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Export Competitiveness of Small Medium Enterprises in India

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Abstract:

An attempt is made in this paper to analyze the export-competitiveness of Small and Medium Enterprises (SMEs) in India. The SMEs play a vital role in the industrial development of any country. The importance of the SME sector is well recognized worldwide due to its significant contribution to gratifying various socio-economic objectives, such as higher growth of employment, output, promotion of exports and fostering entrepreneurship. They are an essential employment-generating sector with 50 per cent of the private sector employment and 30–40 per cent of value addition in manufacturing. They produce a diverse range of products (over 8000), including consumer items, capital and intermediate goods. Drawing from the experiences of countries that have successfully promoted the export competitiveness of SMEs, this paper has identified ways in which SMEs in India can have an access to external markets through exports, which include simplification of procedures, incentives for higher production, preferential treatments to SMEs in the market development fund, linking up SMEs with Transnational Companies or large domestic exporting firms; and formation of clusters and networks in order to reinforce their external competitiveness.

Keywords: external competitiveness, Small and Medium Enterprises, GDP, Exports

Introduction

SMEs have been defined on the basis of various criteria such as the number of workers employed, volume of output or sales, value of assets employed, and the use of energy, etc. Organization for Economic Cooperation and Development (OECD) defines establishments with up to 19 employees as 'very small', between 20 and 99 employees as 'small, from 100 to 499 employees as medium and over 500 employees as large enterprises. However, many establishments in some developing countries with 100 to 499 employees are regarded as relatively 'large' firms. Multilateral Investment Guarantee Agency (MIGA) has recently developed a guarantee program, called the Small Investment Program (SIP) that is specifically designed for SMEs. MIGA defines SMEs, for coverage under this program, as firms with not more than 300 employees, value of assets not exceeding US $15 million and annual sales not exceeding US $15 million. The European Union defines SMEs as enterprises that have employees of less than 250, with a turnover not exceeding Euro 50 million. In India the SMEs are not well defined. The internal group set up by the Reserve Bank of India has recently recommended that the units with investment in plant and machinery in excess of small scale industries (SSI) limit and up to Rs.10 crores may be treated as medium enterprises. As per 'Prudential Regulations for Small Enterprises Financing (First Edition - 2004)' prepared by the Focus Group Team of Bangladesh Bank, a small enterprise means an entity, ideally not a public limited company, which does not employ more than 60 persons (if it is a manufacturing concern) and 20 persons (if it is a trading concern) and 30 persons (if it is a service concern). In many banks, small enterprises are considered as business enterprise where banking financing ranges from BDT 25,000.00 to BDT 500,000.00. Thus the definitions of 'small' and 'medium' sized enterprises differ from one country to another. There is every room for defining SMEs from a country perspective as the definition depends on the regulatory environment, economic structure, availability of capital and suitable investment alternatives, employment level and so many other factors.

Current Scenario of SMEs in India:

The current scenario of SMEs in India can broadly be discussed in terms of different factors from the point of view of contextualization as follows:

a) The amount of investment in fixed capital assets,
b) The extent of employment generation,
c) The contribution to gross domestic production (GDP), and
d) Their contribution towards exports.

The Amount of Investment in Fixed Capital Assets

From Table 1, it is observed that the total number of Small Scale Industries in India has increased from 2.388 million in 1993-94 to 3.572 million in 2002-03. During the same period, the fixed investment (at current price) has increased from Rs. 35.376 billion in 1993-94 to Rs. 90.450 billion in 2002-03.

