Chapter 2

Unorganised Manufacturing Sector: A Review of Existing Literature

2.1 Introduction

The Unorganised Manufacturing Sector (UMS) in India attracted considerable attention of the researchers as well as the policy makers over past few decades because of its capacity to generate sizeable employment in the economy besides efficiently utilizing the local resources. In India, in 2000-01, there were 14.8 million enterprises in the manufacturing sector, employing 45.7 million workers. Of these, only 1 percent of enterprises, and 26 percent of the workers were engaged in the organised sector (World Bank, 2010). As regards the percentage share of the UMS in total industrial value added, it was found that the same declined from nearly 30 percent in 1989-90 to 22 percent in 2000-01. However, it has been noted that despite this declining share in total industrial value added by the UMS, the growth rate of value added was higher during the period of 1994-95 to 2000-01 compared to what it was during 1989-90 to 1994-95. As regards employment, after experiencing a decline in previous periods, the sector experienced positive growth rate during 1994-95 to 2000-01 (Unni and Rani, 2003). This has happened despite the UMS facing strong competition from abroad as well as the large domestic industries during the period of economic reforms.

Recognizing the importance of the UMS in the context of the Indian economy, the present chapter aims at presenting a brief review of the existing literature on this sector. Besides the introductory section, the chapter runs through four sections. Section 2.2 summarizes the debate over the definition of the UMS. In Section 2.3, we discuss the role of this sector in the development process. It may be noted here that, in theoretical discussions, the economists do not make any distinction between the informal sector, unorganised manufacturing sector and informal services sector. In most cases, the unorganised or informal sector represented the non-farm activities outside the organised sector. Section 2.4 discusses how the policies meant for the small-scale industries in general and their tiny units in particular (which come under the unorganised sector) have been changed over the years in India. This section also looks into the implementation status of some of these policies. Finally, Section 2.5 concluded the discussions.
2.2 Definitional Issues

*International Definition of Informal Enterprises*

The existence of informal sector was first recognized by Hart (1973) in her empirical study on urban employment in Ghana. She described the informal sector as that part of the labour force, which falls outside the organised labour market. In her study, Hart used the terms informal income generating activities, unorganised sector, un-enumerated sector, self-employed individuals and urban proletariat more or less alternately and interchangeably.

The ILO-UNDP Employment mission to Kenya (International Labour Office, 1972) adopted the term ‘informal sector’ to analyze the employment situation, and to work out a strategy of employment generation in Kenya. According to this study, the informal sector has the following characteristics: (i) easy entry for the new enterprises, (ii) reliance on indigenous resources, (iii) family ownership, (iv) small scale operations, (v) unregulated and competitive markets, (vi) labour-intensive technology, and (vii) informally acquired skills of workers. The formal sector has just the reverse characteristics.

Subsequently, economists like Weeks (1975), Papola (1980), Shaw (1994), and Mitra (1994) have defined the informal sector using indicators like size of employment, capital-labour ratio, nature of market, and relationship with the formal sector, and so on. Thus, opinions differed regarding the identifying characteristics of informal sector till 1990s.

The International Labour Organization (ILO) was in search for a set of consistent, coherent, and internationally acceptable statistical definition of informal sector enterprises and informal sector employment since 1972. After some debates on the issue of characteristics of informal sector, the 15th International Conference of Labour Statisticians (ICLS) defined the informal sector in terms of the characteristics of production units, i.e., enterprises (International Labour Office, 2003). This approach was followed in the revised international System of National Accounts (SNA) in 1993. According to the SNA (1993), the informal sector consists of units engaged in the production of goods and services with the primary objective of generating employment and income for the persons engaged in the activity. These units form part of the household sector as unincorporated enterprise owned by households. The broad characteristics of these units are:
1. Private unincorporated enterprises (enterprises owned by individuals and households that are not constituted as separate legal entities independent of their owners),
2. No complete accounts are available that would permit a financial separation of the production activities of the enterprise,
3. Produces some parts of goods or services for sale or barter,
4. The employment size of the enterprise is below a certain threshold (to be determined according to national circumstances)
5. And/or not registered under specific form of national legislation.

Definition of Unorganised Manufacturing Enterprises in India

In India, the term ‘unorganised’ manufacturing rather than ‘informal’ manufacturing is used in official statistics. Different organizations in India have been using varying definitions of unorganised manufacturing enterprises depending on the specific requirements of each organization (NCEUS, 2008).

The National Sample Survey Organisation (NSSO) treated the units as unorganised enterprises, which are not covered by the Annual Survey of Industries (ASI). In this respect, it may be noted that the ASI covered all the units (i) using power and employing more than 10 workers and (ii) not using power and employing more than 20 workers. But, in practice, the criterion based on employment and the use or non-use of electricity dominated over the criterion of ‘registered under the ASI, or not’. Thus, the surveys on unorganised manufacturing enterprises, in practice, covered some manufacturing units not covered by the ASI, but which should have been covered. To quote the report of National Statistical Commission, “Many bigger units with a sufficiently large number of workers are also included in the follow up surveys because they are not covered under the ASI as they have not been registered by the Chief Inspector of Factories (CIF), and included in this list. Inclusion of these bigger units in the follow up surveys sometimes distorts the estimates to a great extent.” Therefore, the boundary between organised and unorganised manufacturing is not as neat and clean in practice as it appeared to be in principle.

