We begin this Chapter with a summary, in Section-I, of the evidence and findings recorded in the previous 6 Chapters. It is observed that there are variations in the effectiveness of support systems available to SMEs in India. In Section-II we attempt to explain these variations in terms of the governance structures of support institutions. Finally, in Section-III we discuss some policy implications for SME support provisioning.

Section-I
A Summary of Previous Chapters

7.1 Summary
The wider context in which this study is embedded is the change in the development paradigm since the beginning of the 1990s, as most countries seek to integrate much more with the world economy, and to enlarge the role of the private marketplace vis-à-vis the State. Since 1991, India, too, has been attempting to impart a greater degree of openness to her economy. In an effort to implement a complex set of continually changing policy responses, India has created over the fifty years of her independence a vast network of institutions for industrialisation and exports. Amongst a number of determinants of India’s export competitiveness – both price and non-price factors – the focus of the study narrowed down to seeking an answer to the question: how useful has this support structure been for India’s export competitiveness?
Chapter 7: Summary and Conclusions

The Indian model of actively promoting small-scale industries in order to attain the development objectives of industrialisation, in particular employment, was adopted in many developing countries, with mixed success. Development of small and medium enterprises has, however, become an agenda not only of national governments but also international development organisations. This study, too, has further sharpened its focus to SMEs as users of the aforementioned support systems.

We posited in Chapter 1 that the less developed are marketing, technical and financial support systems, the higher are the transaction costs to SMEs, with a corresponding impairment of their competitive position. Also that for several reasons, the social returns from well functioning SME support systems exceed the private returns to individual firms, implying that if government can intervene in a cost-effective manner to improve the prospects of SME success beyond what a wholly private marketplace would, it should do so. This study therefore set itself a goal to find empirically whether collective interventions (governmental, business and NGO) had been important for the successful development of support systems in India.

The study made a departure from the existing, scanty, macro level literature. It collected primary evidence through a firm survey of 216 SMEs. It envisaged two more new features. First, while the above theme had not been investigated in India earlier, some firm-level evidence was available in respect of Japan, Korea, Indonesia and Colombia. This helped cross-country comparison of support structures. A comparative analysis was, therefore, also built into the study. Secondly, the support systems have been evaluated from the perspective of the users, i.e., SMEs rather than the providers.
In the present study, SMEs are defined in terms of employment size. Small enterprises employ 1-49 workers and medium-sized 50-199 workers. We proceeded to select five sub-sectors for detailed analysis, based on SME dominance, export propensity, degree of sub-contracting, complexity of technology, and the rate of technological change. These were automotive components, footwear and components, gems and jewellery, readymade garments, and computer software. Out of a sample of 375 SMEs from a population of 18,686, we were able to complete field interviews with 216 SMEs in these five sub-sectors. This yielded data on 605 variables, which was put into a 605x216 matrix and processed using the MS-Excel spreadsheet to generate 50 Tables of organised data presented in Chapters 4, 5 and 6.

Chapter 1 further analysed the characteristics of sample enterprises in terms of age distribution, growth of firm size, and structure of manpower. SMEs evaluated the usefulness of government's promotional policies as low, and on subcontracting there was evidence that it acted as a substitute for a less technical background of the SME owner. Although around 90 per cent of the sample entrepreneurs were found to have college education and had previous job experience, only 8.3 per cent had commercialised their own technical ideas, illustrating low spin-off of technical entrepreneurs from incubating organisations.

In Chapter 2 we reviewed the literature on the scope of SME support. On the effectiveness of support programmes, we noted that returns to resources used in SME promotion programmes are often low. On the best policy approach to SME development, we found that it might lie in correction of policy biases that impede employment creation. Especially for provisioning of credit to SMEs, what is better – support programmes or markets; we found evidence on both sides but it was loaded in favour of commercial lending rather than specialised lending.
agencies. We also noted that SME exporters relied mainly on private channels for their external marketing, technical and financial support.

We went on to review the features of India’s exports in the same Chapter. India’s share of world exports has declined steadily from 1.9 per cent in 1950 to 0.53 per cent in 1990, and then slowly inched back to 0.63 per cent in 1997-98 after major economic reforms were introduced from 1991 onwards. On the positive side, the share of manufactures in India’s total exports has steadily risen from 45 per cent in the 1960s to 73 per cent in 1990, and to 77 per cent in 1997-98 in the post-reform period. It was noted that non-price factors, such as product innovation, quality and marketing had significant influence on the competitiveness of India’s exports. If all transaction costs of exporting were eliminated, India’s exports could rise by 22 per cent, according to a study by the Exim Bank.

The Chapter next reviewed the status of small-scale industry in India. The evolution and growth of the SSI sector since the Industrial Policy Resolution of 1956 were traced in terms of size and contribution to employment, output, value added and exports. It was noted that there were serious data limitations in this regard. It was argued that of the plethora of data sources, the Annual Survey of Industries was sufficient to describe the salient features of the “exporting” sub-set of SSIs. It was noted that the shares of SMEs in the number of factories, employment, output and gross valued added had remained nearly constant during the past more than two decades, 1973-74 to 1995-96. SMEs were around 95 per cent of the total number of factories, gave around 40 per cent of total factory employment, and accounted for about 33 per cent of the output (and 25 per cent of the gross value added) over this period. The annual growth rates, at 1980-81 prices, had shown high volatility, but it could be inferred that SMEs had grown faster than large enterprises, and that the growth rates were ordinarily positive. These are fairly impressive features
of the contribution of SMEs to the national economy. An Annex
explaining the myriad data sources about SSIs and their limitations was
attached to the Chapter, for purposes of reference.

