almost all B2B suppliers today use Internet for communication purposes.

- In terms of various forms of ICT penetration, PC/ laptops have the highest penetration levels among B2B suppliers across India. PCs are followed by printers in terms of average number of units per B2B suppliers, followed by accounting software like Tally. ICT penetration in terms of server software is quite low, with an average usage for every 20 B2B suppliers surveyed across India.

- 73% of the B2B suppliers surveyed use Internet to run their own website.

- 55% of B2B suppliers use Internet for promoting their products/services online.

- The penetration rates for online B2B marketplaces is around 45 to 50% among MSMEs in India, and this would further increase to around 80% in the next 4-5 years.

More support is needed for MSMEs from the government in the form of priority sector lending, government procurement programme, credit and performance ratings and marketing support. Technology transfers (such as green technology) and networking can revive the growth of MSMEs.
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