

EXIM BANK: RESEARCH BRIEF

Export Performance of Small and Medium Enterprises in India



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Introduction

The Small and Medium Enterprises (SME) play a vital role in the industrial development of any country. The importance of the SME sector is well recognized world over from its significant contribution in gratifying various socio-economic objectives, such as higher growth of employment, output, promotion of exports and fostering entrepreneurship.

Definition of SMEs in India and World

In India the small and medium enterprises 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 SSI limit and upto Rs. 10 crores may be treated as medium enterprises.

The definitions of 'small' and 'medium' sized enterprises differ from one country to another. SMEs have been defined against various criteria such as the number of workers employed, volume of output or sales, value of assets employed, and the use of energy. Organisation for Economic Cooperation and Development (OECD) defines establishments with upto 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 programme, called the Small Investment Programme (SIP), that is specifically designed for SMEs. MIGA defines SMEs, for coverage under this programme, 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 that have employees of less than 250, with a turnover not exceeding Euro 50 million. Thus the definition of SME varies from country to country and from region to region.

Significance of SSI in India

The SSI sector in India employs around 26 million people and is involved with the production of over 7500 industrial items with the product range varying from very simple items produced with traditional technology to high tech products. At present, the SSI sector accounts for over 90% of industrial units in the country, 40% of value addition in the manufacturing output and approximately 35% of India's exports.

Evolution of Policies

Since independence, the Government of India has formulated a total of six Industrial Policy Resolutions / Statements with a view to promote industrial growth in the country. All these policies have also covered the small-scale sector, in general. To attain higher growth in SSI sector, various incentives pertaining to financial, fiscal and infrastructure related measures were designed and extended to SSI units. Protectionist policies have been devised to guard the SSIs against competition from the large scale sector. Later, on the lines of economic liberalization, it was decided to phase out the reservation policy with the objective of enhancing the potential of SSI sector in their export orientation. With the gradual phasing out of reservation, the list of reserved items for the SSI sector stood at 506, as of March 2005.

Realising the credit requirements of SSI sector, the Government evolved a credit policy under the priority sector lending. Several committees have been constituted to increase the credit flow to the SSI sector. The Internal Group set up by the Reserve Bank of India to review the guidelines of credit flow to the SME sector recommended self set targets for the commercial banks, with an increasing disbursement over the previous year. The Group also advocated for empowering the Boards of the banks

to frame their own policies with regard to SME financing, so that lending policies would be more liberal than the existing policies. The Union Minister for Finance, Government of India in a statement in Rajya Sabha on August 10, 2005 fixed a minimum growth of 20% in credit to SME sector so that the flow of credit to this sector could be doubled from Rs. 67600 crores in 2004-05 to 135000 crores by 2009-10.

SME Policies in Select Countries

Institutional framework and policy specifications are important factors in helping the evolution and success of SMEs across the globe. Today, many countries have a range of programme in diverse areas, viz., financing, technology, innovation, managerial ability, market information and developmental assistance, aimed at improving the working environment for SMEs.

Finance

The Community Programme in Czech Republic provides financial assistance to SME units in areas with less than 2000 population. The Credit Guarantee Corporation of Hungary plays an active role in promoting SME development and improve their competitiveness. In Japan, Credit Guarantee Association acts as a guarantor for SMEs that are having no collateral security. A financial safety net has been established in South Korea to help SMEs to overcome the financial shortage. South Korea also has a facilitative bankruptcy law to enable the exit and restructuring of SMEs that experience financial stress.

Technology

The Czech Republic has a Technos Programme to support research, development and innovation in SMEs by accelerating their rate of technology acquisition through realisation of R&D projects. South Korea has established international cooperation programmes to strengthen

competitiveness through technology transfer.

Innovation

China has an Innovation Fund for small technology based firms to promote technological innovation amongst SME units. The SME agency of Japan supports the innovation activities of SMEs through various products and services. Direct subsidies are also given by Government of Japan for R&D activities of SMEs in Japan.

Information and Marketing

In China, an SME network has been established to meet the information requirement of SMEs on policies, laws, regulations, emerging technologies, emerging product lines, sources of raw materials, trends in supply and demand. National Bank of Foreign Trade (BANCOMEXT), in Mexico provide easy access to information on foreign trade to SME units and help them in their globalisation efforts. Czech Republic has a Marketing Programme aimed at supporting SME units to get subsidy for export and marketing consultation. Mexico has a Supplier Development Programme, which would help integration of SMEs in to productive chains of large business houses in Mexico.