Chapter 3, somewhat longer than intended but necessary if used as
reference material, then presented the research relating to the five
selected sub-sectors. Each sub-sector was studied in respect of its
evolution in terms of industrial organisation, technology, exports and
sector-specific marketing, technical and financial institutional support.
An attempt to recapitulate that research would make this Summary too
long, but it would not be out of place to mention the salient characteristics
of the selected sub-sectors.

Though the automotive components industry started life in the
early 1950s, it entered exports only around 1990. Its share in the number
of factories, employment, output and gross value added during 1973-74 to
1995-96 has risen constantly. The real annual growth rates of the auto
components industry’s number of factories and employment fluctuated a
great deal, often becoming negative, until mid-1980s, when they began to
settle down along an upward slope. Growth of output and gross value
added, too, has been sizeable in the 1990s. The domestic market is
segmented into (i) OEMs, about 40 per cent of the market size, which is
supplied by the organised auto components manufacturers, and (ii) the
replacement market, around 60 per cent of the market size, which is
supplied by both the organised sector (high quality, original parts) and the
unorganised sector (low quality parts). In exports, the competitive
advantage lies in low labour costs. Exports have risen faster than the
manufactured exports as a whole during 1990-91 to 1997-98, and
constitute over 10 per cent of the industry output. Product quality
continues to be a major problem, and the technological level of the
industry is characterised as “very low,” making it necessary that large
investments are committed for R&D. As regards sector-specific institutional support, there is only one industry association, which represented 90 per cent of the total output. Around 50 per cent of the members are SMEs.

The organised leather footwear industry began in the mid-1930s when Bata set up their first factory in India. It has a distinct domestic segment that supplies the huge domestic market (around 85 per cent in 1995-96), and an export segment that caters to foreign demand. Since 1975-76, when the fledgling leather footwear and components industry had a minuscule share of 9 per cent in the Indian export basket of “leather and leather products,” it has shot up to around 33 per cent in 1997-98. Using ASI data, evidence was presented to show that the share of footcomp in overall manufacturing has shown a rising trend during 1973-74 to 1995-96 in terms of all the four structural parameters, viz., number of factories, employment, output and gross value added. Barring a few exceptions, the annual growth rates at 1980-81 prices of these four parameters for the footcomp industry have been generally positive in the 10 to 20 per cent range. Large investments required for technological upgrading have not been possible because the sector is reserved for manufacture by SSIs. The industry is highly fragmented and loses out on both volume and price on account of small production capabilities. In terms of institutional support, there is a large number of sector-specific agencies providing guidance to SMEs in terms of research and technology, design, export assistance, and training.

Gems and jewellery as an industry goes back to the ninth century BC in India. It has become the largest foreign exchange earner among manufactures, constituting 16 per cent of total Indian exports and 20 per cent of manufactured exports in 1997-98. The dominant component of this export is “cut and polished diamonds,” in which India commands a share
of 35-40 per cent of the world trade. This sub-sector is divided into the organised sector, with 800 firms in 1997, and the semi-organised sector, with 9,000 firms, mostly small-scale, in 1997. As per ASI data, while the industry’s share in the number of factories in overall manufacturing kept declining till 1982-83, it began to rise thereafter, though never to equal the level achieved in the 1970s. This means a lot of closure of factories in the 1970s and early 1980s. Shares in manufacturing employment, output and gross value added, on the other hand, have shown a gentle but steady rise during 1973-74 to 1995-96. The compounded annual growth rate, in dollar terms, of gems and jewellery exports in the last three decades has been over 20 per cent. In terms of commodity composition in 1997-98, diamonds accounted for 80 per cent and gold jewellery for 15 per cent of total sub-sector exports. The industry is dominated by obsolete technology, though industry majors have begun to invest in imported machinery. Gold jewellery, which is the segment with the greatest promise, is also beset with problems of traditional designs, uncertainty in the availability of gold, and lack of hallmarking and assaying. A number of collective support institutions are in place, which were briefly reviewed.

Readymade garments has also emerged as an important source of foreign exchange since the second half of the 1980s. There is a fair sized subcontracting system available in addition to the clothing factories. This is a direct consequence of the sub-sector being one reserved for SSIs, making large factories ineligible to invest unless they accept an obligation to export 50 per cent of the output. Although ASI statistics were too understated to be reliable indicators of absolute aggregates, the shares and growth trends were noted. The share of garments in the total number of manufacturing units, employment, output and gross value added shows a monotonic increase in the 1990s. Again, in terms of annual growth rates
at 1980-81 prices, the sub-sector showed healthy movement within a 10-20 per cent band during the 1990s. From the mid-1970s onwards, Indian garment exports have boomed, with their share in manufactured exports being 14.5 per cent in 1997-98, first due to the demand for Indian handlooms and then due to resurgence in the demand for cotton garments. The United States and Europe are the main destinations of these exports. India's export performance is not, however, so impressive when seen in terms of its share in world trade in clothing. It peaked at 2.9 per cent of world exports in 1996-97. Other Asian neighbours such as Hong Kong, Korea, Taiwan and China have recorded much more spectacular performances. In terms of technology, the industry continued to rely on traditional and obsolete machines, hampering growth of productivity and competitiveness. A number of policy measures and institutions to support the industry were also reviewed. In the wake of the dismantling of the MFA quota system in 2005, the route to better export performance would lie via technological modernisation and diversification of the fabric base.

