Chapter – I

INTRODUCTION

Development is the most compelling challenge facing the world economies as it encompasses major changes in social structures, popular attitudes and national institutions as well as acceleration of economic growth, the reduction of inequalities and eradication of absolute poverty (Todaro, 1987). Economic development gives rise to some structural changes which constitute industrialisation, self-reliance and import substitution along with the change in occupational distribution (Mishan, 1977). Economic development is positively correlated with the number of working population engaged in secondary and tertiary sector and low per capita income is associated with high proportion of population engaged in agricultural sector. The development, therefore, entails the movement of resources from a low productivity sector-agriculture to a high productivity sector-industry (Clark, 1957). Even when the agricultural sector undergoes changes, it is primarily the industrial sector which encompasses these changes on large scale and hence industrialisation generally becomes synonymous with economic development. Industrialisation has, therefore, become one of the greater world crusades of our time. “It (industrialisation) is an effort in which the underdeveloped countries place a major hope of finding a solution to their problems of poverty, insecurity and overpopulation and ending their newly realised backwardness in modern economy” (Bryce, 1960). It is through industrialisation that social and economic development in a country is achieved as “Industrialisation is a process of growth and as such is originally linked both to the social and economic past and to parallel process of social and economic development (UN, 1955). In fact industrialisation effects economic development both as cause and effect and in this connection, Sutcliffe (1971) rightly opines that
industrialisation is a process which has invariably been the outcome or accompaniment of economic development.

Moreover, industrialisation creates higher value addition, meets the consumption needs of changed demand pattern, causes changes in pattern and composition of trade, absorbs more labour in the long run and leads to sustained growth. Thus, it becomes utmost necessary to develop the industrial sector and then to diversify it over a wide range of areas and activities (Kuznets, 1969). The League of Nations (1945) described industrialisation as meaningful utilisation of power, machine, latest techniques, organisational methods, divisibility of labour and developed monetary system of goods and commodities. Thus the process of industrialisation is not confined to manufacturing industry alone, it is a process through which the entire economic structure of a country undergoes changes in its various aspects.

Industrialisation, therefore, leads to increase in productivity, as a consequence of changes in structure as well as through more intensive use of given resources. Increased amount of capital is employed per unit of output and this process is described as ‘capital deepening’, while the growth of capital formation together with increase in output and final goods is termed as capital widening. Thus, industrialisation in a way involves the process of both the ‘deepening’ and widening of the capital. Association between industrialisation and high productivity leads to high average incomes.

Development and growth of vibrant and dynamic manufacturing sector is the pillar of accelerated economic growth as manufacturing industry is far more flexible in methods, competition and output than the agricultural sector. While decreasing returns may also be delayed in industrial sector, they are in fact usually postponed by ‘continual improvements’ in techniques by the frequent introduction of new inventions, and improved machinery and by increasing specialisation and
division of labour by raising the efficiency and productivity of labour force. It is of course basically through the application of inanimate energy that manufacturing industry offers greater productivity per worker than agriculture.

One of the major distinguishing characteristics of poor developing countries is the fact that there is very little manufacturing industry (Thirlwall, 1999). Even experts on the subject when try to investigate into the reasons of underdevelopment, they all in the first instance find ‘too little industry’ responsible for it (Myrdal, 1968). Also, with backward agriculture and vast population, there is a little choice but to give priority to the development of industries (Bar, 1962). Growth in manufacturing sector will also boost growth in agriculture, the service industry and commerce. The total growth scenario would translate into high employment oriented economy with better quality of life. Moreover, by making investment in industrial sector, other sectors also can be developed because industrial development is inter-complementary and represents more forward and backward linkages relative to other sector (Sutcliffe, 1971).

In advanced countries, the development of manufacturing industry has led to spectacular economic progress which in turn has raised their standard of living. In the underdeveloped countries also, the productivity of manpower in industry tends to be considerably greater than in the traditional agricultural pursuits. Industrialisation and the growth of working population engaged in industry is, therefore, a means of raising per capita income. In countries like India, with a high ratio of population to natural resources and, in particular, to land, manufacturing industry represents virtually the only hope of greatly increasing the labour productivity and raising the levels of living. But even in countries where the population pressure is less as, in many Latin American countries – the successful exploitation of natural resources requires mostly the growth of manufacturing
industry (Myrdal, 1956). It has been aptly remarked that ‘the real progress must ultimately depend on industrialisation’ (Nehru, 1958). Thus Industrialisation is the best solution to the problems of under developed countries.

In Eastern Europe, for most of the 19th and 20th centuries, large corporates were considered the main driving force of economic and technological progress. Very large corporations dominated research and development and experienced major improvements in production efficiency. It was accepted that large scale enterprise was the most powerful engine of progress. In the beginning of 1970’s, however, large manufacturing firms in key industries began to lose competitiveness. Ever increasing unemployment and low rates of productivity growth, in spite of rapid technological progress, convinced many researchers that industrialised countries were going through a major crisis that marked the end of the model of industrial development based on mass production. As such, a number of important empirical studies began to document the role of small and medium size enterprises. Newer and smaller firms entered the industrial sector as “agents of change”. Studies using direct measures of innovative activity—such as measures of new product and processes—replaced older measures and showed that innovative activity was introduced by small firms and not the larger incumbents. Small and medium enterprises also began to play an important role as efficient providers of intermediate goods and services to large firms. Thus there was a re-emergence of interest in small enterprises due to their labour intensive structure and flexible production techniques. As a result the small scale industrial sector came to be regarded as an engine of growth especially for the developing economies like India.

In the developing nations like India, industrialisation a is a sine qua non of rapid economic development as it is not only a generator of economic growth but
also serves as a transformer of socio economic institutional set up of the economy (Singh, 1982). It is generally believed that industrialisation would create extensive employment opportunities by absorbing the excess labour released by the rural sector and raise production and productivity along with the standard of living. However, for a labour surplus, primary sector based dualistic economy like India, it is not feasible to directly shift the structure of the economy from the primary sector to the ultra modern large scale sector using the advanced labour-esque technology. It is therefore, recommended that these countries should go in for the development of small scale industry which can effectively use the inputs produced by the primary sector and thereby strengthen the agriculture industry linkages. In this context it is imperative to study and analyse the growth pattern, productivity and economic efficiency of small scale industrial sector in the changing economic scenario.

