Introspection into the Working of Indian Small Scale Sector

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Abstract

The small scale industries (SSIs) have a crucial role in a developing economy like India. They play a strategic role in the progress of the country. These industries by and large present a stage in economic transition from traditional segment to modern segment. The transitional nature of this process is reflected in the diversity of these industries. SSI contributes 6% of GDP, 35% of exports, 30 million employments (the second largest after agriculture), nearly 40 % of our industrial output and so on. This clearly conveys the significance of this sector in Indian Economy. Despite its high contribution to Indian Economy, this sector has not done well in the post liberalized and globalize period, partly because of lack of government attention and partly because of its own characteristics which have made it vulnerable to defeat at the hands of big units in the markets. Undoubtedly the small sector has enormous potential and is a crucial sector of Indian Economy. However for the sector to fully realize its potential, it is essential that it shall wake up to the realities of a liberalized India. It needs to be away of its state-designed protective rut. The Government shall realize the need for a shift in policy towards the sector, so that it can flourish.

In the current business scenario it has become imperative to study the working of small scale sector in Indian Economy. The small scale sector has emerged as a dynamic and vibrant sector of the Indian economy. It has contributed significantly to the realization of the socio-economic objectives of growth in employment and exports, fostering entrepreneurship and ensuring industrial dispersal. The numbers shows that it contributes 6% of GDP, 35% of exports, 30 million employments (the second largest after agriculture), nearly 40 % of our industrial output and so on. The small scale sector in India is very diverse producing over 8000 products, from traditional handicrafts to high end technical instruments. Small-scale industries enjoys certain inherent strengths such as lower overhead costs, flexibility in production, informality in labour relations, exploitation of local resources and skills, capacity to execute small orders and to offer customized services.

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SSI at a Glance

Category	2005-06 figures	2001-02 figures
No. of Units	12.34 million	10.52 million
Employment	29.49 million	24.93 million
Production	Rs. 4, 70, 966 crore	Rs. 2, 82, 270 crore
Share in GDP	5.81 percent*	5.77 percent
Share in National Exports	34.38 percent*	34.29 percent
Share in Industrial Production	38.55 percent*	39.12 percent

* 2004-2005 figures
Source- Business Today, September 10, 2006.

The table shows that the small sector has been growing rapidly, even in the face of growing competition, internally and globally, and decreasing protection levels. This growth makes it imperative for researchers to find out a solution to various problems faced by this sector. The problems faced by small scale units are maintaining quality standards, access to credit, over- regulation etc. This paper tries to introspect in these areas and has come out with certain solutions.

An Overview of Small Scale Industries

India boosts of a vibrant and competitive small scale sector for a long time. Before independence, British producers of textiles found hand made Indian textiles a threat to their business that they lobbied hard to have its import banned. Finally Government of India succeeded in the late eighteenth century.

After independence, Indian planners and policy-makers felt that protection was essential to the development of a strong, indigenous economy. Thus the first four decades after independence saw the development of a highly protected economy. Owing to the feeling that the small scale sector was an important tool in employment generation, value creation and poverty alleviation, small-scale units were given further protection. It was, in the pre 1990 protectionist era, further cocooned with extra protectionary measures, and even today post liberalization, continues to enjoy numerous privileges. The reason given for this was primarily two-fold, one being the beneficial role the sector plays in employment generation, and income dispersion, and secondly because of the market imperfections the sector faces.

Small scale units were given the reservation of over 800 products' exclusive production in the small-scale sector, reservation of some of the products produced in the sector for purchase preference by government agencies, supply of scarce materials, input price concessions like lower interest rates and numerous fiscal measures such as excise duty exemptions and other tax concessions. Somewhere in the 90s, when liberalization began to happen, there was a big worry over what would happen to SSI (small scale industries). The ongoing process of liberalization warrants due attention to be given to the medium and long term interests of the small scale sector. This sector needs to be enabled to take on the challenges posed to it by the process of liberalization and globalization.

The Government is conscious of the role and importance of Small Scale Industries in strengthening our economic performance and is therefore committed to putting in place a policy framework that would address the problems of this sector and help it become internationally competitive.

