

The need for a permanent definition of MSMEs in India

Dr. Renati Jayaprakash Reddy Professor of Management
AIMS Institute of Higher Education
1st Cross, 1st Stage, Peenya
Bangalore – 560058, India

Mr.Papaiah Research Scholar in Commerce
AIMS Centre for Advanced Research Centre
(Mysore University)

Abstract

The MSME sector in India has emerged as a highly vibrant and dynamic sector in Indian economy. Though the role of small and tiny industries has been key since 1956, MSME Development Act, 2006 brought a new dimension to this sector through including medium enterprises. The Government of India has been changing the definitions of small scale enterprises quite frequently. While defining small enterprises, the Government dropped the criterion of employee count since 1960 and started considering only investment in plant and machinery. As the investment value is subject to change from year to year, and decrease in case of inflation, the Government was forced to enhance the limits of small enterprises often. That is the reason why the investment limit increased from ₹ 5 lakh in 1950 to ₹ 5 crore in 2006 (100 times increase in a span of 56 years). After including medium enterprises, since 2006, the latest defined limits of Micro, Small and Medium enterprises became outdated and many industry associations are expecting a new definition again with enhancement in the limits of MSMEs. How long will this go? In India, there is no monitoring body for automatic revision of the definition and the policy makers seem to be not serious about this. Further, they are not looking for a permanent definition which will be suitable to Indian environment. In this background, the researcher attempts to give three possible alternatives in defining MSMEs in India. One is employee count, the other is continuous change in the investment limits and third one is the combination of these two. A strong definition of MSMEs will help the enterprises to cope up with global competition and contribute significantly to the GDP of the country.

Keywords: MSMEs Sector, Permanent Definition, Employee Count, Monitoring body.

Introduction

Micro, Small and Medium Enterprises (MSME) sector has emerged as a vibrant, dynamic and highly contributing sector of the Indian economy. It not only plays a crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialization of rural and backward areas, thereby, reducing regional imbalances, assuring more equitable distribution of national income and wealth. It is an important pillar of the Indian economy by way of creating employment of about 70 million through 30 million units, manufacturing more than 6000 products, contributing about 45% to manufacturing output and about 40% of exports, directly and indirectly (SIDBI-2010-11). In recent years the MSME sector has consistently registered higher growth rate compared to the overall industrial sector. With its ability and dynamism, the sector has shown admirable innovativeness and adaptability to survive in the recent economic downturn and recession. It is a well-known fact that Small and Medium Enterprises (SMEs) are the major contributors for all economies in the world. These enterprises became the main source of

economic growth in both developed and developing economies. According to the Organization for Economic Cooperation and Development (OECD), SMEs account for more than 95% of enterprises and provide 60-70% of the jobs. They possess high potentiality for growth. It is not a surprise to say that no economy in the world would survive without SMEs.

Objective

The objective of this conceptual paper is to look into the possibilities of having a permanent definition for MSMEs in India.

Methodology

This paper is prepared completely based on secondary sources like, Annual Reports of national and international bodies, Research Journals, Statements of Prominent personalities, Research Columns in popular media, etc.

Importance

All economies in the world, whether developed or developing, are directly depending on the contribution of SMEs. Their contribution to employment, production, exports and GDP are considerable and in some economies, it is dominant. Thus, defining and redefining of SMEs in all the economies has been a continuous process. The international bodies are trying to have a universally acceptable definition for SME. Of course, it takes some more time to reach that level. As for as India is concerned, the definition of MSMEs is mainly based on investment in Plant and Machinery in case of manufacturing enterprises and Equipment in case of service enterprises. The Government has been raising the investment limits taking inflation and other factors into consideration. It is not looking towards other criteria like employee count, turnover or balance sheet values while defining MSMEs. Further, the contribution of MSMEs is very less when compared to other developed and developing economies. Therefore, the importance of this paper lies in proposing a permanent and suitable definition for MSMEs of India so that their contribution to the GDP increases in the years to come.

Limitation

There are many research reports available on definitions of SMEs both at national and international level. While preparing this paper, the researcher consulted many of those reports but not all. Some reports, which deserve to be looked at, might be missing here. This might have some affect on the conclusion and the new definition of MSMEs.