**Definition of Small Scale Sector-Inter Country Comparison**

There is no single universally accepted definition of a small firm as it varies from country to country. Generally the criterion which defines a small firm depends on the purpose for which the identification is required. At the international level, the size of a unit in most of the countries is determined either by the number of workers employed and/or by a measure of assets (capitalisation, sales etc.). The general practice among countries to define the size of the unit (both in the manufacturing and service sectors) is in terms of number of employees. For example, in the United Kingdom (UK) more than 70 percent of all business employs under 100 people (Huxtable, 1995). Also 18 percent of UK’s gross output (manufacturing) is generated by businesses with fewer than 100 employees (Ghobadian and Gallear, 1996).
Table 1.1 provides the inter-country comparison of definition of small sector which highlights that each country has adopted a working definition of small scale enterprise. The total investment in the plant and machinery and the size of employment are the two criteria used for defining small enterprises. In the industrialised countries, small enterprise sector includes medium scale enterprises and the group is known as ‘Small and Medium Enterprise’ (SME) sector. Due to lack of internationally accepted basis for identification of small enterprises, there exists a lot of ambiguity in the definition of the same.

Small scale sector plays an interesting role in the industrial structure of developed and developing countries, thus small scale industry is a global phenomenon. The age of Mammoth Corporation is over and the future lies with small, dynamic efficient production groups that could respond quickly to customer’s needs. In Japan, the expression used is ‘small enterprises’, in the USA ‘small firm’ and in India, small industry refers to manufacturing activity. Recently, it has also come to include, servicing activities such as repair and maintenance shops but it does not include wholesale and retail trading as is done in Japan or the UK (Desai, 1999). Table 1.2 indicates the concept of small industry in some specific countries of the world and shows that the scope of small industry in India is rather narrow as compared to other countries like Japan, UK and USA.

Small and medium enterprises possess certain inherent attributes which, generally, their larger counterparts lack.

1) Small and Medium Enterprises (SMEs) are owner managed which ensures quicker decision making. There is no passing the buck, no red tape and no committee sitting on decision issues. Personal commitment gets transformed into economic dynamism interfacing local, national and global economies (Selvam, 1996; Arun, 1999).
### TABLE 1.1

**DEFINITION OF SMALL SCALE SECTOR: INTER-COUNTRY COMPARISON**

<table>
<thead>
<tr>
<th>Country</th>
<th>Category of Industry</th>
<th>Criteria/Country’s Official Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>Manufacturing</td>
<td>Independent firm having &lt; 200 employees.</td>
</tr>
<tr>
<td>China</td>
<td>Small manufacturing</td>
<td>Depends on Product group usually enterprises &lt; 100.</td>
</tr>
<tr>
<td>Germany</td>
<td>Small manufacturing enterprise</td>
<td>&lt; 500 employees.</td>
</tr>
<tr>
<td>Italy</td>
<td>Small Enterprise</td>
<td>&lt; 200 employees.</td>
</tr>
<tr>
<td>Japan</td>
<td>Manufacturing</td>
<td>&lt; 300 employees, or asset capitalisation &lt; 100 million yen.</td>
</tr>
<tr>
<td></td>
<td>Wholesale Trading</td>
<td>&lt; 50 employees or capitalisation &lt; 30 million yen.</td>
</tr>
<tr>
<td></td>
<td>Retail trade and Services</td>
<td>&lt; 50 employees or capitalisation &lt; 30 million yen.</td>
</tr>
<tr>
<td>Korea</td>
<td>Manufacturing Services</td>
<td>&lt; 300 employees</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Small Manufacturing Enterprise</td>
<td>No fixed definition</td>
</tr>
<tr>
<td>USA</td>
<td>Very small enterprises</td>
<td>&lt; 20 employees</td>
</tr>
<tr>
<td></td>
<td>Small enterprises</td>
<td>20 – 99 employees</td>
</tr>
<tr>
<td></td>
<td>Medium enterprises</td>
<td>100 – 499 employees</td>
</tr>
</tbody>
</table>

*Source: SIDBI Report on Small Scale Industries Sector (2000).*
### TABLE 1.2

**SCOPE OF SMALL INDUSTRY IN SELECTED COUNTRIES.**

<table>
<thead>
<tr>
<th>Country</th>
<th>Terminology</th>
<th>Scope</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>Small Enterprise</td>
<td>Manufacturing, mining, services, trading (Wholesale and Retail)</td>
</tr>
<tr>
<td>India</td>
<td>Small Scale Industry</td>
<td>Manufacturing, Maintenance Repair and Services (Limited)</td>
</tr>
<tr>
<td>Korea</td>
<td>Small Enterprise</td>
<td>Manufacturing, Mining, Construction, Commerce</td>
</tr>
<tr>
<td>USA/Canada</td>
<td>Small Industry</td>
<td>Manufacturing, Commerce (both retail and wholesale), construction, mining, Transport.</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Small Industry</td>
<td>Manufacturing Services.</td>
</tr>
</tbody>
</table>

2) Moreover, bulk of problems of large businesses can be traced to the huge and escalating wage bill. Allowances, complete neutralisation of rise in cost of living, etc. make many industries sick. Small scale industries can build on its strength taking advantage of cheap labour (Selvam, 1996).

3) Furthermore, not much investment in land and building, less capital intensive production process and the like reduce overhead costs in this sector. This means low break even level of sales. Though small units suffer from lack of scale advantages, they gain from low break even point (Eilon, 1981).

4) Small and medium enterprise units being labour intensive have favourable capital-output ratio. By properly utilising the local reserves i.e. raw material, labour etc., small scale industries can keep low level of capital investment per unit of output (Gowda and Krishnamurthy, 1997).

5) Small enterprises have flexibility to make quick adjustment to changing economic and trading scenario. SMEs can easily absorb new technology, new design, new processes and the like. The cost of such switch over is minimal (Selvam, 1996; McAdam and Mckeown, 1999; Harrison, 1994).

6) Even when large scale industries dominate, many small scale enterprises retain a competitive advantage by serving dispersed local markets, providing differentiated products with low-scale economies for niche markets, or specialising as subcontractors for larger firms (Anderson, 1982).