The Government established the Ministry of Small Scale Industries and Agro and Rural Industries (SSI & ARI) in October, 1999 as the nodal Ministry for formulation of policies and Central sector programmes/schemes, their implementation and related co-ordination, to supplement the efforts of the States for promotion and development of these industries in India. The Ministry of SSI & ARI was bifurcated into two separate Ministries, namely, Ministry of Small Scale Industries and Ministry of Agro and Rural Industries in September, 2001. The role of the Ministry of Small Scale Industries is thus to mainly assist the States in their efforts to promote growth and development of the SSI, enhance their competitiveness in an increasingly market-led economy and generating additional employment opportunities. In addition, the Ministry attempts to address issues of country-wide common concerns of this segment and also undertake advocacy on behalf of the SSI for this purpose. The specific schemes/programmes undertaken by the organizations of the Ministry seek to facilitate/ provide one or more of the following :

- Adequate credit from financial institutions/banks;
- Funds for technology up gradation and modernization;
- Integrated infrastructural facilities;
- Modern testing facilities and quality certification laboratories;
- Access to modern management practices and skill up gradation through appropriate training facilities;
- Assistance for better access to domestic and export markets; and
- Cluster-wide measures to promote capacity-building and empowerment of the units and their collectives.

Parameters considered to Assess Small Scale Industries Performance

The performance of Small scale sector has been assessed on the basis of production, employment and exports.

Production

The small-scale industries sector plays a vital role in the growth of the country. It contributes almost 40% of the gross industrial value added in the Indian economy.

It has been estimated that a million Rs. of investment in fixed assets in the small scale sector produces 4.62 million worth of goods or services with an approximate value addition of ten percentage points.

The small-scale sector has grown rapidly over the years. The growth rates during the various plan periods have been very impressive. The number of small-scale units has increased from an estimated 0.87 million units in the year 1980-81 to over 3 million in the year 2000.

When the performance of this sector is viewed against the growth in the manufacturing and the industry sector as a whole, it instills confidence in the resilience of the small-scale sector.

Year	Target	Achievement
1991-92	3.0	3.1
1992-93	5.0	5.6
1993-94	7.0	7.1
1994-95	9.1	10.1
1996-97	9.1	11.3
1997-98	*	8.43
1998-99	*	7.7
1999-00	*	8.16
2000-01 (P)	*	8.90

P-Projected (April-December)
* Target not fixed at constant prices

Employment

SSI Sector in India creates largest employment opportunities for the Indian populace, next only to Agriculture. It has been estimated that 100,000 rupees of investment in fixed assets in the small-scale sector generates employment for four persons.

Generation of Employment - Industry Group-wise

Food products industry has ranked first in generating employment, providing employment to 0.48 million persons (13.1%). The next two industry groups were Non-metallic mineral products with employment of 0.45 million persons (12.2%) and Metal products with 0.37 million persons (10.2%).

In Chemicals & chemical products, Machinery parts except Electrical parts, Wood products, Basic Metal Industries, Paper products & printing, Hosiery & garments, Repair services and Rubber & plastic products, the contribution ranged from 9% to 5%, the total contribution by these eight industry groups being 49%.

In all other industries the contribution was less than 5%.

Per unit employment

Per unit employment was the highest (20) in units engaged in beverages, tobacco & tobacco products mainly due to the high employment potential of this industry particularly in Maharashtra, Andhra Pradesh, Rajasthan, Assam and Tamil Nadu.

Next comes Cotton textile products (17), Non-metallic mineral products (14.1), Basic metal industries (13.6) and Electrical machinery and parts (11.2.) The lowest figure of 2.4 was in Repair services line.

Per unit employment was the highest (10) in metropolitan areas and lowest (5) in rural areas.

However, in Chemicals & chemical products, Non-metallic mineral products and Basic metal industries per unit employment was higher in rural areas as compared to metropolitan areas/urban areas.

In urban areas highest employment per unit was in Beverages, tobacco products (31 persons) followed by Cotton textile products (18), Basic metal industries (13) and Non-metallic mineral products (12).

Location-wise Employment Distribution - Rural

Non-metallic products contributed 22.7% to employment generated in rural areas. Food Products accounted for 21.1%, Wood Products and Chemicals and chemical products shared between them 17.5%.

Urban

As for urban areas, Food Products and Metal Products almost equally shared 22.8% of employment. Machinery parts except electrical, Non-metallic mineral products, and Chemicals & chemical products between them accounted for 26.2% of employment.

In metropolitan areas the leading industries were Metal products, Machinery and parts except electrical and Paper products & printing (total share being 33.6%).

State-wise Employment Distribution

Tamil Nadu (14.5%) made the maximum contribution to employment.

This was followed by Maharashtra (9.7%), Uttar Pradesh (9.5%) and West Bengal (8.5%) the total share being 27.7%.

Gujarat (7.6%), Andhra Pradesh (7.5%), Karnataka (6.7%) and Punjab (5.6%) together accounted for another 27.4%.

Per unit employment was high - 17, 16 and 14 respectively - in Nagaland, Sikkim and Dadra & Nagar Haveli.

