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Promoting SMEs in a Global Economy for Competitiveness

Abstract ::

The current economic situation, with political and economic integration and technological breakthroughs, warrants the need to make our Small and Medium Enterprises (SMEs) globally competitive. Due to liberalisation policy of government, SMEs have to, now, deal with increased competition even at the local level as a result of globalization. Instead of competing merely with local companies, SMEs now compete with various international competitors, be they MNCs or other SMEs. Competition brings pressures on SMEs to reduce costs, innovate and manage knowledge in similar ways to large companies, often without having surplus resources to invest for such activities, in a fast changing environment. This paper focuses on the major hurdles faced by the Indian SMEs to compete at global level and the proposed solutions for the same. It's time to vibrant the reforms again related with the SMEs and encourage them to compete at global level.

Key words: SMEs, globalization, competition, MNCs, global market.

1. Introduction ::

The current economic scenario has become very crucial and challenging for Indian SME sector. One of the results of globalization is that the costs of distance have been reduced dramatically. Businesses can operate in more markets and transactions can be done much faster and at lower cost. Similarly, consumers have more insight into where to buy the best products and services at the best rates. As a result, even smaller and locally orientated businesses have to see themselves in a global context. SMEs have to, now, deal with increased competition as a result of globalization. Instead of competing merely with local companies, SMEs now compete with various international competitors, be they MNCs or other SMEs. Competition brings pressures on SMEs to reduce costs, innovate and manage knowledge in similar ways to large companies, often without having surplus resources to invest for such activities, in a fast changing environment.

SMEs play a vital role in national development. Fostering a dynamic Micro, Small and Medium Enterprise (MSME) sector is seen as a priority amongst economic development goals, in both developed and emerging economies. MSMEs are a primary driver for job creation and GDP growth. They greatly contribute to economic diversification, exports and social stability. As per data released by the Ministry of MSME, there are about 26.1 million enterprises in this sector which accounts for 45 % of manufactured output and 8 % of the GDP. MSMEs contributed close to 40 % of all exports from the country and employed nearly 59.7 million people, which is next only to the agricultural sector. They also serve as a feeder line for the large corporate of tomorrow as it is from among these small companies that the MNCs and large corporate will emerge. There are numerous examples of large corporate of today, which began as small business ventures some time back.

Many economists and experts believe that the next level of growth in the Indian economy will have to come from the MSMEs. It is this sector that can propel India's growth rate from around 5.5 % at present to a sustainable 9 plus per cent in the medium-to long-term, which is considered as India's desirable growth rate. In fact, it is not possible to think of a healthy Indian economy without a vibrant and healthy MSME sector. However, this is not possible without SMEs developing their capabilities to compete at a global scale. If we focus on the major problem faced by the SMEs is the access of finance.

2. Access to finance for SMEs:

The MSMEs primarily rely on bank finance for their operations. For small corporate, access to timely and adequate finance is a priority, provided the rates charged are not exploitative. Over the years, there has been a significant increase in credit extended to this sector by banks. As at the end of March 2012, the total outstanding credit provided by all Scheduled Commercial Banks (SCBs) to the Micro and Small Enterprises (MSE) sector stood at Rs.5286.17 billion as against Rs.4785.27 billion in March 2011 and Rs. 3622.91 billion in March 2010. Despite the increase in credit outstanding to the sector, the MSME borrowers feel that the lenders are not doing enough for the MSMEs and are catering more to the needs of the large corporate.

3. Problem faced by banks in lending to MSMEs:

Commercial banks are reluctant to service MSMEs for a number of reasons, though at times, not based on facts. MSMEs are regarded by creditors as high-risk borrowers because of insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates. Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans also makes it difficult for creditors to assess the creditworthiness of potential SME proposals. Besides, high administrative/ transaction costs of lending to small amounts may not make SME financing a profitable business.

To encourage commercial banks to lend to SMEs, the Government and RBI have an important role to play by setting out a policy framework for channelling adequate funds to the SME sector. SMEs, on their part, need to be more transparent while representing their businesses and future plans before bankers so that they gain the trust and confidence of creditors to extend finance to them.