In the case of National Accounts, the term Unorganised Sector is used differently and consisted of residual enterprises, which are not included in the organised sector. The organised sector in the specific segment of the economy is, however, defined differently on the basis of availability of production statistics on a regular basis.
In order to find a uniform definition of unorganised or informal sector in India, the National Commission for Enterprises in the Unorganised Sector (NCEUS, 2008) had set up a Task Force to review the existing definitions, evolve a set of criteria for defining the sector, and formulate common definition of unorganised or informal sector. The commission recommended following definition of unorganised or informal sector: “The informal sector consists of all unincorporated private enterprises owned by individuals or households engaged in the sale and production of goods and services operated on a proprietary or partnership basis and with less than ten total workers.”

The NCEUS accepted the above-mentioned definition following the criteria of informal sector, except the criterion of non-registration of the units under specific form of national legislation, as mentioned by ILO in its 17th ICLS. This is because, in India, there is no unique form of registration for all business entities though there are various types of registration, both voluntary and mandatory. For example, a business entity can be registered under the Factories Act, Shops and Establishment Act, Income Tax Act, etc. There can also be voluntary registrations with the Director of Industries as Small Scale Industry, Khadi and Village Industry, etc. In view of such multiple registrations, and in the absence of any registration covering all the business entities, it is not possible to use non-registration as a condition for identifying unorganised/informal enterprises.

The Small Industries Development Organizations (SIDO) is another organization that might not use the term ‘unorganised manufacturing’, but provides data on small-scale industries by conducting census from time to time. The difference between the definitions of SIDO and other organizations is that the former defined ‘small-scale industries’ on the basis of the investment in plant and machinery rather than giving emphasis on the size of employment like others. Obviously, the threshold limit of investment was revised from time to time due to adjustment for the rate of inflation. According to the Micro, Small and Medium Enterprises Development Act (MSME Act, 2006), the micro enterprises (previously known as SSIs) are those whose investment in plant and machinery is below Rs. 25 lakh, and ‘tiny’ enterprises among them are those whose investment is less than Rs. 5 lakh.

The Third All-India Census of Small Scale Industries (Government of India, 2001) reported that 98 percent of units with less than Rs. 25 lakh investment in plant and machinery also employ less than 10 workers. Again, according to the NCEUS, the unorganised enterprises, employing less than 10 workers, invest below Rs. 5 lakh. This
implies that the ‘unorganised’ manufacturing enterprises covered by the NSSO and the ‘small-scale industries’ covered by the SIDO are not two mutually exclusive sets of enterprises (NCEUS, 2009). Rather a considerable part of the small-scale enterprises are within the industry of unorganised manufacturing. Hence, it can be said that the policies directed towards the SSIs or MSMEs in general and their ‘tiny’ enterprises, in particular, also cover the majority of the unorganised manufacturing units surveyed by the NSSO.

2.3 Role of Informal Sector in the Development Process

Lewis (1954) and Ranis and Fei (1961) observed that the surplus labour from the traditional agricultural sector could be transferred to the modern industrial sector to increase non-agricultural production in the economy. This labour-transfer process would continue until all the surplus labourers of the traditional agricultural sector are absorbed in the modern industrial sector. The model by Ranis and Fei is considered to be an improvement over the model by Lewis as the later failed to present a satisfactory analysis of the growth of the agricultural sector. However, all these economists saw the cities with their modern industries as dynamic centers through which the problem of surplus labour faced by a stagnating agricultural sector could gradually be overcome. But the assumption that the surplus labour thus available from the agricultural sector would be absorbed in the modern sector was not proven. Rather it has been experienced that expansion of industrial employment opportunities lagged far behind the growth of the urban labour force. So the question arises why people migrate from rural areas to urban areas.

According to Todaro (1969), the decision of migration depends on higher probability of getting jobs in the modern sector. But Todaro’s model was criticized as it failed to take into account the fact that the majority of the migrants actually engage themselves in highly unorganised jobs in the informal sector.

Since the concept of informal sector was introduced, there emerged a consensus among the researchers over the point that the ‘informal sector’ is permanent in nature. However, ‘informal sector employment’ was considered to be temporary in nature as the migrants engage themselves in this sector temporarily in order to subsist while searching for jobs in the formal sector. So it was argued that there was no need to devise policies to protect the interest of the informal sector. However, the fact remains that, despite such neglect, this sector survived and employed people, especially those who migrated from the
In this context, Hart (1973) added that the migrant people are forced to work in the informal sector partly due to the lack of opportunities to work in the formal sector, and partly due to their lack of skills and experience required to obtain jobs in the formal sector. This signifies existence of lack of mobility of workforce from the informal sector to the formal sector. Therefore, not only the ‘informal sector’, but also the ‘informal sector employment’ is considered to be permanent in nature.

From above discussion, it appears that informal sector plays an important role in employment generation. But since people who are unable to enter into the formal sector are absorbed in the informal sector, the question arises whether the informal sector is a ‘distress driven sink’. It has been observed in theoretical as well as empirical literatures that urban informal sector as a whole is not necessarily a distress driven phenomenon. Rather it can be subdivided into two parts, one, more productive component, and the other relatively stagnant traditional component (House, 1984; Ranis and Stewart, 1999).

