

Micro, Small and Medium Enterprises (MSME): The Importance in Indian Economy

For a country to grow, the government should actively promote business enterprises. Among business enterprises, the Micro, Small and Medium Enterprises (MSME) deserve special attention. Though MSMEs are small investment enterprises, their contribution to the Indian economy is very significant.

What are MSMEs?

Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 which was notified on October 2, 2006, deals with the definition of MSMEs. The MSMED Act, 2006 defines the Micro, Small and Medium Enterprises based on

1. the investment in plant and machinery for those engaged in manufacturing or production, processing or preservation of **goods** and
2. the investment in equipment for enterprises engaged in providing or rendering of **services**.

The guidelines with regard to investment in plant and machinery or equipment as defined in the MSMED Act, 2006 are:

	Investment in plant and machinery excluding land and building for enterprises engaged in manufacturing	Investment in equipment excluding land and building for enterprises engaged in providing or rendering
Nature of activity of the Enterprise		

or production, of **services** (loans
processing or up to Rs 1 crore)
preservation
of **goods**

Micro	Not exceeding Rs.25.00 Lakhs	Not exceeding Rs.10.00 Lakhs
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Small	More than Rs.25.00 lakhs but does not exceed Rs.500.00 lakhs	More than Rs.10.00 lakhs but does not exceed Rs.200.00 lakhs
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Medium	More than Rs.500.00 lakhs but does not exceed	More than Rs.200.00 lakhs but does not
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Rs.1000.00 lakhs	exceed Rs.500.00 lakhs
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List of enterprises that are engaged in providing or rendering services

The illustrative lists of enterprises that are engaged in providing or rendering services are:

- Small road and water transport operators (original investment in vehicles up to Rs.200.00 lacs under Priority sector)
- Retail trade (with credit limits not exceeding Rs.20.00 lakhs)
- Small business (whose original cost price of the equipment used for the purpose of business does not exceed Rs.20.00 lakhs)
- Professional and self-employed persons (whose borrowing limits do not exceed Rs.10.00 lakhs of which not more than Rs.2.00 lakhs should be for working capital requirements except in case of professionally qualified medical practitioners setting up of practice in semi-urban and rural areas, the borrowing limits should not exceed Rs.15.00 lakhs with a sub-ceiling of Rs.3 lakhs for working capital requirements)

Significance of MSMED Act 2006

With the enactment of MSMED Act 2006, the paradigm shift that has taken place is the inclusion of services sector in the definition of Micro, Small and Medium Enterprises, apart from extending the scope to Medium Enterprises.

What is the Importance and role of MSMEs in the Indian Economy?

To generate large scale employment

In India, capital is scarce and labour abundant. MSMEs are thought to have lower capital-output and capital-labour ratios than large-scale industries, and therefore, better serve growth and employment objectives. The MSME sector in India has grown significantly since 1960 – with an average annual growth rate of 4.4% in the number of units and 4.62% in employment (currently employing 30 million). Not only do MSMEs generate the highest

employment per capita investment, but they also go a long way in checking rural-urban migration by providing people living in isolated areas with a sustainable source of employment.

To sustain economic growth and increase exports

Non-traditional products account for more than 95% of the MSME exports (dominating in the export of sports goods, readymade garments, plastic products etc.). Since these products are mostly handcrafted and hence eco-friendly, there exists a tremendous potential to expand the quantum of MSME led exports. Also, MSMEs act as ancillary industries for Large Scale Industries providing them with raw materials, vital components and backward linkages e.g. large scale cycle manufacturers of Ludhiana rely heavily on the MSMEs of Malerkotla which produce cycle parts.

Making Growth Inclusive

MSMEs are instruments of inclusive growth which touch upon the lives of the most vulnerable and marginalized. For many families, it is the only source of livelihood. Thus, instead of taking a welfare approach, this sector seeks to empower people to break the cycle of poverty and deprivation. It focuses on people's skills and agency. However, different segments of the MSME sector are dominated by different social groups.

The Twelfth Plan has listed the following as the objectives for the MSME sector

- Promoting competitiveness and productivity in the MSME space.
- Making the MSME sector innovative, improving technology and depth.
- Enabling environment for promotion and development of MSMEs.
- Strong presence in exports.
- Improved managerial processes in MSMEs.

Evolution and Performance of the MSME Sector in India

Pre-Liberalization

- During the post-Independence period, small firms were expected to play an important role in the development process, especially in absorbing surplus labour and achieving an equitable income distribution. This is the traditional stylized role assigned to small industries.

- At the beginning of the industrialization process, flexibility in production and the ability to offer differentiated products allow smaller firms to grow rapidly.
- Later, large-scale firms come to dominate the size distribution, making up a greater share of output, employment, and value-added because of scale economies, managerial efficiency, better access to finance and infrastructure, and a favourable tariff structure.