It was 12 in Maharashtra, Tripura and Delhi.

Madhya Pradesh had the lowest figure of 2. In all other cases it was around the average of 6.

Year	Target (lakh nos.)	Achieve- (lakh nos.)	Growth Rate
1992-93	128.0	134.06	3.28
1993-94	133.0	139.38	3.28
1994-95	138.6	146.56	5.15
1995-96	144.4	152.61	4.13
1996-97	150.5	160.00	4.88
1997-98	165	167.20	4.50
1998-99	170.1	171.58	2.61
1999-00	175.4	177.3	3.33

Exports

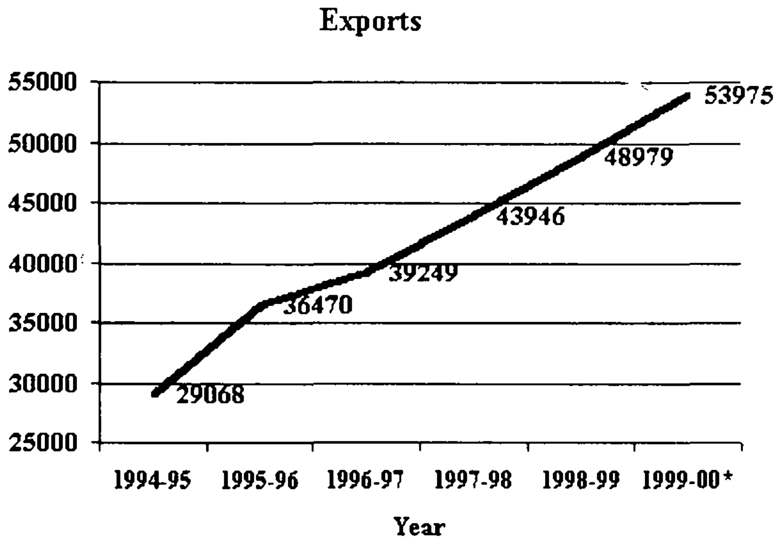
SSI Sector plays a major role in India's present export performance. 45%-50% of the Indian Exports is contributed by SSI Sector. Direct exports from the SSI Sector account for nearly 35% of total exports. Besides direct exports, it is estimated that small-scale industrial units contribute around 15% 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 for finished exportable goods.

It would surprise many to know that non-traditional products account for more than 95% of the SSI exports.

The exports from SSI sector have been clocking excellent growth rates in this decade. It has been mostly fuelled by the performance of garments, leather and gems and jewellery units from this sector.

The product groups where the SSI sector dominates in exports are sports goods, readymade garments, woolen garments and knitwear, plastic products, processed food and leather products.

Year	Exports (Rs. Crores) (at current prices)
1994-95	29,068 (14.86)
1995-96	36,470 (25.50)
1996-97	39,249 (7.61)
1997-98	43946 (11.97)
1998-99	48979 (10.2)
1999-00 (P)	53975 (10.2)



Problems before the Small Scale Sector in India

- Lack of adequate and timely institutional **credit** is a frequent complaint of the small-scale industry. Banks insist on collaterals which the small entrepreneurs, with limited resources, are unable to furnish. Bank officials frequently point out to the high level of NPAs (Non Performing Assets) and the poor culture of repayments to justify their cautious lending policies. The problem is that there is no trust and understanding between bank officials and industrialists in India. During recession, the bankers often cut back on lending, impose heavy penalties for defaults and try to recover as many advances as possible. This makes it nearly impossible for the industry, and especially the small-scale industry, to survive through a recession.

- The small-scale industry in India needs to **upgrade technologies** on a continuous basis to remain competitive. Adopting information technology to increase productivity and leveraging their advantage of flexible operating systems, the small enterprises in the US have performed exceedingly well during the last decade. There is no reason why small enterprises cannot do the same in India. There are very effective software packages available in the country for manufacturing units which can eliminate waste, compress production cycles, and improve the quality of the products. If they are expensive and beyond the reach of individual small-scale units, the packages can be purchased by groups of units and used jointly on a time share basis, paying hourly fees. The government can provide the infrastructure and train the managers in the use of the software.

- **The non-availability of skilled manpower** is an important constraint, especially for hi-tech industries. Government training institutes are often ill-equipped, follow outdated curricula and are theoretical in approach. Specialized training institutes can be started on the PPP (Public Private Partnership) concept wherein infrastructure can be provided by the government while the management can be left to either an NGO or an industry association.

