International Journal of Business
and General Management (IJBGM)
ISSN: 2319-2267
Vol.1, Issue 2 Nov 2012 13-20


International Academy of Science, Engineering and Technology
Connecting Researchers; Nurturing Innovations

# EMPOWERING SMEs THROUGH PRIORITY SECTOR ADVANCES

**[1]S. RAJAMOHAN &[2] D.DURAIRAJ**

[1]Professor, Alagappa Institute of Management, Alagappa University, Karaikudi, TamilNadu, India

[2]Ph.D Research scholar, Alagappa Institute of Management, Alagappa University, Karaikudi, TamilNadu, India

## ABSTRACT

Small and Medium Enterprises are two legs of Industrialization process of a country. In the earlier days this concept was called as a small and medium enterprises, but after 2006 this concept was redefined, from that time onwards called as a Micro Small and Medium Enterprise (MSME), It plays a vital role for the growth of Indian economy by contributing 45 percent of industrial output, 40 percent of exports, employment opportunities for 60 million people, generating 1.3 million jobs every year and produce more than 8000 quality products for the Indian and international markets. SME's Contribution towards Gross Domestic Product in 2011 was 17 percent which is expected to increase to 22 percent by 2012. SMEs are the fountain head of several innovations in manufacturing and service sectors, by promoting SMEs, into rural areas becoming India will be developed. The Indian market is growing rapidly and Indian entrepreneurs are making remarkable progress in various Industries like Manufacturing, Precision Engineering Design, Food Processing, Pharmaceutical, Textile and Garments, Retail, IT, Agro and Service sector.

Although its commendable contribution to the Nation's economy, SME Sector does not get the required support from the concerned Government departments, Banks, Financial Institutions and Corporate, which is a handicap in becoming more competitive in the National and International Markets. SMEs faces a number of problems such as absence of adequate and timely banking finance, limited capital and knowledge, non-availability of suitable technology, low production capacity, ineffective marketing strategy, identification of new markets, constraints on modernization and expansions, non availability of skilled labour at affordable cost, follow up with various government agencies to resolve problems and so on. With this backdrop the present paper has been made an attempt to focus the empowering the exiting SMEs.

**KEY WORDS:** Small and Medium Enterprises, Credit, Priority Sector Advances

## INTRODUCTION

SMEs play a catalytic role in the development process of most economies. The importance of the SME sector is well-recognized the world over using to its significant contribution in achieving various socio-economic objectives, such as employment generation, contribution to national output and exports, fostering new entrepreneurship and providing volume to the industrial base of the economy. It constitutes a very important segment in the priority sector of our economy. The development of this sector came about primarily due to the vision of our late Prime Minister Jawaharlal Nehru who sought to develop core industry and have a supporting sector in the form of SMEs. It has emerged as a dynamic and vibrant sector of the economy. SMEs in India have been given a distinct identity and the Government of India has accorded high priority to this sector on account of the vital role it plays in balanced and sustainable economic growth. It is considered a growth engine of our economy and plays a crucial role in the process of economic development by value addition, employment generation, fostering entrepreneurship and entrepreneurial skills, equitable distribution of national income, regional dispersal of industries and priority depth to the industrial base, mobilization of capital and contributing to the country's exports.

This paper enlightens the overview of SMEs, SMEs contribution for export, Financing for SMEs, Challenges and opportunities, and suggestions.

## OVERVIEW OF SMEs

Today SMEs account for nearly 35 percent of the gross value of output in the manufacturing sector and over 40 percent of the total exports from the country. In terms of value added this sector accounts for about 40 percent of the value added in the manufacturing sector. The sectors contribute more employment opportunities next to agriculture. It is a fruitful sector for investment. This sector is one of the success stories of the modern India. Its success is written large over the face of the country and is equally visible all around.

This is a sector that has emerged victorious in the face of rising competition from large sectors inside and from multi-nationals abroad. Currently SMEs accounts for 95 per cent of industrial units, 46 percent of the industrial production and 43 per cent of the country's total exports. The contribution of this unorganized industrial sector is next to the agriculture. SMEs are too biggest employment provider with approximately six corers of the population depending on them for their livelihood. The survivals of SMEs are vital importance to the people. Table 1 shows that level of finance for SME sector.

