MSME –The Growth Engine of Indian Economy

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ABSTRACT

MSMEs are the power engines of the economy. Micro, Small and Medium Enterprise (MSMEs) constitute over 90 percent of total enterprises in most of the economies and are credited with generating highest rate of employment growth and also account for a major share of industrial production and exports. This study aims to investigate the major challenges faced by MSMEs today. It also suggests policy recommendations that would help in overcoming those challenges. The government needs to hand-hold the MSME units in order to promote growth in the manufacturing sector. The state of infrastructure is not satisfactory and calls for more investment from the government. Banks are not so willing to provide loans to these units which challenge the prospects of growth in these units. Delayed payments are a big problem which needs tighter rules on the buyer-side in order to safeguard the interests of the manufacturers.

Although the current government in power has been taking an active interest in the manufacturing sector, there is still a long way to go when it comes to policy implementations. The need of the hour is to protect these units and take measures which will support them and would help them flourish. Promising alone is not sufficient; making it happen is the key.

Small and Medium Enterprises (SMEs) are crucial for the economic growth and stability of any country and play a vital role especially for developing countries as they facilitate economic activity and provide employment thus contributing to poverty reduction. In the Indian context they can be considered as the backbone of national economy.

Good corporate governance leads to development of a framework that provides adequate protection to the interests of stakeholders and reinforces the fiduciary responsibilities of those vested with the authority to act on behalf of the stakeholders.

This paper would analyze the current status of Indian MSMEs and how, the introduction SMART governance frame work can make the MSMEs SMART Enterprises.

Keywords: MSME, Manufacturing Sector, Precision Tools, Survey, Weavers, Make in India, Loans, Labor Scarcity, Infrastructure, Delayed Payments, Policy, Recommendations
Introduction

Micro, Small and Medium Enterprises Sector in India

The MSME sector plays a significant role in the Indian economy. A catalyst for socio-economic transformation of the country, the sector is critical in meeting the national objectives of generating employment, reducing poverty, and discouraging rural-urban migration. These enterprises help to build a thriving entrepreneurial eco-system, in addition to promoting the use of indigenous technologies. The sector has exhibited consistent growth over the last few years, but it has done so in a constrained environment often resulting in inefficient resource utilization. Of the many challenges impeding the growth and development of MSMEs, inadequate access to financial resources is one of the key bottlenecks that make these enterprises vulnerable, particularly in periods of economic downturn.

Exclusive credit Plans for Micro Small and Medium Enterprise entails providing lower rate of interest for growing business units and offering them access to banking services at low rate of interest, quick processing and servicing.

Indian Micro Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. SMEs not only play crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialization of rural areas. MSMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country. The Sector consisting of 36 million units, as of today, provides employment to over 80 million persons. The Sector through more than 6,000 products contributes about 8% to GDP besides 45% to the total manufacturing output and 40% to the exports from the country. The MSME sector has the potential to spread industrial growth across the country and can be a major partner in the process of inclusive growth.

MSMEs also play a significant role in Nation development through high contribution to Domestic Production, Significant Export Earnings, Low Investment Requirements, Operational Flexibility, Location Wise Mobility, Low Intensive Imports, Capacities to Develop Appropriate Indigenous Technology, Import Substitution, Contribution towards Defense Production, Technology – Oriented Industries, Competitiveness in Domestic and Export Markets thereby generating new entrepreneurs by providing knowledge and training.

Despite their high enthusiasm and inherent capabilities to grow, MSMEs in India are also facing a number of problems like sub-optimal scale of operation, technological obsolescence, supply chain inefficiencies, increasing domestic & global competition, working capital shortages, not getting trade receivables from large and multinational companies on time, insufficient skilled manpower, change in manufacturing strategies and turbulent and uncertain market scenario. To survive with such issues and compete with large and global enterprises, SMEs need to adopt innovative approaches in their operations. MSMEs that are innovative, inventive, international in their business outlook, have a strong technological base, competitive spirit and a willingness to restructure themselves can withstand the present challenges and come out successfully to contribute 22% to GDP. Indian MSMEs are always ready to accept and acquire new technologies, new business ideas and automation in industrial and allied sectors.
India has been the breeding ground for ideas and entrepreneurs in the recent past. Start-up activity is at an all-time high. Start-ups have mushroomed across markets and industries, despite all the murkiness and uncertainty in the policy framework.