House (1984) noted that the urban informal sector in Nairobi is much diversified, both in terms of the productivity and income levels. He subdivided urban informal sector into two segments according to activities, attitudes, and motivation; one, the community of the poor and the other intermediate segment. While the former group always hopes that they would get employment in formal sector and thereby do not invest in their current activities the later invest in the existing informal activities in order to make future. It is also observed that the intermediate sector comprised of enterprising individuals having good growth potential if explored and encouraged properly.

It is also noted in the literature that the productive component of informal sector produces not only consumer goods, which serve the lower and medium income groups but also produces producer’s goods, which cater the demand of intermediate goods by the formal sector. From this, it appears that this sector competes with the formal sector in the consumer goods market and complements them by supplying the intermediate goods. However, this segment might expand along with the expansion of the formal sector. On the other hand, the stagnant traditional component of informal sector produces only consumer goods for the low-income group of the population. Although this segment lacks in dynamism, it is important in the sense that it provides employment to those who would otherwise remain openly unemployed (Ranis and Stewart, 1999).

Another issue that has been highlighted in the literature is that of inter-linkage between the formal and informal sectors. In this context, some scholars argued in favor of
complementary relationship between the formal and the informal sectors, while some others argued in favor of a competitive relationship. For instances, Hemmer and Mannel (1989) suggested a negative relationship between formal and informal sector employment. He argued that with the expansion of formal sector jobs, the demand for labour rises in this sector depending upon the technology used, which will reduce the labour availability in the informal economy given the volume of labour in the urban sector. Stark (1982) also argued in favor of a negative association between the formal and informal sector employment. He noted that, with the expansion of modern sector, new employment opportunities are created which may eliminate some of the informal sector jobs if the activities are competitive. However, if the relationship between the two sectors is complementary in nature, then the informal sector would grow along with the expansion of formal sector.

Ranis and Stewart (1999) argued that the modern informal sector grows as rapid industrialization takes place, and it establishes a complementary relationship with the formal sector. The traditional informal sector, however, gradually disappears as the process of industrialization sets into motion. In a different vein, Papola (1981) argued that the informal sector expands in situations of both ‘limited’ industrial spread and ‘rapid’ industrialization. These scholars not only hinted at the existence of linkage between the formal and informal sectors but also examined whether such a linkage leads to exploitation of the informal units by the formal ones. Their conclusion is that this linkage is not always healthier for the informal / small-scale industries; rather it is exploitative in nature. According to them, the informal sector is incapable of expanding with rising labour productivity and income. This is so because it is exploited by the formal sector, which buys from it at very low prices and sells to it at high prices. As a result, informal sector expands only with constant or falling real income. Again, the linkage so determined not only increases the profit margin of large-scale formal sector units but also adversely affects the distribution of surplus between large-scale and small-scale units.

Whether or not subcontracting should be encouraged by the state policy is another issue that attracted diverse opinions. While some scholars argued that subcontracting should be encouraged by the State so that the small-scale industries can be incorporated into the national and international economy, others opined that subcontracting should be encouraged in a limited manner only, and should be subjected to strict Government regulations to ensure that the smaller units are not exploited by the larger ones. It is further argued that a better policy to subcontracting would be to encourage collectivization of small enterprises,
which can compete more effectively with the bigger units, and succeed in displacing them in certain circumstances.

In sum, we can say that both the ‘informal sector’ and ‘informal sector employments’ are of permanent in nature. The available theoretical and empirical literatures do not reveal that the informal sector has always been a distress-driven sink. In fact, it has one dynamic segment too, which in some cases are likely to be linked with the formal sector to meet the latter’s demand for intermediate goods at a lower cost. Several scholars highlighted the growth potential of this dynamic segment of the informal sector. However, the other segment, the stagnant one, plays an important role in providing employment to those who would otherwise remain openly unemployed. This lagging segment of informal sector produces cheap consumer goods and services, which serve the lower income segment of the population. As such there is not much controversy over the fact that inter-firm linkages exist between the formal and informal sector firms, which might be either competitive or complementary depending upon the circumstances. However, opinion differs as regards the role of the Government to control possible exploitation of the informal sector enterprises by the formal ones.

2.4 Policy Environment for the Unorganised Manufacturing Sector in India

Since independence, although the policy makers were largely concerned about expansion of the large-scale heavy industries, they did not altogether deny the importance of the small-scale village industries, a significant proportion of which falls under the UMS. The initial planners under the leadership of Nehru and Mahalanobis believed that large investment in basic and key industries should be prioritized as that would enable the country to move to a high growth path. On the other hand, Gandhi favored the restoration of the ‘village economy’. He thought that labour-intensive production based on local labour as well as material resources could cater more effectively to the local needs, and would be able to address the problem of un-employment and under-employment (Chadha, 2003). However, if we follow the history of Indian political economy, we see that the Nehru-Mahalanobis strategy dominated over the Gandhian ideology. So the small-scale village industries received attention from the policy makers, especially after 1977. To illustrate this point, we take a brief look at the small enterprise development policies adopted in India since independence.
The Industrial Policy Resolution (IPR) of 1948 (Government of India, 1948) clearly demonstrated that traditional rural industries had a very important role in the national economy. It was viewed that these industries were especially suitable for better utilization of local resources, and achieving self-sufficiency in respect of certain consumer goods like food, clothing and agricultural implements. A number of factors like the provision of raw materials, cheap power, technical advice, organised marketing of produce, education of the workers in the use of the best available technique, and where necessary, safeguards against the competition of large-scale industries were thought to be necessary for healthy expansion of the Cottage and Small-Scale Industries.