The computer software industry is characterised by many novel features. It is the youngest export industry, its output is more in the nature of intellectual knowledge that is invisible rather than goods, firms here usually start small, and its export potential is limited only by the amount of trained manpower India can generate. Software is, therefore, a service industry, much in the same way as consulting is. It is one of the fastest growing industries in the information technology sector, in terms of both exports and domestic use. ASI does not collect data on this sub-sector. We therefore relied on industry sources to find that in the period 1992-93 to 1996-97 (the Eighth Plan) the annual growth rate of software exports was about 42 per cent in dollar terms. In the same period software for domestic use grew at an annual rate of about 38 per cent. The industry output during this period, in 1980-81 prices, grew at an annual rate of 41
per cent. In the world market for customised professional services, though, India’s share was just 16 per cent, and represented a big export opportunity. Software can be exported, in a dematerialised form, through satellite communications with the foreign buyer’s computers. As such special declarations have been devised to record the earnings from such exports. These earnings are accounted as “miscellaneous” receipts in the “invisibles” account of the balance of payments. The share of software in India’s total exports was just 0.8 per cent in 1990-91. It moved up to 5.3 per cent in 1997-98, making it the fourth largest after (i) gems and jewellery, (ii) textile fabrics, and (iii) readymade garments. According to available data, there were only around 625 software development firms that were primarily exporting, and 250 that serviced the domestic market, in 1997-98. A quarter of the software industry is located in Mumbai and another quarter in Bangalore. The 10 Software Technology Parks (STPs), set up with highly efficient data link facilities since 1989, and 5 export processing zones accounted for 64 per cent of software exports in 1997-98. The main destinations of software exports are the United States and Europe. The industry has estimated that in addition to the present around 200,000, nearly 60,000 software professionals would be required annually to achieve the export target of US$ 50 billion by 2008. Elements of policy and institutional support to this sub-sector were reviewed. The key policy move is to ensure convergence of computers, communications, consumer electronics and contents (the 4Cs). The other is to ensure that venture capitalists enter the arena in a big way to provide institutional funds for start-ups. On the working capital front, too, the needs of the industry are large, but there is reluctance on the part of banks to fund it, in view of the intangible nature of its output.

The subsequent three Chapters – 4, 5 and 6 – presented the findings of our firm survey of 216 sample SMEs in the five selected sub-sectors.
After briefly summarising the findings concerning the considerable observed variations in the use and usefulness evaluations by sample SMEs from one source of support to another, this concluding Chapter seeks to explain these variations in terms of governance structures of support institutions. It does so by comparing various dimensions of governance among seven important SME support providers. On the basis of both sets of findings, some policy recommendations are presented at the end of the Chapter.

The conclusions from our firm survey, recorded in detail in Chapters 4, 5 and 6, may be summarised as follows.

**Existence and Awareness:**

(i) The Indian government developed extensive and ambitious SME support systems.

(ii) The sample SMEs had a moderate level of awareness of these support mechanisms.

**Use and Usefulness:**

(iii) With respect to export marketing support systems, in view of the variety of private commercial channels available, collective marketing support systems (CMS) were rarely rated very important. Yet, their use was often moderate and, when used, some sources and specific services provided were rated rather highly.

(iv) In the case of technical support systems, private sources such as foreign buyers and equipment suppliers appear to have played a significant role in all sub-sectors. However, in technologically dynamic sub-sectors, such as auto components, collective support systems (CTS) have also been important. Also, industry-specific R&D institutions are more frequently used, and with higher usefulness scores than general ones.
(v) In the case of financial support systems, collective sources (CFS) have played a significant role in the finance of process modernisation, export marketing, and technology development, and more generally in seeing to it that investment was directed to priority sectors and purposes. On the other hand, private sources (PFS) appear to have played a more important role in the finance of start-up and working capital. PFS and CFS were mostly complements, but where they competed, PFS were rated slightly higher than CFS.

(vi) Across the several support systems, there were some types of support from specific collective support providers that seemed more accessible to certain (somewhat disadvantaged) types of SMEs than support from private sources. For example, the opportunity to small enterprises to meet buyers through ITPO and the concerned export promotion council. Again, small enterprises in footcomp, garments and jewellery found industry-specific technological support to be useful. Similarly, enormous increases in the volume of working capital loans by commercial banks to small enterprises have been registered after bank nationalisation. Otherwise, however, SMEs with better characteristics and capabilities have better access to support from both private and collective sources.

(vii) In general, SMEs that use one type of support system are more likely to use other types. This is because the different support systems are complementary and in some cases even supplied by the same agency.

Problems:

(viii) Even in the case of highly rated support systems such as CFS, large proportions of the sample SMEs said that they had never used these
systems. A major reason for not using them was failure to meet the required qualifications, which were generally highly specific in nature (including lack of sufficient collateral).

(ix) Such a significant level of non-use despite myriad sources of collective support can be, at least partially, attributed to less than optimal design and implementation.

**Governance structures:**

(x) Comparative analysis with Indonesia, Japan, Korea, and Colombia showed India’s SME support systems to be somewhat less effective. Their relative ineffectiveness may be attributed to their considerably less than perfect governance structures.

The presentation of the remainder of this Section is as follows. Conclusions (i) and (ii), which relate to the existence and awareness of support systems, are discussed further in sub-Section 7.2. Conclusions (iii) to (vii), which relate to the use and usefulness of these support systems, are explained further in sub-Section 7.3. Conclusions (viii) and (ix), which identify some problems in the support systems are discussed in sub-Section 7.4. Conclusion (x), which identifies weak governance structures of support institutions to be a possible reason for lesser effectiveness than in some other countries, is taken up for detailed examination in Section-II.

### 7.2 Extensive SME Support Programmes and their Awareness

As shown in the Annexes to Chapters 4, 5 and 6, India has developed an exceptionally long list of mechanisms and systems in support of SMEs. What this study itself identified were 19 different sources of export marketing support, 25 different support agencies that extend assistance to SMEs in terms of technical information, technical extension service, technical training, and joint/contract research, and a
much larger number of financial support mechanisms. Among the financial supports are 14 mechanisms designed to finance starts-up, 5 to finance exports, 4 to finance technology development, 9 to finance process modernisation, 7 to finance working capital for SMEs, and 15 kinds of fiscal incentives.

