Chapter 4

Perspective of Indian Small and Medium Enterprises
4.1 Historical Facts leading to Evolution of Indian Small and Medium Enterprises (SMEs) Sector

After India won its independence on August 15, 1947 the founding fathers of free India came out with the First Industrial Policy Resolution on April 6, 1948 through which the importance of small-scale sector was demonstrated for better utilization of local resources and achievement of the local self-sufficiency. The earliest definition of Small Scale Industries in 1950 was on the basis of the twin criteria of gross investment in fixed assets and work forces. The limit of investment in fixed assets was Rs. 5 lakh and number of workers employed was 50 / 100 with / without power. In 1960, the condition stipulating employment was deleted, while the investment limit in fixed assets remained pegged at Rs. 5 lakh. In 1966, the limit of investment in fixed assets was replaced by limit of investment (original value) in Plant & Machinery (P&M) and same was fixed at Rs. 7.5 lakh. This was further raised to Rs. 10 lakh in 1975. [1]

In 1980 an upward revision in the investment limit in (P&M) to Rs. 20 lakh (original value) whether held on ownership basis or long lease or on hire purchase was made and a provision was added to the definition stating, "Provided further that no undertaking referred to as Small Scale Industrial Undertaking (SSIU) shall be a subsidiary of, or owned or controlled by any other undertaking". The main reason for adding such a provision was to prevent medium/large industrial undertakings from taking away the special benefits exclusively meant for SSIUs including the reservation of certain items being manufactured by small-scale industrial undertakings. By adding this provision, Government of India closely liked the question of ownership by providing baking that SSIUs cannot be owned or controlled or be a subsidiary of any other industrial undertaking. [1]

According, combined investments made in P&M in one or more industrial undertakings set-up by common proprietor / partner / director in case of proprietary / partnership / private limited / public limited industrial undertakings
were to be clubbed together and if the same exceeded the limit of investment fixed for SSIUs, all such industrial undertakings would cease to hold the status of small scale industrial undertaking. The provision, therefore, restricted the entry of medium / large industrial undertakings from obtaining various fiscal and other concessions under the garb of setting up separate entities as SSIUs. Since there were further changes in the price indices, emerging needs of the industry calling for additional investments in P&M laboratory equipments etc., the investment limit in P&M was further raised to Rs. 35 lakh in 1985. [1]

The advent of liberalization in year 1991 brought in further enhancement in the P&M investment limit and the same was raised to Rs. 60 lakh. Further added was a provision, according to which 24% equity in the SSIUs was allowed by any other industrial undertaking without calling for the clubbing criterion. The year 1997 saw a steep hike in the investment limit of SSIUs and the same was enhanced to Rs. 300 lakh. Such a steep hike in the investment limit attracted concerns from small scale industries associations all over the country since majority of SSIUs had investment in P&M less than Rs. 25 lakh. The Government of India, therefore, brought back the investment limit to Rs.100 lakh in 1999. [1]

4.1.1 Evolution of Indian SMEs Sector

The Parliament enacted the MSME (Micro, Small and Medium Enterprises) Development (MSMED) Act, which came into effect on October 2, 2006. The Act has introduced the concept of ‘Enterprise’ as opposed to the earlier concept of industrial undertaking. According to the Act, SMEs are classified into the following: (i) enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule of MSMED Act and (ii) enterprises engaged in providing or rendering services. Table 4.1 defines the SMES in both these sectors. [2]
### Table 4.1: Definition of SMEs in India

<table>
<thead>
<tr>
<th>Manufacturing Sector</th>
<th>Small enterprises</th>
<th>More than Rs. 25 lakh but does not exceed Rs. 5 crore</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Medium enterprises</td>
<td>More than Rs. 5 crore but does not exceed Rs. 10 crore</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Service Sector</th>
<th>Small enterprises</th>
<th>More than Rs. 10 lakh but does not exceed Rs. 2 crore</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Medium enterprises</td>
<td>More than Rs. 2 crore but does not exceed Rs. 5 crore</td>
</tr>
</tbody>
</table>

Source: Ministry of Micro, Small and Medium Enterprises. [www.msme.gov.in](http://www.msme.gov.in)

### 4.2 Growth Trends of Indian SMEs Sector

#### 4.2.1 Growth Trend

The small and medium enterprises sector contributes significantly to the manufacturing output, employment and exports of the country. Analysis of the data in Table 4.2 reveals that during the Ninth (FY 1997-98 to FY 2001-02) and Tenth Plan period (FY 2002-03 to FY 2007-08), the average annual growth in the number of units and employment has been to the tune of 4% and 4.1%, respectively. It is estimated that in terms of value, the sector accounts for about 45% of the manufacturing output and 40% of total exports of the country. [1]
### Table 4.2: Performance and Growth Trend of MSME Sector

<table>
<thead>
<tr>
<th>Sr No</th>
<th>FY</th>
<th>Total MSEs (lakh)</th>
<th>Fixed Investments (Rs. Crore)</th>
<th>Production (Rs. Crore)</th>
<th>Employment (lakh person)</th>
<th>Export (Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Current Prices</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Constant Prices (1993-94)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>1990-91</td>
<td>67.87</td>
<td>93555</td>
<td>78802</td>
<td>84728</td>
<td>158.34</td>
</tr>
<tr>
<td>2</td>
<td>1991-92</td>
<td>70.63</td>
<td>100351</td>
<td>80615</td>
<td>87355</td>
<td>165.99</td>
</tr>
<tr>
<td>3</td>
<td>1992-93</td>
<td>73.51</td>
<td>109623</td>
<td>84113</td>
<td>92246</td>
<td>174.83</td>
</tr>
<tr>
<td>4</td>
<td>1993-94</td>
<td>76.49</td>
<td>115795</td>
<td>98796</td>
<td>98796</td>
<td>182.64</td>
</tr>
<tr>
<td>5</td>
<td>1994-95</td>
<td>79.60</td>
<td>123790</td>
<td>122154</td>
<td>108774</td>
<td>191.40</td>
</tr>
<tr>
<td>6</td>
<td>1995-96</td>
<td>82.84</td>
<td>125750</td>
<td>147712</td>
<td>121175</td>
<td>197.93</td>
</tr>
<tr>
<td>7</td>
<td>1996-97</td>
<td>86.21</td>
<td>130560</td>
<td>167805</td>
<td>134892</td>
<td>205.86</td>
</tr>
<tr>
<td>8</td>
<td>1997-98</td>
<td>89.71</td>
<td>133242</td>
<td>187217</td>
<td>146262.9</td>
<td>213.16</td>
</tr>
<tr>
<td>9</td>
<td>1998-99</td>
<td>93.36</td>
<td>135482</td>
<td>210454</td>
<td>157525.1</td>
<td>220.55</td>
</tr>
<tr>
<td>10</td>
<td>1999-00</td>
<td>97.15</td>
<td>139982</td>
<td>233760</td>
<td>170379.2</td>
<td>229.10</td>
</tr>
<tr>
<td>11</td>
<td>2000-01</td>
<td>101.1</td>
<td>146845</td>
<td>261297</td>
<td>184401.4</td>
<td>238.73</td>
</tr>
<tr>
<td>12</td>
<td>2001-02</td>
<td>105.21</td>
<td>154349</td>
<td>282270</td>
<td>195613</td>
<td>249.33</td>
</tr>
</tbody>
</table>

At 2001-02 prices

|          |       |                   |                             |                          |                          |                   |
|----------|-------|-------------------|-----------------------------|--------------------------|--------------------------|                   |
| 13       | 2002-03 | 109.49            | 1623317                    | 314850                   | 306771                   | 260.21            | 86013            |
| 14       | 2003-04 | 113.95            | 170219                     | 364547                   | 336344                   | 271.42            | 97644            |
| 15       | 2004-05 | 118.39            | 178699                     | 429796                   | 372938                   | 282.57            | 124417           |
| 16       | 2005-06 | 123.42            | 188113                     | 497886                   | 418884                   | 299.85            | 150242           |
| 17       | 2006-07 | 128.44            | 213219                     | 585112                   | 471663                   | 312.52            | 177600           |
| 18       | 2007-08 | 133.68            | 238975                     | 695126                   | 532979                   | 322.28            | NA               |

There are more than 6000 products ranging from traditional to high-tech items, which are being manufactured by the SME in India (Figure 4.1). It is well known that the SMEs provide the maximum opportunities for both self-employment and jobs after agriculture.