Review of Literature

Different Economies in the world defined SMEs according their own perspective and requirements. Thus, there exist no uniform definitions. Many national and regional institutions, as well as intergovernmental and non-governmental organizations, have their own definitions. Criteria such as the number of employees, total net assets, sales and investment level are all commonly used as part of the definition of an SME. The number of employees is perhaps the most common basis in many of the definitions. At the international level, there are some prominent surveys and research reports on this area of defining SMEs and measuring their sizes.

The international agencies of the world have given the following definitions of SMEs:

According to European Commission (2012), the main factors determining whether a company is an SME are the number of employees and either turnover or balance sheet total. It sets limits in the form of employees, turnover and/or balance sheet total as shown in the following table.

Table 1: European Commission Definition

Company Category	Employees	Turnover €	And/or	Balance Sheet Total €
Medium-sized	<250	≤50 million		≤43 million
Small	<50	≤10 million		≤10 million
Micro	<10	≤2 million		≤2 million

The World Bank and the International Finance Corporation’s (2005) definition of an SME is based on three indicators: number of employees, total assets and annual sales. To be classified as an SME, enterprises need to meet two of these three criteria shown in the following table.

Table 2: World Bank and the International Finance Corporation definition criteria

Firm size	Employees	Assets US \$	Annual Sales US \$
Micro	<10	<100 000	<100 000
Small	<50	<3 million	<3 million
Medium	<300	<15 million	<15 million

The Brookings Institution (2008) gives the following table with definitions of SMEs as used by Multilateral Institutions.

Table 3: Brookings Institution’s source of Information on SMEs definition

Institution	Maximum Employees	Max. Revenues or turnover US \$	Maximum Assets US \$
World Bank	300	15 000 000	15 000 000
MIF – IADB	100	3 000 000	(none)
African Development Bank	50	(none)	(none)
Asian Development Bank	No official definition.		
UNDP	200	(none)	(none)

From the above definitions, it is easy to understand that all the prominent sources are considering employees as the basic criterion in defining and measuring the size of SMEs.

Further, many of the economies also consider employee count as the main criterion for defining SMEs. For example, Canada, China, Germany, Japan, South Korea, USA, Singapore, Thailand, etc., have taken

the number of employees as one of the important criterion in defining small and medium enterprises. The following table gives the details:

Table 4: Economies defining SMEs based on Employee count

Country	Category of Industry	Criteria/Country's official Definition
Canada	Manufacturing	Independent firm having < 200 employees
China	Small Manufacturing	Depends on product group usually enterprises < 500 employees
Germany	Small Manufacturing Enterprise	< 500 employees
Italy	Small Enterprise	< 200 employees
Japan	Manufacturing Wholesale Trading Retail trade and services	< 300 employees or asset capitalization < 100 million ¥ <100 employees or asset capitalization < 100 million ¥ < 50 employees or asset capitalization < 100 million ¥
Korea	Manufacturing services	< 300 employees
USA	Very Small enterprises Small enterprises Medium enterprises	< 20 employees 20 – 99 employees 100 – 499 employees
Singapore	SMEs	< 200 employees or < 100 million \$
Thailand	Small – Manufacturing Small – Services Small – Wholesale Small - Retailing Medium – Manufacturing Medium – Services Medium – Wholesale Medium – Retailing	< 50 employees and < 50 THB million total fixed assets < 50 employees and < 50 THB million total fixed assets < 25 employees and < 50 THB million total fixed assets < 15 employees and < 30 THB million total fixed assets 51 - 200 employees and 50 - 200 THB million total fixed assets 51 - 200 employees and 50 - 200 THB million total fixed assets 26 - 50 employees and 50 - 100 THB million total fixed assets 16 - 30 employees and 30 - 60 THB million total fixed assets

Source: Compiled from country related websites

The definition of SME on the basis of a specific criterion is not uniform across countries. For instance, a specific country may define an SME to be an enterprise with less than 500 employees while another country may define the cut-off to be 250 employees. Despite the variance, a large number of sources define an SME to have cut-off range of 0-250 employees. (Meghana Ayyagari, 2003).

MSMEs study of World Bank during 2010 revealed that out of 132 economies surveyed, 46 economies define MSMEs as those enterprises with less than 250 employees. This survey denotes that 78% (103 out of 132) of the economies are considering employee count as one of the criterion while defining their SMEs (Khrystyna Kushnir et al, 2010).