It is interesting to note that even if 2 per cent of Indians turn entrepreneurs and employ 25 people each on an average, half the Indian population will be employed.

While we see a positive trend in the start-up space in India, there are still challenges that act as roadblocks to their growth. The government has been focusing on the start-ups keenly. There have been numerous policies and initiatives focusing on them that have been announced in the recent past, aimed at supporting new ventures at different stages of their growth.

While it has been a great beginning, there is more that needs to be done to make India start-up friendly. Lack of existence of a robust ecosystem that can act as a catalyst for the growth of a start-up is another challenge that is faced by the start-up community. There is a need for more incubators. The infrastructure support can be improved upon, as it will go a long way in enabling
Review of Literature

*Lahiri (2014)* conducted a study on the Small Scale Industries at the Howrah district in West Bengal and found out that labor scarcity and problem of skilled labor to be one of the ten topmost problems of those MSMEs. He investigated that about 50 percent of the enterprises faced labor issues. Although MSMEs are known for highly skilled laborers with extremely high degree of precision and proficiency, they are not familiar with the latest machinery and are unable to match up their skills according to the demands of the market and requirements of the job.

*According to the Annual Report on MSME, Ministry of Micro, Small and Medium Enterprises, Government of India (2013-14)*, a Credit Guarantee Fund Scheme for MSEs has ensured credit availability for loans upto 100 lakh without collateral/third party guarantees.

*Chakrabarty (2012)* mentions that delayed payments from big companies to the MSMEs disrupt their business cycle and eventually lead to sickness. The MSMED Act, 2006 brought in improved provisions but that is not helping the enterprises to a significant level because the enterprises are afraid of filing complaints against the corporate companies. The MSMEs are also discouraged due to onerous legal procedures. RBI has instructed banks to maintain sub-limits within overall limits sanctioned to the corporates for payment to MSMEs in lieu of their purchase orders.

*Das (2011)* adds that the emergence of microfinance in the 1980s was mainly due to the failure of subsidy- oriented targeted programs in the past decade. In India, there are two streams of micro financing: bank linked SHGs and microfinance intermediaries in India. Unlike the fixed repayment system in general loan products, in case of microfinance, the enterprises can repay as and when they have sufficient cash flows; it’s a flexible repayment. Enterprises operating in the rural areas have totally different dynamics as compared to the ones in urban areas and hence, their micro financing needs also differ. The lending priorities are biased towards the large enterprises because they contribute more to exports and exports rather than employment. It is clear that capital alone cannot guarantee the success of microenterprise sector. It is limited by a lot of external and internal barriers. Without accessible and affordable support, informal enterprises will stagnate after a certain stage of growth even if sufficient investment is available to them.

Statement of Problem

The major constraints of SMEs are finance for initial capital and working capital, Line of credit from the suppliers, new technology to produce quality products, provide service, ability to hire qualified and professional staff for production, service and marketing.

Majority of the banks consider lending to MSMEs an unattractive venture due to a range of factors including information asymmetries and consequently high transaction costs, collateral requirement, financial products not meeting SME sector requirements in medium to long term Information asymmetries, due to inefficient legal system and weak governance structures of SMEs, result in higher transaction costs on the supply side. On the demand side we find most of
the MSMEs tend to shy away from formal modes of financing due to the high cost of credit, lengthy procedures, collateral requirements and lack of awareness about the benefits of corporate governance. External finance cannot be obtained by firms in their start-up phase as their management structures are not transparent and usually have intangible assets. International investors are often reluctant to invest in developing countries because their institutions do not provide an adequate level of security for their investment particularly in terms of enforceability of legal rights and governance framework. MNCs and international investors will be willing to forge partnership with SMEs only when their level confidence and trust increases regarding transparency and governance of the local partner.