To further strengthen the SME support mechanisms, the government also made stipulations for directed credit. Thus commercial banks are obligated to allocate at least 40 per cent of net bank credit (gross advances less recoveries during the year) to the priority sector, which includes SSIs. In actual practice, too, around 40 per cent of the priority sector advances has been going to the SSI sector every year in the 1990s. In 1993, however, government announced a substantial financial liberalisation programme, which greatly reduced regulations on the banking system, and thereby interest rate differentials between banks and non-banking financial institutions. SMEs now compete with large enterprises for finance in an environment where prudential lending norms are in force. Since SMEs are perceived as high-risk borrowers on account of a high proportion of loans past due, availability of finance for them has become high-cost. RBI has estimated that the percentage of overdue bank advances to small-scale industries in 1995, 1996 and 1997 was 20.6 per cent, 20.23 per cent and 18.83 per cent, compared to 12.46 per cent, 12.51 per cent and 14.57 per cent, respectively, for large industries, and 16.19 per cent, 15.29 per cent and 15.16 per cent, respectively, for “all sizes.”

For these support systems to be effective, a number of conditions have to be satisfied. One of the most basic of these is that the target SMEs be aware of such programmes. The findings presented in the three preceding Chapters show that overall awareness of the support systems is moderate among sample SMEs. The exception was collective marketing support, of which nearly all SMEs were aware. Less than 75 per cent
were aware of collective technical and financial support systems. Awareness is, however, a necessary but not sufficient condition for the effectiveness of the SME support systems.

7.3 Use and Usefulness of Support Systems

Even if awareness of support systems is moderate, the more important condition for success is the effectiveness of the assistance offered to SMEs. This section recapitulates the findings on the effectiveness of SME support systems, in large part based on the assessments of SMEs themselves.

Export marketing support systems: The Indian government has established various CMS providers for SMEs and two of them - Export Promotion Councils and ITPO - have presence abroad through associates or their own offices. The data show that a majority of SMEs in each of the five sampled sub-sectors used at least one of these sources of CMS.

Generally speaking, as experience in exporting in a given sub-sector increased, networks of local agents and foreign traders (which make it easier for late entrants to export) developed. Typically, although never rated as important relative to PMS sources, CMS sources have proved more useful relatively early in a particular sub-sector's life cycle. There is also evidence that SME user evaluations of the usefulness of CMS vary considerably from one specific service provider to another. Some are very highly evaluated whereas others are rated rather poorly. In general, the more highly rated services are those that are quite specific in character such as providing import-export services, participating in trade fairs, and obtaining foreign standards. Being more specific, they are less frequently used. On the other hand, more general services, such as providing information on market opportunities, identifying foreign buyers
and distributing promotional materials abroad, are more frequently used but not so highly evaluated.

**Technical support systems:** Acquisition of technological capabilities is one of the most important means with which firms can strengthen their market competitiveness. For the firm to be a market leader, or even a follower, it needs to have both the human and financial resources to undertake some R&D. Since SMEs generally lack these resources they have to rely heavily on external support systems. In general, buyers and equipment suppliers play a major role in extending technical help to sample SMEs for both product and process improvement, as seen from Tables 5-2 and 5-3. In some sectors, such as footwear and garments, CTS was highly evaluated, though more in the nature of implementing the designs provided by buyers.

The role of general collective institutions is being eroded, as technology and its rate of change become increasingly important. Even in the jewellery sub-sector where technology is less critical and CTS received less frequent mentions of use than in the other sampled sub-sectors, the industry-specific R&D support through the G&J Export Promotion Council received quite frequent mentions and fairly high usefulness scores. The establishment of industry-specific R&D centres in other sub-sectors would appear long overdue and, once established, could play a major role in future SME development in these sub-sectors.

**Financial support systems:** Collective financial support systems (CFS) have played a significant role both in financing process modernisation, exports, and technical development. Tax incentives are another form of CFS widely used by sample SMEs. Most forms of CFS have also had the effect of implementing national planning priorities with respect to sub-sectors, regions, and activities.
In the case of finance for start-up, and to a lesser extent exports, however, PFS sources were more important than CFS ones. Leaving aside start-up finance, where self-finance and family and friends are still the main sources of finance for SMEs, in working capital and export finance the government has played an important role. The important measures in this regard are encouragement of bill discounting, concessional rates of interest, and directed credit allocations to SSIs.

As with the other support systems, there are several specific forms of support for which many sample SMEs never applied. Generally, however, there were remarkably few instances in which applications for finance were turned down, presumably reflecting communication between the CFS-supplying agencies and their SME customers prior to the submission of a formal application. Indeed, in the case of the heavily used export finance, only 3 of the 216 sample SMEs reported that a submitted application had been turned down. In general, however, because of moderate use of the various forms of financial support and the moderate usefulness scores of CFS assigned by the sample SMEs, CFS in general, and that for exports in particular, appear to be not very effectively managed of SME support systems.

One type of financial support mechanism, the influence of which was considerably less than expected among sample SMEs, is that designed for the high-tech sub-sectors (auto components and software). That is because the initiatives taken by CFS providers for venture capital or technology finance are minimal.

While the existence of preferential terms in borrowing from CFS sources is an attractive feature of such finance, the survey results indicate that this advantage is offset by other disadvantages (mainly delays and additional accounting costs) vis-à-vis PFS sources. Few sampled SMEs would, however, drop their investment and other plans, instead of turning
to higher cost sources of finance, if their applications for finance at preferential rates were turned down.

