

ROLE OF MSMEs IN INDIAN ECONOMY

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ABSTRACT

The SME sector is one of the important parts of the Indian economy. It accounts for about 40% of the manufacturing sector's value while around 95% of the industrial units. It absorbs approximately 80% of the workforce of the manufacturing sector. The SME sector is the second largest employment providing sector in India after agriculture. It also accounts for around 35% of the total Indian exports. The Indian economy is growing at a good rate of 8% and is targeting a growth rate of more than 9 % in the time to come. To do this SME sector would be the prime focus for the economy as it smooth the progress of the small size units into medium and large organizations.

Introduction

The small and medium industries have good command in the overall Indian market. The presence of creative entrepreneurs adds new dimensions in the small and medium industry. They are competitive and offer goods at the minimum operating costs. One more distinctive feature of SMEs in India is their ability to work in groups that helps them to evolve according to their field of offerings.

The SME sector is one of the important parts of the Indian economy. It accounts for about 40% of the manufacturing sector's value while around 95% of the industrial units. It absorbs approximately 80% of the workforce of the manufacturing sector. The SME sector is the second largest employment providing sector in India after agriculture. It also accounts for around 35% of the total Indian exports. The Indian economy is growing at a good rate of 8% and is targeting a growth rate of more than 9 % in the time to come. To do this SME sector would be the prime focus for the economy as it smooth the progress of the small size units into medium and large organizations.

The small enterprises have variety of products and huge offerings but due to the fact that the goods produced in the small enterprises are not of superior quality and are made mainly for Indian rural and semi urban population so its contribution to the total exports is not defensible. The goods in the small enterprises are mainly from artisans, handicrafts, handlooms etc.

The biggest limitation for the small enterprises is the lack of favorable credit policy. The Reserve Bank of India (RBI) and the Ministry of Finance has taken some steps to encourage the small enterprises. They have given directives to the commercial banks to ease credit facility for small scale enterprises. But this step is not working for small enterprises since banks are controlled by RBI and the nature of instructions posed by RBI and the absence of an incentive system based on accomplishment of proactive bankers is not allowing the commercial banks to smoothen the credit policy for small enterprises. According to a study “there are strong structural underpinnings to the inadequate flow: the organizational structure of banks, and processes within

them, have taken them far from task orientation, and have created a specific bias against small loan portfolios”. The small scale enterprises are finding it difficult to take loans from the banks due to the tight RBI directives. Although some commercial and other financial organizations are helping SMEs by introducing some loan assurance schemes for them.

The policy in which some items were completely meant to be manufactured by the small enterprises has now become obsolete and uncompetitive. Examining the results the effect of this greatly contentious scheme, researchers have pointed out the problem of practical incompetence of goods produced under reserved class in contrast to the non-reserved class of goods (Balasubrahmanya, 1995). Studies have also proved the irrationality and irrelevance of putting some goods in the category that is meant to be completely manufactured by small enterprises.

A number of the usual matters concerning the reserve list are: (i) repeated revision (addition and deletions) of listed goods were not reasonable every time and believed to have been manipulated by political considerations; (ii) attempts to make policy wide-based were careless because investigations have revealed that broad-basing, as surveys found that manufacturers of ‘reserved’ products did not have any inkling about the policy; (iii) the medium and large scale units were also engaged in producing some ‘reserved’ items as they were manufacturing them before their inclusion in the list; and (iv) in most of the cases the quality of items which were reserved was substandard.

SMEs in India are not competitive enough when it comes to international market due to several reasons. These are- they are not easily adhered to the laws, lack of suitable knowledge regarding measures for global subcontracting, unfamiliarity with complex routine processes relating to external trade on international front and making use of e-commerce for executing deals. For increasing the awareness of MNEs towards increasing their investments in India particularly in the fields like garments, automobiles, electronics, chemicals, etc a decent change in the norms concerning FDI is made. This change is quite different from the earlier policies. Some administrative steps are also been taken so as to establish strong link between SMEs and foreign business.