Another problem for most of the MSMEs being family owned enterprises is that there is no clarity on the roles resulting in credibility problems and inability to arrive at strategic decisions. Good governance is vital for the development of a healthy and competitive corporate sector. For MSMEs, corporate governance is about the respective roles of the shareholders as owners and the managers. It is about establishing rules and procedures to manage and run the enterprise it has been empirically tested that good governance practices of a company gives a positive signal to investors. With the globalization of markets, international capital flows have become extremely valuable source of external financing.

**Objective of Study:**
Building on the efforts already underway, there are several potential interventions that can be undertaken to expand the access to MSME finance in India through enabling infrastructure, liquidity management and risk management. Some of these potential interventions include:

**Enabling infrastructure**
- Encourage securitization of trade-receivables in the sector through conducive legal infrastructure.
- Promote institutions to syndicate finance and provide advisory support to MSMEs in rural and semi-urban areas.
- Incentivize formation of new MSME-specific venture funds by allowing existing government equity funds to make anchor investment in venture funds.

**Liquidity management**
- Improve debt access to non-banking finance companies focused on these enterprises and provide regulatory incentives for participation in the sector.
- Develop an IT-enabled platform to track MSME receivables to facilitate securitization of these trade receivables, or alternatively expand the scope of SIDBI and NSE’s IT platform NTREES to facilitate securitization.
- Provide credit guarantee support for MSME finance to non-banking finance companies.
Risk management

- Develop a better understanding of financing patterns of service enterprises in the sector.
- Expand the scope of the sector’s credit information bureau to collate and process important transaction data, including utility bill payment.
- Strengthen the recently established collateral registry and create stronger linkages with other financial infrastructure.
- Facilitate greater debt access to non-banking finance companies.

Research Methodology:

The objective of this study is to conduct secondary research on the MSME industry in order to identify the major challenges faced by the enterprises and focusing mainly on the Precision tool to identify the hindrances that these enterprises currently face and to suggest policy measures that will improve the condition of these enterprises and will empower them.

Role of MSMEs

Micro Small and Medium Enterprises (MSMEs) are crucial for the economic growth and stability of any country and play a vital role especially for developing countries as they facilitate economic activity and provide employment thus contributing to poverty reduction. In the Indian context they can be considered as the backbone of national economy.

Churchill and Lewis (1983) identified five stages of growth for the SME’s as under:
In each stage of development a different set of factors is critical to the firm's survival and success. The Churchill Lewis model gives an insight into the dynamics of MSME growth, including the distinguishing characteristics, problems and requirements of growing MSMEs and explains business growth processes amongst MSMEs.

The major constraints of SMEs are finance for initial capital and working capital, Line of credit from the suppliers, new technology to produce quality products/ give service, ability to hire qualified and professional staff for production, service and marketing.

In the Indian context SMEs can be considered as the backbone of national economy and as a significant solution for our development issues as they
- Provide resilience in the economy and foster an entrepreneurial culture
  - Creates more jobs
  - Contributes to export
  - Reduces poverty
  - Provide more employment at lesser capital costs compared to large enterprises.
  - Reduces inequalities in the economy by contributing in distribution of wealth
  - Facilitate learning across the sectors as well as geographically

**Classification of the MSMEs in India**

Indian MSMEs comprise three sub-sectors:

1. Predominantly rural based, traditional household industries
2. Small and medium industries, functioning with relatively obsolete technologies
3. Modern small and medium enterprises, which are owned and operated by techno-entrepreneurs, operating in new industries such as software and bio-technology, among others.