7) Small scale industries have more flexible production schedules, and can operate closer to rural homes than the larger units and thus serve as an important entrepreneurial source among women in developing countries.
Thus the limitations of the large scale industry are the opportunities for the small and the latter has its distinct and profitable part to play in the vast and elaborate structure of medium economic organisation.

**Definition of Small Scale Industrial Sector in India**

To evolve a frame work for the development and support of small scale industrial sector, various policy decisions have been taken by the Government of India. With a view to ascertain the types of industrial units which require special support, it was considered necessary to develop an appropriate classificatory definition for small scale industrial units. In India, to begin with, the definition of small scale industrial sector combined two aspects viz. “Investment and employment”, but gradually these aspects became more specific and now only one aspect, investment in plant and machinery is emphasised. The official definition of small scale industries was first evolved in 1950 by the Small Scale Industries Board, which defined small industry as a unit employing less than 50 persons if using power and less than 100 persons without the use of power and with capital assets (Land, Building, Plant and Machinery etc.) not exceeding Rs 5 lakhs. Further in September 1957, the working definition was modified further to cover those units working on bigger programme on a multi-shift basis.

The employment criterion was given up in 1960 and a new concept of ancillary industry was also defined, having investment in capital asset upto Rs 10 lakhs. Further in 1966, the original amount invested in plant and machinery was adopted as the sole norm for defining a unit as small or otherwise. These definitions of SSIs based on investment have been changing with the passage of time. A new concept of tiny sector, having investment upto Rs 1 lakhs in plant and
machinery and situated in a town or village with population below 50000, was introduced in 1977. Under the Industrial Policy Statement of 1980, limit of investment was raised to Rs 20 lakhs in case of SSIs and Rs 25 lakhs in case of ancillary units and tiny sector limit was raised from Rs 1 lakhs to Rs 2 lakhs. The investment limit was raised to Rs 60 lakhs and Rs 75 lakhs for SSIs and ancillary units respectively in April, 1991 in the new industrial policy for small scale sector. Further tiny sector includes units having an investment limit of less than Rs 5 lakhs.

The investment limit for small scale and ancillary unit was raised to Rs 3 crores in February, 1997 in pursuance of the recommendations of the Abid Hussain Committee Report. The investment limit for tiny sector has also been hiked to Rs 25 lakhs. According to the Government, the hike in investment limit has been made to offset the fall in value of rupee caused by inflation and devaluation. With the increased limits, small scale can expand, diversify, modernise and graduate into viable and profitable large-sized unit. Further, in National Development Council meeting in February, 1999, Government of India reduced the investment limit for SSIs and ancillary units to Rs 1 crore. As per the changes in definition, in 2001, the different segments of small scale industries have been broadly defined as under:

i) **Small Scale Industrial Units**: An industrial unit in which the investment in plant and machinery, whether held on ownership terms or on lease/hire-purchase basis, does not exceed 1 crore is regarded as a small scale industrial undertaking. An SSI unit cannot be controlled or owned or be the subsidiary of any other industrial undertaking. With effect from 9th October, 2001, the investment ceiling in plant and machinery in respect of
41 items covering two broad groups of Hosiery and Hand Tools has been enhanced to Rs. 5 crores.

ii) **Ancillary Industrial Undertaking:** An industrial undertaking which is engaged or proposed to be engaged in the manufacturing or production of parts, components, sub-assembling, tooling or intermediates, or in rendering of services is termed as in ancillary undertaking. The ancillary unit is required to supply or is purposed to supply not less than 50 percent of its production or services to one or more other industrial undertaking. The investment in plant and machinery, whether held on ownership basis or on lease or on hire purchase basis, should not exceed Rs 1 crore in the case of ancillary industrial undertaking.

iii) **Tiny enterprises:** A unit is treated as tiny enterprise where the investment in plant and machinery does not exceed Rs 25 lakhs, irrespective of the location of the unit.

iv) **Women Entrepreneurs’ Enterprise:** A women entrepreneurs enterprise is termed as SSI unit/industry related service or business enterprise, when it is managed by one or more women entrepreneurs in proprietary concerns, or in which she/they individually or jointly have a share in capital of not less than 51 percent as partners/share holders.

v) **Export Oriented Unit:** A unit with an obligation to export at least 30 percent of its annual production by the end of third year of commencement of production and having an investment ceiling as prescribed for small scale undertakings, i.e., upto Rs 1 crore in plant and machinery, is termed as export oriented SSI unit. Periodic revision in the definitions of SSIs as made by the Government of India are furnished in table 1.3.
TABLE 1.3
NORMS FOR DEFINITIONS OF SMALL SCALE INDUSTRIES IN INDIA