Definition of MSMEs in India

With a view to develop a framework for the development and support of small enterprises, various policy decisions have been taken by the Government of India. Defining it is the first step in this direction. The main purpose of a definition is to provide an instrument for the targeting of policy. In the beginning, Indian definition combined two aspects viz. "Investment and employment", but gradually these aspects became more specific and now only one aspect, i.e., investment in plant and machinery (Equipment in case of services enterprises) is emphasized. The official definition of small scale industries was first evolved in 1950 by the Small Scale Industries Board, which defined small industry as a unit employing less than 50 persons if using power and less than 100 persons without the use of power and with capital assets (Land, Building, Plant and Machinery etc.) not exceeding ₹ 5 lakh. The employment criterion was given up in 1960 and the investment limits have been increased from period to period and reached to ₹ 1 crore by 1999. The following table shows how the investment limits of small, ancillary and tiny units have changed from period to period.

Table 5: Small, Ancillary and tiny units definitions since 2005

Year	Category	Definition
1950	Small scale	Investment in Fixed Assets up to ₹ 5 lakh Employing less than 50 workers per day with the use of power or Employing less than 100 workers per day without using power
1958	Small scale	Investment in Fixed Assets up to ₹ 5 lakh Employing less than 50 workers per shift with the use of power or Employing less than 100 workers per shift without using power
1960	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 5 lakh
1960	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 10 lakh
1966	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 7.5 lakh
1975	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 10 lakh
1975	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 15 lakh
1977	Tiny	Investment in Fixed Assets(Gross value) up to ₹ 1 lakh
1980	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 20 lakh
1980	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 25 lakh
1980	Tiny	Investment in Fixed Assets(Gross value) up to ₹ 2 lakh (for units located in rural areas/towns with maximum population of 50000 as per 1971 senses)
1985	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 35 lakh
1985	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 45 lakh
1985	Tiny	Investment in Fixed Assets(Gross value) up to ₹ 2 lakh (for units located in rural areas/towns with maximum population of 5 lakh as per 1981 senses)
1991	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 60 lakh
1991	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 75 lakh
1991	Tiny	Investment in Fixed Assets(Gross value) up to ₹ 5 lakh
1997	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 3 Crore
1997	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 3 Crore
1997	Tiny	Investment in Fixed Assets(Gross value) up to ₹ 25 lakh
1999	Small scale	Investment in Fixed Assets(Gross value) up to ₹ 1 Crore
1999	Ancillary	Investment in Fixed Assets(Gross value) up to ₹ 1 Crore
1999	Tiny	Investment in Fixed Assets(Gross value) up to ₹ 25 lakh

Source: Compiled from different sources

After 2005, the Indian Government had started including and defining medium enterprises along with micro and small enterprises. MSME Development Act, 2006 defined MSMEs based on their investment in plant and machinery for manufacturing enterprises and on equipment for enterprises providing or rendering services. According to the Act, a micro manufacturing enterprise is where the investment in plant and machinery does not exceed ₹ 25 lakh. A small enterprise is where the investment in plant and machinery is more than ₹ 25 lakh but does not exceed ₹ 5 crore. A medium enterprise is where the investment in plant and machinery is more than ₹ 5 crore but does not exceed ₹ 10 crore. In the case of the enterprises engaged in providing or rendering of services, as a micro enterprise is where the investment in equipment does not exceed ₹ 10 lakh, a small enterprise is where the investment in equipment is more than ₹ 10 lakh but does not exceed ₹ 2 crore and a medium enterprise is where the investment in equipment is more than ₹ 2 crore but does not exceed ₹ 5 crore. The following table shows these facts:

Table 6: Definition of MSMEs as per MSME Act, 2006

Manufacturing (Investment in Plant and Machinery)	Micro Enterprises	Up to ₹ 25 lakh
	Small Enterprises	Above ₹ 25 Lakh & up to ₹ 5 Crore
	Medium Enterprises	Above ₹ 5 Crore & up to ₹ 10 Crore
Service (Investment in Equipments)	Micro Enterprises	Up to ₹ 10 lakh
	Small Enterprises	Above ₹ 10 Lakh & up to ₹ 2 Crore
	Medium Enterprises	Above ₹ 2 Crore & up to ₹ 5 Crore