**Problems of MSMEs**

Despite being pillars of economy, the MSMEs continue to face several problems in their day-to-day operations, that is, in production and marketing of their products. They find it difficult to sell their output at remunerative prices and cannot spend much on advertising, marketing research, etc. They also face stiff competition from large firms. Inadequate infrastructural facilities and access to credit are other major problems. MSMEs are often unable to procure adequate financial resources for the purchase of machinery, equipment and raw materials as well as for meeting day-to-day expenses. Further, they find it difficult to recruit and motivate skilled managerial and technical personnel. They are mainly reluctant to adopt modern methods of organization and management. Despite constituting more than 80 % of the total number of industrial enterprises and supporting industrial development, many MSMEs in India have problems such as sub-optimal scale of operation, technological obsolescence, supply chain inefficiencies, increasing domestic and global competition, fund shortages, change in manufacturing strategies and turbulent and uncertain market scenario.
The major five factors for failure has been identified as
- Inadequate finance
- Inadequate market linkages
- Obsolete technology
- Industrial Sickness
- Problems in Frequent Inspection
- Tough competition and Inadequate margin
- Low collection in Account Receivables

**Inadequate finance**
The mind set of banks towards SMEs have somewhat changed in the recent past. With the entry of private banks, increased competition has led to a rush for lending to prime customers. The multiple financial options from the capital market have also compelled banks to take more risks in the case of MSMEs. The increased lending to MSMEs is propelled by the compulsion of the market as well as by the rapid expansion of these companies. But there exists a stark disparity amongst small players and big players within the SMEs sector. Loans to bigger companies are growing at a faster pace than loans to the SSI sector. By the the proportion of SSI loans to total loans has remained small at 8.4%. The Small Industries Development Bank of India (SIDBI) was set up in 1990 under the Act of Indian Parliament as the principal financial institution for promotion, financing, development of industry in the small sector and coordinating the financial activities of other institutions engaged in similar activities.
➢ **Inadequate market linkages**
Next to finance, marketing is the big problem area for small entrepreneurs. The survival of small entrepreneurs very much depends on sound marketing techniques. One of the most important tools in the hands of small entrepreneurs for promoting their sales is low prices coupled with credit to buyers, which give rise to number of problems at a later stage. Marketing as a profession has not yet developed in the SME sector. Professional agencies are not engaged by small entrepreneurs on account of paucity of funds. The concept of marketing is not known to the majority of small entrepreneurs. For majority, marketing means advertisement or personal contacts. There are many ad-hoc initiatives taken by the Government to promote marketing of products/services of small units but no concrete action plan has been chalked out or targets made.

➢ **Obsolete technology**
Modernization, technological and quality up gradation has assumed great significance in the present day context. With the inflow of latest technology reducing the cost of production and the increasing competition from within and outside, the small scale sector will have to attach more importance and pay attention to the areas of technology up gradation and modernization. However, due to lack of information on the areas of technology up gradation, entrepreneurs who have plans for technical up gradation are not to go ahead.

➢ **Industrial Sickness**
A host of developmental schemes launched by the Government for solving the problems of small scale industries have yet to achieve their goals to arrest sickness in SSI sector. The plight of existing small scale industries is visible in many industrial complexes wherein the industrial sheds have been converted into allied activities like showrooms, banquet halls, Restaurants, etc. There seems to be some lacuna in the implementation part of the developmental schemes.

➢ **Problems in Frequent Inspection**
One of the major grievances of the small scale sector is that the frequent inspections by multiple government agencies are a source of harassment. At present, 55 inspectors of different levels are visiting the small scale units, which is a cause of major concern to the small scale units. It is suggested that the government should streamline the inspection procedure. It should also include repeal of laws and regulations applicable to the sector that has become redundant.

➢ **Tough competition and Inadequate margin**
By virtue of the fact that most of the entities in SME sector are small players in their field, they may have to encounter tough competition from the bigger players. They face the pressure on their margins they can’t raise their price but have to absorb the high input cost.

➢ **Low collection in Account Receivables**
As is evidenced in the increasing trend of outstanding receivables in the SSI sectors, there exists collection risk in the receivable portfolio of SME sectors for the reason that SMEs cannot dictate terms to their customers. As SME sector business entity is at the receiving end, this may put strain on the liquidity position of the business entity. However, the track record of SMEs as borrowers reveals that the default rate is low. Very low rates of bad debts may be the result of banks restricting their exposure to this sector.
Micro Challenges unearthed

Apart from the challenges discussed and solutions seek for; there are few unaddressed issues at the grass root level. A grounded network study revealed the understanding that most labour intensive MSMEs is facing the challenge of available work force. Moreover the initiatives are addressed for skill development of unskilled labour that might be inconsistent in any job offer and bargains for higher wages and demands conveniences that MSMEs could not afford. Thus losing the worker to a competent entrepreneur. The competency in most cases is addressed based on the ability to fund the workers sustainability at the unit. Other than this the Women entrepreneurs still find the social perception and attitude could not transform as easy as the schemes, policies and frameworks which hinder the growth of women entrepreneurs in the State.