Table 1: Time Series Data for SSIs in India

Year	Units (Million nos.)	Production (`crore)		Employment (Million nos.)	Productivity (thousand)
		Constant prices	Current prices		Constant prices
1991-92	7.06	87355	80615	16.60	53
1992-93	7.35	92246	84413	17.48	53
1993-94	7.65	98796	98796	18.26	54
1994-95	7.96	108774	122154	19.14	57
1995-96	8.28	121175	147712	19.79	61
1996-97	8.62	134892	167805	20.59	66
1997-98	8.97	146263	187217	21.32	69
1998-99	9.34	157525	210454	22.06	71
1999-00	9.72	170379	233760	22.91	74
2000-01	10.11	184401	261297	24.09	77
2001-02	10.52	282270	282270	24.93	112
2002-03	10.95	306771	314850	26.02	116
2003-04	11.40	336344	364547	27.14	122
2004-05	11.86	372938	429796	28.26	130
2005-06	12.34	418884	497842	29.49	140
2006-07	26.10	471663	709398	59.46	151
2007-08	27.28	532979	790759	62.63	165
2008-09	28.52	NA	880805	65.94	NA
2009-10	29.81	NA	982919	69.54	NA

Source: Development Commissioner (SSI), Ministry of Small Scale Industries, Government of India.

This significant rise in the number of SMEs reflects:

a) It has been easier to establish a small and medium enterprise as it requires a relatively less amount of investment both in fixed and flexible capital assets.

b) The small and medium enterprises are growing at a much faster rate and thereby creating potentials for output, employment and exports.

c) The scope for their growth has been enhanced greatly due to the adoption of more liberalized policy measures

The Extent of Employment Generation

The small enterprises sector is a vibrant segment of the Indian Economy which has contributed over 39 percent of the industrial output and 34 percent of the nation's exports and provided employment to over 19.965 million persons through 3.572 million units (2002-03) spread both in the urban and in the rural areas of India. It has been estimated that 100,000 rupees of investment in fixed assets in the small-scale sector generates employment for four persons.

Along with agriculture, the SME sector provides the largest employment generation potentials in the country. During 2003-04 the small sector registered a growth rate of 8.6 percent as against 7.0 percent for overall industrial growth. The significance of SMEs in employment generation can be noted that while in 1990-91 the sector provided employment opportunities to around 12.53 million of people which over the decade has gone up to 18.56 million in 2000-01 and to 19.96 million by 2003-04. In a steady growing populated country like India this huge contribution to the tune of almost 80 percent in fifteen years is definitely a significant benchmark in the growth process.

Contribution to Gross Domestic Product

By analyzing the SMEs' contribution to the GDP for the period 1990-91 to 2003-04, it is noted that in the year 1990-91 the GDP from this sector was Rs.68295 crore (at Constant 1993-94 prices) which has increased to Rs.184428 crore in 2000-01 and further to Rs.228730 crore (constant prices at 1993-94) reflecting an overall growth rate of 3 times a decade and 4 times in fourteen years, though in terms of percentage their share has been reduced from 14 to 8 of GDP for the same period.

Contribution to Export Performance: SSI Sector plays a vital role in India's present export performance. About 45%-50% of Indian Exports are contributed by this sector. Direct exports from the SSI Sector account for nearly 45% of total exports.

Table 2: Growth of SSI exports

Year	SSI Export		
	Crore	US$ million	Share of SSI (%)
1991-92	13883	5632	34.01
1992-93	17784	6140	35.12
1993-94	25307	8068	36.40
1994-95	29068	9258	35.10
1995-96	36470	10903	34.20
1996-97	39248	11056	33.40
1997-98	44442	11958	35.19
1998-99	48979	11642	34.59
1999-00	54200	12508	33.97
2000-01	69797	15278	34.47
2001-02	71244	14938	34.29
2002-03	86013	17773	34.03
2003-04	97644	21249	35.10
2004-05	124417	27690	35.47
2005-06	150242	33935	36.14
2006-07	182538	40309	35.14
2007-08	202017	50202	37.36
2008-09	197480	51100	36.87
2009-10	201475	51740	35.48

Source: Total Exports - Economic Surveys – Various Issues

Besides direct exports, it is estimated that small-scale industrial units contribute around 45% to overall exports. The SMEs' contribution has gone up from Rs.25307 crore in 1993-94 to Rs. 69796 crore in 2000-01 and to Rs. 86013 crore in 2002-03 (Table 2) with respect to exports. In terms of percentage, the share of SSI in Indian exports has raised from 31.5 in 1991-92 to 34 in 2002-03.