7.4 Problems Associated with Support Systems

The high proportion of non-users: Despite the extensive and ambitious support programmes to help SMEs, many of them are little used. Mention has been made above of the low rate of use of venture capital assistance, and various institutions designed to assist SMEs in technological acquisition and training. But, even in some of the more popular programmes and activities, non-users account for a significant proportion of the 216 sample firms in this study.\(^\text{181}\) Why is non-use so high?

The major reasons for non-use: The most frequently cited reasons for not applying for financial support are "did not know the system" or "did not need it." Over 87 per cent of the non-applicants gave these reasons. These non-applicants are generally small in size, measured in term of employment. The analysis presented in the preceding Chapters shows a consistent relationship between firm size and the frequency of use of support mechanisms. That is, the relatively larger SMEs benefit more frequently from various support mechanisms than the smaller ones. Large SMEs often have greater capabilities in production, finance, organisation, management and technology, more and better collateral and greater ability and willingness to comply with the accounting and other bureaucratic procedures, delays and requirements than small SMEs.

Implementation problems in support programmes: Despite the extensive and ambitious collective support programmes of all types but

\(^{181}\) The proportion varies. For example, non-use of any source of CMS was 38% overall (the third row of Table 4-26). That for CTS ranged between 33% for technical assistance in garments to 100% in software (derived from Table 5-4). For CFS, this incidence of non-use ranged between 10% and 97% (derived from the last but two column of Table 6-12)
especially of finance, there are indications - well publicised in India - of implementation problems. For example, there is under-utilisation of sanctioned loans. This is despite the fact the SMEs themselves identified financial constraint as their most severe problem.

Part of the explanation for the paradox of under-utilisation of the available sources of finance would appear to lie in the decentralised implementation of various finance programmes and imperfect incentive compatibility between the bureaucratic principals and bank officials. High-level bureaucrats may want to assist SMEs in getting through their financial crises. Yet, because making "bad loans" can have such a devastating effect on the performance evaluations, and hence future promotion possibilities, of lower-level loan officers and bank managers, the latter use very stringent financial criteria (including heavy collateral requirements) in their lending decisions. This occurs very commonly, leading to complaints that SMEs, which concentrate on speculative investments, such as real estate, often have a better chance of getting preferential finance than those that have instead concentrated on investments in plant and equipment, R&D and human resources. Hence, contrary to the intent of government policy, the deserving SMEs do not necessarily receive preferential treatment from the SME promotion programmes.

Section -II

The Governance of Support Institutions

Three observations clearly emerge from the above:

(1) the low level of success of SME support systems in India compared to other developing countries,
the considerable variations in use and usefulness scores among different support providers reported by sample SMEs, and

(3) some signs of implementation problems.

How to explain these observations? Could they be explained by differences in the governance structures and incentive systems among India's support agencies, and between India and other countries?

Following Hirschmann (1970) and others, this section analyses institutional governance on the basis of in-depth interviews with key members of six public support agencies and one industry association. The analysis of governance focuses on four distinct mechanisms for inducing performance: hierarchical controls, human resource policy, voice (private participation), and market tests. The public agencies include the most important SME-related financial institution (SIDBI), three important export marketing support institutions (ITPO, and two EPCs), and the two most important technical support agencies (SIDO and NSIC). The industry association is the ACMA.

**Hierarchical controls:** Table 7-1 identifies for each SME support provider both the bureaucratic principal and the instruments the principal uses to monitor and supervise the support providers. It shows that these bureaucratic principals exercise their control over support agencies in different ways at the pre-operative, operative, and post-operative stages.

At the pre-operative stage, the principals control the objectives and work domain of support agencies mainly through the evaluation and approval of their budgets. All support agencies have government nominees on their boards of directors. Table 7-2 shows the degree of bureaucratic control as perceived by the support agencies on a 5-point scale (1=low, 5=high). Note that SIDO, NSIC, and the EPCs, all perceive
themselves as subject to a high degree of budgetary control, and ACMA to the lowest.

At the operative stage, the hierarchical principals control the operation of support agencies through regulations and personnel appointments. The latter is a very important means of control by bureaucratic principals in that it is they who appoint the executives of all support agencies, except those of the industry associations. Our survey shows that on average 33 per cent of top director-level executives of the support agencies are promoted from within and 67 per cent are brought in from outside, mainly from government. Although political networks play an important role in such appointments in India as they do in other countries,\textsuperscript{182} India is distinguished from other developing countries in that individual competence is almost equal in importance to political connections. Because of the importance of competence as a criterion in appointments, full-time directors, either promoted from within or brought in from outside, are under significant pressure to demonstrate their competence through performance. All support agencies, except the industry association ACMA, scored at least 4 on a 5-point scale (1=low, 5=high) on degree of control in the operative stage.

At the post-operative stage, the bureaucratic principals evaluate the performance of support agencies mainly through participation in management (Board of Directors) and annual performance audit. Table 7-2 shows that the degree of audit control perceived by the sample support agencies on a 5-point scale (1=low, 5=high) is low (1.0) for the industry association, and ranges from 3 to 5 for the other agencies.

In general, the overall degree of control perceived by the support agencies varies from 3.25 to 5 for public support agencies, and is the

\textsuperscript{182} See Kim and Nugent (1994) for Korea.
lowest (1.0) for the industry association on a 5-point scale (1=low, 5=high), as shown in the last column of Table 7-2.

**Human resource policy:** The delivery of quality service cannot be attributed solely to hierarchical supervision. Organisational behaviour literature postulates that the performance of organisational members is a function of motivation (M) and ability (A) \[P = f (M, A)\]. This suggests that human resource policies with respect to recruitment practices, and incentives within the organisation, are at least as important for the performance of organisational members as supervision by hierarchical principals. Also important is the legal status of employees because this has a bearing on morale and job security.