**Table 1: Finance for SMEs Sector**

| CLASSIFICATION OF MSME SECTORS | | |
|---|---|---|
| **SECTOR** | **MFG/SERVICE** | **INVESTMENT IN** |
| | | P & M / Equipments |
| Micro level-I | Mfg. | Upto Rs.5 lacs |
| | Service | Upto Rs.2 lacs |
| Micro level-ii | Mfg. | Rs.5 lacs to Rs.25 lacs |
| | Service | Rs.2 lacs to Rs.10 lacs |
| Small | Mfg. | Rs.25 lacs to Rs.5 crore |
| | Service | Rs.10 lacs to Rs.2 crore |
| Medium | Mfg. | Rs.5 crore to Rs10 crore |
| | Service | Rs.2 crore to Rs.5 crore |

Source: RBI bulletin

The Government of India recently unveiled a policy package aimed at stepping up credit flows to the SME sector, which is under priority sector. The policy package clearly defines medium enterprises, proposes a one-time settlement scheme for Non-performing Assets of Banks and a corporate debt restructuring mechanism for the SME sector.

A small scale industry consists of small industrial units having investment on fixed capital not exceeding Rs.1 crore, while recognizing the need for larger investment in some of the more important segments of the small scale industry; the government has enhanced this to Rs.5crores for specified industries.

Besides that the Government of India has reserved 836 items exclusively for small scale production and 409 items for exclusive purchase from small scale industries.

In order to promote the small scale sector, so this sector brought under the priority sector for the purpose of utilizing the bank credit to this sector.

## EXPORT CONTRIBUTION

SMEs constitute an important segment in Indian industrial production and it contributes to 33 percent of total exports. During the period 2003-06, India’s total merchandise exports in US dollar terms witnessed a Compound Annual Growth Rate growth of 25 percent, while in the same period of SMEs exports grew at a CAGR of 24 percent. The remarkable contribution of SMEs in generating employment in the country has been instrumental in addressing issues pertaining to poverty and inequality of income. As per the Third All India Census on Small Scale Industries-2001-02, highly populated states such as Madhya Pradesh, Uttar Pradesh, West Bengal, Maharashtra, Karnataka and Jharkhand together contributed to around 55.4 percent of the total exporting units in India. In terms of distribution of value of exports from the SMEs sector states like Punjab, Haryana, UttarPradesh, Tamil Nadu and Maharashtra together contributed 64.75 percent of total exports besides direct exports, it is estimated that SMEs are contribute around 15 percent to exports indirectly. This takes place through merchant exporters, trading houses and export houses. They may also be in the form of export orders from large units or the production of parts and components for use of finished exportable goods. It would surprise many to know that non traditional products account for more than 95 percent of the SMEs exports. The exports from SMEs have been looking excellent growth rates in this decade. It has been mostly worked by the performance of garment, leather, and gems and jewelry units from this sector. The lucrative product groups where the SMEs dominate in exports are sports goods, readymade garments, woolen garments, plastic products, processed food and so on.

## MAJOR ISSUES AND CHALLENGES TO SMEs SECTOR

Though Indian SMEs are a diverse and heterogeneous group, they face some common problems, which are briefly indicated below:

1. Lack of availability of adequate and timely credit
2. High cost of credit
3. Collateral requirements
4. Limited access to equity capital
5. Problems in supply to government departments and agencies
6. Procurement of raw materials at a competitive cost
7. Problems of storage, designing, packaging and product display;
8. Lack of access to global markets
9. Inadequate infrastructure facilities, including power, water, roads, etc.
10. Low technology levels and lack of access to modern technology
11. Lack of skilled manpower for manufacturing, services, marketing, and like.
12. Multiplicity of labour laws and complicated procedures associated with compliance of such
13. Laws
14. Absence of a suitable mechanism which enables the quick revival of viable sick enterprises and allows unviable entities to close down speedily; and
15. Issues relating to taxation, both direct and indirect, and procedures thereof.

