

Issues in SME Development in India

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Abstract

This paper discusses the characteristics, contributions of SMEs to economic development, and the constraints to SME development in developing countries with particular reference to India. SMEs sector is a only solution to the problems of poverty, insecurity, unemployment, over population in the modern world. The contribution of SMEs has been remarkable in the industrial and economic development of the country. It has contributed a share of 40% in the industrial production and 35% of the total manufactured exports of the country. This sector is second in the rank of employment generation next to the agriculture. This sector employing approximately 14 million people. Overall this sector has contributed a lot to the economic development of the country. This paper provides some relevant recommendations to policy makers, development agencies, entrepreneurs, and SME managers to ascertain the appropriate strategy to improve the SME sector in the developing countries like India.

Keywords: SME development, contributions, India.

1. Introduction

The Small and Medium Enterprises (SMEs) are of key importance in economic development. They are often described as effective and inventive job creators, the seed of big businesses and the fuel of national economic engines. Even in the well-developed industrial economies, it is the SME sector rather than the multinationals that is the largest employers of workers (Mullineux, 1997). Despite of the importance of the SMEs in Indian economic growth, the sector is facing challenges and does not get the required support from the concerned Government Department, banks, financial institutions and corporates which is proving to be a hurdle in the growth path of the SMEs. Government at all levels have undertaken initiatives to promote the growth of SMEs. SMEs development can encourage the process of both inter and intra-regional decentralizations; and, they may become a countervailing force against the economic power of large enterprises. More generally, the development of SMEs is seen as Accelerating the achievement of wider economic and socio-economic objectives, including poverty alleviation (Cook and Nixon, 2000). According to an OECD report, SMEs produce about 25% of OECD exports and 35% of Asia's exports (OECD, 1997). Small and medium enterprises (SMEs) play a vital role for the growth of Indian economy by contributing 45% of industrial output, 40% of exports, employing 60 million people, create 1.3 million jobs every year and produce more than 8000 quality products for the Indian and international markets. SMEs contribution towards GDP in 2011 was 17%. SMEs therefore have a crucial role to play in stimulating growth, generating employment and contributing to poverty alleviation, given their economic weight in India. How do SMEs in India compare with their counterparts in other countries and what policy lessons can be drawn for other countries to enhance the contribution of the sector remains the focus of this paper?

2. DEFINITION OF SMES

SME's are defined differently in different parts of the world. Some use terms of assets, while others use employment, sales or shareholders' funds as criteria to define SMEs. Some others use a combination of employment and revenue as a combined criterion. It is a well-debated issue, but the definition of small and medium enterprises in India was recently settled. The Micro, Small and Medium Enterprises Act, 2006, defines enterprises on the basis of investment in plant and machinery. According to the new Act, the MSMEs are defined as follows:

Category	Investment (Plant & Machinery)
Service Micro Enterprises	Less than 25 lacs
Small Enterprises	Less than 10 lacs
Medium Enterprises	Less than 5 crores

Less than 2 crores

In the European Union, SMEs are defined in the Commission Recommendation of May 6, 2003. An enterprise is regarded as medium sized if it has not more than 250 employees, not more than 50 million Euro turnovers and if not more than 25% of the shares of such an enterprise are in the ownership of another enterprise (OECD, 2005). A small enterprise is with 50 employees, not more than 10 million Euro turnovers and less than 10 million Euros in balance sheets. The micro enterprises are defined as enterprises with 10 employees, not more than 2 million Euro turnovers and less than 2 million Euro in balance sheet.

3. Formation of SMES in India

Formation of SMES in India is governed by MSMED Act 2006. The registration under Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 is for aiding the promotion, development and

improving the competitiveness of Micro, Small and Medium enterprises. Registration of a firm under the Act is a means to avail the benefits available to SMEs like easy finance availability from Banks, preference in acquiring Government tenders, stamp duty and octroi benefits, concession in electricity bills, timely receipt of payments from the buyers or debtors, reimbursement of ISO Certification expenses and so on. All sectors and classes of enterprises, whether Trading, Hindu undivided family, Service or Manufacturing, Co-operative society, Partnership firm Proprietorship, Association of persons, Company or Undertaking, can apply for the registration and get qualified for the benefits provided under the Act.