<table>
<thead>
<tr>
<th>Year</th>
<th>SSI</th>
<th>ANC</th>
<th>TINY</th>
<th>EOU</th>
<th>SSSE</th>
<th>SSSBE</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>Gross Investment in fixed assets: not exceeding Rs. 5 Lakhs</td>
<td>Did not exit</td>
<td>Did not exit</td>
<td>Did not exit</td>
<td>Did not exit</td>
<td>Did not exit</td>
<td>Employment less than 50 workers per day (with power) or less than 100 workers per day (without power)</td>
</tr>
<tr>
<td>1960</td>
<td>Gross investment in fixed assets: upto Rs. 5 lakhs</td>
<td>Value of gross fixed assets upto Rs. 10 lakhs</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>The employment condition was dropped from the definition</td>
</tr>
<tr>
<td>1970</td>
<td>Upto Rs. 7.5 Lakhs</td>
<td>Upto Rs. 10 Lakhs</td>
<td>Upto Rs. 1 lakh</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>Units located in rural areas/towns with a maximum population of 50000 (1971 census)</td>
</tr>
<tr>
<td>1977</td>
<td>Upto Rs. 10 Lakhs</td>
<td>Upto Rs. 15 Lakhs</td>
<td>Upto Rs. 1 lakh</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>Units located in rural areas/towns with a maximum population of 50000 (1971 census)</td>
</tr>
<tr>
<td>1980</td>
<td>Upto Rs. 20 Lakhs</td>
<td>Upto Rs. 25 Lakhs</td>
<td>Upto Rs. 2 lakhs</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>Units located in rural areas/towns with a maximum population of 50000 (1971 census)</td>
</tr>
<tr>
<td>1985</td>
<td>Upto Rs. 35 Lakhs</td>
<td>Upto Rs. 45 Lakhs</td>
<td>Upto Rs. 2 lakhs</td>
<td>-</td>
<td>Upto Rs. 2 Lakhs</td>
<td>-</td>
<td>Units located in rural areas/towns with a maximum population of upto 5 lakhs (1981 census)</td>
</tr>
<tr>
<td>1991</td>
<td>Upto Rs. 60 Lakhs</td>
<td>Upto Rs. 75 Lakhs</td>
<td>Upto Rs. 5 lakhs</td>
<td>Upto Rs. 75 Lakhs</td>
<td>-</td>
<td>Upto Rs. 5 lakhs</td>
<td>(a) the location specific condition was withdrawn. (b) the SSSEs classification was replaced by the term SSSBEs'.</td>
</tr>
<tr>
<td>1997</td>
<td>Upto Rs. 3 Crore</td>
<td>Upto Rs. 3 Crore</td>
<td>Upto Rs. 25 lakhs</td>
<td>Upto Rs. 3 Crores</td>
<td>-</td>
<td>Upto Rs. 5 lakhs</td>
<td>-</td>
</tr>
<tr>
<td>1999</td>
<td>Upto Rs. 1 Crore</td>
<td>Upto Rs. 1 Crore</td>
<td>Upto Rs. 25 lakhs</td>
<td>Upto Rs. 1 Crore</td>
<td>-</td>
<td>Upto Rs. 5 Lakhs</td>
<td>-</td>
</tr>
<tr>
<td>2001</td>
<td>Upto Rs. 1 Crore</td>
<td>Upto Rs. 1 Crore</td>
<td>Upto Rs. 25 lakhs</td>
<td>Upto Rs. 1 Crore</td>
<td>-</td>
<td>Upto Rs. 5 lakhs</td>
<td>With effect from October, 2001, the investment ceiling in respect of 41 items has been enhanced to Rs. 5 Crores.</td>
</tr>
</tbody>
</table>

Note: SSI-Small Scale Industry: ANC-Ancillary Industry; TINY-Tiny Unit; EOU-Export Oriented Unit; SSSE-Small Scale Service Establishment and SSSBE-Small Scale Service & Business (Industry related enterprises).

Source: Ministry of SSI and ARI, Government of India, New Delhi.
Till 2005, the government had defined the small scale industries and within the small scale, it provided a definition of tiny enterprises. However, from the small scale there was a direct shift to large scale units and no definition was provided for medium scale enterprises. Thus, the Government of India enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 which provides the first ever legal framework for recognition of the concept of “enterprise” (comprising both manufacturing and services) and integrating the three tiers of these enterprises, viz. micro, small and medium. For manufacturing enterprises, the investment limit of micro enterprises is fixed at Rs. 25 lakh, small enterprises above Rs. 25 lakh to Rs. 5 crore, medium enterprises above Rs. 5 crore to Rs. 10 crore. In case of service enterprises the investment limit for micro enterprises is upto Rs. 10 lakh, small enterprises between Rs. 10 lakh and Rs. 2 crore and medium enterprises between Rs. 2 crore to Rs. 5 crore.

The Act also provides for a statutory consultative mechanism at the national level with a balanced representation of all the sections of stakeholders and with a wide range of advisory functions. The other features of Act include: (i) establishment of specific funds, for the promotion, development and enhancement of competitiveness of these enterprises; (ii) notification of schemes/programmes for the purpose; (iii) progressive credit policies and practices; (iv) preference in government procurement to products and services of the micro and small enterprises; (v) introduction of most effective mechanisms for mitigating the problems of delayed payments to micro and small enterprises and (vi) simplification of the process of closure of business by these enterprises.

**Historical Perspective of Small Scale Industries in India**

The cottage and small scale industries form an integral part of Indian economy and these industries have a glorious past which contributed to the rich heritage of India. India was producing best of steel, brass, dyes, cotton and silk. In
fact, India excelled in every sphere and in the economic and industrial development, contribution of the small sector was remarkable. Even wonders like wrought iron pillar (standing near Qutab Minar, Delhi) was cast in small scale industry and further, best of ships were also made by small sector, With the passage of time various causes began to bring about the rapid decline of the rural and urban industries and these causes became very marked by the middle of the 19th century. Establishment of alien rule, policy of East India Company and competition from European manufacturers further accelerated the descent of the urban and rural industrial structure. Indian industry that mainly consisted of craftsmen and rural artisans suffered a serious setback during the British Colonial Rule. Many of the rural artisans became agricultural labourers. This increased the pressure of people on the available cultivable land and intensified rural poverty. Similar apprehensions were anticipated once the factory culture took off in India. This situation generated the political compulsion to revive village and small industries in order to rehabilitate the displaced artisans and to avoid further technological unemployment.

The boycott of imported goods and the call of ‘Swadeshi’ movement was the main plank of Congress party so as to promote the already decaying village based crafts and small scale enterprises. Mahatma Gandhi played a pivotal role in reviving the village based industries and crafts by identifying his khadi (hand spun and hand woven cloth) as the symbol of Indian nationalism. Consequently, the support of small and traditional industries became symbolic of the Congress’s economic philosophy, and was considered essential to ensure the decentralisation of economic activity and the successful functioning of a democratic and self-reliant government. It was, therefore, natural that amongst the first tasks undertaken by the Congress government after coming to power in August 1947, there was an Industries Conference in 1947, which devoted considerable attention to the problem of revival and development of cottage and small industries. This Conference put forward three broad policy measures:
1) establishment of national level organisations to coordinate policies, development programmes and promotional measures for the “decentralised” sector;

2) initiate a regime of preferential treatment of small scale firms with regard to factor inputs; and

3) establishment of certain institutes and agencies (e.g. Cooperative Banks and marketing organisations) to particularly serve the needs of small and cottage industries. These recommendations were accepted by the newly accepted government and were incorporated as a part of the Industrial Policy Resolution of 1948. Following this, various Boards were established whose basic objectives and functions were to advise the government on organisation and development of decentralised sector (e.g. Central Silk Board reconstituted in April 1952, Coir Board and Small Scale Industries Board in 1954).