The objective of SMEs has changed over a period of time. It was known for creating job opportunities earlier but now SME sector is developing in such a way so that it becomes more competitive in the international market. The SME sector in India is moving towards a new direction where it is positioning itself in the bigger and fresh market. Currently the proficiencies, raw materials and huge market to target are the three main advantages for the SME sector. Seeing the growth of the market the people who will be associated with this sector will surely be benefited.

The job generation capacity of the small scale enterprises were focused by two studies in 1970s, made use of cross sectional data for calculating the job share of small units and found some appealing proof that shows that the relevance of small scale units is increasing because of the reduction in the share of big enterprises in the total employment. On the other hand the second study uses size and area of the enterprises for calculating the same. (Acs and Audretsch , 2001).

These two studies show that the job generation capacity of small unit enterprises is increasing rapidly. Economists at that time use various tools to prove this point. They counted the number of people employed in the same category in two different periods. This line of analysis was based on the presumption that movement between different classes was insignificant. On the other hand, according to study done by Birch (1981) it was found that the increase in the total employment is due to the conversion of small units into large enterprises. Birch's method of analysis was later challenged by Davis, Haltiwanger and Schuh (1999).

The increase in the employment in small units may be reflected in two ways i.e. the reduction in the jobs opportunities in the big enterprises or increase in the job opportunities in the small enterprises. Hence a careful analysis of generation of jobs at the unit levels should be done so as to find the reason behind the increase in job opportunities. Despite of higher job generation rate in small enterprises its contribution to the overall scenario is small as compared to bigger organizations. Furthermore these studies also help in analyzing the factors that creates differences in the generation of jobs between small and big enterprises.

While designing the policies for the SMEs the output and the business environment should be kept in mind. The data based study is more effective in the establishment and development of the SMEs. This study is based on the fundamental principle that the small enterprises are the only job creating sector for the industrialized economy even in the times of recession.

We cannot apply our understanding of enterprises to the whole economy as there are differences in the industrial and service sector enterprises. The number of job changes in the service sector is quite higher as compared to the industrial sector. Other factors that cause differences between these two sectors are manpower requirements, rates of entry and exit, periodic variations in demand, differences in the capability of facing external competition.

In some other region it has been stated that elsewhere that jobs generation business replacement (settled businesses) is a lot higher (lower) significant in businesses of service sector compared to the manufacturing one (Armington and Acs, 1999 and Audretsch et al., 1995). In order to confirm whether the overall scenario is similarly applicable in all segments, we proceed to work out the provision to job generation and part of small enterprises in total number of jobs in different sectors such as manufacturing, construction and services.

According to Audretsch (1995), the businesses these days are now more technology driven due to internationalization and technical changes in the modern environment. The business involving information technology has become more beneficial. The main attention in these businesses is on the person and not on the company. This is due to the fact that the lack of regularity in the knowledge results in varied opinions by the company and the person. This kind of situation led the person to make a shift from the company where he is working to his own business. This is the evolution stage of entrepreneurship where a person applies his knowledge which he earns in one company into his own business. The small and big enterprises in the service segment differ in the pattern of creation of jobs.

According to the conclusion drawn from the study it was found that for the generation of jobs in big and small size enterprises are important. The rapid increase in the employment of the small sector in other industrialized economy makes it more important part of the economy and distinctive approach should be adopted while making policies for this sector. As it is known that

small enterprises acquire relatively higher price towards organizational hindrance as compared to big organizations so it is important for small units to follow the guidelines of governments. The financial procedures should also need to be eased in order to provide easy credit to small units so that they can meet their business requirements effectively

According to the previous studies it can be seen that the job generation and the business size are inversely related to each other. Likewise, Hohti (2000) discovered that total jobs generation and jobs obliteration are in inverse proportion to the size of businesses in Finland. On the basis of data Finnish manufacture business between 1980-1994, Hohti (2000) has established the rates of per year job flow, in terms of births and deaths, is alike to what Broesma and Gautier (1997) come across for Dutch manufacturing businesses and by Klette and Mathiassen (1996) identified for Norwegian manufacturing firms. Job generation and job destruction both have a high proportion in the new enterprises. Hence, the experience of Finland, equally as of Sweden and the Netherlands, shows analogous commercial activity as discovered in North America. Similarly, facts confirm that during some preceding years small businesses in Germany, as in other industrialized economies, are rising as the main force of employment generation. For instance, Haid and Weigand (1998) discovered that family owned small and medium sized businesses creates more job opportunities as compared to the big businesses that are managed by administrators.