- **Difficulties in marketing their products** have always been a major problem for the small manufacturers. Government agencies have often failed in providing assistance since officials have little understanding of market intricacies. Instead of competing severely against each other through undercutting in prices, the small manufacturers could try a collaborative approach by setting up marketing consortia. Government could provide infrastructure support for such consortia (showrooms, godowns, trade fairs and convention centers) and promote trade delegations. E-commerce has, of late, opened up tremendous opportunities for cost-effective marketing for small-scale industries which need to be exploited fully.

- **Quality Standards and Lack of R&D**
  One effect of the protectionism has been production of a sub standard quality product, with little emphasis on Research and Development. This is the general trend in the sector, except new service oriented units like IT. This has meant that the quality of products available to the Indian consumer is of low grade quality, with little effort to improve. In the changing global scenario this sector has rendered the less competitive products in the global market. The scale of production being so small until now and the sector being highly protected, standardization and quality checks were generally ignored.

- **Nature of Government Policies**
  The role of the state in the development of the small scale sector has not always been greatly beneficial to the sector itself. The government has also been very muddled in its definitions of the word 'small-scale' itself. In 1997 the definition stood at a unit with investment in plant and machinery of Rs.60 lakhs or less. This was raised to Rs. 3 crore, so as to encourage small units to expand and grow and upgrade their technology. In 2000 however the government lowered the limit to Rs.1 crore,

In 2006 a new bill was passed, 'The Micro, Small and Medium Enterprises Development Act,' which defines the enterprises as the following, "a small enterprise, where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees." The act also envisages the setting up of a National Board for Micro, Small and Medium Enterprises which is supposed to "examine the factors affecting the promotion and development of these enterprises and review the policies and programmes of the Central Government in regard to the facilitating the promotion and development and enhancing the competitiveness of such enterprises." This Board is also to make recommendations to the government on the matter of the development of such enterprises and how to overcome their problems.

The policy regulations relating to the small scale sector are such that they ensure that units progress. The importance of the small scale sector was highlighted, due to its big role in

a) Creation of broad-based employment op portunities and
b) Wide dispersal of industrial production is the main backbone of public policy.

Wrong Reservation of Production Lines and its Effect on Exports of SSI

The reservation of certain production lines solely for the small scale sector has been and remains the most important instrument of policy regarding the sector. The objective of this policy was to improve the competitive strength of the small scale sector, and protection was seen as a transitional step. In 1997, more than 40 years after the adoption of this policy, the Abid Hussain committee, an expert group was set up to look into the matter of small scale sector policy. They made a strong case for the abolition of these reservations and went to the extent of saying, "Reservation of products for the small scale sector must be totally abolished. It has been so ineffective that even a phased abolition will serve no purpose." The primary problem with this policy is that instead of being an instrument of transitional protection, it has become an end in itself. This has ensured that the primary objective of improving the sector's competitive strength has been completely side-lined and forgotten. A successful small scale industry, instead of expanding to achieve its economies of scale and increase quality levels, is forced to remain small if producing a reserved item. This has only had a detrimental effect on the growth of manufacturing, exports and employment generation. Exports especially has been badly hit as firstly no firm was able to gather the experience needed in the home market to exploit the global market, and secondly because, due to reservations, no firms are large enough to handle large orders.

Credit Market

There are primarily two market imperfections the small scale sector faces regarding the credit market:

1. Capital costs faced by SSEs (Small Scale Enterprises) are typically higher because of market imperfections in the availability of information for investors and lenders.

2. Transaction costs in bank lending exhibit pronounced economies of scale with respect to loan size.

Thus, the unit transaction costs for SSEs are higher than those for large firms. Moreover, provision of collateral or other risk-reducing securities is often difficult for SSEs. In the credit market, small scale units face a disadvantage due to the greater behavioral risk of default as well as the higher cost of lending. To solve this, the aim of the government should have been to aid the credit market in developing techniques and practices specific to the sector which would have reduced risk and cost of lending. The government attempted to counter the problem by enforcing mandatory credit allocation to the sector. It did this, in an already protected environment, by offering the sector lower interest rates and through the requirement that at least 15 percent of all bank credit was to be allocated to the small scale sector. This ensured that the sector not only got used to 'easy money' and very often remained economically unviable, but also that those units which most deserve credit did not necessarily get it as banks were only looking to fill their quotas. The government also set up specialized lending institutions for the small scale sector at the state level.

Facts & Fiction about SSI

Small enterprises are of critical importance to the functioning of an economy and thus economic development. In developing economies, about 60 percent of GDP is generated by small enterprises, i.e., enterprises with a maximum of 50 employees. A modern market economy consists of thousands of markets, which require millions of enterprises to be reasonable competitive and efficient. A large number of small enterprises guarantees a high degree of competition, and the variety of economic activities is so great that as many enterprises as possible are needed in a modern economy.