4. Steps taken by Government of India / Reserve Bank of India fostering financial support to MSMEs:

Recognizing the important role played by MSMEs in economic development and its sizeable contribution to employment and GDP, and realizing that financial access is critical for MSME growth and development, Government and RBI are taking the lead in supporting initiatives that improve access to finance. In view of the high level of financial exclusion in this sector (93%), the drive to universal financial access, including SME finance, is no longer a policy choice, but a compulsion. The RBI has intensified a number of measures and endorsed quantitative access targets over the last few years to further financial inclusion. Following are some major steps taken by the RBI.

• Steps towards Financial Inclusion:

With an objective of ensuring uniform progress in provision of banking services in all parts of the country, banks were advised to draw up a roadmap to provide banking services through a banking outlet in every unbanked village having a population of over 2,000 by March 2012. Such banking services need not necessarily be extended through a brick and mortar branch but could be provided also through any of the various forms of Information and Communication Technology (ICT) - based models, including Business Correspondents (BCs). As at the end of March 2012, as reported by the State Level Bankers' Committees of various States/ Union Territories, banking outlets have been opened in 74199 villages across the various States in the country. This comprises of 2493 branches, 69374 business correspondents and 2332 other modes like rural ATMs, mobile vans, etc. The process for ensuring coverage of villages with population below 2000 is underway.

• Priority Lending to MSMEs:

To ensure enhanced credit flow to the sector, banks were advised to achieve a 20 % year-on-year growth in credit to micro and small enterprises; with allocation of 60% of the MSE advances to micro enterprises, which is to be achieved in stages viz. 50% in the year 2010-11, 55% in the year 2011-12 and 60% in the year 2012-13 and achieve a 10% annual growth in number of micro enterprise accounts.

• Special Promotion Schemes for New Entrepreneurs:

As the MSE borrowers, especially new generation entrepreneurs, do not have collaterals to offer to avail of bank finance. To solve this issue, the Credit Guarantee Scheme (CGS) of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) is mandated banks, on May 6, 2010, to provide collateral free loans to the MSE sector up to Rs.10 lakh, which was increased

from Rs. 5 lakh earlier and the banks, in turn, could take cover for the collateral free credit facilities under CGS.

- **Fast and Easy Procedure for Finance:**

All Scheduled Commercial Banks have also been advised on May 4, 2009, to review and put in place an MSE Loan policy, Restructuring / rehabilitation policy and Non-discretionary One Time Settlement Scheme for recovery of non-performing loans, duly approved by their Board of Directors. Banks were advised in December 2009 to give wide publicity to the Non-discretionary One Time Settlement Scheme for recovery of non-performing loans for the MSE sector by placing it on their website and through other possible modes of dissemination.

- **Advisory support to MSMEs:**

As the lack of financial literacy, operational skills, including accounting and finance, business planning, etc. represents formidable challenge for MSE borrowers. From August 1, 2012, banks are advised to play a more proactive role in the affairs of their MSE clients by providing them with financial literacy and consultancy support. For this, banks could either separately set up special cells at their branches, or vertically integrate this function in the Financial Literacy Centres (FLCs) set up by them, as per their comparative advantage. The bank staff should also be trained through customised training programs to meet the specific needs of the sector.

- **Other Promotional Steps:**

On the issue of alternate sources of credit, dedicated Exchange for MSMEs, marketing, technology up-gradation and infrastructure, the PM's Task Force has examined the issues and has made several recommendations to address the bottlenecks. The implementation of the recommendations in a time bound manner is being monitored by the Government of India.

5. What more needs to be done? Even after various promotional measures taken by the Government and RBI, the performance of MSME sector is not as per desired level. That means something is lacking in the system. Following points discuss the lacking area where the Government and RBI should focus to boost the SMEs.