Post-Liberalization

- The growth rate of MSME, on an average, has declined considerably in terms of units and even employment but has improved marginally in terms of output and exports, in the post-liberalization period compared to the pre-liberalization period.
- This could be probably due to – (a) With the threat of competition, new MSME units would not have come up as significantly in the liberalization period as compared to the pre-liberalization period (b) The new MSME units that came up after liberalization may have been much more capital intensive than those that have come up in the past – with some proportions of the existing MSME units having modernized themselves to rely less on labour and also to take advantage of developments in the global market (c) Unable to face the competition some MSMEs exited the market, thereby affecting MSME employment and output initially.
- However, though it appears that the MSME growth performance (in terms of employment, output, and exports) might have suffered initially it has been able to recover impressively subsequently in the decade of 2000s.
- The share of the registered MSMEs in India's GDP more than doubled during this period and its share in total organized sector employment increased to 34% during the same period. Although the share of registered MSME exports declined sharply initially, it bounced back to 12% in 2006-07.
- The improved economic health of registered MSME sector is reflected in another parameter i.e. industrial sickness. Sickness in the registered MSME sector has declined both absolutely and relatively. This may be the outcome of improvements in management deficiencies, insufficient financial control, research and development, obsolete technology, inadequate demand, shortage of raw materials, infrastructure bottlenecks, etc.
- There are two more issues concerning MSME performance:

1. **Ancillarisation** – the promotion of inter-firm linkages between large firms and MSME through subcontracting and ancillarisation in both

public and private sectors has been an important dimension of India's MSME policy. Any growth of ancillarisation and sub-contracting would be advantageous to the MSME sector by way of assured marketing, covered technical assistance, finance, and supply of raw materials and training. During this period the percentage of ancillary units increased from 5 percent. Note that however a significant proportion of MSME subcontracting and ancillarisation are informal in nature. The growing inter-firm linkages, formal as well as informal, would have benefited the economic performance of the MSME sector.

2. **The degree of internationalization** – the world over, an export strategy has been the primary foreign market entry mode adopted by MSMEs in their internationalization efforts – this has been observed in the Indian context as well. At the national level, several factors contributed to the increasing trend of MSME internationalization like – structural shift in the composition of MSME exports from traditional to non-traditional items, modes of entry such as MNCs and e-Commerce etc.

Evaluation of the Reservation Policy

- The policy of reserving products for exclusive manufacture in the small-scale sector was started in 1967 with forty-seven items; the list of reserved items rose to 873 in 1984.
- The number of items on the reserved list for the SSI sector was brought down to 836 by 1989.
- The pace of reforms accelerated after 1991: average tariff rates have been steadily lowered, quantitative restrictions have been removed, and domestic investment policies have been liberalized.
- Over time, the number of items on the reserved list has also been reduced and stands at 605 in 2005.
- With liberalization, since all the items on the reserved list can now be imported, MSMEs face competition from foreign enterprises even though large scale industries in India cannot produce these products.
- The Censuses of the SSIs also suggest that the policy of reserving goods for production by SSIs has not been very effective. The number of units making reserved products was small compared to the overall size of the MSME sector, and the reserved products account for a small share of the total value of output in the MSME sector.
- Also, it appears that the export performance of India may have suffered because of the reservation policy. Most growing economies witness a changing structure of exports, with high growth of exports of labour-intensive and resource-based industries. The export structure of India has not changed much in the last two decades, and this may

be because many commodities in the potential high-growth category come under the reserved list.

What are the challenges of MSME?

- Most of the unregistered MSMEs would predominantly comprise micro-enterprises, particularly confined to rural India, operating with obsolete technology, limited access to institutional finance etc. And there is a need to transform the huge unregistered MSME into registered MSME.
- Need to improve the competitiveness of the overall MSME sector.
- Access to technology.
- IPR related issues.
- Design as a market driver.
- Wasteful usage of resources/manpower.
- Energy inefficiency and associated high cost.
- Low ICT usage.
- Low market penetration.
- Quality assurance/certification.
- Standardization of products and proper marketing channels to penetrate new markets.
- The definition for MSMEs must be updated – considering inflation and availability of better technologies since the last change in 2006.

Recent Initiatives

- As part of the National Manufacturing Competitiveness Programme (NMCP) – 10 specific initiatives were taken to enhance the competitiveness of the entire value chain of the MSME sector.
- Limited Liability Partnership (LLP) Act, 2008 was introduced to enable early corporatization of MSMEs and tap the capital market for fund raising. Accordingly, MSME platforms are created in BSE and NSE in 2012.
- To develop a roadmap for the development and promotion of MSMEs, a task force was created by the Prime Minister of India in 2009. The Task Force, which comprised, among others, six specific theme-based sub-groups (on credit, marketing, infrastructure, technology, skill development, exit policy, labor, and taxation) submitted its report in 2010 suggesting: (1) Immediate policy measures (2) Medium-term institutional measures (3) Legal and regulatory structures to create a conducive environment for entrepreneurship and growth of MSMEs.
- The Inter-Ministerial Committee for Accelerating Manufacturing in Micro, Small and Medium Enterprises made recommendations on –

(a) the promotion of start-ups (b) facilitating operation and growth (covering credit, technology, and marketing) (c) closure and exit (d) labour laws and regulations.

- These policy initiatives are clear and consistent, aimed at transforming the ecosystem for the MSMEs sector by influencing: (1) Birth (encouraging Start-Ups) (2) Operations and growth (by simplifying laws and regulations, and facilitating their access to credit. Better technology and dynamic markets, apart from skilled labour and reliable infrastructure) (3) Orderly and easy exit
- Thus, the emerging focus of India's MSME policy aims at covering the entire lifecycle of MSMEs to ensure a healthy, vibrant and competitive MSME sector.

Summary

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