**Figure 4.1: Classification of Products of SMEs**

![Classification of Products of SMEs](image)


### 4.2.2 Comparison of the SMEs Sector with Overall Industrial Sector

The SME sector has consistently registered a higher growth rate than that of industrial sector. Table 4.3 and Figure 4.2 depict the comparative annual growth rates of production in the SME segment vis-a-vis that of the industrial sector as a whole since 1997-98. It is pertinent to note that the annual growth rate of SME sector has consistently outpaced that of the industrial sector during the Ninth and Tenth Plans. [2]
Table 4.3: Growth Trend of SME and Overall Industrial Sector

<table>
<thead>
<tr>
<th>FY</th>
<th>SME Sector (% growth over previous year)</th>
<th>Industrial Sector (% growth over previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ninth Plan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997-98</td>
<td>8.43</td>
<td>6.7</td>
</tr>
<tr>
<td>1998-99</td>
<td>7.7</td>
<td>4.1</td>
</tr>
<tr>
<td>1999-00</td>
<td>8.16</td>
<td>6.7</td>
</tr>
<tr>
<td>2000-01</td>
<td>6.06</td>
<td>5</td>
</tr>
<tr>
<td>2001-02</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Tenth Plan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002-03</td>
<td>8.68</td>
<td>5.7</td>
</tr>
<tr>
<td>2003-04</td>
<td>9.64</td>
<td>7</td>
</tr>
<tr>
<td>2004-05</td>
<td>10.88</td>
<td>8.4</td>
</tr>
<tr>
<td>2005-06</td>
<td>12.32</td>
<td>8.2</td>
</tr>
<tr>
<td>2006-07</td>
<td>12.6</td>
<td>11.5</td>
</tr>
</tbody>
</table>


4.2.3 Employment in SMEs Sector

The employment as per the Fourth all India Census grew to 597.29 lakh, up from 249.33 lakh as was reported from the Third Census data. This was mainly because of inclusion of enterprises, falling under KVIC/KVIB, Handloom, Handicraft, Retail Trade sector etc besides an overall enhancement in the investment limits of the constituents of the sector. [1]
According to the Eleventh Plan document, “the SME sector in India has grown significantly since 1960, when there were only 12,376 SMEs providing employment to 10 lakh people of which, direct employment was 1.85 lakh; annual production level was Rs. 875 crore. At the beginning of the Tenth Plan, 249 lakh people in the rural and urban areas were employed in 105.21 lakh SMEs. This has increased to 295 lakh people in 128 lakh units now; an average annual growth rate of 4.4% in the number of these units and 4.62% in employment, if the units in the khadi, village, and coir sector are taken into account, the employment is estimated to be over 332 lakh. With the inclusion of handlooms, handicrafts, wool, and sericulture, the total job in the SME sector in India goes up to 650 lakh. The employment intensity of the registered units indicates that an investment of Rs. 0.72 lakh is required for creating on employment in SME sector as against Rs. 5.56 lakh in the large organized sector”. [1]
4.2.4 Growth Pattern, Productivity and Efficiency of SMEs Sector vis-a-vis Large Industries Sector in India

4.2.4.1 Growth Pattern

The data made available by Annual Report FY 2008-09 of the Ministry of SME indicates that since FY 1990-91 to FY 2006-07, the number of SSIUs/SMEs grew from 67.87 lakh to 128.44 lakh i.e. the sector has grown at an annual growth rate of 4.07%.

The employment has gone up from 158.34 lakh to 312.52 lakh i.e. at an average growth rate of 4.17%. The average employment per SME works out to be 2.43. However, the actual nos. of SMEs as detailed by quick results of Fourth census are of the order of 261.00 lakh and the employment stand at 597.29 lakh i.e. employment per enterprises is 2.29. The actual nos. of registered SMEs are 15.49 lakh offering employment to 99.48 lakh person i.e. employment per registered enterprises stand at 6.42. Exports from small scale sector are growing at an average rate of over 20% while its average share in overall export from the country is approximately 34% to 35%. The sector also contribute nearly 15% to 20% of our direct exports through merchant exports, export houses and through exports of large organizations, thus making overall export from SMEs almost touching the figure to 40% of India’s total exports.

4.2.4.2 Efficiency of SMEs Sector

The SME sector has shown resilience in spite of heavy competition over the years and recession in some of the years; still it has grown from strength to strength. One of the interesting aspects would be to see as to how the SME sector compares with the large scale sector.
The Central Statistical Organization (CSO) in the Ministry of Statistics and Programme Implementation has been conducting a survey every year on organised manufacturing activities. This survey is called Annual Survey of Industries (ASI). The ASI covers, inter alia, all the units registered under section 2 (m) (i) and 2 (m) (ii) of the Factories Act. The coverage under the ASI includes manufacturing, repair and maintenance activities. Services sector is not covered in ASI.

The results of Fourth census registered of SMEs in respect of manufacturing, repair and maintenance activities are compared with the ASI results in the following Table 4.4. The latest final results available of ASI are for FY 2005-06 and covered information on number of units, employment and output which could be compared with Fourth Census.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>ASI as per 2005-06</th>
<th>4th Census of SMEs Registered (2006-07)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of units</td>
<td>140160</td>
<td>1163394</td>
</tr>
<tr>
<td>Employment</td>
<td>9038523</td>
<td>8615140</td>
</tr>
<tr>
<td>Output (Rs. lakh)</td>
<td>190835548</td>
<td>66174150</td>
</tr>
<tr>
<td>Fixed Capital (Rs. lakh)</td>
<td>60694028</td>
<td>44590846</td>
</tr>
<tr>
<td>Per unit Employment</td>
<td>64.48</td>
<td>7.41</td>
</tr>
<tr>
<td>Per unit Output (Rs. lakh)</td>
<td>1361.55</td>
<td>56.88</td>
</tr>
<tr>
<td>Per unit Investment (Rs. lakh)</td>
<td>433.03</td>
<td>38.33</td>
</tr>
<tr>
<td>Employment per Rs. One lakh Investment</td>
<td>0.15</td>
<td>0.19</td>
</tr>
<tr>
<td>Output per Employee</td>
<td>21.11</td>
<td>7.68</td>
</tr>
<tr>
<td>Investment of Output (Rs. lakh)</td>
<td>0.32</td>
<td>0.67</td>
</tr>
</tbody>
</table>


The comparison of SME sector with large scale manufacturing sector covered through ASI reveals that the SME sector is a better employment generating sector. The Fourth census showed that the employment generated by the SME sector per Rs. 1 lakh investment is 0.19, as against 9.15 in respect of ASI. This means that the organised sector requires an investment of Rs. 6.66 lakh to generate employment to
one person, whereas the SME sector generates employment for 1.27 persons with the same investment. With regard to investment – output ratio, the SME sector fared almost at 50% that of the organised sector.

4.2.4.3 Sustainability and SMEs Sector

Sustainability is defined as forms of progress that meet the needs to the present without compromising the ability of future generations to meet their needs. Sustainable development is broadly defined as the advancement of economic development while maintaining quality of environmental and social systems. Incorporating Environmental and Social (E&S) issues into development is important because environmental resources provide a basis for social and economic development. The principles of sustainable development are important in all industrial and commercial sectors, as all activities have the potential to influence social and environmental welfare quality. The financial sector is of particular importance, as this sector is able to affect many projects and the development trends that result from them.

Word over, there is an increasing awareness about incorporating principles of sustainability in the bank's operations and outlook. Several forces are driving the paradigm shift in favour of sustainability of development process. An excellent approach to map these drivers in broad terms is the economists well known demand side and supply side framework. Within this framework, the relevant pressures can be classified under global and local ones. The two can be combined under what is now fashionably termed as global sustainability drives.
4.2.4.4 Demand Side Drivers

Emerging Markets

Customers across the world are demanding green and clean labels. These market forces are mounting day by day manifesting themselves through consumer attitudes and willingness to pay for such basket of goods and services. Organic foods, renewable energy appliances, sustainability harvested timber and leather are only a few illustrative examples of this rapidly emerging market trend. The pressure does not limit itself just to sustainable consumption patterns but extends now to sustainable production processes and ‘cradle to cradle’ systems. SMEs are an integral part of supply chain as they are vendors for MNC/Large companies. They have a lot of stake in this ‘sustainability’ revolution.