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External finance cannot be obtained by firms in their start-up phase as their management structures are not transparent and usually have intangible assets. International investors are often reluctant to invest in developing countries because their institutions do not provide an adequate level of security for their investment particularly in terms of enforceability of legal rights and governance framework. MNCs and international investors will be willing to forge partnership with SMEs only when their level confidence and trust increases regarding transparency and governance of the local partner.

Most of the SMEs do not function efficiently due to the delay of decision-making process, poor organization, poor staffing, weak controlling and directing financial management of most of the SMEs is found to be very weak. Most SMEs do not calculate total expenses, total revenue, profit etc, for they do not keep any account systematically.

Another problem for most of the SMEs is family owned enterprises. The most important feature of family-owned enterprises is the lack of separation of ownership from control implying that directors and managers cannot be distinguished. This leads to credibility problems as there is no system of checks and balances between shareholders, directors and managers. The duties and responsibilities, and privileges of family members are not clearly defined. Usually in family-owned firms, the family has the requisite voting power to unilaterally dismiss boards or management or to over-rule their decisions. Thus the concept of independent directors does not prevail in these firms.
**Problems confronted by MSMEs**

The greater variance in profitability, survival and growth of MSMEs compared to larger firms accounts for special problems in financing. SMEs generally tend to be confronted with higher interest rates, as well as credit rationing due to shortage of collateral. The issues that arise in financing differ considerably between existing and new firms, as well as between those which grow slowly and those that grow rapidly. The expansion of private equity markets, including informal markets, has greatly improved the access to venture capital for start-ups and SMEs, but considerable differences remain among countries.

Regulatory burdens remain a major obstacle for SMEs as these firms tend to be poorly equipped to deal with the problems arising from regulations. Access to information about regulations should be made available to SMEs at minimum cost. Policy makers must ensure that the compliance procedures associated with, e.g. R&D and new technologies, are not unnecessarily costly, complex or lengthy. Transparency is of particular importance to SMEs, and information technology has great potential to narrow the information gap. It would be of great help to set up a “one-stop-shop system”, where all the necessary information which affects firm strategies and decisions is made available in one place, as exists already in some countries.

Other issues for family-owned businesses include:
- Absence of clear policies and long term planning
- Lack of outside opinions on strategic direction.
- Benefits and compensation for family members are not clearly defined
- Hiring family members who are not qualified or lack the skills and abilities for the organization
- They usually do not have a succession plan
- Most of the time there is thus no clarity on the roles resulting in credibility problems and inability to arrive at strategic decisions.

Performance of many MSMEs is very poor due to the deficiencies in management. Poor knowledge in management of entrepreneurs causes the managerial deficiencies. A major proportion of the manufacturing enterprises in the Indian SME sector operate with obsolete technology. This lack of technology sophistication will act as a constraint in exploiting the opportunities presented by globalization.

Small industry in India is facing stiff competition due to
- Liberalization of the investment regime in the 1990s that favours FDI (Foreign Direct investment)
- Restriction of imports imposed by World Trade Organization (WTO)
- Domestic economic reforms.

The cumulative impact of all these developments is a remarkable transformation of the economic environment in which small industry operates, implying that the sector has no option but to 'compete or perish'.
Support for MSMEs

Research has shown that the following five key behaviours, which mark out the best performing SMEs:

- A strong leadership team
- The ability to attract and retain quality people
- A disciplined approach to their business
- The ability to strategically use technology
- The wise use of trusted outside advisors.

