Chapter- 1

INTRODUCTION

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Take a look at any big company. Now, look back through time and track down when the company actually began. Not too many were born the size of the National Federal Bank or Procter & Gamble. Almost every company we know of began as an SME. The all-powerful Microsoft began with a couple of guys in a small garage in North-America; Vodafone as we know it today was once a little spin-off from Racal; Hewlett-Packard started in a little wood shack; Google was begun by a couple of young kids who thought they had a good idea; even Volkswagen at one point was just a little car maker in Germany, as opposed to being a giant small car maker globally today.

Small and Medium Enterprises (SME) all over the world have been recognized as the silent drivers of a nation’s economy. Their enterprise is laudable and their ability to generate pools of growth and employment, invaluable. This is true for most developed, as well as developing economies. In the emerging economic order SMEs are the leading edge when it comes to innovation and entering new global markets. The SME story in India is no different. With over 50% of industrial output through 95% industrial units, SMEs form the backbone of the Indian economy. Their contribution to the economy is huge and hence they are entitled to their rightful share of attention from Financial Institutions. Some of the important features of Indian Small & Medium Enterprises are exhibited below:

- India has nearly 13 Million SMEs
- Industrial Production Rs. 6,95,100 Cr. as on March 2008, which is 50% of total Production.
- 40% share of total Exports.
- Employing more than 42 Million People, next only to Agriculture.
- Growth rate more than overall Industrial growth rate.
- Produces a wide range of products, more than 8000.
- Contributes 8% to GDP.
- Credit to SMEs from PSU Banks Rs.148,600 Cr. as on March 2008.

1.1 Background

The post war period witnessed the widening of the economic gap between developed and underdeveloped nations and a growing awareness on the part of the latter to bridge this gap. Underdeveloped nations had particularly pinned their hopes on industrialisation, which had historically proved itself to be dependable means to achieve the supreme objective of economic development, namely to elevate the living standard of the people and to promote
their social and economic well being. The developing countries had generally fared well in the field of industrial development and have been instrumental in accelerating the pace of industrialisation of the country.

There are numerous reasons why developing countries had to accelerate their rate of industrial advance. In the first place, 7% annual growth rate of manufacturing could not meet the increasing demand for manufactured goods by these countries which as a consequence became more dependent on net imports of manufacturers. Secondly, most developing countries had experienced demographic rates well above 3% so that the rate of success in manufacturing attained by a number of developing countries, when measured in per capita terms was moderated.

Unless the underdeveloped countries had strived to accelerate the pace of industrialisation, the hope of achieving a decent standard of living for their people remained a mirage. In many underdeveloped countries like India, which had undertaken planned economic development, a large number of new and modern industries had been set up. Such industries neither induced the technology transformation all over the economy nor have they made any dent on the basic problems of poverty and under-employment.

Despite of industrialisation in many underdeveloped countries, the per capita income of inhabitants had not recorded a substantial improvement. A sustained increase in per capita real output over a period is necessary to raise the standard of living of the people.

The term ‘industry’ refers mainly to manufacturing activities, agriculture, mining and most of the other services are excluded from it. The term ‘industrialisation’ is used to designate the growth of manufacturing industry. It is thus a part of much broader process of economic development, which involves the raising of standard of living, through a steady increase in the efficiency of factors of production. India is a developing country and economic development here must basically mean raising the productivity of agriculture workers. After a certain stage of development however, it may become more profitable to transfer the surplus labor to other gainful employment such as manufacturing. Economic development involves an inevitable shift away from agriculture to manufacturing, transport and communication. This structural shift from agriculture is the essence of economic development and termed as industrialisation.

The SMEs Sector plays an important role in the economies of both industrialised as well as in developing countries. While in the advanced countries, the typology of this sector tends to be homogeneous (mainly in term of firm size and technology). In the developing countries (characterized by low industrialisation) there is co-existence of both very small craft-type enterprises in the informal economy and Small and Medium businesses in the organized sectors. As industrialization progresses, the composition of SMEs Sector would undergo a change in favor of modern small enterprises. These modern small enterprises firms are
capable of adopting state of the art technology, relatively big with larger market share, quality conscious and may also be export-oriented units.

The Small and Medium Enterprises exercise a stabilizing influence on the vagaries and uncertainties of rural economy besides contributing to its prosperity especially in countries predominantly by agriculture. Short gestation period, less infrastructural facilities and low capital cost are the advantages of Small and Medium Enterprises. They mobilize effective utilization of resources, capital and skill which might otherwise remain unutilized or inadequately utilized particularly in rural, remote and backward regions. These industries can be set up in any part of the country depending upon the availability of local skill and resources thereby facilitating balanced industrial development in the country.

1.2. Defining the Problem

Credit is undoubtedly, the jugular vein of small enterprise development in any economy. But, a major constraint in the development of Small and Medium Industries is inadequate credit to finance operations and expansions in our country. The difficulties in obtaining Institutional Credit largely stem from a lack of collateral and the inability to comply with documentation requirements. Better understanding of the financing patterns of small firms and how they change with institutional development has important policy and resource implications.

Many policymakers in governmental and international aid organizations believe that in developing countries small firms have inadequate access to external finance as a result of market imperfections. In response, significant resources are being channeled into the promotion and financing of small and medium-size enterprises in developing countries. For example, the World Bank Group lends more than $2 billion a year in SME support programs. Significant renewed interest has also emerged in development banks, which seek to provide loans that promote development by lending to constrained borrowers in developing countries, particularly small firms.

Understanding how financing patterns of small firms differ across institutional environments is an important first step in assessing these costly policies. Simplification of procedures and flexibility in rules governing small borrowers would help to increase the flow of institutional funds required for increased investment in the post WTO regime. The possibility of interaction between formal and informal sources to increase loanable funds for small and medium enterprises needs to be probed for the development of SMEs Sector in India.