What, then, is the human resource policy of support agencies in India? Five of the seven sample support agencies adopt open competition in hiring (via public advertisement) and in the screening of applicants on the basis of their educational qualifications, experience and competence. Such an emphasis on applicant qualifications and competence should enable these support agencies to recruit employees who are more qualified than in the private sector, but lower remuneration levels preclude that. The other two agencies, namely, ESC and ACMA, use personal contacts as the primary means of recruiting new employees.

The method of recruitment practice, as shown in Table 7-3, is directly correlated to both the extrinsic motivators (salary) and the intrinsic motivators (job esteem and social prestige) of the support agencies. The average salary level varies widely among support agencies, ranging from Rs. 3,000 per month (p.m.) at SIDO to Rs. 10,000 p.m. at SIDBI. It is interesting to note that the average salary level of all sample support agencies (Rs. 5,000 p.m.) is 17 per cent lower than the industry average of Rs. 5,922 p.m., and 29 per cent lower than the average salary
of large firms with 200 or more workers, according to the Annual Survey of Industries, 1995-96. Not surprisingly, these agencies end up with only marginally qualified personnel with low self-esteem and prestige.

On the legal status of the employees, six of the seven sample support agencies have the same service rules as for the government. Their employees, therefore, enjoy semi-civil servant status. This status offers the advantage of job security. Support providers with high salaries, job security, and high social prestige are able to attract relatively better educated work forces than the others. For example, excluding the peons, drivers and clerks, college graduates, mostly from leading universities, comprise 70 per cent of the total work force of SIDBI.

In short, and with the partial exception of SIDBI, these support agencies do not have either competent workers (A) or proper motivators (M) to deliver quality services to SMEs.

**Voice (private participation):** The "voice" or participation of user SMEs in the support agencies, however, is average. Only three of the seven support agencies, viz., ESC, CLE and ACMA, have functional representation of user SMEs on their boards, although consultative representation to SMEs is given by all agencies. The aforementioned three agencies are essentially industry groups, and their directors are largely from amongst member SMEs. These representatives are generally selected from the SME population according to both the importance of the SME to the support agency and the personal qualifications of its entrepreneur.

In the absence of functional SME representation on their boards, the other support providers in the sample use somewhat weaker and more

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183 Annual Survey of Industries, 1995-96. Provisional Results for the Factory Sector. Statement 6. "Wages to workers" was subtracted from "Total emoluments," and divided by the difference between
indirect mechanisms to reflect SME voice. This is done through consultative meetings, and occasional surveys to identify the needs of their client SMEs.

**Market tests:** Support agencies in India vary in the extent to which they charge fees from their clients. The one sample financial institution charges no fees for its management, legal, tax, and industrial relations consulting services and only direct costs (not including labour) for its training programmes.

Among export marketing support agencies, all three, being associations of members, charge an annual membership fee for their publications and other trade-related information and direct costs to participants in their training programmes. None of the seven, however, operates like a private firm and charges actual costs plus margin.

In the case of CMS, support providers face little competition from the private sector. No private firms offer as extensive a service in export marketing as EPCs and ITPO, but private trading companies do help the SMEs market their products. Although the trading companies do not publish information on export markets, the information and other services they provide is more up-to-date and specific to the needs of the individual exporter.

Among technical support agencies, NSIC and SIDO offer various technical services ranging from testing, technical inspections, instrument corrections, and technical assistance but in all cases charge only direct costs to clients. The income accruing from these services, however, accounts for less than 10 per cent of their annual budgets. In short, the fees charged by support agencies in India are only nominal.
Consequently, it appears that the fee is not at all a barrier to SME use of services provided by support agencies.

In the case of CTS providers, however, there is much more competition from the private sector. Principal contractors often provide technical assistance to their SME subcontractors on an ad hoc basis to ensure that the parts and components supplied by SMEs meet the contractor's technical specifications. Hence, in general, more SMEs have access to private sector-supplied alternative sources of technical services. One of the reasons for this is that the technical services provided by CTS agencies are of poor quality and behind times. At the same time, however, it must be conceded that technical support to SMEs is the most difficult to provide.

With respect to CFS providers, the SIDBI is in competition with private banks, foreign banks, urban cooperative banks, and regional rural banks, apart from non-banking financial institutions in offering financial services to SMEs. Indeed, the private, local or regional banks cater almost exclusively to SMEs. Yet SIDBI receives almost no competition in handling the highly desirable low-interest rate "strategic funds", which, as noted in Chapter 6, have been set up to service SMEs.

In general, therefore, although some of the collective support agencies have structural advantages over private ones in some areas such as the distribution of directed, low interest credit and other services at below-market prices, there appear to be no barriers to the entry of private companies in providing services. As a result, the average degree of competition perceived by sample support agencies ranges from 3 to 5 with the mean value of 3.75 on a 5-point scale.

In conclusion, the less frequent use of collective support institutions and the lower value placed on such use by the SMEs which use them in India, compared to other developing countries such as Japan
and Korea, may be attributed to relatively less well-structured hierarchical control systems, and the poorer quality of personnel in these institutions, even though comparable services from the private sector are available at higher prices.

There is thus no area investigated in which the sample support system providers are relatively strong. As such, few of the sample support providers are equipped with adequate means of ensuring that the services they provide are what SMEs actually want. Rather they sell what they produce, unlike Japan or Korea. Effective competition by private support providers may be the only policy to correct this deficiency.

Section - III

Policy Implications

Several implications for policy with respect to SME support provision may be derived from this study.