The IPR (1948) advised the Central Government to investigate how far and in what manner the small-scale industries could be coordinated and integrated with the large-scale industries. This point is important as it is indicative of the policy makers’ intention of encouraging a complementary relationship between the large and the small-scale industries. Following this, the Government had set up All-India Boards to advise and assist in formulation of development programmes for the Handloom, Khadi and Village Industries, Small-Scale Industries, Handicrafts, Sericulture and Coir during the First Five Year Plan. The Khadi and Village Industries Board prepared programmes for the industries with which it was concerned as well as implemented them through registered institutions and cooperative societies. The other Boards rested the responsibility for implementation of programmes mostly with the State Governments.

The Industrial Policy Resolution (IPR) of 1956 (Government of India, 1956) asked the State to continue its support to the Cottage and Small-Scale Industries by restricting the production of large-scale industries as well as by providing differential tax concessions and direct subsidies. However, it was clearly stated that the aim of the State Policy would be to ensure that the Cottage and Small-Scale Industries acquired sufficient vitality to become self-supporting. Consequently, emphasis was given on the integrated development of the small- and large-scale industries. This IPR also recommended for enhancement of competitiveness of the Cottage and Small-Scale Industries by improving and modernizing
the technique of production. The process of modernization of production technique was supposed to be regulated by the Government so as to avoid technological unemployment, as much as possible.

The IPR, 1956, observed lack of financial and technical assistance, unsuitable work place, and inadequacy of facilities for repair and maintenance as serious problems faced by the Cottage and Small-Scale Industries. In order to make improvement in these regards, the IPR recognized the importance of industrial estates and rural community workshops. The IPR emphasized on rural electrification and the availability of power, at prices affordable by the workers so as to create suitable work infrastructure. It was also felt that many of the activities relating to small-scale production would be greatly helped by the organization of industrial cooperatives. Consequently, the IPR favored such cooperatives in every way.

This IPR further emphasized on provisioning of technical and managerial personnel not only for the expansion of the public sector but also for the development of Cottage and Small-Scale Industries. For this purpose, the IPR recognized the importance of training facilities in universities and other technical institutions and apprenticeship schemes in private and public enterprises.

*Industrial Policy Statement 1977*

In 1977, the political power changed at the centre and the focus of the industrial policy with this. The new Janata Government questioned the strategy of heavy industrialization by the Congress Government in view of tardy growth of heavy industries. Consequently, it gave primary importance to the Cottage and Small-Scale Industries in their new industrial strategy. A number of initiatives were taken subsequently.

First, the Industrial Policy Statement (IPS), 1977 (Government of India, 1977) recommended extension of number of items reserved exclusively for production in the small-scale sector from 180 to more than 500. However, the IPS also felt the need to ensure that the production capacity of the small-scale sector does not lag behind the requirements of the economy. Thus, it was recommended to conduct annual review of the reserved industries in order to ensure that the reservation accorded to the small-scale sector was efficient.

One of the important proposals of this IPS was to define ‘tiny enterprises’ (the units with investment in machinery and equipment up to Rs.0.1 million, and situated in towns or
villages with a population of less than 50,000 as per 1971 census) within the small-scale sector and to provide special attention to it.

Again, in order to encourage decentralization, the IPS expected the district industrial centres (situated in district head quarters) to provide a package of assistance and facilities (for example, assistance and facilities for credit guidance, raw materials, training, marketing, etc. including necessary help to unemployed educated young entrepreneurs) required by the Cottage and Small-Scale Industries. The IPS also advised the Government to provide preference to the Cottage and Small-Scale Industries during purchase by various government departments and Public Sector Undertakings (PSUs).

As regards the provisions of financial support to the Cottage and Small-Scale Industries, the IPS advised the Industrial Development Bank in India to set up a separate wing to deal with the credit requirements of the Cottage and Small-Scale Industries, and to monitor and coordinate credit off-take by this sector from other financial institutions, especially from the nationalized banks. The banks were requested to earmark a specified proportion of their total advances for promotion of small, village, and cottage industries. The IPS also proposed that the Government would observe that no worthwhile scheme of small or village industry was given up for wants of credit.

Regarding the use of technology, the IPS observed that the technology appropriate under the prevailing socio-economic condition of India did not receive much attention till then. Accordingly, it presumed that the Government would ensure an effective and coordinated approach for the development and widespread application of suitable small and simple machines and devices for improving the productivity and earning capacity of workers in small and village industries.

*Industrial Policy Statement, 1980*

In 1980, the Congress returned to power. Yet, they decided to continue with the central part of the Janata Government’s IPS of 1977 regarding the Cottage and Rural Industries, though with a changed perspective. In the IPS of 1980 (Government of India, 1980), a new concept of ‘economic federalism’ was introduced as a counter to Janata Government’s division between the small and large industries. In fact, the Congress Government returned to their position in 1956, which emphasized on the integrated development of the large- and the small-scale industries. Adopting the principle of
economic federalism, the Government proposed setting up of a few ‘nucleus plants’ in the industrially backward districts. It was expected that each nucleus plant would concentrate on producing the inputs needed by a large number of smaller units, assembling the products of the ancillary units falling within its orbit, and making adequate marketing arrangements. Thus, it can be said that the IPS 1980 re-emphasized on the linkage between the small and ancillary enterprises with large industries.