Need to relook business processes and strategy and to innovate: Globalization is bringing new opportunities and the SME entrepreneurs have to seize these opportunities. For this, MSME entrepreneurs have to have a relook at their business strategies and innovate. To successfully do so, four major aspects need to be kept in mind.

Firstly, MSME entrepreneurs have to apply the discipline of innovation to identify and develop new business. Entrepreneurs have also to be prepared to face the fact that new inventions or product / service is not always successful in the market for which they were originally designed, but could be successful in a totally different market.

Secondly, business should pay attention to cash flows. Entrepreneurs believe that profit is what matters most in a new enterprise. But profit is secondary. It is the cash flow that matters. A business that grows fast devours cash. Constant investments have to be made to just keep even.

Thirdly, when a business grows, it is necessary to create a management team. Young entrepreneurs cannot pay to bring in a management team. It is, therefore, necessary to identify the core competencies of the people working with you so that your business is geared to seize the opportunities opening up.

Lastly, when the business is a success, the entrepreneur needs to ask what the business needs at this stage and whether he is concentrating on the right things. As successful entrepreneurs, they have gained experience and wisdom from their mistakes and going forward, it is necessary to ensure that the same mistakes are not repeated.

1. **Access to Equity Capital:**

Access to Equity capital is a genuine problem. At present, there is almost negligible flow of equity capital into this sector. Availability of sound equity capital base is essential as it enhances the loss absorptive capacity of new ventures. Absence of equity capital may pose a serious challenge to

development of knowledge-based industries, particularly those that are sought to be promoted by the first-generation entrepreneurs with the requisite expertise and knowledge. Most MSMEs, particularly the knowledge based enterprises, when starting off, have negative cash flows and no collateral and therefore, find it difficult to access debt capital or bank financing. Venture/ Risk capital is often a more appropriate financing instrument for high-growth-potential and start-up SMEs. Firms typically look for venture capital to provide them with the financing they need, to expand, break into new markets and grow faster. Thus, the ability of MSMEs (especially those involving innovations and new technologies) to access alternative sources of capital like angel funds/risk capital needs to be enhanced considerably to encourage and develop entrepreneurship.

2. Dedicated Exchange for MSMEs:

There is a demand for a dedicated Exchange for MSMEs. In the Union Budget 2012-13 the Finance Minister has announced to set up a Rs.50 billion India Opportunities Venture Fund with SIDBI to enhance the availability of equity to the MSME sector. The BSE and the NSE have also set up separate dedicated exchange / platform for listing and trading of shares of SMEs, making it easier for them to raise equity capital.

3. Factoring Services:

Timely payments from customers will help SMEs in reducing their working capital requirements, leading to lower interest costs, improved profitability and a positive impact on the long-term health and sustainability of India's SME sector. Delays in settlement of dues adversely affect the recycling of funds and business operations of the SME units. A study of 5000 SMEs by CRISIL shows that high quantum of receivables is an endemic problem across industry sectors and geographies in the SME space. Smaller SMEs, perhaps due to their lower bargaining power, are in a more disadvantageous position with weaker receivables positions. The CRISIL study estimates that SMEs can enhance profits by at least 15 % if they receive payments on time from their large corporate customers.

It is, therefore, critical to ensure that the small entities are able to raise liquidity against their receivables. This problem can be institutionally tackled by factoring, which provides liquidity to SMEs against their receivables and can be an alternative source of working capital. World over, factoring is a preferred route of accessing working capital for SMEs and even larger organisations. Some banks and financial institutions in India have already launched factoring services.

1. Access to Technology:

With the increasing competition, globalization and the uncertainty due to the global downturn, it is essential for SMEs to be technology literate. SMEs will have to continuously incorporate the latest technology into their production processes as well as in their marketing and management functions, to cut costs, gain efficiency and consistency. There are additional challenges to be met. The influx of low-cost products from China has made it even more difficult for Indian manufacturers to compete solely on the price front. What SMEs need today is knowledge and access to new technology. In fact, innovation and technology are the two tools MSMEs have with them that need to be capitalized fully to compete with firms much larger in size.