Indian MSMEs and the facts

Since 1956, i.e., from the second Industrial Policy onwards the Government of India is considering small enterprises as labour intensive as the economy has vast reservoirs of unskilled human power and unsolved unemployment. Further, the per capita income of the country was also very less. In addition, it resulted in difficulties in capital formation. Because of these reasons, the Government had created protective environment for small enterprises. Reservation of some items, exclusively for small enterprise production, is one among them. Thus, small enterprises in India neglected growing themselves through technology up gradation, facing the competition and producing quality products which are competitive in the world market. Rather, it can be said that, most of the small enterprises are indigenous and give less importance to the outside world. The Government of India, not concentrating much on internationalization, started encouraging them through large network of national level and state level organisations, Industrial Estates, Industrial Development Areas, Establishment of SIDBI, formulation of many schemes, programmes and policies (National Manufacturing Competitiveness Programme – NMCP, Prime Minister’s task Force, Public Procurement Policy, etc.), giving incentives and subsidies, marketing and technical support, etc. No doubt, the Government had done much to these enterprises keeping mainly their employment potentiality in mind. Indian MSMEs have been contributing significantly to the economy. Their growth in number, employment and market value of fixed assets has been consistently increasing. Though MSMEs growth in number of enterprises, contribution to employment and market value of fixed assets has been increasing year after year, when compared to other economies in the world, it is discouraging. Despite their high enthusiasm and inherent capabilities to grow, MSMEs in India are facing a number of problems like sub-optimal scale of operation, technological obsolescence, supply chain inefficiencies, increasing domestic and global competition, working capital shortages, not receiving trade receivables from large and multinational companies on

time, insufficient skilled manpower, change in manufacturing strategies and turbulent, uncertain market scenario, etc.

According to the 4th census, MSMEs employs an estimated 59.7 million persons spread over 26.1 million enterprises. This accounts for about 45% of the manufacturing output and around 40% of the total export of the country (Chakrabarty, 2011). However, the MSMEs in India, due to their low scale and poor adoption of technology, have very poor productivity. Too many enterprises stay small, unregistered and un-incorporated in the unorganized sector. According to 2014 Economic Survey, the firms have little incentive to invest in upgrading skills of largely temporary workers or in investing in capital equipment. For example, the MSME minister’s statement in Lok Sabha reads, “Strong competition from China faced by Indian Small industries is evident in high growth of India’s imports from China. Relating to eight major product groups including electrical and electronics, mechanical, metallurgical, chemical, glass, ceramics, etc., the imports from China have increased at a rate higher than their respective imports from all countries combined during 2010-11 to 2013-14” (Business Nonstop Desk, 2014). The contribution of MSMEs in India to the GDP was only 7.28% during the year 2013-14 (MSME, 2013-14) from manufacturing activities. It increases to 37.54% when service sector is included. For any economy, a definition which is easy for comparison, helps in promotion of enterprises, aids in accessing capital, supports in promoting innovation and improves access to Research and Development should be adopted. When most of the economies are defining their SMEs based on employee count and getting maximum contribution from them, India cannot neglect this. The inadequacies of current conventions in defining SMEs and the inconsistencies among official SME definitions can lead to serious distortions in the allocation of donor spending for private sector development (Van der Vaart and Tom Gibson, 2008).

If Indian definition of SMEs is moving away from the definitions of other economies, then the problems persist. For example, in 2012 India asked EU to change SME definition for its fee concessions. Under the European Union’s environment legislation, popularly known as REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals), India has asked the 27 nation trading block to amend its definition of SME. This pathetic situation is mainly because the Indian definition does not match with the definitions of other economies.

Current Scenario

The MSMEs definition of 2006 became obsolete because of the decrease in the value of money. In India, the average yearly inflation is about 7.97%(calculatorstak.com). The value of 100 in 2006 is equal to 214.62 of 2016. Keeping this mind, the industry associations are asking the Government to extend the limits of MSMEs. The Government has to define MSMEs again by doubling the investment limits. Then the new definition may look as under:

Table 7: MSMEs definition(Assumed)of today

Manufacturing (Investment in Plant and Machinery)	Micro Enterprises	Up to ₹ 50 lakh
	Small Enterprises	Above ₹ 50 Lakh & up to ₹ 10 Crore
	Medium Enterprises	Above ₹ 10 Crore & up to ₹ 20 Crore
Service (Investment in Equipments)	Micro Enterprises	Up to ₹ 20 lakh
	Small Enterprises	Above ₹ 20 Lakh & up to ₹ 4 Crore
	Medium Enterprises	Above ₹ 4 Crore & up to ₹ 10 Crore

But this is not fair. The entrepreneurs were not utilised the provision of the Government evenly from 2006 to 2016. This trend has been a practice in India since 1950. Therefore, a permanent definition for MSMEs which is suitable to Indian environment is required. MSMEs definition should be flexible and dependent upon the end purpose for which they are segregated. They should be understandable to the common man, easy to administer and should not be in conflict with the Indian laws.