4.2.4.5 Supply Side Forces

Production Cost Trends

Based on life cycle computations of resource costs and economy wide benefits, a broad range of green and clean consumer products and services are becoming comparatively cheaper than their conventional substitutes. Emergence of services sector aided by innovative bridging financing instruments and mechanisms are further bringing down the initial high capital cost barriers to adoption of these environmentally benign options, rapidly bringing them within the reach of affordability by large cross-sections of people. As a general trend, costs of sustainably produced goods and services are falling, while on the other hand, those of their counterparts are rising. Fossil fuel based energy vis-a-vis renewable energy is an excellent illustration of this point. According to Intel co founder Gordon Moore’s Law, the numbers of transfers of some conductor chip of silicon will double every 18 months. The same size chip will, in other words, deliver twice the
computing power at the same cost. Many experts now believe that clean energy sources could experience a kind of Moore's Law of their own.

4.2.4.6 Pressures Point

4.2.4.6.1 Internal Pressures

The Environment Protection Act (1986) was enacted soon after the 1984 Bhopal Gas disaster and then, the supporting institutional structure of Ministry of Environment & Forests (MoEF), Central Pollution Control Board (CPCB), State Pollution Control Boards (SPCBs) and Pollution Control Committees was created. The law is becoming stronger against negative externalities caused in the form of air, water and other adverse impacts on safety, health and environment. Potential liability of the polluter to pay compensation to the victim's regulation and other fiscal and non-fiscal instruments which have been put in place are working as deterrents. The progress towards sustainability would be directly commensurate with the degree of success in enforcement of compliance with the new resource efficient low / no carbon world order.

4.2.4.6.2 External Pressures

Climate Change

Climate change has become the most notable global issue of this decade. Controls on the generation of greenhouse gases (GHGs) will affect the price of conventional forms of energy and the products, services and sectors that rely on such energy. In the face of this emerging reality, a question arises as to how climate change as a macroeconomic variable will affect Small and Medium Enterprises Sector. What are the opportunities in this market transition and what are the threats? It is, however, certain that competitiveness of SME Sector would be impacted by the climate change
related phenomenon. In the context of climate change, the factors which are expected to affect the competitiveness of SME are:

**Weaknesses**

- Use of obsolete technologies
- Low energy efficiency
- Low technical or managerial expertise
- Lack of awareness / access to new products / technology
- Lack of access to institutional finance
- Lack of suitability / appropriate infrastructure
- High inertia to change

**Challenges**

Technology

- Lack of off-the-shelf technological solutions
- Underdeveloped technology / services market
- Environment protection issues leading to closure of units

Capacity Building

- Lack of scientific approach, measured data and hence, the awareness of energy performance status
- Continued dependence on ‘experienced person’ rather than a scientific designing

Economic / Financial

- Increasing worldwide competition
• Scale of operation
• Access to institutional finance

A rational analysis of the issue of sustainability reflects on the issues of environmental protection and energy efficiencies.

4.3 Indian SMEs Sector Issues/Challenges

All across the world, the SMEs have been accepted as the engine for promoting equitable economic development. As discussed earlier, in India the SME sector constitute 95% of all enterprises and play a pivotal role in the overall industrial economy with 40% contribution towards manufacturing output and 33% towards total exports. It employs a total of 60 million people spread over 26 million enterprises. The SME sector in India is heterogeneous, dispersed and mostly unorganized. They continue to face a number of common problems, 'Report of the Prime Minister's Task Force on Small and Medium Enterprises' (2010) provides below list: [1]

• Lack of availability of adequate and timely credit
• High cost of credit
• Collateral requirements
• Limited access to equity capital
• Problems in supply to government departments and agencies
• Procurement of raw materials at a competitive cost
• Problems of storage, designing, packaging and product displays
• Lack of access to global markets
• Inadequate infrastructure facilities, including power, water, roads etc
• Low technology levels and lack of access to modern technology
• Lack of skilled manpower for manufacturing, services, marketing etc
• Multiplicity of labour laws and complicated procedures associated with compliance of such laws
• Absence of a suitable mechanism which enables the quick revival of viable sick enterprises and allows unviable entities to close down speedily
• Issues relating to taxation, both direct and indirect and procedures thereof

To further, understand the challenges faced by the Indian SMEs and do a pragmatic analysis; a detailed study is conducted based on the secondary data and information. The study reveals these top 8 challenges: [1]

1. Non-availability of adequate infrastructure support
2. Non-availability of adequate and timely credit
3. Inability to upgrade technology and production facilities to achieve cost competitiveness
4. Lack of adequate knowledge about government schemes and facilities
5. Non-availability of skilled personnel
6. Constraints in adopting energy efficiency in production process
7. Lack of proper means and support for brand building
8. Inadequacy of requisite R&D support

These issues are discussed in the following paras.

4.3.1 Non-availability of adequate infrastructure support

Much of the potential of small firms to grow and nurture innovativeness is shaped by the kind of infrastructure, both physical and economic, available and can be accessed at reasonable costs. Moreover, the nature and implications of such infrastructural absence or inadequacy could vary between small enterprises located in urban areas and those in rural and semi-urban areas.
Access to dependable supply of electricity is the most crucial issue hindering the rise of productivity and output of SMEs. Power cuts generally range from 24-48 hours per week. Similarly, poor transportation facilities, especially in rural and semi-urban areas, have been cited as constraints encountered by SMEs; access to newer and larger markets has been restricted due to this reason. The crucial infrastructure facilities required are improved roads, railways and port facilities. In addition to the generic infrastructure that boosts the local economy in general, there is a need for enterprise specific infrastructure, viz. provision of common effluent treatment plants (CETPs), well-developed industrial estates / parks. Common testing / quality check facilities, etc. Even provision of potable water to SMEs was considered as important infrastructure that could add to productivity enhancement. [1]

4.3.2 Non-availability of adequate and timely credit

Due to proactive policies of Government of India and Reserve Bank of India, the credit flow to SME Sector has shown an increasing trend in the recent years. Nevertheless, financing continues to be most important challenge for the creation, survival and growth of Indian SMEs, especially the innovative ones. Shortage of working capital, fixed capital, equity, etc is widely recognized as the hurdle in the growth of SMEs.

The Figure 4.4 shows the various sources of finance. As it can be seen, 28% of Small enterprises took loans from financial institutions compared to 31.8% of medium enterprises. Small enterprises took more loans from friends and relatives and from money lenders who generally charge a higher interest rate of 20-30%. [1]

A related issue is the inadequate knowledge of various schemes of Government of India and SME. The survey shows that only 40.2% small enterprise and 33.3% of medium enterprises are aware about the Government financing schemes.
Figure 4.4: Sources of Finance for SMEs

<table>
<thead>
<tr>
<th>Source</th>
<th>Small enterprises</th>
<th>Medium enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self Finance</td>
<td>93.00%</td>
<td>93.20%</td>
</tr>
<tr>
<td>Loans from Financial Institutions</td>
<td>28%</td>
<td>31.80%</td>
</tr>
<tr>
<td>Loans from money lenders</td>
<td>2.60%</td>
<td>4.50%</td>
</tr>
<tr>
<td>Loans from friends / relatives</td>
<td>4.10%</td>
<td>4.50%</td>
</tr>
</tbody>
</table>


According to OECD report on 'The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses, 2009, SMEs are generally more vulnerable in times of crisis for many reasons which are:

- It is more difficult for them to downsize as they are already small
- They are individually less diversified in their economic activities
- They have a weaker financial structure
- They have a lower or no credit rating
- They are heavily dependent on credit
- They have fewer financing options

The report also mentions that the SMEs were confronted with a clear downturn in demand for goods and services and subject to two related stress factors: a) increased payment delays on receivables which added - together with an increase in inventories result in a shortage of working capital and a decrease in liquidity and b) an increase in reported defaults, insolvencies and bankruptcies.
4.3.2.1 Issues relating to delayed Payments

The SMEs generally experience a delayed settlement of dues owned by the large scale buyers, thus, adversely affecting the flow of funds and business operations of the SMEs concerned. Seasonal business face the major issue and suffer the most in debt collection. Many of the SMEs still find it difficult to do so, because of the fear of loss of business and procedural hassles.