4. Importance of SMES

The contribution of the Small and medium enterprises (SME's) in the economic development of a nation is well acknowledged. In developing countries, as some authors argue (Leutkenhorst, 2004) the contribution of SME's towards employment generation is significant because they

- use more labour intensive production processes than large enterprises, leading to increase in employment and more equitable income distribution
- Provide livelihood opportunities through simple, value adding processing activities in agriculturally based economies;
- Promote entrepreneurship; and
- Support the building up of productive capacities and the creation of strong economic systems, through linkages between small and large enterprises

5. Contribution of SMEs to Economic Development of India

There is a general consensus that the performance of SMEs is important for both economic and social development of developing countries. From the economic perspective, SMEs provide a number of benefits (Advani, 1997). SMEs have been noted to be one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low-income countries. These enterprises have been recognized as the engines through which the growth objectives of developing countries can be achieved. They are potential sources of employment and income in many developing countries. SMEs seem to have advantages over their large-scale competitors in that they are able to adapt more easily to market conditions, given their broadly skilled technologies. They are able to withstand adverse economic conditions because of their flexible nature (Kayanula and Quartey, 2000). SMEs are more labour intensive than larger firms and therefore have lower capital costs associated with jobcreation (Anheier and Seibel, 1987; Liedholm and Mead, 1987; Schmitz, 1995). They perform useful roles in ensuring income stability, growth and employment. Since SMEs are labour intensive, they are more likely to succeed in smaller urban centres and rural areas, where they can contribute to a more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Due to their regional dispersion and their labour intensity, it is argued, small-scale production units can promote a more equitable distribution of income than large firms. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus facilitating long-term economic growth (Kayanula and Quartey, 2000). According to an OECD report, SMEs produce about 25% of OECD exports and 35% of Asia's exports (OECD, 1997). Small and medium enterprises (SMEs) play a vital role for the growth of Indian economy by contributing 45% of industrial output, 40% of exports, employing 60 million people, create 1.3 million jobs every year and produce more than 8000 quality

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6. General constraints to SME Development

Despite the potential role of SMEs to accelerated growth and job creation in developing countries, a number of bottlenecks affect their ability to realize their full potential. SME development is hampered by a number of factors, including finance, lack of managerial skills, equipment and technology, regulatory issues, and access to international markets (Anheier and Seibel, 1987; Steel and Webster, 1991; Aryeetey *et al.*, 1994; Gockel and Akoena, 2002). The lack of managerial know-how places significant constraints on SME development. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. The scarcity of management talent, prevalent in most countries in the region, has a magnified impact on SMEs. The lack of support services or their relatively higher unit cost can hamper SMEs' efforts to improve their management, because consulting firms are often not equipped with appropriate cost-effective management solutions for SMEs. Besides, despite the numerous institutions providing training and advisory services, there is still a skills gap in the SME sector as a whole (Kayanula and Quartey, 2000). This is because entrepreneurs cannot afford the high cost of training and advisory services while others do not see the need to upgrade their skills due to complacency. In terms of technology, SMEs often have difficulties in gaining access to appropriate technologies and information on available techniques (Aryeetey *et al.*, 1994). In most cases, SMEs utilize foreign technology with a scarce percentage of shared ownership or leasing. They usually acquire foreign licenses, because local patents are difficult to obtain. Regulatory constraints also pose serious challenges to SME development and although wide-ranging structural reforms have led to some improvements, prospects for enterprise development remain to be addressed at the firm-level. The high start-up costs for firms, including licensing and registration requirements, can impose excessive and unnecessary burdens on SMEs. There is worldwide consensus that high rate of economic growth contribute to economic and social development and poverty reduction. At the same there is growing recognition that poverty reduction growth depends on the quality of growth, its composition, distribution and sustainability.

7. Conclusion

This paper has reviewed various definitions of SMEs and also discussed the formation of SMEs in India and its importance, contributions of SMEs to economic development, and the constraints to SME development in India. In reviewing the definitions of SMEs, it was concluded that there is no single, universal, uniformly acceptable definition of SMEs.

The international and national policy changes have opened lot of opportunities and markets for the SMEs in India. Integrated and unified effort is required from the small industry and government to understand and absorb technological dynamic way. Technological up gradation, Research and Development and encouragement of inter-firm linkages need to be promoted clearly and consistently. Financial infrastructure needs to be enhanced and sufficient credit to the sector be made available taking into consideration the growing investment demand, globalization, increasing competition and the requirements of technological transformation. It is important to take care of this sector to enable it to contribute towards growth in the Indian economic development.

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