It is this intersectoral transformation which is a significant reason for the present study.

SMEs: Major compositions and their share in exports

The small scale industrial sector of Indian economy encompasses almost all of the products (including a large number of services) produced by the Indian industries within the economy. Most of the times the products produced by the small and medium enterprises comprise the intermediary products produced by the large scale industries. They include:

- Food Processing Readymade Garments
- Agricultural Inputs Leather and leather goods
- Chemicals & Pharmaceuticals Bio-engineering
- Engineering, Electrical, Sports goods
- Electronics Plastics products
- Electro-medical equipment Computer Software, etc

Major sectors contributing to SSI exports include readymade garments (27%), engineering goods (14.5%), chemicals & pharmaceuticals, electronics & computers, and processed foods (11% each).

Outlook for Indian SMEs

Outlook towards the SMEs is very much important to strengthen it. The premises for such an outlook that is essential for Indian SMEs to combat the challenges ahead are outlined below:

a) SMEs continue to be the thrust area for Government policies.

b) The growing economy and the tremendous market potential of the country promise well for the sustained growth of SMEs in the country.

c) Avenues for employment and decentralized industrial development.

d) Latest policy package for SMEs envisages 20 percent annual growth in credit to SME sector from FY 2005, to be doubled by 2010.

e) With the enactment of MSME Act, the sector is set to emerge as the most vital contributor to the national economy.

f) SIDBI as the apex institution will continue to play its key role in facilitating timely and adequate credit besides meeting the developmental needs of the sector.

Export competitiveness of Indian SMEs:

In developing countries like India, making the SMEs more export competitive is particularly pressing as trade liberalization and deregulation increase the competitive pressures and reduce the direct subsidies and protection that Governments offer to SMEs. Nevertheless, with their dynamism, flexibility and innovative drive they are increasingly focusing on improved production methods, penetrative marketing strategies and management capabilities to sustain and strengthen their operations. The capability of Indian SME products to compete in international markets is reflected in its share of about 34 per cent (Table 2) in national exports. In the case of items like readymade garments, leather goods, processed foods, engineering items, the performance has been commendable both in terms of value and their share within the SME sector. In view of this, export promotion from the SME sector has been accorded high priority in India's export promotion strategy, which includes simplification of procedures, incentives for higher production of exports, preferential treatments to SMEs in the market development fund and simplification of duty drawback rules. They are thus poised for global partnership to absorb and more importantly to impart latest technologies in diverse fields.

Constraints to SMEs in India:

The constraints those come across by the SMEs in India to be export competitive include product reservations, regulatory hassles– both at the entry and exit stages, insufficient finance at affordable terms, inflexible labor markets and infrastructure related problems - like high power tariff, and insufficient export infrastructure. These are briefly elaborated below:

a) Lack of entrepreneurial, managerial and marketing skills

b) Bureaucracy and red tape

c) Lack of accessibility to information and knowledge

d) Difficulties accessing financial resources/Lack of capital

e) Lack of accessibility to investment (technology equipment and know-how)

f) Non-conformity of standardization and lack of quality awareness

g) Product and service range and usage differences

h) Language barriers and cultural differences

i) Risks in selling abroad

j) Competition of indigenous SMEs in foreign markets

k) Inadequate behaviors of multinational companies against domestic SMEs.

l) Complexity of trade documentation including packaging and labeling

m) Lack of government incentives for internationalization of SMEs

n) Inadequate intellectual property protection

Indian SMEs - strategic thrusts for the future

Drawing from the experiences of countries that have successfully promoted the export competitiveness of SMEs, the following section lays down the strategy for Indian SMEs to achieve their export potential and make them increasingly export oriented. Promoting the export competitiveness of SMEs needs the active involvement of various stakeholders – government, the private sector and the international community.