To avoid recurrence of delayed payments, a need has been expressed by SMEs for providing an in-built mechanism, which could include:

(i) Establishment of a central / state level government agency which regularly monitors and mandates the debt payment time period of large scale industries to SMEs. The agency should benchmark and do ratings of the large sector companies on the basis of their debt payment period.

(ii) Disallowance of CENVAT credit on goods purchased from SMEs, if payment was not made within the stipulated period.

(iii) To make deduction of expenses ineligible to the extent of outstanding dues for calculation of income tax, if the purchaser did not make the payment up to the agreed time period.

4.3.3 Inability to upgrade technology and production facilities to achieve cost competitiveness

Technology is one of the most critical elements in the growth of the SME sector. India is ranked very high in terms of availability of Science and Engineering personnel; however, SMEs in India have not been able to fully utilize this vast infrastructure to achieve competitive edge in the global markets through access to modern technology. Owing to obsolete technology, the cost of manufacturing is much higher in India compared to the other developing countries in Asia. The SMEs
are facing stiff competition from imports and need technological upgradation to produce better quality products at cheap rates.

The utilization of Information and Communication Technology (ICT) in the SME sector is generally found to be limited. Given the financial limitation, IT budgets are usually small for SMEs. In addition, adopting ICT is not a one-time cost because there are ongoing costs of maintenance, upgrading and human capacity building.

Limited ICT literacy of SME owners hinders their ability to choose the appropriate technology and understand the concrete benefits it can bring to their business. Many SME owners are still sceptical of the concrete benefits to its core business and have the stereotype that ICT is only for larger companies. Even if they have the will and financial resources to integrate ICT into their core business, SME owners often find it difficult when needing to choose the most appropriate and cost efficient product.

Moreover, while technology solution providers can help SME customers unlock the potential of scattered and unrelated data through integration and analysis, SMEs are not well-versed with prevailing ICT legal system and feel hesitant to go in for internet based transactions.

4.3.4 Lack of adequate knowledge about government schemes and facilities

The Government has taken various steps and launched many schemes and programs for the benefits of SME sector. But many SMEs are still not aware about the various government schemes.

A survey done by ‘Rajiv Gandhi Institute of Contemporary Studies’ for the utilization of Government Schemes among the SMEs reveals that only 14 - 50% SMEs (Table 4.5) are participating in the schemes and availing the benefits.
Various problems, such as lengthy paperwork, timeliness and relevance in addressing business needs make it difficult for SMEs to avail benefit of the schemes. Among those surveyed, 83% SMEs find the application process lengthy, 80% SMEs have faced delays in receiving benefits and 40% SMEs feel the schemes are unable to address their business needs.

Table 4.5: Participation of Surveyed SMEs in Government Schemes

<table>
<thead>
<tr>
<th>Government Schemes</th>
<th>No of Enterprises Benefitting</th>
<th>Percentage of Total (Total = 200)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise Duty Exception</td>
<td>87</td>
<td>43.5</td>
</tr>
<tr>
<td>Income Tax Exception</td>
<td>31</td>
<td>15.5</td>
</tr>
<tr>
<td>Credit Facilitation Schemes</td>
<td>43</td>
<td>21.5</td>
</tr>
<tr>
<td>Infrastructure Support</td>
<td>26</td>
<td>13</td>
</tr>
<tr>
<td>Export Incentives</td>
<td>60</td>
<td>30</td>
</tr>
<tr>
<td>Import Incentives</td>
<td>93</td>
<td>46.5</td>
</tr>
<tr>
<td>Foreign Market Access Support</td>
<td>63</td>
<td>31.5</td>
</tr>
<tr>
<td>SEZs/EPZ etc</td>
<td>59</td>
<td>29.5</td>
</tr>
<tr>
<td>Access to ITC</td>
<td>63</td>
<td>31.5</td>
</tr>
<tr>
<td>Quality Upgradation</td>
<td>43</td>
<td>21.5</td>
</tr>
</tbody>
</table>


4.3.5 Non-availability of skilled personnel

In today's economic scenario, the growth and development of any organization, be it an MNC or a SME is directly proportional to the employee's growth. Therefore, a severe talent crunch can impact any organization's bottom line and growth. SMEs are struggling to fill talent gap, find skilled workers especially at middle level positions. They need to identify as who is their real candidate with the right skills, how their business model can get the quality cost scale balance right, and most importantly how they can retain their key talent.

SMEs seem to be less inclined towards adopting modern methods of hiring, which is why candidates often complain to have less information about the available job opportunities across the board. The fact that there is no transparent mechanism for
employer and the candidate to engage leads to pitfalls for middle and senior level recruitment. Innovation is critical for the growth of SMEs and for grabbing the attention of potential candidates. Candidates should feel the urge to join the organization because of its capability to innovate and stand out from the crowd.

Apart from these, the major hurdles for SMEs in this regards is disadvantage in their ability to offer competitive packages.

4.3.6 Constraints in adopting energy efficiency in production process

‘Rajiv Gandhi Institute of Contemporary Studies’ survey founded that energy efficiency in the production process is very important for all (surveyed) SME firms. 100% of the SME firms who were surveyed during the study confirmed that profitability increases by adopting energy efficient technology. However, only 37% of the sample firms have adopted energy efficient technology. Others have not been able to adopt similar technology not because they feel such investments are unprofitable, but because of several other factors which are discussed below.

The interviews during the survey also revealed that there is a strong perception, among the SME firms, that the initial investments required for adopting energy efficient technology are substantially large (Figure 4.5). This perception acts as a major deterrent for these firms, whose capital base is not often adequately strong, to undertake such investments. 40% of the non-adopting firms in the sample further reported that though they are aware of the long term profitability gain in adopting energy efficient technology, they face considerable impediments in arranging for investible funds required to meet the high initial investment. [3]
Hence, although energy efficiency is perceived as a profitable proposition by the SME firms, high initial investments, constraints in arranging funds and lack of knowledge about the optimal technology can act as important barriers for the firms from undertaking such projects.

4.3.7 Lack of proper means and support for brand building

Unorganized sector enterprises generally suffer from weak marketing. Most SMEs do not have money to invest in market research, advertisement, and packaging are unable to carry out design and technical improvements to keep up with market demands. This limits their ability to tap markets and attract consumers.

According to survey, five major challenges restricting access to domestic markets are cost of production, market information, import surges, regulatory and availability of professional management skills. 71% of enterprises have found that their sales
suffered due to imports with sales declining by 26-50 percent for 63% of surveyed units and by less than 25 percent for 21% of the surveyed units. [4]

4.3.8 Inadequacy of requisite R&D support

According to the survey ‘Rajiv Gandhi Institute of Contemporary Studies’ 87.7% of small enterprises are doing some R&D expenditure compared to 88.6% of medium enterprises. The larger the size of the enterprise, the more is its R&D expenditure, with average R&D expenditure of Rs. 21.38 lakh among medium enterprises as compared to Rs. 15.15 lakh among small enterprise (Table 4.6). Due to limited availability of finance and skilled R&D activities for the product improvement, this further restricts the growth and expansion of these enterprises. [1]

<table>
<thead>
<tr>
<th>Size of Enterprises</th>
<th>Total Enterprises</th>
<th>No of Enterprises doing R&amp;D Expenditure</th>
<th>Avg. R&amp;D Expenditure (Rs. Lakh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>114</td>
<td>100 (87.7%)</td>
<td>15.15</td>
</tr>
<tr>
<td>Medium</td>
<td>44</td>
<td>39 (88.6%)</td>
<td>21.38</td>
</tr>
</tbody>
</table>


4.3.9 Other Issues

4.3.9.1 Procurement Issues

Demand of products of SME sector is a major concern, especially during economic crisis period. Generally, SMEs find it difficult to participate in public procurement mainly due to unavailability of financial guarantees, lack of knowledge about tender procedures, new opportunities and large size of contracts. Formulation of a Procurement Policy, which sets an annual procurement target from the SME sector for the central ministries / departments / PSUs, could address this concern and be a great support to this sector.
Across the globe, Government Procurement Policies (Table 4.7) have been able to provide a big boost to the SME sector. In India also, the size of public procurement is huge and can provide a high potential for growth to the SME sector, which covers a wide range of supplies, services and works required by governments, local authorities and public organizations.