After Independence, the foremost task of the government was to achieve rapid industrialisation of the country within the overall framework of a welfare state. The objective of economic growth with social justice was kept in view in the overall strategy of industrial development. Large, medium and small industrial units were assigned a mutually complementary role with a view to facilitate an integrated and harmonious growth of industrial sector as a whole. Right from the inception of development programmes, the revival of various stagnant village and cottage industries was given a prominent place in the country’s economic agenda. The guiding principles were enshrined in the Directive Principles of State Policy in the Constitution of India, which enjoined upon the state to strive to minimise income inequalities and regional disparities, and promote cottage industries in the rural areas. Because of its historical background and the constitutional mandate, the Government of India, while framing the industrial policy, accorded special status and importance to the “Small Scale Industries”.
Keeping in view the importance of industrialisation, Indian government has announced different policies from time to time. The pace, pattern and structure of industrialisation in a country is highly influenced by its industrial policy. Before independence there was no proper policy for determining industrial development of country. It is only after independence, a beginning has been made in this direction by announcing industrial policy of 1948. This policy was aimed at the simultaneous development of all segments of small industry, viz. village, cottage and modern enterprises. The policy framework and the promotional measures were intended to enable the small-scale units to withstand competition from the large-scale enterprises. So far, a total of six Industrial Policy Resolutions have been formulated to promote industrial growth and also to determine the pattern of state assistance to small industries for fulfilling socio-economic objectives. Numerous incentives related to financial, fiscal and infrastructural measures, were targeted at for achieving the growth of this sector during the various Five Year Plan periods. Incentives were extended either on a “one-time” basis (initial support for setting up units) or in the form of sustained support for a specific period (protectionist measures, subsidies etc.) and these were made applicable to all industrial units the large as well as the small scale sector.

The Industrial Policy Resolution of 1948 and subsequent enactment of Industries Development and Regulation Act, (1951) and the Industrial Policy Resolution of 1956, marked the beginning of “organised direction” for industrial development in India. The Industrial Policy of 1948, stated that cottage and small scale industries are particularly suited for better utilisation of local resources and achievement of “local-self-sufficiency” in respect of certain types of essential goods. Thus the Industrial Policy Resolution of 1948 reflected an emergence of a “dualistic” approach in government policy viz. emphasis on both traditional as well as modern small scale sector. The Industrial Development and Regulation Act 1951 which was promulgated in order to provide the organisational support to 1948 Policy Resolution, provided scope for a coordinated development of cottage
and small scale industries within the general framework of large scale development programmes. The policy aimed at balanced growth of different manufacturing sectors and focused on the co-existence of large, cottage and small industries. Emphasis was laid on the promotion of cottage and small-scale industries as these could play a crucial role in the rehabilitation of displaced persons through the establishment of individual/cooperative enterprises. The Industrial Policy Resolution, 1956, supported the initiation of measures to improve the competitive strength of small enterprises keeping in view the role of the small scale industrial sector in providing employment opportunities, mobilising local skills and capital resources, and integration with the large sector.

The Industrial Policy Statement, 1977, stressed the wider dispersal of cottage and small industries into rural areas and small towns. It emphasised that “whatever could be produced by small and cottage industries must only be so produced”. This led to the expansion of the list of reserved items for exclusive production by the small scale industrial sector. The new concept of “Tiny Enterprises” within this sector was introduced in 1977 for the first time. The Bhatt Committee (1971) had recommended a separate category- ‘Tiny Sector’ to address the problems of the local small entrepreneurs, which utilise local raw material, local skill, and local technology and cater to local market. The concept of District Industries Centres (DICs) was also mooted so that in each district a single agency could meet the requirements of village and small industries under one roof.

The industrial policy statement, 1980, focused on integrated industrial development and suggested setting up of nucleus plants in industrially backward districts which would concentrate on assembling the products of the ancillary units falling within its orbit, on producing the inputs needed by a large number of smaller units and making adequate marketing arrangements. The nucleus plant would also make provision for upgrading the technology of small units. The policy statement also proposed to introduce “a checklist” to serve as ‘early warning
system’ for identifying symptoms of sickness and also to take stern measures about deliberate mismanagement and financial improprieties leading to sickness. In exceptional cases only the management of sick units would be taken over in public interests. The Industrial Policy, 1990, introduced important measures like raising the investment ceiling in plant and machinery for small scale industries, export-oriented and tiny units, creating a central investment subsidy exclusively for this sector in rural and backward areas and assisting women entrepreneurs with the objective of widening the entrepreneurial base.

The Industrial Policy, 1991, announced “New Policy Measures for Small, Tiny and Village Enterprises” with the objective of imparting vitality and growth impetus to the sector. These measures were announced subsequent to the policy of delicensing, decontrol, deregulation, overall liberalisation and structural reforms of the economy in general and industrial and trade policies in particular that were initiated in July, 1991. The small-scale and ancillary undertakings were exempted from licensing for all articles of manufacture which were not covered by the reserved list for the public sector and those kept under compulsory licensing. The investment limit for tiny enterprises was raised and locational conditions were withdrawn. All industry-related services and business enterprises (with an investment ceiling as those of tiny enterprises) irrespective of location were recognised as small scale industries. Equity participation by other industrial undertakings was permitted up to a limit of 24 per cent of shareholding in these industries to boost ancillarisation and strengthening of the capital base. A new scheme of Integrated Infrastructural Development (including technological back-up services) for small scale industries was provided for with the participation of state governments and financial institutions. The New Small Enterprises Policy literally changed the very philosophy of dealing with small scale sector. The small scale sector, growing under protective umbrella, since independence, has been left open to the invisible hands of market forces. It has increased the sphere of
competition both horizontally and vertically in national as well as in international market. It has created an environment where fittest will survive and inefficient will be weeded out.

The emphasis on the growth and development of small scale sector significantly increased with the establishment of the planning commission which initiated the formulation of a series of Five Year Plans. Indian plans have given a special place to the small scale industrial sector, due to: a) creation of broad based employment opportunities; and b) wide dispersal of industrial production. To fulfill the aforesaid objectives, a “Common Production Programme” for the small scale industries was adopted in the First Five Year Plan document. This programme included the provisions for:

1) reservation of sectors of production for small scale sector;

2) a ban on the capacity expansion by large scale units in the sectors reserved for small scale industries;

3) imposition of a cess on large scale units to be used for the development of small scale firms;

4) preferential access to and special arrangements for supply of raw materials to small firms; and

5) government coordination in research and training for developing small enterprises.