First, there are very justifiable grounds for a government role in developing SME support systems. There are genuine market failures in connection with export marketing, finance and technological learning and upgrading. These externality problems are relatively more serious for SMEs than for large firms. Especially considering the growing advantages of SMEs in terms of flexibility, technical efficiency, and the ability to fit market niches, SME support provision can be amply justified.

Second, due largely to the fact that in several dimensions Indian support providers have unsatisfactory governance structures relative to other countries, SME support provision has been relatively less successful than elsewhere. Even so, at least the multiplicity of use, and relatively high values attached by SME users to the support received, are worthy of
note. Thus, there should be an endeavour to improve governance structures.

Third, although use of the SME support systems reported in this study (mostly ever-use) pertains to the entire lifetime of the SME (which on average was 14.5 years), thereby seemingly making the usage rate seem much less impressive than it otherwise might, there are offsetting considerations. One of these is that because of the multiplicity of sources it is not surprising that many sources are used by relatively few sample SMEs. Moreover, there is little reason to doubt that most ever-used sources were in fact frequently used. As a result, for most forms of collective support, the ever-use rate would seem to provide only an extreme lower bound on the actual number of uses.

Fourth, there is considerable variation in use and to a lesser extent in reported usefulness among sub-sectors, functions (type of support system), firms and the environments in which they function, and supplying agency and programme. As a result, despite what is overall rather considerable use, there are sometimes many SMEs that have not used any source of a certain type of support mechanism and, even those that have, have not always been satisfied. The explanations for non-use are quite revealing and lead to the following suggested reforms.

(a) The SME voice aspect of the governance structure of SME support providers should be strengthened, so that SMEs can better exert pressure to improve the match between the support provided and SME needs.

(b) There is need for building up the human resource base in the support providers through higher salaries and better conditions, so that they can attract high quality personnel. One proposal worth considering in this respect is a programme to improve productivity through the use of
computerisation and information technology, including Internet resources.

(c) Technical support systems are (i) the least available from private suppliers, (ii) the most difficult to supply because of the increasing complexity and specificity of the relevant technology, and (iii) the most likely to grow in future importance. Such systems deserve, therefore, the highest priority in future attention in India and perhaps other countries of India's stage of industrial development. One proposal that deserves attention in this respect is that, as the industry evolves over time in response to market and technological changes, it is imperative for technical support systems to evolve accordingly to assure that the assistance offered to SMEs is relevant and timely. Industry-specific R&D institutes would appear to be important steps in the right direction. A relevant lesson of the *footcomp* experience is that it is wise to locate such centres near clusters of SMEs in the same industry. General institutions such as SIDO and NSIC should develop national networks of local support providers, with the involvement of industry associations, so as to assure that the services are readily available to geographic clusters of SMEs in the same industry.

(d) The appropriate design of support delivery systems is a complex issue with significant tradeoffs between the benefits of specificity and narrowness on the one hand and those of breadth and comprehensiveness on the other. Among the benefits of a narrow, specific-purpose agency are that (i) it can concentrate on a single objective and the most efficient way of accomplishing it, (ii) it can afford to hire genuine specialists, and (iii) the transaction costs of preparing and reviewing applications for support can be reduced. On the other hand, greater breadth (i) takes advantage of economies of scope, (ii) makes it more feasible to develop national networks of local support providers,
and (iii) raises the possibility that different firms in different industries will find at least some service that is useful, thereby raising the probability of the agency's creation and survival. The optimal balance in the design of these various support systems might well vary from one type of support to another, suggesting that the choice among these alternative design methods should be support system-specific and perhaps also industry-specific. Technology support would seem to have the greatest need to be industry-specific and financial support, because of the fungibility of money, the least. As a result, the proliferation of special funds would seem to be unnecessary, in terms of administrative costs, physical proximity, and the ability of a given firm to qualify for any one of them. In this light, it is not surprising that "irrelevance" is the dominant explanation for non-use in most sub-sectors and support systems.

(e) Despite the acknowledged importance of government in developing SME support systems, it is by no means necessary that collective support systems (CSS) should also be dominant in the implementation stage. Some evidence is provided in the study that CSS providers play a more important and catalytic role in earlier years, when the alternative sources may be much less available, than at later stages in the firm's and industry's life cycle. Several proposals to encourage greater SME support provision from the private sector, especially in the later stages, should be considered:

1. First, collective support suppliers should charge sufficient fees to cover the cost of service, thereby levelling the playing field between collective and private support providers. Even though "levelling the field" is not an end in itself, it would facilitate the entry of private service providers, making everybody better off.
Second, even if there should be a need to provide services at nominal fees by public agencies, private provision can be encouraged by contracting out the services to private providers through a transparent competitive process.

Third, even if originally there should not exist private providers of the services required, thereby justifying initial entry by CSS providers, it may be advantageous to privatise them later.

(f) Market tests and competition in the provision of SME support should be encouraged wherever possible. Indeed, the contracting out proposal within reform (e) can be a useful means of accomplishing this, since any given service can be contracted out to a number of private suppliers at the same time.

(g) Private and commercial sources of support can and should be encouraged also in other ways. The credit guarantee system is a good example. Although international experience with deposit and credit guarantees suggests that care has to be taken in CFS provision so as not to undermine the incentives for careful screening and maintaining reputation for prompt repayment, properly designed and managed measures can increase the incentives for private support provision to SMEs.

(h) Given the fact that most of the support systems are more frequently used by large SMEs than small ones, efforts should be made to encourage support providers to pay more attention to the needs of small SMEs. Since in most cases the greater usage of support systems by large SMEs is less pronounced in commercially and business association-provided support systems, recommendations (c) and (f) are complementary to this one. At the same time, in view of the important finding with respect to technical support systems (TSS) that small SMEs may be better supplied with informal sources of support, such as retired or moonlighting engineers as consultants, than by formal systems,
collective TSS support providers can be especially helpful to small SMEs by providing them with rosters of available consultants in different areas of expertise.