**Table 4.7: Best Procurement Policy Practices for assisting SMEs in selected countries**

<table>
<thead>
<tr>
<th>Sr No</th>
<th>Particular</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>USA - Statutory annual goal for small business procurement by federal agencies is 23% of prime contracts</td>
</tr>
<tr>
<td>2</td>
<td>In Malaysia, 30% of the procurement activity is reserved for SMEs who have been involved in the vendor development program</td>
</tr>
<tr>
<td>3</td>
<td>In Brazil, a new law in force since January 2007 establishes criteria that are meant to increase participation of smaller business in public procurement.</td>
</tr>
<tr>
<td>4</td>
<td>A set percentage of contracts in particular industries must go to SMEs are prevalent in Australia, Thailand and China.</td>
</tr>
<tr>
<td>5</td>
<td>UK - Special Contract Arrangements require contracting authorities to give special consideration to buying goods and services from suppliers which employ severely disabled people.</td>
</tr>
<tr>
<td>6</td>
<td>Malaysia - Tenders from bumiputera companies receive preferential treatment in government contracts</td>
</tr>
<tr>
<td>7</td>
<td>South Africa - Preferential Procurement to Promote the advancement of people historically disadvantaged by unfair discrimination on the basis of race, gender or disability.</td>
</tr>
</tbody>
</table>


### 4.3.9.2 Access to Global Markets

Many segments of SME, especially the traditional sectors, find it difficult to compete against aggressive marketing by the big domestic and multinational players. Street vendors, petty traders, handloom and power loom weavers, home-based food processing units, khadi institutions, attar perfumers, zari workers, and rural artisans are the worst affected. There is a need to evolve a constructive response to this situation. As these sectors employ the most marginalized, the indigenous /
traditional industries should be given opportunities to tap both the domestic and international markets.

Among those surveyed by ‘Rajiv Gandhi Institute of Contemporary Studies’, only 24.5% of small enterprises and 50% of medium enterprises are engaged into exports and have accessed global markets (Table 4.8). The prominent countries of export are United States of America, United Kingdom, China and Germany. Due to limited market information and lack of adequate resources and capital, SMEs find it most difficult to tap global markets. [1]

Table 4.8: Access to Global Markets among Surveyed SMEs

<table>
<thead>
<tr>
<th>Size of Enterprise</th>
<th>Total Enterprises</th>
<th>100% Export Oriented Units</th>
<th>No of Enterprises into Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>114</td>
<td>10%</td>
<td>28%</td>
</tr>
<tr>
<td>Medium</td>
<td>44</td>
<td>3%</td>
<td>22%</td>
</tr>
</tbody>
</table>


According to the survey, the major challenges faced by SMEs in accessing global markets, in decreasing order of priority are:

- Market information
- Price competitiveness
- Cost of transport
- Availability of professional management skills
- Non-tariff barriers
- Domestic regulations

Among medium enterprises, cost of production is a major concern as they are able to gather market information easily, as compared to small enterprises, which are not well educated about global markets and sometimes also lack the resources to gather market information.
4.4 The Future of Indian SMEs

According to the MSME Annual Report 2010-11, the sector will see healthy growth with a large number of enterprises being set up, and their gradual up scaling into small and medium enterprises. This would be accompanied by enhancement of their contribution to the GDP, manufacturing output, employment and exports.

Established players must be allowed to operate in an environment, which helps them achieve higher levels of investments and market shares. The objectives of Ministry of Micro, Small and Medium Enterprises include (a) supporting and developing existing MSMEs; (b) creating new enterprises; and (c) providing support to khadi, village and coir industries. These objectives can be met by creating an ecosystem which supports entrepreneurship and skills development in MSMEs.

4.5 Selected Industry Snapshot for Indian SMEs

4.5.1 The Pharmaceutical Industry

4.5.1.1 Industry Overview

The Indian pharmaceutical industry had a turnover of Rs. 10 crore, that is, about USD 2 million in 1948. Currently it is the world's third-largest by volume with a contribution of about 8-10%. However, in terms of value it contributes only 1.5% of the global pharmaceutical turnover, and is placed at the 13th position. The reason for lower share in terms of value is the lower cost of drugs in India, which is 50% less as compared to most other countries. [5]

The number of pharmaceutical product manufactures is quite large. However, most of the 20,000 plus registered units belong to the SME category. The industry operates
in an inverted pyramid structure. The top 250 large players control 70% of the market, and the rest of the industry competes for the remaining 30% of the pie. [5]

Being a low-cost manufacturing of drugs, India has become a global hub for the production of generic drugs. It had an annual production worth more than Rs. 1,00,000 crore including exports worth Rs. 42,000 crore during the fiscal year 2009-10. Also, Indian pharmaceutical companies have created a niche for themselves in the area of Contract Research and Manufacturing Services (CRAMS). [5]

![Figure 4.6: Growth of the Indian Pharmaceutical Market (FY08 – FY16) (USD Billion)](image)

Source: IndiaMart Knowledge Services. www.indiamart.com. (Note: growth for year 2012, 14 and 16 are (E) Expected)

4.5.1.2 Domestic Market

The consultancy firm, IMS Health, states that the domestic pharmaceutical sector grew by 16.5% to reach Rs. 46,787 crore in 2010. During FY 2005-10, the Indian pharmaceutical market grew at 19.5% compound annual growth rate vis-a-vis 7.6% growth registered by the global pharmaceutical industry. It is expected to grow by 15-17% during 2012. [5]
The domestic formulation segment contributes about half of India’s pharmaceutical market. During FY 2006-10, the segment has grown by 14.2% CAGR to reach USD 0.4 billion, says Pharma Conference 2011, a report by SBICAP Securities. Over the next three years, the domestic formulation market is expected to remain buoyant with a healthy growth momentum of 14T. [5]

McKinesy & Company has projected that India’s domestic pharmaceuticals market would reach USD 55 billion in 2020 from USD 12.6 billion in 2009. The McKinesy report titled India Pharma 2020: Propelling Access and Acceptance, Realising True Potential says that the domestic pharmaceutical market can go up to USD 70 billion by 2020, if the growth scenario remains aggressive. [5]

Figure 4.7: Year-wise Pharmaceutical Export Revenues (2005-10) (In Rs. Cr.)

4.5.1.3 Growth of Exports

There are clear signs that pharmaceutical exports are coming out of the recessionary phase. The industry expects to register about 20% growth in exports in 2010-11, compared to a meagre growth of 4.13% in 2009-10. The Pharmaceutical Export
Promotion Council has projected that export revenue would reach approximately Rs. 50,000 crore in 2011-12, growing about 20% over Rs. 42,092 crore in 2009-10. [5]

The USA, UK and Germany are the top three destinations for Indian pharmaceuticals exporters. The USA contributed 22% of India’s total exports of drugs, pharmaceuticals and fine chemicals (in 2009-10) whereas the UK and Germany contributed only 3.89% and 3.56%, respectively. [5]

4.5.1.4 Paving the Way for SMEs

According to IndiaMART Knowledge Services, easily accessible financial assistance, efficient technology, and good marketing strategies are needed to ensure the growth of SMEs in the pharmaceutical sector. The government has taken some steps to bring the SMEs in the sector on par with other industries. The Department of Pharmaceuticals along with the United Nations Industrial Development Organisation (UNIDO) has implemented a project to assist the sectoral SMEs in incorporating cleaner manufacturing practices in their production units. This has
enabled small players to become more productive and competitive in the global arena. The project is likely to give technical support to domestic SMEs so that these firms can efficiently deal with waste minimisation, safety and other environmental hazards while manufacturing drugs.

To encourage small players to join the field, tire-II and tire-III cities must be developed as pharma clusters. India needs to take a cue from countries like Denmark, Norway and Sweden where the SMEs are major participants in the economy. Also, the government should come up with subsidies, tax cuts and easily accessible loan procedures.