The Plan also made provisions for adequate availability of finances for small scale sector. The rules and conditions for granting loans were liberalised and the powers for sanctioning of loans of the Director of Industries were enlarged. Some of the state governments started State Finance Corporations (SFCs), which enjoyed refinancing facilities from the Reserve Bank of India (RBI) which transferred these functions to Industrial Development Bank of India (IDBI) in the seventies.
The development of small scale industrial sector received a new thrust after the adoption of the Ford Foundation’s perspective plan in 1953-54. The Ford Foundation team laid emphasis on setting up of the necessary institutional and organisational infrastructure for addressing the functional weaknesses of this decentralised sector. The team earmarked the areas of functional and operational weaknesses in this sector, the major ones being; market research, design, raw material availability, research and technical assistance, distribution and promotion, and finance and professional management. On the basis of recommendations of Ford Foundation Team, two foremost promotional organisations were established, namely Central Small Industries Organisation (later renamed as Small Industries Development Organisation) in 1954 and National Small Industries Corporation in 1955.

The Second Five Year Plan (1956-61) based on Mahalanobis Model, relied heavily on what is known as the economic philosophy of capital fundamentalism. The Mahalanobis strategy of development accorded the highest priority to heavy industries and implementation of this policy involved rapid development of the public sector. The role of small scale sector was envisaged as supplier of consumer goods. It obviously implies that this strategy can be sustainable only if small scale sector can generate enough surplus to sustain and support a programme of heavy industrialisation. This called for a separate component of planning to promote modern small scale industries within the overall gamut of rural, village and small industries. Moreover, attempts were also made to utilise resources which were expected to be available for the development of village and small scale industries like, the imparting of training and technical advice regarding the adoption of improved tools, machines and new techniques, supply of raw materials and power at reasonable rates, supply of adequate finance on fair terms, facilities for importing or purchasing machines and assistance in the marketing of products. Special efforts were made to develop cooperatives for production to the extent possible and also for purchase and distribution of raw material, provision of
common facilities, assembling of parts and components, marketing of products and securing orders in bulk. Along with cooperatives, trade associations also played a useful role for further development of these industries.

Among other developments in the field of small-scale industries envisaged in the Third Five Year Plan (1961-66), reference may be made to the proposed establishment of deposits for stocking raw materials in short supplies which are to be made available to small units with a view to assisting in fuller utilisation of the existing capacity. Facilities for training in the manufacture of small machines would be enlarged through the establishment of additional prototype production and training centres. During this plan period it was proposed to set up about 300 more new industrial estates of varying sizes and types. In order to foster the growth of small scale industries, the policy of product reservation was initiated in 1967 with 47 items in the list, as a significant protective instrument. The basic objective of reservation policy was to make products of small scale sector competitive with those of the large scale sector by offsetting the disadvantage of mass scale production, economies of scale, wider marketing network, better credit availability and publicity through mass media and advertisements.

In the Fourth Five Year Plan (1969-74), rural industrialisation was accepted as an effective instrument for the promotion of decentralisation, development of agro-industries and dispersal of industries in backward areas for reducing regional disparities in income and employment opportunities in the country. The Ministry of Commerce constituted a Committee on Khadi and Village industries under the chairmanship of Shri Ashoka Mehta to make recommendations for strengthening and expanding the programmes of this sector. The Committee also stressed the importance of evolving appropriate technology for small scale industries in rural areas and recommended the constitution of a small and compact research group for not only conducting researches on selected problems but also for disseminating research results. Accepting the recommendations of the Committee, the
government formulated the common production policy and programme for the balanced development of large, small scale and village industries. An appropriate technology cell was created for positive forms of assistance such as evaluation and extension of appropriate technology for small units.

The Fifth Five Year Plan (1974-79), emphasised that rural industrialisation had an important role to play in the removal of poverty, disparities in income and regional imbalances. Some small scale industries were anticipated as main instruments of rural industrialisation arising out of area development and decentralisation which were the basic ingredients of a “socialist pattern of society”. This growth centres approach envisaged area development and provision of infrastructure for industries with the national programme of minimum needs for the backward areas.

The Sixth Five Year Plan (1980-85), aimed at a strategy based on industry cum development approach leading to vertical and horizontal integration of the programmes. Its major objectives being: (i) to generate opportunities for further and full time employments; (ii) revitalising and developing the existing traditional and other small-scale industries; (iii) promoting intensive development of new viable industries; (iv) to raise the level of earnings of rural artisans, handlooms, weavers, craftsman and other employed in the industries; (v) to promote the growth of these industries in rural areas; and (vi) to reduce progressively the role of subsidies by providing selective credit, development of skills, design and marketing.

The major objectives of rural industrialisation in the Seventh Five Year Plan (1985-90) were: (i) to assist in the growth and widespread dispersal of industries; (ii) to manage the level of earnings of rural artisans; (iii) to sustain and create avenues of self-employment; (iv) to ensure regular supply of goods and services through the use of local skills and resources; (v) to develop entrepreneurship in combination with improved methods of production through
appropriate training and package of incentives; and (vi) to check the exodus of rural artisans to urban concentrations. In order to achieve these objectives, the following strategies were adopted: (i) to upgrade rotations of technology to ensure standard and quality of production for wider marketing and modernisation; (ii) to create cover organisations so as to provide support for raw material supply, marketing, credit and technology; and (iii) to adopt adequate measures for ensuring viability. To accelerate the need-based credit flow to small scale sector, the Nayak Committee was constituted by the Reserve Bank of India (RBI) in 1991. On the basis of the recommendation of this Committee, guidelines were issued by RBI to banks, *inter alia*, advising them to: (i) give preference to village industries and the smaller tiny units while meeting the credit needs of small scale sector; (ii) grant working capital to small units computed on the basis of minimum 20 percent of their estimated annual turnover whose credit limits in individual cases is upto Rs 2 crores; (iii) extend Single Window Scheme of Small Industries Development Bank of India (SIDBI) to all districts of the country; and (iv) prepare annual credit budget on the ‘bottom up’ basis to ensure that the genuine requirements of small scale sector are met in full.