According to the study conducted by Audretsch (1995), it was found that the number of employees in big enterprises who works in stock exchanges has decreased of 1 percent per annum. The SMEs also show the reduction of 3.97% per annum in job opportunities. In case of non listed big enterprises, this rate was 4.60% while for SMEs (non-listed) it was 1.26%. Hence it was observed that in Germany there is a reduction in job opportunities in big and small enterprises.

Thus from the above data it can be inferred that the entrepreneur business creates different job opportunities in Europe and United States. On both shores of the Atlantic Ocean, small and new businesses play a pivotal role as motive force of jobs generation (European Commission, 2002).

It can also be said that the employment opportunities of any business varies according to its size and experience.

The process of globalization is altering the pattern of vying for all activities of enterprises, making it necessary to adopt a worldwide growth plan to affirmatively influence their long-standing development and endurance (Karagozoglu and Lindell, 1998). The small enterprise segment business sector has grown to be more significant as it has risen to become a leading power influencing the development of financial systems of countries. In the process of their change to a global milieu SMEs confront many intrinsic drawbacks. SMEs, often, faces lack of resources and unavailability of capable workers due to their small size. With worldwide economic integration and the fall in barricades of international trade, globalization of SMEs is getting more and more consideration (Lu and Beamish, 2001). The enterprises are becoming more competitive due to the rapid increase in the number of enterprise in the global trade arena. More rivalry in the markets causes decrease in the capability of SMEs to have power over the course of their own growth (Etemad et al., 2001). In an extreme cutthroat situation, it becomes imperative to recognize and appreciate aspects that affect global functioning (Kuivalainen et al., 2004). SMEs symbolize a segment of increasing significance and make a vital contribution in the progress of developing countries particularly in the fields of jobs generation and accelerating economic advance (Kula and Tatoglu, 2003). Initially any industry is tiny and have limited resource base but it grows with time and always tries to transform itself from tiny to large industry. Competition, technical variations and legislative guidelines are some of the factors that are important for both industrialist and policy creator.

Indian SMEs are also growing at a very good rate. The growing success of information technology has helped Indian SMEs to grow at a faster rate in the modern era of globalization. India is providing very good opportunities for setting up new commercial enterprises. Administrative measures are important to determine the extent to which India can go on to make improvements in the information sector. Indian government is making constantly making some new agendas and policies that need to be worked on properly so as to decide the effectiveness of the policies. It will also help in analyzing as to how much efforts needs to be put on the Indian SMEs sector.

SME sector is one of the important sectors in the Indian economy and it has contributed a lot towards the national wealth of the country since independence. Its contribution in the net domestic product of the country is about 60% and that in the total employment is 92%. It is facing number of difficulties after the economic reforms of 1992 but still manages well to provide good growth to the country. And the SMEs are expected to perform better in the future because in big enterprises job creation is very sluggish and flexibility of employment is shallow and waning (Papola, 2004). Hence, SMEs can now enter in the market that was earlier meant for big enterprises only. Furthermore schemes like elastic manufacture schemes and use of sub contracting for the division of their manufacturing activities also helps SMEs a lot to make their operations more organized and competent.

Measures like decrease in the degree of protection and abolition of the job safety section are part of the labor market modifications and can make the job problem more serious in big enterprises (Nagaraj, 2004). Further, liberalization of economy and abolishing licensing system has paved the way of the actualization and feminization of labor.