Possible Solutions

Based on the above discussion and analysis, the researcher brings out three possible solutions for defining MSMEs in India on a permanent basis.

1. Employee count

It is a fact that most of the economies consider employee count as one of the criteria in their definitions. The employee count can also be different for different sectors and segments like in China. Only Indian MSMEs definition is ignoring this. Most Indian MSMEs are labour-intensive and this seems to be coming in the way of similar definition like other economies in the world. However, a point to be noted here is that even China, where the population is more than India, has defined SMEs based on employee count (usually less than 500 employees) with annual revenue and total sales. The definition also varies with industry category. Though the definition is complex, it takes into account all the parameters and conditions. Therefore, labour intensiveness cannot be shown as the reason to include employee count in defining MSMEs in India. The advisory committee to MSME Ministry, associations and other stakeholders are not thinking about this seriously. The associations are only looking at enhancement of investment limits in plant, machinery and equipment as their costs are increasing year after year. The authorities might be thinking of other reasons like competition, poor technology, shortage of finance, etc to explain less contribution from the MSME sector, not the definition.

Despite the volume of SMEs definitions, there is a tendency to accept quantitative criteria, first and foremost the headcount or employee number criterion as the main determinant in categorizing SMEs (Gentrit Berisha et al. 2015). In a recently (2014) held FICCI-CMSME and ISED conference, the prominent personalities opined that the defining criteria that delineate the SMEs from the rest of the system, however, cannot be arbitrary. It need to have a scientific basis, and should be subject to periodic review based on hard data and field experience. In India, the need for a revision of the definition of MSMEs has often been highlighted, but, their relevance needs to be examined from the point of view of empirical evidence and objective rationale. The number of employees is the most frequent characteristic used in the definitions of national governments and statistical agencies. The number of employees is also a fair characteristic to assess MSMEs contribution to GDP. When the number of employees has limit, the enterprises put effort to make them skilled and they also show interest in increasing investment in capital goods and thus increase their production with quality. It seems that in the Indian scenario, where more number of people is to be absorbed in small enterprises, it is not applicable. Many of them need to be divided as per the new definition which takes employee count as one of the criterion. It looks odd and difficult, but in the days to come, improvement in technology and human skills are inevitable. Further, the number count results in more number of small enterprises and more quality production and much contribution to GDP. When employee count is taken for defining MSMEs in India, some of the micro enterprises may become small, small as medium and medium as big. They are forced to divide or start new enterprises to restructure their enterprises. Further, to face the competition in the world,

MSMEs adapt to new technology, train their employees and increase the productivity which results in increase in GDP of the economy.

2. Yearly Review Mechanism

Actually, a permanent review mechanism for defining MSMEs is lacking in India. Enhancing investment limits based on inflationary conditions should be done on yearly basis..

3. Employee count and Investment

The policy makers can also consider employee count along with investment limits while defining MSMEs. These investment limits and the employee count should be reviewed every year by an **MSME monitoring committee** without referring to parliament every time. The employee (permanent) count shall be as follows:

Table 8: Proposed Employee count in MSMEs definition

Type	Micro	Small	Medium
Manufacturing	Less than 10 employees	11 to 100 employees	101 to 250 employees
Service	Less than 10 employees	11 to 50 employees	51 to 150 employees

The structure of employee count for Micro, Small and Medium enterprises for both manufacturing and service enterprises is built mainly based on Indian requirement, and other worldwide research studies. However, investment limit is subject to review every year. The present investment limits should also be increased taking the inflation rates into consideration. The impact of the new definitions on GDP can be tested and changes can be made according to the requirement.

Conclusion

Considering the above facts and possible solutions, it is high time for the Ministry of Industry to look into global definitions and advise the Government for a change in MSMEs definition involving all the stakeholders and form a monitoring committee for its flexibility. The ministry can also conduct an in depth study at the national level on induction of employee count into the definition of MSMEs. Such research findings can also be incorporated in finalizing the definition. Flexible and dynamic definition is the first step for the Indian economy to get maximum contribution from MSMEs.

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