Skill Development

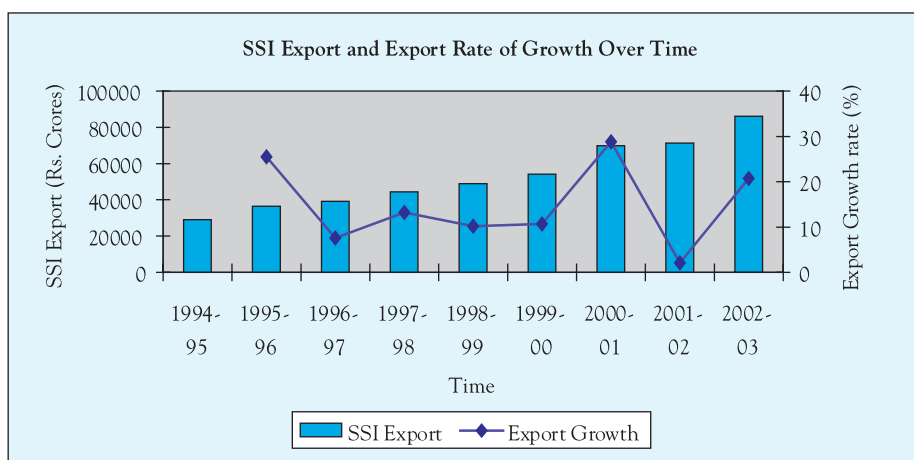
Italian Government provides

curriculum on entrepreneurial skill development as vocational course to their citizens, which enables them to start SME units and contribute to the economic and social development of the country. Japan has SME support centers which provide over the counter consultation, on-site professional assistance, business feasibility assessments and information services. South Korea has business incubators to increase management skills of women entrepreneurs. The Global Supplier Programme of Malaysia helps in developing critical skills in SME units and also facilitate linkages with MNCs and large scale units.

Export Performance

SSI sector in India has been exhibiting a striking export performance. Barring few years, exports have grown double digit in the last 10 years. Exports at current prices in 2002-03, the latest year for which data is available, stood at Rs. 86000 crores. This works out to about 34% of total exports in India in the same year. Major sectors contributing to SSI exports include readymade garments (27%), engineering goods (14.5%), chemicals & pharmaceuticals, electronics & computers, and processed foods (11% each).

In terms of export orientation, sports goods have 100% exports from SSI sector, followed by readymade

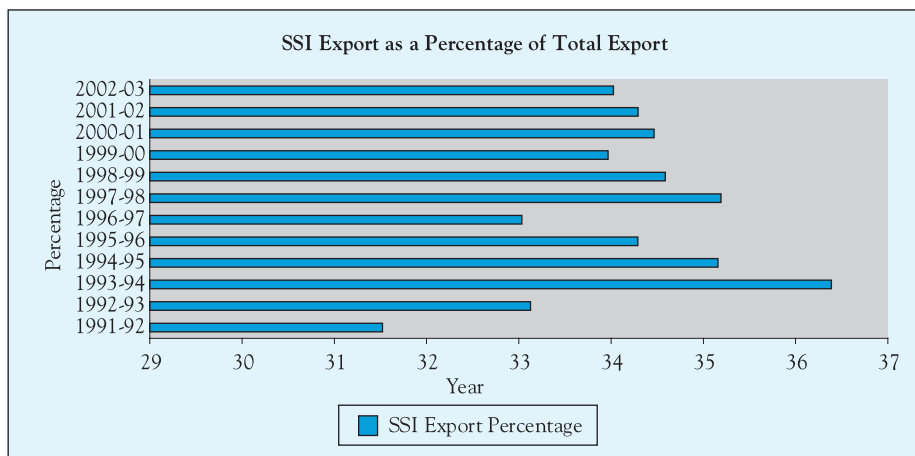


Source: Economic Survey 2004-05

garments (90%), leather (70%), marine products (47%) and chemicals & pharmaceuticals (44%).

Over the last 10 years, the share of SSI exports has increased in most of the

capital investment to come out of the SSI net and emerge as global players. Such a trend is happening especially in sectors like basic chemicals, pharmaceuticals, engineering goods, leather and textile sectors.



Source: SIDO

sectors. At the same time, in some sectors, the share of SSI in total exports has come down. The SSI intensive sectors that have witnessed increase in export share include engineering goods, chemicals and allied products, plastic products, processed foods, marine products, woolen garments and knitwear, processed tobacco. Sectors like basic chemicals & pharmaceuticals, finished leather and leather products, synthetic and rayon products have witnessed declining share in total exports. Sectors like readymade garments and sports goods were observing neutral trend, with the share remaining the same.

These 12 SSI intensive sectors accounted for about 95% of total SSI exports from India, in the year 1991-92. However, the share has come down to 85% in 2002-03. While these sectors have improved their cumulative share in India's total exports from 51.6% in 1991-92 to 55.5% in 2002-03, the export share by SSI units in these sectors have come down from 58.4% in 1991-92 to 52.4% in 2002-03. Thus, it may be inferred that, since liberalisation, more and more exporting units from SSI sector have been increasing their

There are no official data for compilation of export performance by the medium scale units. However, analysis has been made using the CMIE's India Corporate Database, which represents more than two-third of Indian manufacturing sector. Analysis has been made to measure the export performance of medium scale units in select sectors, using two definitions, viz., based on capital investment, as defined by RBI, and based on sales turnover of units up to Rs. 75 crores. The analysis revealed that sectors like food and beverages, chemicals, auto-components, machinery, electronics, metals, castings and forgings have witnessed increasing export orientation trend over the last decade.