It has been empirically tested that good governance practices of a company gives a positive signal to investors. With the globalization of markets, international capital flows have become extremely valuable source of external financing. Good governance is vital for the development of a healthy and competitive corporate sector. For SMEs, corporate governance is about the respective roles of the shareholders as owners and the managers. It is about establishing rules and procedures to manage and run the enterprise. Good corporate governance leads to development of a framework that provides adequate protection to the interests of stakeholders and reinforces the fiduciary responsibilities of those vested with the authority to act on behalf of the stakeholders.

Corporate governance is a basically a set of relationships between a company's board, management, its shareholders and the society within an institutional framework. These relationships evolve into the corporate governance framework, which is “the system by which companies are directed and controlled”. It is essential to recognize that every company operates within a 'unique' jurisdiction of its stakeholders including investors, creditors, employees, managers, and regulators. Good corporate governance seeks to create an institutional framework that encourages all participants to contribute towards better corporate performance aligned with good governance practices. Corporate governance encourages companies and those who own and manage them to achieve their corporate objectives through a more efficient use of resources. Moreover, corporate governance framework should recognize the rights of stakeholders as established by law.

Corporate governance is a significant factor in improving economic efficiency and growth. Practicing good governance will help MSMEs establish robust business processes and prepare them for future expansion. Good corporate governance is likely to reduce the cost of capital, encourage more stable sources of financing and facilitate the broadening and deepening of local capital markets. It is critical to consider the effect of economic growth on human welfare. A sluggish economic activity results in poverty and unequal distribution of resources, lack of health and education facilities and unemployment. Good governance does not guarantee business success. But it is one of the main factors which can help in long-term success. It creates a system of checks and balances to prevent abuses of authority and to ensure the integrity of financial statements.

A strong corporate sector boosts “sustained” and “shared” economic growth, i.e. growth that can withstand economic shocks and benefit all. Poverty alleviation and equitable distribution of wealth can be achieved by encouraging long-term economic growth through a well-planned and well implemented approach to corporate governance.
SMEs not embracing corporate governance in majority of the developing countries due to the following reasons:

- There is generally a lack of awareness among SMEs regarding corporate governance and/or its relationships with corporate performance.
- The costs for implementing corporate governance are too high as compared to its benefits.

The lack of awareness among SMEs generally results in increase of financial difficulties, worsening of relationships between SMEs and financial institutions, and decrease public confidence. According to Grant Thompton International Business Owners’ Survey (IBOS) in India of more than 500 mid-sized family-owned businesses, more than 71% have already tightened up internal controls, 25% have appointed non-executive directors and 46 per cent Indian family-owned businesses have formed an audit. This is very promising for Indian economy.

Most of the SMEs are generally suppliers to larger corporate. Most of these large firms do not trust the SMEs as SMEs do not deliver on time or do not deliver quality items. The large firms speak of TQM but do not practice making their supplier as their partners due to the lack of quality and standard of the products as well as the uncertainty of the delivery by the SMEs and would rather complete the supply chain themselves or try to make the SMEs to compete with one another. Lack of access to technology, trainings, environmentally friendly processes and lack of access to international markets are barriers to discharging their social and environmental responsibility.

SMEs need to win the trust of their customers (These large firms) by adhering to quality and standards. Large firms need to trust them and help them by example in Quality and standardization. Only then the SMEs as well as the large firms can survive and grow in today’s global market. In SMEs generally a small number of persons may be doing many key jobs. It is also not easy to get skilled hands. It is therefore in their own interest to have sound business practices and working conditions. This can result not only in increased productivity of its employees but is crucial for their survival and growth.

SMEs are more strongly connected with the community they operate as they are embedded with it and most of its employees are locals. SMEs rely on the prosperity of the local communities in which they operate and vice versa. This has to be utilized properly. SMEs contribute to community through silent CSR because of their relationship with community. Many of these advantages will visible to these SMEs only after some time. They need to have a long term vision and should not focus or survival in the short term. The larger firms need to help the SMEs in this respect and the SMEs also need to develop themselves. Large firms should therefore lead by example by promoting ethical culture. SMEs must also join together among themselves and form a cluster to address these issues.