In order to boost development of the small-scale industries, the IPS also proposed raising the investment limit in small-scale units to Rs. 2 million, and in ancillary units to Rs. 3.5 million. In the case of tiny units, investment limit was raised to Rs.0.2 million.

Moreover, in order to assist the growth of small-scale industries, this IPS proposed a scheme for building of buffer stock of essential inputs, which were often difficult to obtain by the producers. In this regard, the priority was given to the states that heavily depended on a few essential raw materials. The existing policies regarding marketing support and reservation of items for the small-scale industries were continued in the interest of the growth of these industries. In order to correct regional imbalance, this IPS encouraged dispersal of industry and setting up of units in industrially backward areas.

For the first time, it was proposed in this IPS that all the incentives provided to the industries would be performance-oriented. Hence, it was decided to make a regular and periodic assessment of the impact of various types of incentives to see the extent to which they fulfilled their intended purpose.

*Industrial Policy, 1990*

In the Industrial Policy of 1990 (Government of India, 1990), the Government further raised the investment ceiling in plant and machinery for the SSIs. Now, a clear distinction was made between the small-scale, ancillary, export-oriented, tiny and industry-related service/business units. Investment limits in plant and machinery were raised to Rs. 6 million for small-scale units, Rs. 7.5 million for ancillary and export-oriented small units, and Rs. 0.5 million for tiny and industry-related service/business units.

This Industrial Policy proposed central investment subsidy for this sector in rural and backward areas. Again, it was proposed that the special assistance would be granted to women entrepreneurs for widening their entrepreneurial base. Reservation of items to be
produced by the SSIs was increased to 836. This Industrial Policy also proposed identification of more items that may be provided similar reservation.

In order to improve the competitiveness of the SSIs, setting up of a number of technology centers, tool rooms, Process and Product Development Centres, testing centres, etc., were proposed under the umbrella of an apex Technology Development Centre in Small Industries Development Organisation (SIDO).

The Small Industries Development Bank of India (SIDBI), established in 1989, was supposed to ensure adequate flow of credit to the SSIs. Emphasis was also given on the functioning of the SIDBI and other commercial banks/ financial institutions to channelize need-based credit in adequate quantities to the tiny and rural industries, both by way of term-loan and working capital.

*Industrial Policy Statement, 1991*

Soon after the declaration of the Industrial Policy of 1990, the Indian economy faced a major change in its policy perspective. The economic reforms were introduced in 1991 with the objectives of liberalization, globalization, and privatization. In order to keep pace with these objectives, a new industrial policy was announced in August, 1991. It was accompanied by a Special Policy Statement for the Small-Scale Industries (Government of India, 1991) with the primary objective to impart more vitality and growth impetus to the sector. There were many schemes introduced for the first time. Though the investment ceiling for different units announced in 1990 was left unchanged, the tiny enterprises got the special attention of the development programs and official supports.

Now, while the small-scale (non-tiny) enterprises would be mainly entitled to one time benefits like preference in land allocation/power connection, access to facilities for skills/technology up-gradation etc., the tiny enterprises would be eligible to continuously receive additional support including easier access to institutional finance, priority in government purchase programme, and relaxation from certain labour laws. It proposed widening the scope of the National Equity Fund Scheme\(^1\) and Single Window Loan

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\(^1\) The National Equity Fund Scheme provides equity type support to small entrepreneurs for setting up new projects in tiny/small-scale sector and also assistance for rehabilitation of viable sick units in the small-scale sector.
Scheme\(^2\) in order to extend access to loan by a large number of entrepreneurs. Another important change related to equity participation was introduced for the first time. In order to provide the access to the capital market, 24 percent equity participation by other industrial undertakings in the small-scale industries were permitted.

Further, this IPS provided emphasis to ensure adequate flow of credit on a normative (or need) basis rather than providing subsidized/cheap credit, except for specified target groups. This policy move seemed extremely significant as it clearly indicated that the Government’s intention was to increase reliance of the SSIs on private initiatives rather than depending on budgetary support. In order to prevent delays in payment, a legislation to ensure prompt payment of bills was also introduced.

Moreover, in order to promote industrialization in rural and backward areas, a new scheme of Integrated Infrastructural Development (IID) was introduced. The IID scheme proposed development of production sites, power distribution networks, water, telecommunications, drainage and pollution control facilities, roads, banks, raw material depots, storage and marketing outlets, common facilities, and technological back-up services. Thus, the IID aimed at providing economic as well as technological, marketing, and financial infrastructure for the development of the small industry in backward regions. Again, emphasis was given on technology up-gradation by setting up a Technology Development Cell (the same announced in the Industrial Policy of 1990 as well) and strengthening the facilities available with SIDO in this regard.

Besides emphasizing on promotion of marketing of the SSI products through co-operatives and PSUs, it was decided that the National Small Industries Corporation (NSIC)\(^3\) would concentrate on marketing of mass consumption items under a common brand name.

Stress was also given to encourage a complementary relationship between the large and the small-scale industries. For that purpose, the policy statement encouraged the production of parts, components, sub-assemblies, etc., required by the large public/private sector undertakings in a techno-economically viable manner through the small-scale ancillary units. In this process, the industry associations were expected to encourage

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\(^2\) The Single Window Loan Scheme provides working capital loans along with term loans for fixed capital to new tiny and small-scale units.