The Expert Committee on Small Scale Industries in December 1995, under the Chairmanship of Shri Abid Hussain addressed itself to the need of reforms in the existing policies and design new policies which would facilitate the growth of viable and efficient small scale industries to make them globally competitive. The expert Committee in its report laid emphasis on the removal of protection, abolishing reservation, enhancement of SSI investment limit and restructuring supportive, specialised and financial institutions. It also emphasised on cluster approach for future strategy of development. The major recommendations of the Committee were: (i) special treatment to smaller among small industries; (ii) enhancement in the quantum of composite loans; (iii) removal of procedural difficulties in the path of advances to small enterprises; (iv) sorting out issues relating to mortgages of land including removal of stamp duty and permitting
equitable mortgages; (v) no collaterals for loans upto Rs 2 lakh; (vi) setting up of Small Industries Infrastructure Fund for developing industrial areas in/around metropolitan and urban areas; (vii) change in the definition of sick small scale units; (viii) setting up a guarantee organisation and opening of 1000 additional specialised branches; and (ix) enhancement of Small Industries Development Bank of India’s role and status to match with that of National Bank for Agriculture and Rural Development (NABARD).

The Ninth Five Year Plan (1997-2002) laid down the strategy for the development of small scale sector. The Plan proposed: (i) review of list of reserved items; (ii) inducement to financial institutions to offer factoring services to small enterprises; (iii) extending the coverage of Prime Minister Rozgar Yojana in order to create new self employment opportunities. Due emphasis was given for making credit available to small scale units to promote production and productivity through technological upgradation. Moreover, under the scheme of Integrated Infrastructure Development Centres (IIDC), infrastructure facilities are being developed in backward rural areas. The scheme continued in the Ninth Plan with more incentives and financial assistance in hilly areas and North Eastern States. To provide technological support and training to small scale sector, tool rooms with German, Danish and Italian assistance are being set up in Indore, Ahmedabad, Bhubneshwar, Jamshedpur and Aurangabad.

In 1999, the Planning Commission constituted a Study Group on Development of Small Enterprises under the chairmanship of Dr S.P. Gupta. The committee recommended three tier definitions for: (i) tiny sector with an investment in plant and machinery up to 10 lakh; (ii) small scale unit with an investment in plant and machinery above Rs 10 lakh to Rs 1 crore; and (iii) medium scale unit with an investment in plant and machinery above Rs 1 crore to Rs 10 crores. The Study Group also recommended the enactment of a separate Small Enterprises Development Act for governing the promotion and development
of small enterprises. Hence, with effect from October 2, 2006, a comprehensive act called Micro, Small and Medium Enterprises Development Act, 2006 came into force which aimed at facilitating the growth of small enterprises so that they could graduate to medium enterprises, thus improving their competitive strength.

The Tenth Plan (2002-07) plan proposed to: (i) Adopt a promotional approach to the small scale industrial sector as there is a growing realisation that the policy of reserving the manufacture of certain items exclusively for small-scale units is unsustainable and prevents them from attaining economies of scale and dealing with competition; (ii) raise the ceiling on investment in plant and machinery to Rs 5 crore for SSIs to enable the small-scale industry to graduate smoothly into medium enterprises; (iii) expedite the recommendations of the Committee established for addressing the problem of multiple inspection and consequent harassment of small scale units; and (iv) provide the Small and Medium Enterprises (SME) sector with adequate term and working capital loans. The other areas which merit consideration are credit rating, capacity building in project appraisal and compliance with RBI instructions on collateral free loans.

In order to achieve the targeted growth in the Eleventh Plan (2007-12), it has been expected that Medium and Small Enterprises must grow at the rate of 12 percent as they are instruments of inclusive growth which touch upon the lives of the most vulnerable, the most marginalised- women, muslims, SCs and STs – and the most skilled. The Eleventh Plan approach to the Medium and Small Enterprises sector marks a shift from the welfare approach to that of empowerment. In the Eleventh Plan, the Ministry of Micro Small and Medium Enterprises would establish a Technology Mission to promote new and emerging technologies, assess present levels of technology and their upgradation, set up technology information centres/data banks and an IT portal for information dissemination to carry out detailed technology audits. In 2006, the government launched the National Manufacturing Competitiveness Programme (NMCC). The
NMCC and the Ministry of Micro, Small and Medium Enterprises chalked out a five-year programme which includes setting up of design clinics, application of lean manufacturing technologies for increasing competitiveness of firms by systematically identifying and eliminating waste throughout the business cycle. It has been observed that Labour Laws and Factory Laws generally create problems for Micro and Small Enterprises (MSE) units in terms of number of inspections. To address this issue, the committee set up under Planning Commission recommended a system of third-party inspection to give enterprises an option to get their regulatory compliance certified by accredited agencies. Once such certification has been obtained, the unit would be exempted from routine inspection.

Thus the general trade and industrial policies that India adopted till the 1990s insulated Indian industry from competition – domestic as well as foreign. Within this generally insulated business environment, small units were further protected from the competition from large scale units through various policies. Perceiving that small industries are handicapped on various fronts like technology and finance, the Government of India initiated numerous policy measures to remove their handicaps and thereby to impart competitive strength to these industries. These measures include the provision of infrastructure such as developed plots in industrial estates, credit, and critical materials. At the same time, protection has been provided to these units through policy measures such as reservation and fiscal concessions as these units were considered weak and not in a position to face market competition. While protective measures led to the proliferation of small units, discretionary promotional measures without much dissemination of information but with cumbersome procedures made policy assistance out of reach for the majority of small units especially the smaller ones. Larger units within the sector that have better access to policy assistance developed perverse incentive in remaining small in order to enjoy the protective umbrella. The result was that the small scale industrial (SSI) sector has been
growing in terms of number of units, production and employment but with a dual structure where a large number of tiny units operating with obsolete technologies and hence low productivity levels co-exist with a few larger units working at high productivity levels. In other words, the small scale sector although growing, remained mostly tiny, technologically backward and hence lacking in competitive strength.