However, the export orientation of sectors like leather, textiles and readymade garments has more or less remained static over the period. It may be inferred that these sectors, since they require plenty of capital investment to meet the global challenges, need to be kept out of any limit on capital investment, to emerge as global players.

Exim Bank and SMEs

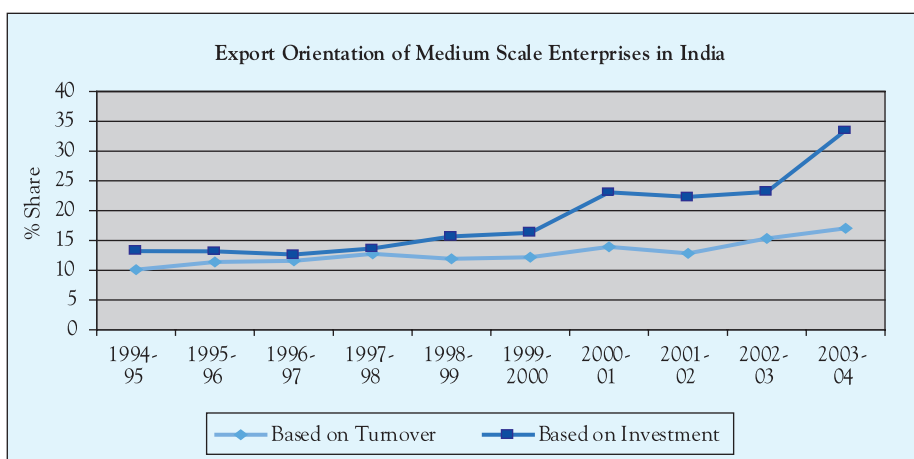
Export-Import Bank of India (Exim Bank) has been focusing on SME exporters as a significant target group of clients. In the past, Exim Bank has implemented a number of innovative programmes focusing primarily on SMEs. The Bank, in the past, has operated an Agency Line of Credit for IFC and an Export Marketing Programme for the World Bank, which are targeted towards SME sector. The Bank proactively assists SME units in establishing their products in international markets. Exim Bank's Lines of Credit help SMEs to offer competitive credit term to the buyers and to explore newer geographical markets. Recently, the Bank has signed a Memorandum of Cooperation with the International Trade Centre (ITC), Geneva, to implement the Enterprise Management Development Services (EMDS) programme, for supporting SMEs in their globalisation efforts. This initiative is being launched by ITC for the first time in any country.

Constraints and Strategies

Constraints

The constraints faced by the SSI sector include product reservations, regulatory hassles – both at the entry and exit stages, insufficient finance at affordable terms, inflexible labour markets and infrastructure related problems - like high power tariff, and insufficient export infrastructure. These are briefly elaborated below:

- The policy of product reservations has restricted operation of economies of scale and greater efficiency in the small scale sector.
- Starting a business in India requires number of permits, even after the initiation of liberalization programme, as compared to many other developing Asian nations.
- Insufficient finance at affordable terms is another challenge daunting the performance of Indian SME sector.



Source: Compiled From Prowess Database

- Infrastructural bottlenecks such as transportation / communication facility and insufficient export infrastructure increases the transaction cost of SME units in India.
- Problems in assessing adequate and reliable power at affordable price is another key constraint of Indian SMEs.

Strategies

SME development requires a cross-cutting strategy, that touches upon many areas. Apart from conducive policies, there is a need for simplified legal and regulatory framework, good governance, abundant and accessible finance, suitable infrastructure, entrepreneurial skill development infrastructure and competitive environment. Some of the strategies are highlighted below:

- Conducive WTO compatible policies are required for this sector to decide on various issues such as cap on capital investment, ceiling on FDI, interest subsidy, de-reservation of items, creation of technology upgradation fund.
- Existence of adequate institutional framework and efficient administrative system, along with deregulation of economic activities, would facilitate restructuring of small and medium

enterprises in India.

- The small and medium scale enterprises could be defined as one entity for policy purposes, with the objective of facilitating higher investment and thereby encouraging the technology upgradation.
- Reservation of items should be phased out substituting with promotional support to strengthen their globalisation efforts.
- Reengineering the entire gamut of regulatory processes, especially at the state and local levels, with the objective of installing transparent policies would bring down the cost of investment related delays.
- 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.
- There is a need for development of a comprehensive programme for improving the technology base and strengthening of innovation culture in SMEs.
- Management skills are very necessary for the success of SMEs

in any developing country. Strengthening National Entrepreneurship Development Board, devising comprehensive plan for promotion of rural entrepreneurship, fostering close linkages with premier institutions engaged in management and entrepreneurial training may be considered on priority basis.

- Access and integration into local, national and global markets require substantial investments. Partnerships between various stakeholders, viz., Government, society and industry, foster such investment.

The contents of the publication are based on information available with Export-Import Bank of India and primary desk research through published information of various agencies. Due care has been taken to ensure that the information provided in the publication is correct. However, Export-Import Bank of India accepts no responsibility for the authenticity, accuracy or completeness of such information.

Note: Indian Rupees are referred in crore and lakhs:
 1 crore : 10 million
 1 lakh : 100 thousand

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