It is shown through various studies that the liberalized policies that were initiated during the economic reforms have greatly influenced the manufacturing sector of the country. Due to the policies of reforms manufacturing sector experienced a decline in the employment growth rate during 1990s (Nagaraj, 2004). But, these reforms have both favorable and unfavorable effects on the manufacturing enterprises. Several steps such as abolition of licensing system in industry and import, elimination of limits on production capacity, tariff decline and permission for foreign investment has helped industrial enterprises to enter into the sector which was earlier meant only for informal sectors. Informal sector have some limitations and the economic reforms of 1990s were also not proved much advantageous to this sector which results in the decline in its efficiency. The use of obsolete technologies in the production process of the informal sector is one of the main reasons behind its declining efficiency. So in order to increase the productivity of the informal sector more focus needs to be given to the technology and skills.

The economic advancements and wide employment opportunities are the main areas of interest for small and medium enterprises. Earlier most of the theories were focused on the globalization.

It is only after the publication of the article titled “Towards a theory of international business studies” by McDougall and Oviatt’s (1994) that importance of internationalization of SMEs or international entrepreneurship were recognized. Later on Sharma’s work (2004) also provided deep knowledge on the internationalization from various socio-economic environments.

Rutihinda (1996) and Ahokangas (1998) introduced Resource-based Internationalization framework in which he uses resource based view of the firm to put together strategic aspects with the globalization processes. This research was proved to be quite important as companies are constantly working towards the expansion in the international market because of increased competition. Factors such as government incentives and support (like low interest loans) and export development bodies helps SMEs to find new markets to penetrate.

Sharma (2004) suggests SMEs to attempt various entry routes to penetrate the foreign market while Peng and York (2001) suggested two options for an exporting firm that are either to reach the foreign customer directly or through a mediator. Fletcher (2004), defined it as the means “whereby small firms are involved in exporting, sourcing or distribution agreements with intermediary companies who manage, on their behalf, the transaction, sale or service with overseas companies”. Peng and York (2001) emphasize further on the pivotal role of export mediators by “linking individuals and organizations that would otherwise not have been connected”. Mediators plays vital role by bringing in their expertise of working in foreign countries thus reducing risks related to international operations.

Peng and York (2001) further added that Export mediators would also helps in saving costs related to customer mapping and costs incurred in monitoring the enforcements of contracts. Notwithstanding the potential negative outcomes like loss of control over the assignee or additional costs –transaction expenses and rent extractions (Acs et al., 2007), the overall benefits of using the intermediary stand out. Mediators could either be the agents or the distributors who are settled within the same country or the foreign country (Peng and York, 2001) and could also be the local subsidiaries of existing Multinationals.

SME export research, like Cavusgil’s and Nevin’s (1981), focuses on the direct approach by including product uniqueness as the focal point. In contrast to this, the study on the role of

external factors, such as government support for internationalization (Wilkinson, 2006), environmental turbulence (Westhead et al., 2004), and the characteristics of foreign markets and domestic markets develops and tests two theories of external environment factors: resource dependency and institutional theory.

Sherer and Lee (2002) further works on these two theories and specified the common points of the same. According to them both the theories were restricted to the nature of relationship between the firm and its environmental factors, both the theories are regulated by external factors, and that organizations are concerned with building legitimacy and acceptance vis-à-vis external stakeholders, and hence conclude the two theories may prove to have greater predictive potential when used together. Resource dependency theory further explains how lack of resources forces the organization to look for new and unconventional resources. Institutional theory, Scott (1995) defines, organizational practices that accepted and legitimized within the specific organization. Both the theories described the impact of external factors on the organization. The difference between resource theory and institutional theory is that where resource theory focuses on the presence of other factors that are directly proportional to resource accessibility institutional theory gives more importance in imitating the behavioral norms of other factors in the organizational field.

It is found that SMEs working in the home markets which are endeavoring through direct mode are more successful as compared to other SMEs which are working in other environment. This is because of favorable production costs, intellectual property rights protection, government regulation and the presence of related and supporting industries in the home market.