The IndiaMART Knowledge Services Survey (2010) has revealed that three-fourths of the SME units from the pharmaceutical and medical devices sector has witnessed improved market conditions since 2009. While 41.4% of the SME units participating in the survey reported more than 20% sales growth in 2010, roughly half of the respondents saw their annual sales growing between 0-20 percent. For the year 2011, the industry seems to be more optimistic, as 66.7% of the survey participants expect more than a 20% increase in their sales. About 28.9% SME respondents feel that their sales growth will be limited between 0-20 percent in 2012. Only 4.44% however feel otherwise and state that they may see a decrease in their sales in 2012. [5]

4.5.1.5 Luring Multinationals

The India advantage has attracted a number of MNC pharmaceutical companies to the country. In an attempt to gain a foothold, they have followed the routes both of acquisitions and tie-ups. Ranbaxy, Dabur Pharma, Shanta Biotech, Piramal Healthcare, Matrix Lab and Orchid Chemicals are some of the prominent names which got acquired in recent years. On the other hand, the global pharmaceutical giant GlaxoSmithKline (GSK) has tied up with Dr. Reddy’s Laboratories. Another global giant, Pfizer, has tied up with Aurobindo Pharma, Strides Arcolab and Claris
Life Sciences. Abbott has teamed up with Cadila Healthcare, with AstraZeneca formed an alliance with India-based Torrent Pharmaceuticals in March 2010. [5]

MNCs have started giving special attention to emerging markets, including India, due to several reasons. A SBICAP Securities report says that global pharmaceutical companies are facing challenges in the existing markets: (a) lower visibility for new drug launches; (b) declining research and development (R&D) productivity; (c) stringent US Food and Drug Administration (US FDA) norms for drug approvals, and (d) increasing healthcare costs. Due to these challenges, MNCs are going through a strategic shift in their traditional business model to focus on increased presence in generic categories, branded generics and over the counter (OTC) drugs. SBICAP Securities says that MNC majors are trying to strengthen their growth platforms through partnerships and acquisitions in emerging markets, which are growing at about 14.7% annually. [5]

MNC’s quest for acquisitions and partnerships in India can be viewed in the context of the above mentioned situation. Indian companies offer MNCs the advantage of low-cost production, and fit perfectly in their strategy of increasing presence in the generic drugs space. Besides, the Indian market is growing rapidly. Increasing population of the higher income group is expected to create a USD 8 billion market for MNCs selling costly drugs by 2015. Also, the domestic pharmaceutical market is estimated to touch USD20 billion by 2015, making India a lucrative destination for clinical trials for global giants, says a report by Ernst & Young. [5]

4.5.1.6 Generic Giants

According to the Yes Bank report, Indian Pharmaceutical Industry: Vision 2015, the global generic market is estimated to reach USD 140-150 billion while Indian formulations exports will reach USD 12-13 billion by 2015. Indian pharmaceutical companies have made strong inroads in the developed markets through the route of generic drugs. Recently, the acceptability of generic drugs has increased and even
the governments in many countries have started promoting these drugs due to the advantage of low costs. The new Healthcare Bill in the US has provided a big impetus to generic drug manufacturers. Indian generic drug manufacturers stand to gain when patented drugs go off-patent. It is estimated that patented drugs worth more than USD 200 billion are going to become off-patent during 2010-15. [5]

The SBICAP Securities report says that Indian pharmaceutical companies will continue to introduce plain vanilla generic with several limited period exclusivities. The report also notes that the share of Abbreviated New Drug Application (ANDA) filings from India companies in the US has risen from 7% in FY 2005 to 25% in FY 2010. Increased ANDA filings are mostly in the areas of complex to manufacture products, which have the potential to offer good margins. Indian companies are also benefiting from several First-to-File (FTF) challenges, as the cumulative opportunities stand at about USD 27 billion. [6]

4.5.1.7 Performance of Major Players

The healthcare index of Bombay Stock Exchange (BSE) has performed much better, with 34.19% return in 2010 compared to the 17.43% rise in the Sensex during the same period. Among the major pharmaceutical companies, Cadila Healthcare has shown the best performance with an 80.08% increase in 2010 over 2009. The other outperforming stocks include Orchid Chemicals, IPCA Lab, Sun Pharma, Lupin, and Biocon, all of which gained more than 50% during 2010. Only Jubilant Life and Divis Lab have given negative returns, while some of the large-cap stocks like Cipla and Ranbaxy couldn’t charm the investors much with their performance. [5]

4.5.1.8 The Future

Several estimates by reputed organizations suggest that the Indian pharmaceutical sector can grow by 15-17% CAGR in the coming years. It should touch the mark of
Presently, the Indian SME pharma companies are lagging in research facilities due to a shortage of funds. Setting up modern research labs equipped with state-of-the-art technology is a costly affair, which only big players can afford. To overcome the limitations resulting from the shortage of funds, SMEs can adopt CRAMS. This time-tested services market offers a lucrative outsourced business space for Indian SMEs. They can leverage their current cost arbitrage in collaboration with the large local and global pharmaceutical companies.

Domestic SMEs can also conduct clinical trials of the newly formulated drugs. Considering the sizeable costs associated with these operations, SMEs can offer to conduct the contracted job at lower costs with financial aid from sponsors. Another area where SMEs can join hands with the major players is in the process of developing new drugs. The formulation of new drugs consists of different stages such as subject, synthesis, classification, screening, and assessments of the therapeutic efficiency. To complete each stage, huge funds are needed. Big pharmaceutical companies can cut costs at each of these stages by making use of Indian SMEs through CRAMS.

Thus, the future of pharma SMEs is quite good, if they choose the right business model for growth. However, it is worth noting that SMEs will now face much more and newer challenges as a result of globalisation of the Indian economy and markets. They will also have to deal with regulatory and social needs for improved quality of medicines and conformance to more stringent environment and safety standards.
4.5.2 The Plastic Industry

4.5.2.1 Industry Overview

This industry has been growing at the rate of 12-15% per year. The domestic demand for plastics is estimated at about 7 million metric tonnes with a compound annual growth rate (CAGR) of 13%, according to Frost & Sullivan. The high growth potential is attracting significant investments. It is estimated that fresh investments of about USD 80 billion will be made in this sector during the next two to three years. [5]

Table 4.9: Growth Trends (2009 vs. 2010) (Figures in kilo tonnes)

<table>
<thead>
<tr>
<th>Parameter</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capacity</td>
<td>6,753.00</td>
<td>8,193.00</td>
</tr>
<tr>
<td>Production</td>
<td>3,384.00</td>
<td>7,061.00</td>
</tr>
<tr>
<td>Imports</td>
<td>1,748.00</td>
<td>1,323.00</td>
</tr>
<tr>
<td>Exports</td>
<td>593.00</td>
<td>953.00</td>
</tr>
<tr>
<td>Demand</td>
<td>6,739.00</td>
<td>7,432.00</td>
</tr>
</tbody>
</table>

Source: Dominic Britto, Principal Consultant, South Asia and Middle East. *Materials, Frost & Sullivan.*

4.5.2.2 Consumptions

Asia (excluding Japan) has emerged as the world’s largest plastic consumer with about 30% share of the global consumption. Japan has a share of about 6.5%, North America consumes approximately 26% of global production, while Western Europe has a 23% share in the global markets. [5]

The consumption of plastics in India is expected to grow faster than the world average, as the per capita consumption in India is only about 8 kgs compared to 109 kgs in the US, 32 kgs in Brazil, and 25 kgs in China. [5]

On the basis of the processes used in production, plastic products can be classified into four categories - extrusion plastics, injection moulding plastics, blow moulding
plastics, and roto moulding plastics. Extrusion plastics, which contribute about 60% of the total consumption in India, comprise products like films and sheets, conduits and profiles, fibre and filament pipes. [5]

The second major category is of injection moulding that contributes about 25% consumption. Household and industrial injection moulding products, thermo-ware and moulded luggage fall in this category. Bottles, house-ware, containers, toys, etc., are examples of blow moulding plastic, which contributes 6% of the total consumption. Large circular tanks like the one used for water storage are examples of roto moulding, with 1% share of the total consumption. Other products contribute about 8%. [5]

![Figure 4.9: Plastic: Consumption by Product/Application (2010)](image)

Source: Indo-Italian Chambers of Commerce and Industry.