## OTHER HANDICAPS OF SMEs

a) The problems faced by SMEs access to bank credit, access to capital, technology, skill, market, and so on are quite unique to the nature of the sector. These concern several institutions and departments of the Government. There is need for an SME perspective in the functioning of such institutions and departments some of the major bottlenecks impeding the growth of the SME sector.

b) Access to adequate and timely credit at a reasonable cost is the most critical problems faced by this sector. The major reason for this has been the high risk perception among the banks about this sector and the high transaction costs for loan appraisal. While the quantum of advances from the public sector banks (PSBs) to the MSEs has increased over the years in absolute terms, from Rs. 57,199 crore in March 2000 to Rs. 4, 84,473 crore in March 2011.

c) Access to equity capital is a genuine problem. At present, there is almost negligible flow of equity capital into this sector, the fact that overall capital inflows have witnessed significant increase in the recent years. Absence of equity capital may pose a serious challenge to development of knowledge-based industries, particularly those that are sought to be promoted by the first-generation entrepreneurs with the requisite expertise and knowledge.

d) In the present global environment, the SMEs have to be competitive to survive and thrive. To ensure competitiveness of the SMEs, it is essential that the availability of infrastructure, technology and skilled manpower are in tune with the global trends. SMEs are either located in industrial estates set up many decades ago or are functioning within urban areas or have come up in an un-organized manner in rural areas. The state of infrastructure, including power, water, roads, and like in such areas is poor and unreliable.

e) India continues to be a growing market cheap imported goods have a direct impaction the SMEs and their survival. Given the globalization, governments across the world are providing supportive measures to the SMEs through targeted benefits and facilities.

f) Worldwide, SMEs are credited with high level of innovation and creativity, which also leads to higher level of failures. Keeping in this view, most of the countries have put in place mechanisms to handle insolvencies and bankruptcies. The present mechanism available in India for MSMEs is archaic. It does not focus on revival. Hence, business failure in India is viewed as a shame, which adversely impacts individual creativity and development in the country. An enabling policy environment, which helps viable enterprises facing temporary disruptions to continue while allowing others to close down speedily, with an appropriately structured social security, is essential for the promotion of MSMEs in India.

g) The government has provided an overarching legislation in the form of Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 for the MSME sector; there are a large number of regulatory issues which impact on the development of entrepreneurship generally and the efficiency of MSMEs in particularly.

## FINANCING THE SMEs

In Feb 2008, the Ministry of Micro, Small and Medium Enterprises (MSME), continued with its de-reservation policy by removing 79 items from the list of 114 items reserved specifically for SSI (small scale industries) manufacturing. Only 35 items remain in the reserved category from the total of 836 selected in 1994 denoting the declining monopoly of the SSI segment on the reserved products. The government has set up various schemes in place such as the priority sector Credit Linked Capital Subsidy Scheme, MSME Cluster Development Scheme and ISO 9000 Reimbursement Scheme to help SMEs for procuring timely funds. Also the government has put in place the Credit Guarantee Scheme to encourage banks to lend upto Rs 50000 without collateral. There has also been a recent budget announcement of setting up of a

Risk Capital Fund. Though SMEs are being touted as the priority sector within the economy, they continue to face problems pertaining to credit. When it comes to banks, they have a very traditional way of lending to this segment against collateral and SMEs end up being under financed. The biggest challenge before the SMEs today is to have access to non-debt based and non-traditional financial products such as external commercial borrowings, private equity, factoring and the like.

## CREDIT TO SMEs SECTOR BY COMMERCIAL BANKS IN INDIA

SMEs plays a important role in the economic in the way of generating the employment opportunity, generating fund mobilization and so on, in order to encourage the SMEs commercial banks are providing credit to SMEs sector, the table 2 explains the credit performance of commercial banks in India for decade of over the years.

**Table 2: Credit to SMEs Sector by Commercial Banks in India (Amount in Crore)**

| Years | Amount | SME credit as percent NBC (%) | Growth to total percentage (%) |
|---|---|---|---|
| 2002-03 | 57199 | 12.5 | - |
| 2003-04 | 60394 | 11.1 | 2.05 |
| 2004-05 | 65855 | 10.4 | 2.09 |
| 2005-06 | 76114 | 9.5 | 2.15 |
| 2006-07 | 82434 | 8.1 | 2.08 |
| 2007-08 | 104703 | 8 | 2.27 |
| 2008-09 | 116908 | 18.2 | 2.11 |
| 2009-10 | 256128 | 19.9 | 3.19 |
| 2010-11 | 364001 | 41.4 | 2.42 |
| 2011-12 | 484473 | 33.7 | 2.33 |

Source: RBI bulletin, Trends and reports, Business line newspaper.

The table 2 elucidates that year wise credit performance of commercial banks to the SMEs sector, over the previous year's in the year 2009- 10 the credit at maximum 3. 19 percent provided by banks. Followed by the 2.42 percent in the year 2010 -11, low performance of credit provided by the banks in the year 2003-04, following the years are increased significant level, the same trends continue this sector will be growth in high level.