There are however some arguments made in favor of small units which need to be briefly examined in the Indian context.

Growth

Small firms are often said to grow faster than large firms, thus making the size distribution shift in favor of small firms would allow the economy as a whole to grow faster. However empirically what one sees is that though some small firms may have high growth rates, they as a group have a high death rate, that is, many firms do not last very long. This means that the total effect on the economy may not be much greater than that of relatively larger firms. Also an important point to note here is that historically only a very small percentage of small firms have grown into large ones.

Employment: Small firms and enterprises are an important source of employment in many developing nations, often employing a sizable share of the labor force. However it is often suggested that small firms are more labor intensive, and therefore should be encouraged as a way of generating employment. Empirical data however seems to suggest that small firms may be more capital intensive than large firms in the same industry. Employment growth as well has been seen as something which small firms can aid in. Here again, the evidence is mixed: if viewed in net terms (job creation less job destruction), it is difficult to conclude that small firms do any better than large firms, since small firms exhibit high birth rates and high death rates, and many small firms fail to grow.

Efficiency: Productivity is often said to be the highest in small firms. This however varies greatly, both within and across industries. Studies also seem to suggest that it is not small firms which are the most efficient; in fact they are the least, but medium-scale firms. Small and medium scale firms do however have the advantage of being more dynamic and flexible than larger firms, thus giving them the ability to offer more customized products to their customers.

Intervention by the state is often argued on the grounds that small firms are more efficient, contribute to more equitable distribution of income, and generate employment. Empirical data however does not always support these claims. It is undeniable however that the small scale sector exists, and is a very sizable sector, often employing large proportions of the work force. This in itself should give the state a reason to be concerned with the sector. Its interventions however should be aimed at correcting market inefficiencies and failures rather than a paternalistic approach of protection, which often results in actually stinting the growth of the sector. The affects of this 'paternalistic' approach are further analyzed in the Indian context, where the small scale industry has been, and still is largely protected.

Concluding Remarks

An introspection of Small scale sector exposes us to an indifferent working of this sector. On the one hand it is a sector with enormous potential, and which seems to be growing despite the restraints on it and on the other hand It is a sector where, after liberalization, only 20 of 700 toy manufacturing firms in Delhi managed to stay out of the red, due to Chinese competition, and yet in a matter of less than five years had regained their lost ground, driving even the dreaded Chinese out of the toy market. This is an example of high potential of this sector, something which hasn't been utilized as yet.

If we talk about the future outlook of Small-scale industries, they enjoy certain inherent strengths such as lower over-head costs, flexibility in production, informality in labour relations, exploitation of local resources and skills, capacity to execute small orders and to offer customized services. The small scale sector is often able to offer the niche services which the larger manufacturers are unable to. For example, countries such as China, Bangladesh, Malaysia, Philippines, Sri Lanka have no reservation for the garment industry and yet the small-scale units, are thriving. The large units specialize in executing large orders of institutional garments while the small units take on smaller orders of high fashion, seasonal garments. Collaborative relations between the large, medium and small units through subcontracting arrangements are well established. This can be used in the Indian context as well. The government's policies should seek to strengthen and promote such collaborative efforts rather than keep them apart through protectionism. To counter competition in the long run and to be economically viable, the small scale sector needs to improve its productivity and quality, reduce costs (given the higher qualities) and innovate. Government policy should promote the small scale sector by helping them increase their efficiency and competitiveness within a market driven economy. For this it is essential that it no longer follows a protectionary stance, as that has already been shown to be harmful to the sector. What is required is an enforcement of time bound concessions, emphasis on core advantages of small scale sector, emphasis on innovation, an increasing of the amount of credit information on the sector, and strengthen local associations of small units as collectively they can counter many of their problems. Till date however, the policies have been paternalistic in nature, leading to dependency. The skewed approach of the government ensured that small units had no incentive to actually solve their common problems of inadequate finance and lack of information. Instead the policies only created perverse incentives for these units to remain small, while being unable to provide infrastructure and to remove the basic problems of small units such as limited access to markets and finance. New approaches like the cluster approach or harnessing the power of industry associations should also be encouraged.

Undoubtedly the small sector has enormous potential, and is a crucial sector of the Indian economy. However for the sector to fully realize its potential, it is essential that it shall wake up to the realities of a liberalized India. It needs to be away of its state-designed protective rut. The Government shall realize the need for a shift in policy towards the sector, so that it can flourish.

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