### 4.5.2.3 Packaging

In terms of usage, packaging is the largest segment of the industry, accounting for more than 35% of global consumption. Among plastic materials, polyolefin accounts for about 53%, out of which polyethylene has 33.5% and polypropylene contributes 19.5% consumption. The other segments are polyvinyl chloride with 16.5%,
polystyrene with 8.5%, polyethylene terephthalate and polyurethane with 5.5% styrene copolymers with 3.5% and other engineering and high performance and speciality plastics, blends, alloys, thermosetting plastics with 13% share. [5]

The All India Plastics Manufacturer's Association (AIPMA) estimates that India's per capita consumption of plastics would jump to 20-25 kgs by the next five years. AIPMA has projected that the production of plastics in India would grow by 60% to touch 12.75 million tonnes by 2012 due to rising consumption. By 2012, India is expected to become the third-largest consumer of plastics. Further, it is expected that India would require USD 10 billion of the projected investment by 2020 for installing 42,000 new machines. [5]

4.5.2.4 Industry Structure

India has more than 30,000 plastic processing units. The plastic industry is dominated by SMEs and employs more than 36 lakhs people directly. While SMEs comprise more than 85% of the industry, small-scale industries (SSIs) constitute more than 75% of the total units. [5]

More than 60% of the plastic units which participated in the IndiaMART survey conducted in 2010 testified that their market picked up pace in 2010 compared to 2009. The consumer sentiment, which had suffered a beating due to the global recession, improved for 61.54% units at an average pace, while 17.95% reported a rise beyond expectations. However, 20.51% of the total respondents said that the consumer sentiment was negative. [5]

For the current calendar year, however, more than half of the SME units hoped to achieve sales growth higher than 20%, while 37.18% expected it to be in the range of 0-20%. Only 11.54% were apprehensive of a decrease in sales during 2011. [5]
Similar to many other industries, input costs rose much faster than product prices during 2009. While only 15.38% respondents suggested that the prices of their products improved by more than 20% in 2010, 48.72% said that input costs grew by more than 20%. This indicates that a large number of plastic products manufacturers could not fully pass on the burden of increased input costs to their customers. Liquidity is also a major concern for plastic manufacturers as 74.36% of the units participating in the IndiaMART survey felt that lending norms should be eased further. [5]

Figure 4.10: The Plastics Industry is Large and Fragmented

Source: IndiaMART Knowledge Services

4.5.2.5 Export Performance

India’s plastic exports registered a growth of 9.9% in 2009-10 to reach USD 3.86 billion, according to the Directorate General of Commercial Intelligence and Statistics at the Ministry of Commerce and Industry. All India Plastics Manufacturer’s Association (AIPMA), on the other hand expects the exports of
finished goods to reach USD 5.3 billion in 2010-11, with an annual growth rate of 15%. [6]

China has now become the top destination for India’s export of plastic products, displacing the US to the second position. According to the Plastics Export Promotion Council (PLEXCONCIL), exports to China jumped by 75.57% to reach USD 446.66 million, while exports to the US shrank by 6.27% to USD 387.46 million. UAE, UK, Italy, Germany, Saudi Arabia, Turkey, Nigeria and Indonesia are the other countries among the top 10 destinations of India’s plastics exports. [6]

The IndiaMART survey revealed that 28.21% of the SME units registered more than 20% growth in sales during 2010, while exactly half of them had annual sales growth between 0-20 percent. Export growth was in the range of 0-20 percentage for 53.85% units, while only 7.69% could deliver a better performance. More than a third of the exporters registered negative growth. [6]

4.5.2.6 Technology Upgradation

The plastics industry is linked to the petrochemicals industry, which provides most of its raw material. Rising oil prices adversely impact both industries. The United Nations Industrial Development Organisation (UNIDO) has started a programme for technology upgradation of the Indian plastic product manufacturers, particularly the plastic processing and manufacturing units. The UNIDO programme aims to pick 100 companies with an objective of helping less productive MSMEs upgrade their technical and quality management systems, and improve their global market share. It is a two-year programme during which experts from UNIDO would identify gaps in areas like technology, marketing, skills, quality and exports at selected companies. The programme would also increase awareness about eco-friendly, biodegradable plastics as an effective waste management strategy in India. [5]
4.5.2.7 The Future

Significant progress and healthy economic growth have been registered by the Indian plastics industry. India is already in the reckoning as one of the top five global economic powers on purchasing power parity basis and is slated to be among the top three by the end of this decade. Given the way in which demand for plastics is rapidly increasing, India will soon become one of the fastest-growing markets in the world. The next two decades are expected to offer unprecedented opportunities for the plastics industry in India. This would mandate industry initiatives to increase investments, grow the market, improve quality standards, enhance global participation, and encourage Indian industry to adopt and adapt world-class technology and manufacturing practices.

4.6 Insights into Finance and Taxation Hurdles for SMEs in India

Small and Medium Enterprises require entrepreneurs to conceive new ideas and take the risk to start a venture. In India, we have technocrats who come up with ideas to start commercial ventures. There are another set of entrepreneurs who take up projects aligned with their family background or allied activities. Sometimes, they venture into new areas. Then there are those who are keen on starting SMEs because they have not got jobs or want to become employer rather than employees. SMEs require the right business plan, appropriate technology, capital to start the venture, infrastructure of various kinds, market for the product and a congenial commercial environment to flourish.

4.6.1 External Players Supporting SMEs

There are multiple external players who support SMEs. The state governments and their various undertakings provide infrastructure to SMEs at an affordable cost. They provide developed industrial estates, plots, sheds, power supply and an ideal
commercial environment for new ventures to thrive. States nurture enterprises through industrial polices, offering concessions in duties and takes. There are bodies of industries that also provide common facilities for SMEs so that the scale of operations suite players of any size. Since the 1950s, SME clusters have flourished in India with the support of the state governments.

4.6.2 Viability of an Enterprise

Viability of an enterprise depends upon multiple factors uninterrupted availability of raw materials, proper infrastructure, inexpensive skilled labour, ready market, adequate generation of surplus from each cycle of production to sustain the cost of capital invested in the project and, profit margin to keep one committed to the enterprise. A financial institution examines a project along with an entrepreneur to assess these aspects thoroughly, before committing any assistance.

4.6.3 Sensitivity Analysis

A sensitivity analysis of various aspects of the project economics is done to ensure that under normal variations, the project will continue to be a viable venture. Generation of surplus from each cycle is very important, without which, the enterprise will bleed. This could happen without the knowledge of the promoter and maybe reflected in a huge loss at the end of the year. To ensure generation of surplus, costing of the product with various components is important. Often entrepreneurs quote aggressive pricing to capture the market. They do not have adequate capital to sustain losses from such aggressive pricing and the venture may soon become sick. Similarly, they may assume a certain credit period while making suppliers and price the product accordingly. But, often payments are delayed, eroding the profit margin in the product. This is more so in respect of enterprises, which are inadequately capitalised and depend more on debt capital.
4.6.4 Finance Plays a Key Role in Viability

The capital structure of an enterprise is vital. If a unit is undercapitalized and depends more on debt capital, it will suffer a lot from interest rate risk as well as working capital strain. A unit largely dependent upon debt capital will also face the strain of an uncertain interest burden. If the interest rate moves up from 12% to 14% on a loan, the same translates to 16% increase in interest costs. If the unit is lowly capitalised, such large interest burden will be a strain on its viability. Similarly, if the working capital cycle of a unit increases from 60 days to 90 days, working capital requirement will go up by 50%, adding to higher borrowings and in turn, higher interest costs. The profit margin may be inadequate to sustain the additional interest burden, thereby challenging the viability of the unit. The reason for high sickness among SMEs is such vulnerabilities due to low capitalisation.

4.6.5 Debt and Equity Capital

Entrepreneurs need adequate debt equity to start their venture. Depending upon the size of the project, technical competence of the venture, gestation period, and repayment period etc., an entrepreneur is expected to bring at least 25% of the project cost as equity. Technocrats with great ideas but inadequate finance should partner with other entrepreneurs with better financial standing to augment their equity. In such cases, the value of the technological input contributed by the technocrat too should be given adequate weightage and compensated for. This can be done in the form of goodwill or higher salary compensation for such partners. Equity schemes are offered by some banks and organisations to strengthen the enterprises.