## FINANCIAL ASSISTANCE TO SMEs

1. All the scheduled commercial banks should achieve a 20 percent growth in credit year-by-year to micro and small enterprises and strictly adhere to the allocation of 60 percent there of to micro enterprises to ensure enhanced credit flow. From 1st April 2010, shortfall of any bank against the already accepted target of 60 percent to micro enterprises may be put into an appropriately named corpus with the Small Industries Development Bank of India (SIDBI). This would facilitate additional credit flow of over Rs.3 lakh crore to micro enterprises from the scheduled commercial banks over a period of 5 years.
2. A target of 15 percent annual growth in number of micro enterprise accounts may be stipulated for all scheduled commercial banks till financial inclusion has been substantially achieved. Reserve Bank of India (RBI) may issue necessary instructions in this regard. This would help in covering an additional 30 lakh micro enterprises under institutional credit in a period of 5 years.
3. The stimulus package announced by the government RBI, IBA may be extended upto 31st March 2011 including special refinance facility of Rs.7000 crore provided to SIDBI.

4. The ability of MSMEs to access alternative sources of capital like angel funds risk capital needs to be enhanced considerably. For this purpose, removing fiscal regulatory impediments to use such funds by the MSMEs should be considered on priority.
5. Securities and Exchange Board of India (SEBI) may expedite the process of setting up of SME Exchanges in consultation with all the stakeholders.
6. Banks should approve project loans for MSEs to avoid delay in tying up of funds by the SMEs. The RBI may consider making this mandatory for the banks.
7. Banks may be encouraged to use scoring model so as to have speedy disposal of loan applications of micro and small enterprises. In order to simplify the process of credit dispensation to micro enterprises, a uniform loan application form for loans up to Rs.25 lakh should be devised by the IBA that should be applicable to all the banks. The Financial Services may bring out a model form within 3 months.
8. Taking into account the recent experience during the economic slow down, banks may extend liberal moratorium on their term loans and working capital to MSEs entrepreneurs by including interest during first 6-12 months of operation as part of the long term funding of the projects. While loans up to Rs.50,000 are covered under micro finance, banks are generally not inclined to provide loans below Rs.5 lakh due to a high risk perception and transaction costs. Banks may lend to pool of micro entrepreneurs who have been financed by Micro Finance Institutions and are now ready for borrowing at higher levels in the missing middle segment of Rs .50, 000 to Rs. 5 lakh by covering them under the Credit Guarantee Scheme.

## SUGGESTIONS FOR EFFECTIVE GROWTH OF SMEs

Finance is as crucial one to an enterprise as is blood to the human body. The requirements of finance are inevitable for SMEs and setting up new enterprises as well and almost every where in the world. However, a fund for SMEs has been made available more liberally to the entrepreneurs in the western world then in the developing countries. Development financial institutions were meant to support to large scale enterprises, but slowly they have started equally themselves with the commercial Banks in terms of stringency and rate of interest.

In India, the government has taken several measures to expand availability of credit to SMEs through commercial Banks for working capital and through term lending institutions (SIDBI, SFC etc), the problems of SMEs are far from over. SMEs traditionally have face difficulty in obtaining formal credit or equity. This is because of the maturity of commercial bank loans extended to SMEs are often limited to a period for too short to pay off any sizeable investment. Banks in many developing countries have traditionally lent over helpingly to the government, which offered less risk and higher returns.

1. The government should ensure strict adherence to the stipulated targets by the commercial banks for the micro enterprises (like. 20 percent year-by-year growth for micro and small enterprises lending with 60 percent apportionment for micro sector).
2. A separate fund may be created with SIDBI, using the short falls, if any, against the MSE credit targets set for the commercial banks. This fund named ‘Special Fund for Micro Enterprises’ should be utilized exclusively for lending to the micro enterprises.
3. A Public Procurement Policy for MSMEs as envisaged in the Micro, Small and Medium Enterprises Development Act, 2006 may be introduced at the earliest. The policy may set a goal for government departments and PSUs to reach, over a stipulated period, a target of at least 20 percent of their annual volume of purchases from micro and small enterprises (MSEs), and mandate them to report their achievements in this regard in the annual reports.