(i) Although the creation of geographic concentrations of producers and support providers in certain specific regions is often more affected by historical accident than by conscious policy, because of the relevance of spatial external economies and agglomeration effects, appropriate regional concentrations should be encouraged by public policy whenever possible.

Fifth, since the roles of foreign buyers, which seem to be quite heterogeneous, have been relatively important and have changed over time, it would perhaps be worthwhile to factor in their perhaps rather different perspectives on the relevance of collective support systems (CSS) of all types, if this study were to be done again.

Sixth, the cross-country comparison reveals that the leading source of support comes from private channels – from buyers and traders, from similar firms, suppliers and subcontracting principals, from banks, and from the determined efforts of SMEs themselves. It follows that the first order of business for SME support policy is to ensure that the private marketplace can work, that liberal rules govern the international flow of technical and marketing resources, and that private banks can go about their business of making and collecting loans, and earning profits in the process.

Seventh, the benefits of private support mechanisms are not available equally to all, but vary with an SME’s “endowments.” For financial support, where private banks typically make their lending decisions according to the availability of collateral, the point is an

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184 Banks are considered public channels in India, unlike some other countries with which comparison has been made.
obvious one. But less obvious kinds of endowments turn out to be crucial influences on the availability of marketing and technical support: whether SMEs are embedded in pre-existing private inter-firm or community-based network; whether firms are pioneers in a new activity or one of many participants in an already mature sub-sector; whether the country in which they are active has a high profile in the export marketplace. Collective marketing, technological and financial supports turn out to be used and valued disproportionately by less well endowed – though subsequently successful – firms.

Eighth, in all three areas, the record of delivery of collective support is a chequered one, but some promising new approaches appear to be coming to the fore. For finance, the success of Japan with collective delivery highlights the importance of combining programmes of collective support with broader efforts to develop a disciplined and sustainable financial system. For technical and marketing support, the most promising interventions are those with a “soft touch”: their delivery mechanisms generally are decentralised; and their goals are to support, rather than supplant, the private marketplace – to co-finance SME efforts to tap the marketplace for new marketing and technical resources, to make available additional sources of technical information, and to facilitate communication between firms, including between SMEs and international buyers.

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### Table 7-1: Oversight Agencies and Control Mechanisms

<table>
<thead>
<tr>
<th>Controlling Agencies</th>
<th>Pre-operative control</th>
<th>Operative control</th>
<th>Post-operative control</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIDBI</td>
<td>Ministry of Finance</td>
<td>Budget approval</td>
<td>Regulations, Executive appointments</td>
</tr>
<tr>
<td></td>
<td>Ministry of Industry</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Reserve Bank of India</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IDBI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ITPO</td>
<td>Ministry of Commerce</td>
<td>Budget approval</td>
<td>Regulations, Executive appointments</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ESC</td>
<td>Ministry of Commerce</td>
<td>Budget approval</td>
<td>Regulations, Executive appointments</td>
</tr>
<tr>
<td></td>
<td>Ministry of Electronics</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CLE</td>
<td>Ministry of Commerce</td>
<td>Budget approval</td>
<td>Regulations, Executive appointments</td>
</tr>
<tr>
<td>SIDO</td>
<td>Ministry of Industry</td>
<td>Budget approval</td>
<td>Regulations, Executive appointments</td>
</tr>
<tr>
<td>NSIC</td>
<td>Ministry of Industry</td>
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</tr>
<tr>
<td>ACMA</td>
<td>Autonomous industry association</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

**Legend:**
- SIDBI: Small Industries Development Bank of India
- ITPO: India Trade Promotion Organisation
- ESC: Computer Software Export Promotion Council
- CLE: Council for Leather Exports
- SIDO: Small Industries Development Organisation
- NSIC: National Small Industries Corporation
- ACMA: Automotive Components Manufacturers Association
Table 7-2: Perceived Degree of Control on a 5-point Scale
(1=low, 5=high)

<table>
<thead>
<tr>
<th></th>
<th>Pre-operative Budget approval</th>
<th>Operative</th>
<th>Post-operative audits</th>
<th>Average</th>
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<tr>
<td></td>
<td>Regulations</td>
<td>Executive appointments</td>
<td></td>
<td></td>
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<tr>
<td>SIDBI</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>3</td>
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<tr>
<td>ITPO</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>ESC</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>CLE</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>3</td>
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<tr>
<td>SIDO</td>
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<td>5</td>
<td>5</td>
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<tr>
<td>NSIC</td>
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<td>ACMA</td>
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</table>

Table 7-3: Human Resource Policy

<table>
<thead>
<tr>
<th></th>
<th>Recruitment practice</th>
<th>Average annual Remuneration (Rs.)</th>
<th>Job esteem</th>
<th>Social recognition</th>
</tr>
</thead>
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<tr>
<td>SIDBI</td>
<td>Open competition, qualifications &amp; competence</td>
<td>120,000</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>ITPO</td>
<td>Open competition, qualifications &amp; competence</td>
<td>60,000</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>ESC</td>
<td>Personal contact</td>
<td>60,000</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>CLE</td>
<td>Open competition, qualifications &amp; competence</td>
<td>48,000</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>SIDO</td>
<td>Open competition, qualifications &amp; competence</td>
<td>36,000</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>NSIC</td>
<td>Open competition, qualifications &amp; competence</td>
<td>48,000</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>ACMA</td>
<td>Personal contact</td>
<td>48,000</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

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