4.6.6 Promoters' Stake

Promoters' financial stake is essential for any venture. This may at times include contributions from close friends, relatives and partners, with or without their joining
the venture as stakeholders. Contributions for the promoters' stake in the form of equity or other loans from friends and relatives are comparatively low cost capital and they need not be serviced on strict terms. This ensures moral commitment of the promoters. 'Angle funding is a more formal arrangement for such equity, which comes with documented terms and conditions. The promoters' are bound more by legal covenants rather than by moral commitment. In India, there is no large-scale angle funding in the organised sector. However, the scope exists for such organised angle funding, whereby, high net-worth individuals (HNIs) may be encouraged to make investments in successful or potential ventures through common organisers who may bring the two parties together.

4.6.7 Risk vs. Return

This is a crucial factor for the success of any SME venture. Whether it is the capital investment made by the promoter or any angle funding made by neutral players or commercial lending by banks, the basis of the investment decision would be the return from such venture as compared to the risks involved. When a technocrat invests in a SME, he weights the long-term gains. If the enterprise flourishes, he will get good return on the capital invested. Also, he would be the beneficiary of other intangible gains as an employer, and a successful entrepreneur. An angel investor would, on the other hand, expect substantial return, which is much higher than investment in bank deposits. At the same time, he would keep the risks low by monitoring the functioning of the enterprise periodically and contributing in its management, as provided for in the terms of the funding agreement. As compared to these, commercial banks do not expect very large return from the investments. They expect 3% to 4% interest spread over the cost of funds with their operational costs taken care of. Further, banks play a neutral role in handling the day-to-day management of the venture. Except in rare cases of assistance under rehabilitation packages or unduly high concessions, banks do not insist on any managerial roles in SME projects. Thus, bank finance is an extremely comfortable and affordable option for entrepreneurs. The interest spreads changed by the banks are risk evaluated
rates. SMEs rated as higher risks bear higher interest burden as compared to those rated as low risks. Further, banks are presently expected to maintain adequate capital as per Basel guidelines and also offer prudential provisioning, even for standard assets. These costs are in turn loaded on the interest rate for the SME borrowers. [7]

4.6.8 Types of Loans and Loan Products

Banks offer various types of products and services to meet the credit needs of SMEs, based on the nature of the requirement and duration of credit. Some of the common generic products available in India as well as abroad are listed below:

4.6.8.1 Term Loan

Banks and State Financial Corporations offer term loans to SMEs mainly for their fixed assets like plant, machinery, inventory that will be used over a long period of time. Normally, the term loan is given with repayment terms ranging between 3-7 years. The repayment can be in monthly or quarterly instalments, depending upon the cash flow of the unit. Based on the time taken for initial cash generation, a start-up period is given before the commencement of the first instalment. Viability of the project is tested with varying sensitivity to input costs, sales prices, production levels and interest scenario. Normally, the instalments are fixed adequate cushion to cash generation so that not more than 50% of the cash generation is used for repayment of term loans.

4.6.8.2 Working Capital

In India, the cash credit or the overdraft are the most common ways of financing working capital needs of SMEs. The working capital cycle of the SME is evaluated; based on the inventory, the time taken for the process, build up of finished goods, terms of payment or realisation period of sundry debtors etc., to arrive at the total
working capital requirement of the SME. Once this is arrived at, eligible bank finance is worked out based on the margins specified for various components of the current assets. Normally, receivables or book debts are assigned higher margins as well as work in progress. Raw material stock and finished goods are assigned lower margins. Banks are also guided by the recommendations of the Naik committee for calculating the working capital eligible for SMEs. Based on a simple thumb rule, the Naik committee has recommended that for manufacturing SMEs, the minimum working capital to be fixed by the banks should be 20% of the projected turnover in a financial year. Based on bulk purchases and availability of organised players in the supply chain, at times a part of the working capital is also offered in the form of usance letters of credit (LCs). The suppliers give adequate time to the SMEs to pay for the supplied goods or provide bill limits, when the buyers of the goods are of repute. Such factors help the SMEs in lowering their cost of working capital, since the LCs or bill discounting are done at more competitive pricing. Working capital limits are normally sanctioned for a period of 12 months. There may be exceptions, where at times the period may be shorter or longer, depending upon specific projects that are being executed as part of the working capital cycle.

4.6.8.3 Packing Credit

SMEs engaged in export avail this form of credit. Based on specific confirmed orders or past trends and capacity to manufacture and export, SMEs are sanctioned packing credits. Though the assessment of the credit requirement is the same as for working capital requirements, the interest rates are more competitive and tenor of such packing credits is for shorter durations.

4.6.8.4 Bill Discounting

Often SMEs supply to reputed buyers and even based on LCs drawn in their favour. In such cases, they may avail bill discounting facility, either as part of their working capital funding or at times, even outside the limits, based on the tenor and standing
of the LC. The discount charges too can be much cheaper based on the credit rating of the buyer.

4.6.8.5 Channel Finance

SMEs which are part of supply chains – either as vendors or dealers of large corporate, are also offered channel finance. This is done at terms that are negotiated by the channel partner for the benefit of all players. Such credits are normally offered attractive rates of interests, minimal collateral security and least documentation formalities. Credits are also available on an electronic platform, with integrated solutions giving a single view of bank loans, position of sundry debtors and stock positions. Online options are gaining popularity in India with many banks offering channel finance in a seamless electronic platform.

4.6.8.6 Factoring

This is one type of credit, which is widely prevalent in the developed countries of the West and is almost rare in India. There are a few factoring companies and subsidies of banks that cater to the factoring needs but the volume of business generated by them is extremely negligible to make any impact among the SMEs. The State Bank of India and Canara Bank has factoring subsidies, and there is a third prominent player Global Trade Finance, promoted by Exim Bank, which has since been taken over by SBI. There are other players too like HSBC, but the volumes have remained very small. Factoring is a product of convenience for SMEs in bigger value chains. When SMEs supply to larger companies or export their goods, the bill can be passed on to factors for discount. These can be with or without resource. The factors provide numerous services apart from mere provision of finance such as maintenance of books, giving credit reports on both sellers and buyers, market information on overseas markets etc. The culture among Indian companies to make delayed payments and non-adherence to time schedule as per the original contract, are the main reasons for the shallow factoring market in India.
4.6.8.7 Credit Cards and Revolving Credit Lines

In western countries, this is again a very common way of accessing credit for SMEs, particularly the micro enterprises. They are issued with business credit cards with limits and interest rates decided by the credit risk scoring of the issuing bank. These credit lines are available for short duration like 6 months or 12 months and are to be used by the SME for specific business purposes. End use of funds is normally monitored from the place where these cards are used. Better turnover and prompt payments ensure improvement in the credit scores of the SMEs. In India, the availability of various industrial and business inputs through point of scale machines supporting cards is yet to become popular. Often personal credit cards are sued by entrepreneurs for business purposes. However, this leads to much higher interest payments, since revolving credit for personal credit cards are charged much higher interest rates.

4.6.8.8 Collateral Security Issues

Many financial institutions seek collateral security from promoters in addition to their equity stake. Often, promoters are unable to provide for the same and hence, are deprived of timely bank credit. To facilitate easy flow of credit, SIDBI with the support of Government of India, has set up the Credit Guarantee Trust for Micro % Small Enterprise (CGTMSE). As per the guarantee cover provided by the Trust, bank loans up to Rs. 1 crore to Micro & Small Enterprises are protected in case of default provided such loans are granted without third party collateral security. Thus, promoters who did not have third party collateral security can avail bank loans and seek the guarantee cover of the CGTMSE for their loans. There is a one-time fee payable to the Trust at the time of sanction as well as annual service fee. These fees are either absorbed by the banks or are passed on to borrowers. Such guarantee cover provided by CGTMSE has encouraged banks to extend liberal credit assistance to SMEs, based only on their viability and without seeking collateral security.
To bring to a close, Chapter 4 has discussed all about Indian SMEs sector. It has covered historical fact leading to evolution of the sector, evolution of Indian SMEs, growth trends of the sector, Indian SMEs issues and challenges, industry snapshot for Pharmaceutical and Plastic industries and insights into finance and taxation hurdles for SMEs in India. One of the core components of work is role of investment banks. The disclosure or presentation of investment bank is quite appropriate. The range of services provided by these banks is very wide. The subsequent chapter deals with all about Investment Banks.
4.7 Bibliography


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