\(^3\) The NSIC Limited is a public sector undertaking, set up by the Government of India in 1955 to promote aid and foster the growth of SSIs in the country. It helps SSIs through its various schemes such as hire purchase, equipment leasing, marketing, domestic as well as export, raw material assistance at a concessional rate, single point registration, etc.
establishment of sub-contracting exchanges. In order to enlarge the export activities by this sector, it was decided to set up an Export Development Centre in SIDO.

The IPS 1991 also proposed creation of a greater degree of awareness among the small-scale producers to produce goods and services conforming to national and international standards. It was decided to encourage and support the Industry Associations to establish quality counseling and common testing facilities. It was decided that quality control would be enforced in the event of non-conformity with quality and standards as that might involve risk to human life and public health.

Other salient features of this policy were related to the modification in all statements, regulations, and procedures to ensure that they did not go against the interest of small and village enterprises, expansion of entrepreneurship development programs, special training programs for women entrepreneurs etc.

Some Indirect Policies Relating to the Unorganised Manufacturing Sector in India

For a long time, the external policies of the independent India were mostly guided by the principle of import substitution. This was primarily due to the goal of attaining self-reliance as also the concern of foreign exchange deficit. The continuing and often acute shortage of foreign exchange led to application of policy instruments like import licensing, quantitative restrictions on imports, and high tariff rates. In addition, there were restrictions on foreign direct investment, import of technology, and foreign collaborations of industrial units. All these policies together provided complete protection to the Indian industries, both small and large, by eliminating the scope of foreign competition.

However, the business environment changed significantly with the opening up of the economy in 1991. Following the suggestions of the IMF and World Bank, the Government cut down import duties on a vast range of products including capital goods, intermediate goods, raw materials, and consumer goods. Again, with extension of the coverage of Open General License, some goods that were previously produced by the SSIs (SIDO reported that all 799 items reserved for the small scale sector on 2000-01 were under the list of OGL) started being imported that led to domestic producers from the SSI sector facing stiff competition from their foreign counterparts (Chadha, 2003).

The above-mentioned competition further intensified when the expert committee on Small Enterprises (Government of India, 1997) suggested the Government to withdraw the
reservation policy as it became unnecessary to allow the large-scale domestic industries to produce the reserved items, when the imports of reserved products entered the markets. Accepting this recommendation, the Government started implementing a de-reservation policy since 1997, although in a phased manner. Meanwhile, the World Trade Organization (WTO) came into existence in 1995 and India committed to WTO to remove quantitative restrictions on imports within April 1, 2001.

All the above-mentioned policy moves by the Government forced both the large- as well as the small-scale unorganised industries to face strong competition during the post-1991 period. However, while the larger units were capable of taking advantages of greater access to capital markets, superior business services like foreign banking facilities, advices of overseas technical experts, superior management consultancy, both domestic and foreign, and advanced technology during the era of reforms, the financial constraint of the SSIs prevented them to do so.

**Comprehensive Policy Package for Small-Scale Industries and Tiny Sector in 2000**

Recognizing the challenges faced by the smaller industrial units in the competitive environment of economic liberalization, the Government announced the Comprehensive Policy Package for the SSIs and Tiny Sector in 2000 (Government of India, 2000). The primary objective of the package was to facilitate the provisions of credit, infrastructure, technology, and marketing.

Accepting the importance of technology up-gradation, it has been decided to raise the investment limit of a specific list of hi-tech and export-oriented industries up to Rs. 50 million. The investment limits for the tiny enterprises and the SSI sector continued to remain at 2.5 million and 10 million, respectively. In order to extend the fiscal support, the exemption for excise duty limit was raised from Rs. 5 million to Rs. 10 million.

The credit support has been extended by increasing the limit of composite loans from Rs. 1 million to Rs. 2.5 million. There was a proposal to widen further the scope of the National Equity Fund Scheme as well as newly launched Credit Guarantee Scheme (August, 2000) to improve the credit facilities to the SSIs. The ‘tiny’ sector was given special emphasis too. It has been announced that under the National Equity Fund Scheme, 30 percent of the investment would be earmarked for the tiny sector. The Small Industries Development Bank in India (SIDBI) would continue to provide concessional rate of
refinance to the tiny sector at 10.5 percent interest as compared to 12 percent interest for the SSI sector.

Regarding infrastructure, the IID scheme was supposed to continue with 50 percent reservation for rural areas. Under this scheme, 50 percent of the plots would be earmarked for the tiny sector. A cluster development plan has been proposed for the first time. Under the National Programme for Rural Industrialization, cluster development has been proposed to take up by Khadi and Village Industrial Corporation (KVIC), Small Industrial Development Organisation (SIDO), Small Industrial Development Bank of India (SIDBI) and National Bank of Agriculture and Rural Development (NABARD). The Government expected that the tiny sector would be the major beneficiary of this Cluster Development Plan.

In order to improve the technological support, the policy package proposed provision of capital subsidy to the extent of 12 percent for investment in selected sectors. A compendium of available technologies from R & D institutions in India and abroad was supposed to be prepared jointly by SIDO, SIDBI and NSIC, and circulated amongst the industry associations. The commercial banks were requested to develop schemes to encourage investment in technology up-gradation. To encourage Total Quality Management, the scheme of granting Rs. 75,000 to each unit for opting ISO-9000 Certification was continued with till the end of the 10th Plan.