Apart from policy protection, it was geographical and product market segmentation that helped small units to survive so far, despite being non-competitive. Underdevelopment of infrastructure like transport created sheltered local markets for small scale units by raising transport and transaction costs for the large units to reach semi-urban and rural segments. Product differentiation in terms of quality with the existing income inequalities segmented the product market into two parts: price-sensitive and quality-insensitive, and price-insensitive and quality-sensitive. Lower income households constitute the former while the higher income households constitute the latter market segment. Small scale industries units mostly being producers of lower quality but cheaper products cater to the former segment. The small scale units, nurtured hitherto in a protective framework are ultimately going to be exposed to dynamic market forces.

The phenomena of liberalisation, globalisation and rapid technological developments are changing business environment world over for the past two decades. These policies are not only exposing industrial units to market competition to a greater extent but also making markets more and more competitive. Technological developments, on the other hand, are providing opportunities to the industrial units to improve their competitive strength so as to deal with these challenges. Globalisation, whether taken in a limited way in terms of ‘multilateral trade liberalisation’ or in the broader sense of ‘increasing internationalisation of production, distribution and marketing of goods and services’ is resulting in the opening of the world economies and intensifying
competition in the domestic markets. For example, the World Trade Organisation (WTO) that regulates multilateral trade started enforcing its member countries not only to remove various restrictions on imports and to reduce tariffs but also to impart national treatment to multinational corporations thereby prohibiting any preferential treatment for local firms.

As per the GATT agreement, India has to bring down its tariff rates to 40 percent for finished products and 25 percent for intermediate goods. In addition, India was to remove quantitative restrictions on imports by 2001 and all export subsidies by 2003. As a result, every enterprise in India, small or large, whether exporting or serving the domestic market, is exposed to competition. There is a direct competition in the domestic market with the import of high quality goods from the developed countries and cheap products from the other developing countries. Competition in the domestic market is intensifying further with the arrival of multinational companies (MNCs). To be able to compete with imports or multinationals in the domestic market, or to export successfully without any external support, Indian enterprises, small or large, need to improve their productivity and quality, reduce costs and go for higher performance products and better services simultaneously.

In effect, globalisation has been intensifying market competition thereby creating pressures on firms to pay more attention to quality, price and delivery considerations rather than profitability. All these require substantial improvement in various dimensions of technology, viz. transformation, organisation and information which enable industrial units to supply high quality products at cheaper prices. At the same time, due to introduction of modern techniques and technological upgradation of industrial units, the existing technologies have become unviable. Unless Indian industrial units continuously upgrade their technologies, it is difficult for them to withstand international competition arising
from liberalisation and globalisation. This applies more to small units as they lag both in terms of technology and competitiveness.

The small scale industries occupy a very important place in the Indian economy as they provide immediate large scale employment and have comparatively higher labour capital ratio; need shorter gestation periods and relatively smaller markets to be economic; need low investments; offer a method of ensuring a more equitable distribution of national income; facilitate effective mobilisation of capital and skill; stimulate the growth of industrial entrepreneurship and promote a more diffused pattern of ownership and location. This sector is considered the harbinger of economic progress and has stemmed out from India’s own skill, resource, enterprise and culture and thus, is considered as elixir for the ills of a developing economy like India. This sector, on an average, has been growing at the rate of 6.5 percent per annum during the period of 1990-91 to 1997-98 and around 8 percent for the years 2003-04 and 2004-05 (Economic Survey, Various Issues).

The Government of India fully realised the socio economic significance of this sector and thus, initiated several policy measures for its development. Although, the policies emphasised technological upgradation of small scale industry as crucial for improving their competitive strength, yet they created a paradoxical situation by protecting these units indiscriminately. As a result, even after the policy support for more than four decades, they remained too small and technologically backward to be competitive. The major problems faced by this sector relate to low factor productivity, increased capital intensity, inadequate credibility, incompetent marketing, low capacity utilisation and cheaper imports from other countries. Rapidly changing business environment due to globalisation and liberalisation has increased the role of technology and scale in enhancing the competitive strength. There has been a shift from ‘policy regulation’ to ‘market orientation’ all over the world through liberalisation of the state
controls on economic transactions. Globalisation is taking place in the sense that all the economies are becoming highly integrated and these two phenomena are together posing significant challenges to the individual enterprises. In this context, a study of economic efficiency and productivity of small scale industrial sector in liberalised regime assumes significance.

The present study is an endeavour in this direction and effectively utilises the measures of economic efficiency, technical efficiency, and Total Factor Productivity (TFP) growth to evaluate the performance and growth potential of small scale industrial sector in India. The main aim of the present study is to examine whether the process of liberalisation has significantly affected output, employment and productivity growth of Indian small scale industrial sector along with its impact on economic and technical efficiencies of this sector.

More specifically, the objectives of the study are:

1) To study the level and growth pattern of Indian small scale industrial sector before and after liberalisation;

2) To study the growth and magnitude of sickness in small scale industrial sector before and after liberalisation;

3) To examine the impact of liberalisation on economic and technical efficiencies of small scale industrial sector of India;

4) To evaluate the impact of liberalisation on total factor productivity growth of Indian small scale industrial sector;

5) To study the impact of globalisation on Indian small scale industrial sector under the WTO regime; and

6) To draw policy implications from the empirical results and suggest suitable measures.
Plan of the study

To pursue the aforementioned objectives, the study has been divided into nine chapters. Chapter I is introductory in nature and discusses the role of Indian manufacturing sector in general and small scale industrial sector in particular alongwith nature, scope and objectives of the study. Chapter II reviews the literature relating to the study and Chapter III discusses the data base, concepts and methodology. The growth performance of Indian small scale industrial sector has been analysed in Chapter IV, whereas Chapter V examines the growth and magnitude of sickness in the small scale industrial sector of India along with the estimation of working capital gap therein. In Chapter VI, an attempt has been made to measure and decompose the economic efficiency of Indian small scale industrial sector into technical and allocative efficiencies. Chapter VII empirically analyses the total factor productivity growth of Indian small scale industrial sector in the context of liberalisation. The impact of globalisation and WTO regime on Indian manufacturing in general and small scale industrial sector in particular has been examined in Chapter VIII. The findings of the study have been summarised in Chapter IX along with conclusions and policy implications.

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