Role of Government:

Creating a business-friendly environment: The points for the creation and further development of a business-friendly environment enabling SMEs to start exporting or to help consolidate the activities of SMEs are outlined below:

a) Combating corruption and red tapism that hinders the growth and export potential of SMEs.

b) Creation or reform of administrative and legal institutions in order to guarantee SMEs a stable legal framework in which to operate and to facilitate an anti-monopolistic and competitive business environment.

c) Delivery of an appropriate public infrastructure, especially in transportation, power, telecommunications and other infrastructure needed to enable domestic and external trade (e.g. testing and certification laboratories).

Measures to improve SMEs' access to finance: These may include,

a) Providing credits directly from state owned banks to SMEs;

b) Liquidity incentives to commercial banks that provide loans to SMEs (lowering of reserve requirements, access to discount lines, etc.);

c) Interest rate subsidies;

d) Guarantee programs; and so on and so forth.

SME trade promotion through public-private partnerships: Governments may approach domestic and foreign large corporations to design specific institutions or tools to provide exporting or promising SMEs with specific services. Such partnerships can take various forms, including:

a) Training facilities,

b) Technology upgrading centers,

c) Research and testing labs,

d) Scientific hubs,

e) Investment funds,

f) Incubators, etc.

Role of Private Sector:

A wide range of measures could also be considered at the B2B level to boost the export capacities of SMEs in India.

Clusters: SMEs should be encouraged to work in a cluster environment ensuring complementarities, common activities, collective goods and institutional stability. This strategy requires sector specific actions, aimed at increasing the competitiveness of the cluster, promoting networks and cooperation amongst firms. National governments, local authorities, TNCs and SMEs associations should be involved in efforts to identify the optimal division of labor among individual SMEs, large firms and central/local governments in developing countries so as to enable duplication of the successes of the best exporting SME clusters and industrial districts.

Financial and non-financial business development services (BDS): Smooth access to financial and non-financial services can play a role in supporting some SMEs aiming at exporting or to consolidate regular foreign orders.

Combination of financial and non-financial support services: The rigid separation between financial and technical service providers should be reduced to improve proximity to the real multi-level needs of SME exporters. The combination and teamwork of financial and technical services should be much more systematically explored both by banks and by BDS providers to match SME export needs.

Role of International Society

National policy versus international commitments: An important issue is the choice between incentives and subsidies for exporting SMEs, their compatibility and legality with existing international agreements needs further exploration.

SMEs' access to finance: The international community should play a more active role in facilitating SMEs' access to finance. This can be achieved in the following ways:

a) Enhancing SME export credit and long-term finance: Facilitating SME access not only to short-term export credit but also to long-term loans for the expansion of SME export capacity. The issue of credit collateral and guarantees should be revised. Foreign buyers, TNCs and other business linkage makers should be invited as facilitators or guarantors.

b) Coordination between financial and non-financial support institutions**:** Agreements with selected financial institutions to enable SMEs to quickly access medium- to long term finance at preferential interest rates; and export development and investment funds (EDIF) designed to improve the export competitiveness of SMEs at low comparative interest rates.

Conclusion:

SMEs which constitute more than 80 per cent of the total number of industrial enterprises and form the backbone of industrial development in India now are not export competitive and contribute only about 34 per cent of exports. Boosting the contribution of small and medium enterprises in total exports of India is vital to India's future economic growth, which can be promoted in the following manner: a) Independent SMEs specializing in specific niches and highly profiled productions; SMEs that link up with TNCs or large domestic exporting firms; and SMEs that are part of clusters and networks in order to reinforce their external competitiveness be encouraged. b) Special emphasis should be put on linkages between TNCs and SMEs as a way to enhance the export competitiveness of SMEs. Linking up with TNCs is increasingly perceived as a way for SMEs to solve their traditional problem of access to certain critical resources, the most important of which are finance, technology and managerial skills, as well as to new markets. c) Policy intervention for SMEs could be particularly export-effective when it is based on the Triple C (Customer oriented, Collective and Cumulative). However, it is also essential to create and sustain a business environment that reinforces the international competitiveness of the export sector as a whole. This can be achieved by active collaboration between governments, the private sector and international agencies with a view to reaping the significant potential benefits of exports through SMEs.

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