In order to improve the marketing facilities, the Vendor Development Programme, Buyer-Seller Meets and Exhibitions have been proposed, which were supposed to be organised more frequently. In addition, priority was given on entrepreneurship development. The strategy for this was supposed to be drawn up jointly by the Ministry of Small Scale Industries and Agro and Rural Industries and the Ministry of Labour.

Policy Package for Stepping Up of Credit to the Small and Medium Enterprises, 2005

The Government of India announced the ‘Policy Package for Stepping up of Credit to Small and Medium Enterprises (SMEs)’ on 10 August 2005 (Government of India, 2005). In this Policy Package, measures were taken to increase the credit flows to the SMEs (including micro and small enterprises) and also to strengthen the monitoring and review mechanisms to ensure adequate credit flows to the targeted groups. The main features of this policy package are as follows.
To increase the quantum of credit to the SME sector, the Government asked the public sector banks to fix their own targets for funding SMEs in order to achieve a minimum 20 per cent year-on-year growth in credit to the SME sector. However, the public sector banks are allowed to follow a transparent rating system with cost of credit linked to the credit rating of the enterprises to avoid the problem of non-performing assets. The banks are also advised to adopt a cluster based approach for SME financing which helped the banks by reducing the transaction cost as well as mitigating the risk associated with loan advancements. Moreover, to increase the outreach of formal credit to the SME sector, the Government advised the commercial banks, including the regional rural banks, to make joint efforts to provide credit on an average to at least five new tiny, small and medium enterprises at each of their semi-urban/urban branches per year.

As regards the monitoring and review mechanisms, the Reserve Bank of India (RBI) was advised to issue detailed guidelines relating to debt restructuring mechanism so as to ensure restructuring of debt of all eligible small and medium enterprises. Again, as regards providing the loan facilities to the sector, the Government asked the banks to consider the existing RBI guidelines as indicative minimum to formulate a comprehensive and more liberal policy relating to advances to the SME sector. The Government also announced constituting an empowered committee with the Regional Director of RBI as the Chairman to review the progress of SME financing and rehabilitation of sick small and medium units.

The boards of commercial banks were also advised to review the progress in achieving the self-set targets as also rehabilitation and restructuring of SME accounts on a quarterly basis to ensure that the required emphasis at the highest forum of the banks was given to the sector.

Implementation Status of the Policies

It is clear from our above discussion that since the beginning of the planning era, the Government undertook a number of policy initiatives for the Small-Scale Industries, a large proportion of which fell under the UMS. However, the past studies on the growth performance of the UMS in India revealed that the sector experienced low/negative growth rates as regards employment and gross value added till about mid-1990s, although its performance in these regards improved marginally by late 1990s (Kundu et al., 2001; Chadha 2003; Mukherjee, 2004; Rani and Unni, 2004; Chadha and Sahu, 2006; Kathuria, et
Some scholars as well as government reports held ineffective implementation of the direct policy initiatives taken for the SSIs responsible for such an unsatisfactory performance of this sector.

For instance, increasing competition in the domestic market, in one hand, and inability of the UMS to upgrade its production technology, on the other, was considered as one of the reasons behind the negative growth of value added and employment of this sector till mid-1990s. In this context, Rani and Unni (2004) observed that the UMS industries, in general, obtained the scope to modernize their production techniques either directly by imports or indirectly by new products assembled domestically from imported inputs during the period of liberalization. However, they failed to take such an advantage primarily due to lack of finance that eventually reduced their competitiveness.

Further, it is to be noted that even though the special policy statement of 1991 permitted equity investment up to 24 percent in SSIs by private undertakings that would solve their inability to up-grade production techniques, they actually failed to attract such investment. This is because it is difficult as well as costlier for the private investors to assess a new project under the SSIs due to unavailability of complete information regarding such units. For business services or technology up-gradation, the SSIs depended mostly on the state-sponsored institutions that were unable to keep pace with modern technological development. This ultimately resulted in the reduced competitiveness of the small-scale industries at domestic as well as international markets (Government of India, 1997).

Poor growth performance of the UMS during 1980s and 1990s might also be the outcome of unsatisfactory implementation of domestic credit policies of the Government. In this regard, the NCEUS reported that despite many committees and interventions by the Government, the flow of commercial bank credit to the Small and Medium Enterprises (SMEs) was negligible during this period (NCEUS, 2009). The micro-credit facilities through the Self Help Group (SHG) bank linkage programme was considered to be the main micro-finance mode by which the formal banking system would reach these enterprises. However, it was found that the loan amount through micro credit was insufficient to replace the existing machineries by the modern ones.

As regards the commercial banks’ unwillingness to provide loans to the small-scale units, Papola (2004) observed that the unorganised units failed to obtain recognition as economic entities by the suppliers of credits (i.e., commercial banks or other financial institutions) that acted as a barrier in the credit market. He viewed that registration of these
units might solve this problem. An obvious question here is why these units do not go in for voluntary registration when registration gives them recognition and identity that would help to access certain facilities and services? The Third All-India Census of Small Scale Industries (Government of India, 2001) reported that majority of the small-scale units were not aware of the provision of registration and the benefits obtained accordingly, while others were not interested in registration, though aware of its provisions. A report prepared by the Institute of Studies in Industrial Development showed that huge cost in registration (which includes registration/license fees, hiring lawyers and accountants as well as illegal payments to officials) prevented a large number of smaller units to go in for registration (ISID, 2004).