They must remember that in the 21st century it is not competition but collaboration that will bring wealth and success. International businesses and multinational corporations should also promote fairness and honesty in business transactions among small firms. SMEs should also be
provided orientation towards developing long-term vision as against short term objectives and how these two are interlinked for business growth as well as benefit of the community

The Policy advantage
From 1st April 2015, overall procurement goal of minimum of 20 per cent is made mandatory. The data on Government procurements from Micro and Small Enterprises is vital for strengthening the Policy and for this purpose, every Central Ministry or Department or Public Sector Undertaking shall report goals set with respect to procurement to be met from Micro and Small Enterprises and achievement made thereto in their respective Annual Reports.

The Ministries or Departments or Public Sector Undertakings shall also prepare Annual Procurement Plan for purchases and upload the same on their official website so that Micro and Small Enterprises may get advance information about requirement of procurement agencies. To enable wider dispersal of enterprises in the country, particularly in rural areas, the Central Government Ministries or Departments or Public Sector Undertakings shall continue to procure 358 items (Appendix) from Micro and Small Enterprises, which have been reserved for exclusive purchase from them. This will help in promotion and growth of Micro and Small Enterprises, including Khadi and village industries, which play a critical role in fostering inclusive growth in the country.

More than 50 per cent of SME programmes are administered locally, making co-ordination between authorities critical. There is potential for integrating programmes into fewer schemes but with a wider scope, making it easier for SMEs to understand them, and lowering administrative costs. Almost 70 per cent of SME programmes last for more than five years. Stable and predictable programme management is in the interest of users; however, a constant review process is vital to ensure quality and flexibility. Governments need to intensify their efforts to disseminate information, eliminate unnecessary red tape, and make programmes more responsive to the changing needs of SMEs. Between 30 and 60 per cent of SMEs can be characterised as innovative, of which some 10 per cent are technology-based.

Innovative SMEs tend to be market-driven rather than research-driven, and quicker in responding to new opportunities than large firms. They play a key role in pioneering and developing new markets. Programmes for improving the diffusion of technology have shifted from a supply focus to raising the capacity of SMEs to absorb technology. However, governments need to: reduce uncertainties in the tax, regulatory and macroeconomic environment; make sure that business framework conditions do not impact unfavorably on the risk/reward ratio; and encourage the mobility of human resources and the markets for specialised services. Although these are important for the entire economy, such actions will produce benefits of particular value to SMEs.

MSME Clusters – an opportunity and a challenge
The traditional view of stand-alone MSMEs has become increasingly unsustainable. The imperative for situating them as part of larger value chain, has become all the more important. The experience of the electronics and auto components subsectors provide important learnings on subsector based development strategies. The Ministry of Micro, Small and Medium Enterprises (MSME), Government of India (GoI) has adopted the cluster development approach.
**Best practice policies**

The report ends with lessons from policies undertaken in *five areas*:

**✓ Financing**
The primary role of the public sector in supporting *venture capital* is to reduce the risk and cost of private equity finance, complementing and encouraging the development of the private capital industry. There is major variation across OECD countries in the use of funding methods for SMEs, but the provision of *equity financing to start-up companies* is more advanced in the United States and Canada than elsewhere. Taxation should not impose a disproportionately heavy burden on SMEs.

**✓ The business environment**
This can be improved by systematic and careful scrutiny of new regulations and by implementation of a business impact system to ensure the audit and monitoring of new legislation. Canada, the United Kingdom and the Netherlands have successfully introduced procedures to that end. The use of information technologies provides opportunities for reducing bureaucratic burdens on all companies, including SMEs.

**✓ Technology**
Technology diffusion programmes should: ensure quality control; promote customer orientation; upgrade the innovative capacity of firms -- including the promotion of general awareness of the value of innovation among management -- and stimulate demand for technical and organisational change; build on existing inter-relationships in national innovation systems and provide greater coherence between programme design (e.g. targets, objectives, modes of support) and service delivery; build on evaluation and assessment. Technology diffusion programmes should in particular have mechanisms for assessment which can guide and improve their operation and management on a continuing basis. The United States has programmes effectively stimulating quality in diffusion processes, while Germany has sophisticated institutional set-up catalysing interactions between existing actors in the national innovation system.