A firm targeting export market is also influenced by export-entrepreneurial orientation. According to Ibeh (2004), a firm with high export shows greater innovation and higher proactivity in initiating exportation. Analyzing the correlation between owners' degree of entrepreneurial orientation and the organization's competitive accomplishment Kazem and Van der Heijden (2006) arrive at the juncture from where exporters are perceived to be better self-starters than non-exporters. The study by Francis and Collins-Dodd (2000) indicates the fallacy of conservative approach in the unstable environment and goes on to reflect that high proactive

approach proves effectual in enhanced export performance. Studies spanned over couple of years, by Ibeh (2004) and Marino & Weaver (2002) also concluded the strong relation of high SME orientation, including that of the owner or manager works directly in proportion with export performance.

According to Suarez-Ortega (2003), the financial resources that restrict the timely accumulation of internal resources need to be given some attention by the internal resources of the firm. Some other barriers as suggested by Suarez-Ortega are Knowledge gap, or knowledge barriers. Furthermore lack of adequate knowledge about the potential market and that of the availability of the assistances in the market also leads to the deterioration in the export market.

SMEs in India are quite advantageous as it generates employment at low capital investment, increases the availability of skilled and semi-skilled workforce and also helps in reducing the gap between the rich and the poor. The studies done by Kazem and Ven der Heijden (2006) have shown the importance of SMEs in any nation as its development results in industrialization and economic development. Despite of the fact that SME sector is very significant sector for any economy and various studies has tried to make a linkage between the export competitiveness and SME development in the western countries it has not received much focus by researchers in the Indian sub-continent.

In India, SMEs plays vital role in the development of the economy and provides several economic benefits. These are: (i) Higher employment to capital investment ratio, thereby generating higher employment with lesser investment (ii) Low time and money required for establishment (iii) Niche focus on smaller markets; (iv) Development of a pool of skilled and semi-skilled workforce; (v) Bridging the divide in income disparities by creating value for the lower and lower-middle class; (vi) Facilitate innovation and entrepreneurialism at a large scale; and (vii) Ensures better utilization of capital and low-skill manpower resources

The whole SME industry is based on three main hypotheses as per the study conducted by UNIDO. These are: focus on overall economic upliftment of the country and not just economic development; generation of employment opportunities so as to provide support to large scale sectors; and support needed for the development of SMEs in order to overcome the

disadvantages that SMEs face because of its small size. SME sector in India is becoming competitive day by day as country is liberalizing. As such SMEs don't get any financial support from the government due to deregulation but in order to develop this sector and to make it competitive with the multinationals government needs to develop some policy based institutional support for the SME sector. The institutional based support that SMEs needs from the government is: advancement in technologies and backing of their working capital needs. SMEs also require government support in order to increase co-operation within the SMEs and to share resources that are common to SMEs while working with other organizations. The UNIDO report also explores some of the hurdles in the development of SME cluster. These are : due to the cultural differences there is little co-operation between individual companies as well as larger organizations; higher spending on developing suitable tie-ups and building partnerships; unavailability of the government support in terms of financial incentives that is needed in order to implement common projects. Although these challenges poses some problem for the SME industry but there are positive signs which indicates that the SME cluster is stabilizing and is moving towards SME growth in the country.

Conclusion

It is found that SMEs working in the home markets which are endeavoring through direct mode are more successful as compared to other SMEs which are working in other environment. This is because of favorable production costs, intellectual property rights protection, government regulation and the presence of related and supporting industries in the home market. The institutional based support that SMEs needs from the government is: advancement in technologies and backing of their working capital needs. SMEs also require government support in order to increase co-operation within the SMEs and to share resources that are common to SMEs while working with other organizations. The UNIDO report also explores some of the hurdles in the development of SME cluster. These are : due to the cultural differences there is little co-operation between individual companies as well as larger organizations; higher spending on developing suitable tie-ups and building partnerships; unavailability of the government support in terms of financial incentives that is needed in order to implement common projects.

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