Production of low quality products was considered to be another problem regarding the expansion of small-scale units, especially those operated under the unorganised manufacturing sector. It appears that poor financial conditions as well as unavailability of credit facilities compelled such units to use degraded production techniques, which resulted in the production of low quality items. However, the existing literature observed that modernization of production techniques by increasing the capital-labour ratio is a way to improve product quality. Innovation and adaptation of existing technology may also increase the labour productivity and thereby product quality. Thus, a policy of knowledge sharing among the local units as well as the promotion of training programs to make the workers better acquainted with the machineries they worked with has been recommended (Majumder, 2004).

It is necessary to mention here that the necessity of providing trainings to the workers in the small-scale sector was recognized by the Government and such programmes were undertaken at regular intervals, especially after 1991. However, it was found that most of the enterprises under the UMS did not appreciate the importance of such programmes and/or were unwilling to participate in these programmes as they were unable to pay the entry fees. Moreover, the duration of these training programs were typically very long. Hence, participating there means long time off from productive work, which would cause loss of income. This also explains willingness of a large number of units especially those operating with one/two workers, to participate in training programs (Damodaran, 2008; NCEUS, 2009).

The available literature showed that the issues related to product marketing provided another hindrance in the way of smooth functioning of the unorganised manufacturing units
over the years. In one hand, the units located in remote areas do not have any other option except to serve the limited demand in the local market. On the other hand, when such units operated from the urban areas, they faced strong competition from the organised industries. In order to reduce such marketing risk, the unorganised units, especially those in urban areas, get involved in ‘subcontracting’ agreement with other private enterprises/middlemen. Although subcontracting has many advantages like obtaining assured market, getting raw materials from the parent units, remain updated as regards the customers’ preferences, etc., it also has some disadvantages. The field based survey commissioned by the NCEUS (2009), and conducted by the Institute for Studies in Industrial Development (ISID) in the National Capital Region, revealed that the incidence of products being rejected by the parent units on the plea of poor quality is greater among the subcontracted units. Even when they were able to sell their products to the parent company, they suffered from considerable delays in payments. It is to be noted here that although there existed the ‘Delayed Payment Act’, the smaller units did not take advantage of it out of a fear of the contracts not being renewed further.

Thus, it appears that the UMS in India were unable to face strong competition from the organised industries in the newly emerged competitive business environment. This is the general conclusion that one could draw. However, a disaggregated analysis suggests that the performance has not been uniform for all categories of unorganised manufacturing units (Chadha, 2003; Mukherjee, 2004; NCEUS, 2009). It is the units that operated with one or two family workers suffered declines in growth rates of employment and gross value added in 1980s and early 1990s. Their poor financial base coupled with lack of awareness regarding various promotional programmes taken by the Government in their favor could explain such an unsatisfactory performance. It is also a fact that the subcontracted units among them were exploited by the parent units in various ways due to their low bargaining strength. As against this picture, the larger-sized units within the UMS were endowed with better financial base, adopted more capital-intensive techniques of production, used more of skilled hired workers, and benefitted from the policy initiatives taken by the Government. Consequently, this segment enjoyed expansion of employment as well as gross value added although the level of market competition kept on increasing with globalisation of the Indian economy.
2.5 Summing Up

The concept of informal sector was first introduced in late 1960s. Since then it has attracted significant attention of both theoretical and empirical researchers. There is no doubt about the fact that it plays an important role in employment generation although its level of value added is not very high.

There exists a debate on the issue of whether the informal sector may be viewed as a ‘distress-driven’ sink or there exists a ‘dynamic’ segment within it. The broad conclusion is that the emergence of this sector should not as a whole be considered as a distress-driven phenomenon. Rather, there exists a segment within it, which is linked to the ‘factory sector’ maintaining a complementary relationship, and it has good growth potential. The other segment might have emerged due to the ‘distress-factors’, but it is also important at least for two reasons: (i) it provides employment to those who would otherwise remain unemployed, and (ii) this segment caters to the demands of the lower income group of the population.

However, there is divergence of opinion among the researchers on the issue of ‘inter-firm linkage’, involving the formal and informal sectors. While some scholars portrayed such relationship to be complementary, others viewed it competitive. A similar divergence of opinion is visible on the issue of the role of the Government to check exploitation, if any, of the informal sector enterprises by the formal ones.

The studies conducted outside India did not distinguish between the ‘informal’ and ‘unorganised’ sectors, and used these two terms interchangeably. However, in the context of the manufacturing sector in India, the terms ‘organised’ and ‘unorganised’ are used instead of ‘formal’ or ‘informal’ sectors respectively. It is to be noted that a large segment of the Small-Scale Industries (SSIs) in India fall under the UMS. Thus, the policies directed towards the SSIs covered the segment of the unorganised manufacturing industries as well.

A perusal of various policies taken for the SSIs since independence revealed that the Government really sought to help the entrepreneurs of this sector right from the beginning of the planning era. A number of favorable policies were taken that relate to provisions of tax concessions, investment subsidies, credit facilities, technical assistance, training programs, marketing supports, etc. The Government also encouraged integrated development of the large- and small-scale industries appreciating the complementary relationship between these two segments of the industry. However, poor employment and gross value added growth of the UMS in India till about 1990s, especially by the tiny units
operating with very few workers, is a pointer towards ineffective implementation of such policies.

In context of above, it becomes necessary to examine the performance of the UMS in India during the decade of 2000s when the Government came up with more focused policies to help the units of this sector. It is precisely an issue that we take up for detailed investigation in this study.