4. The government should earmark additional public spending to the tune of Rs.5, 000-5,500 crore over the next 3-5 years to specifically target deficiencies in the existing infrastructure and institutional set up. These funds may be used to: (a) support the establishment of Rehabilitation Funds in the States for the revival of potentially viable sick units; (b) assist MSMEs in the acquisition and adaptation of modern clean technologies as well as creation of Technology Banks and product- specific Technology Development Centres (c) promote establishment of business incubatorsin educational institutions of repute; (d) renovate existing industrial estates and develop new infrastructure for MSME sector, with sustainable urban governance mechanisms; (e) re-engineer, strengthen and revitalize District Industries Centre's to enable them to play a more active role in advocacy and capacity building for MSMEs and as appropriate, in their rehabilitation; (f) strengthen National Small Industries Corporation equity base for enhanced market support to MSMEs; and (g) up-scale the existing programmes of entrepreneurship and skill development targeted at MSMEs.
5. Line entry may be incorporated in the Annual Plan 2010-11 of the Ministry of MSME.
6. The ongoing exercise to introduce a new Direct Tax Code (DTC) and Goods and Services Tax (GST) should specifically seek to achieve these policy objectives through appropriate provisions forgraded corporate tax structure, tax pass through for angel and venture capital fundsand incentives for R and D.

## CONCLUSIONS

SME sector is the boost of business world and the backbone of our economy, especially in a developing country like India. This sector contributes 8 per cent of the nation GDP, 45 percent of the manufactured output and 40 percent of exports. The MSMEs provide employment opportunities to 60 million persons through 26 million enterprises. The labour to capital ratio in MSMEs and the overall growth in the MSME sector is much higher than in the large industries. The geographic distribution of the MSMEs is also more even. The MSMEs are important for the national objectives of growth with equity and inclusion. In order to develop this sector properly there is a need for government agencies, regulators and financing agencies to come forward help to this sector. Commercial Banks should come out of the traditional asset based lending mind set, while devising cash flow or collateral-based lending models, and simplified assessment, appraisal models must be introduced. SMEs need transaction, banking and trade finance services in addition to lending and for this banks need to offer sophisticated advances to the SMEs in a simplified manner. SMEs look of convenience and simplicity in their banking requirements and these should be delivered through the effective use of technology by the banks. Banks should view priority sector lending to the SMEs as a profitable avenue rather than an avenue for forced lending.

## REFERENCES

1. Das, K. (2005a). "Industrial Clustering in India: Local Dynamics and the Global Debate." InIndian Industrial Clusters, ed. K. Das. Aldershot, UK: Ashgate.

2. Das, K. (2005b). "Can Firm Clusters Foster Non-farm Jobs? Policy Issues for Rural India." In Rural Transformation in India: The Role of Non-farm Sector, ed. R. Nayyar and A.N.Sharma. New Delhi: Institute for Human Development.

3. Das, K. (2005c). "Competition and Response in Small Firm Clusters: Two Cases fromWestern India." In Indian Industrial Clusters, ed. K. Das. Aldershot, UK: Ashgate.

4. Das, K. (2003). “Income and Employment in Informal Manufacturing: A Case Study.” InInformal Economy Centrestage: New Structures of Employment, ed. R. Jhabvala, R.Sudarshan and J. Unni. New Delhi: Sage Publications.

5. Das, K. (2001). “Small Enterprises and Trade Policy.”, In Alternative Economic Survey2000-2001, Second Generation Reforms: Delusion of Development, ed. Alternative SurveyGroup. Delhi: Rainbow Publishers Limited.

6. Das, K.; M. Gulati; T. Sarkar; and S. Banerjee (2007) Policy and Status Paper on ClusterDevelopment in India. New Delhi: Foundation for MSME Clusters.Ecotec Research & Consulting (2004). A Practical Guide to Cluster Development:. Report tothe DTI and the English RDAs.

7. http://www.berr.gov.uk/files/file14008.pdf (accessed November 10, 2007).

8. Government of India (2005). Handbook of Industrial Policy and Statistics 2003-2005. New

9. Delhi: Ministry of Industry.

10. Government of India, (2004). Final Results: Third All India Census of Small Scale Industries2001-2002. New Delhi: Development Commissioner (SSI), Ministry.

11. http://www.adb.org/Documents/Reports/Consultant/TAR-IND-4066/Trade/morris-asant. pdf (accessed June 29, 2007).

12. http://msme.gov.in/PM_MSME_Task_Force_Jan2010. Mohan, R. (2003). “Small-Scale Industry Policy in India: A Critical Evaluation.” InEconomic Policy Reforms and the Indian Economy, ed. A.O. Krueger. New Delhi: Oxford.