**✓ Management capabilities**
Governments have sought to enhance the “quality” of owner/managers of SMEs either by encouraging training and/or by providing access to advisory and consultancy services. The most extensive assistance is provided by Japan which has both a highly developed system of advisory services and SME colleges. The United Kingdom and Italy have also implemented interesting schemes. Subsidy-schemes aimed at enhancing the skill base of SMEs should take the following into consideration: specification of objectives; situation after the removal of the subsidy; collecting information from SMEs themselves. Measures to encourage information networks must seek to customise databases and avoid information overload. Four approaches have been developed to address these issues: know your customer; access; explicitly avoid interference with market mechanisms; and subsidisation of information.
Access to markets

Measures to ease access to markets have focused on international markets, on the one hand, and public procurement, on the other. Japan has the most developed policy and institutional set-up for the former, based upon the use of non-discriminatory measures which seek to support efforts made by SMEs themselves. Policy in this area seeks to tackle the disadvantages experienced by SMEs due to their lack of access to human resources, to external markets and to technology. Regarding public procurement, the United States, and other OECD countries such as Australia, have made comprehensive efforts to increase the “share” which small firms obtain of government contracts.

The successes

A limited number of so-called high-growth MSMEs make important contributions to job creation and productive growth of economy. At the earlier stages, management capabilities are crucial to survival. As the firm matures, human resource and innovation strategies increase in importance. By the time the firm has become established, innovation is crucial for growth. The fastest growing entrants are those that translate strategy into action in the form of R&D, innovation and training, put great emphasis on hiring skilled employees and motivating employees, and balance the enhancement of their capabilities in different areas -- the last being particularly important in high-knowledge sectors.

Women-owned SMEs are growing at a faster rate than the economy as a whole in several OECD countries, allowing capitalisation of the skills of educated and trained women who might otherwise be blocked in corporate advancement because of the “glass ceiling”. The increased flexibility inherent in owning one’s business allows women to contribute to the income of their families while balancing work and family responsibilities. However, the economic potential of women entrepreneurs remains partly untapped; measures are required to improve information and statistics in this field, as well as to strengthen the preconditions for financing, networks and technology. Entrepreneurship tends to vary markedly across regions.

An increasing number of regions are known for generating clusters of dynamic firms which benefit from “information spill-over” and other intangible factors. Regional development policies have been introduced to assist regions suffering from declining industries. The primary policy tools for attracting firms to disadvantaged regions are investment in infrastructure, social assistance, training and other forms of public assistance. The regional dimension of entrepreneurship is not limited to clusters of enterprises but also includes micro enterprises. Programmes to assist the creation and development of micro enterprises in inner cities and remote rural areas have become widespread policy tools. Governments wishing to adopt policies used successfully in other regions or countries should take the regional context into account.
Conclusion

MSME Sector in nutshell
Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. MSMEs not only play crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialization of rural & backward areas, thereby, reducing regional imbalances, assuring more equitable distribution of national income and wealth. MSMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country. The Sector consisting of 36 million units, as of today, provides employment to over 80 million persons. The Sector through more than 6,000 products contributes about 8% to GDP besides 45% to the total manufacturing output and 40% to the exports from the country. The MSME sector has the potential to spread industrial growth across the country and can be a major partner in the process of inclusive growth. On 9 May 2007, subsequent to an amendment of the Government of India (Allocation of Business) Rules, 1961, erstwhile Ministry of Small Scale Industries and the Ministry of Agro and Rural Industries were merged to form the Ministry of Micro, Small and Medium Enterprises (M/o MSME). This Ministry now designs policies and promotes/ facilitates programs, projects. The MSMEs constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. MSMEs are highly adaptable between the developed and developing economies, provided that they have a facilitating environment to grow Micro, Small and Medium Enterprises (MSMEs) are a critical economic factor in poorer countries as well as the more developed economies in the world today.

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