2. Coping with the economic downturn and checking sickness in MSME units:

The world is presently facing economic crisis due to which economies world over are facing slowdown in economic activities. These are, indeed, challenging times for all of us. In order to cope with the downturn, the MSMEs to plan for the future and be transparent in their dealing with the banks. They should approach the banks well in advance with their problems and articulate what they specifically want from the banks. Transparency in approach is the key. Very often the entrepreneur tends to mix his own transactions with that of the business. They should delink the two and plan well in advance as to what is needed for the business. Timely detection of sickness is critical to make the possibility of revival of potentially viable sick units bright.

3. Skilled Manpower and Managerial Talent:

Human resource development issues are fundamental in improving SME competitiveness. The ability of SMEs to adjust to the competitive pressures that come with trade liberalization and globalization will depend on the level of skills available domestically. It is, indeed, ironic that in a

nation of more than a billion individuals, skilled labour is cited as scarce. India needs to capitalize on its unique demographic dividend. The Government of India and various State governments have been implementing a number of schemes and programs over the years for skill development. The Rural Self Employment Training Institutes (RSETIs) are also working in this direction. However, given the growing requirements of the MSME sector and the huge 'demographic capital' we possess, significant efforts are still needed for skill and entrepreneurship development. In addition to the initiatives taken by Government agencies, the industry has to contribute to building up a large base of appropriately skilled workforce available for employment in MSMEs. There should be training programmes by the industry associations to upgrade the skills of the workers and to acquaint them with the skills compatible with the new technology.

4. Corporate Governance:

Weak corporate governance of small firms, burdened further with poor availability of crucial inputs, has made these firms extremely vulnerable. Good governance practices in SMEs will help them grow or attract additional investors. The absence of good corporate governance practices makes it difficult for them to access finance from banks or investors. Adoption of sound corporate governance by SMEs is indispensable for taking this sector to a higher growth trajectory. The lack of corporate governance is attributable to lack of awareness about corporate governance practices and its impact on corporate performance. There is a need to educate SMEs about benefits of adopting sound corporate governance practices and industry associations have a key role to play in it.

5. Role of MSME Associations:

The MSME Associations and Chambers of Commerce have an important role to play in stepping up credit to this segment. Asymmetry of information and lack of transparency and reliability of data has been a major concern for organizations dealing with MSMEs world over. The Associations need to, therefore, proactively engage themselves in organising workshops and training programmes for their members to enlighten them about cash flow cycles, various financial products, accounting practices, etc. The MSME Associations and Chambers of Commerce should have collaboration with banks, NIBM or any other training institute in banking and finance, basic accountancy and information technology for the benefit of MSMEs.

6. Separate Umbrella Organization:

It is felt that a centralized umbrella organization providing focused attention to the development of the MSME sector as a whole, including the unorganized sector, may help in bringing the sector in proper focus of the policy makers. Although the Ministry of MSME, RBI and SIDBI have taken several initiatives in the promotion, financing and development of MSMEs in the country, there should be an umbrella organization for overseeing the coordinated development of the MSME sector with a view to fully exploits its growth potential. This umbrella organization may focus not only on the availability of funds but also provide all round support including technological support, design output, facilitating raw material supplies, marketing support, etc.

6. Conclusion:

The MSME sector is vital for the nation's economic progress and hence, needs to be carefully nurtured and supported. MSMEs are the best vehicle for inclusive growth in the country, to create local demand and consumption. Besides supporting employment generation activities, they also act as feeder lines for the MNCs and large corporate of tomorrow. SMEs, should on their part, to be transparent, particularly when in distress, so as to gain the trust and confidence of lenders. Besides, SMEs need to constantly innovate, both in terms of products and processes and have a wide vision, so that they are able to spot new opportunities for their products/ services. MSME Associations and Chambers of Commerce also have an important role to play in this formidable task of building a robust MSME sector by generating awareness about good practices. With the concerted efforts of all the stakeholders, there is no doubt that the MSME sector would become globally competitive and offer significant contribution to India's economic development.

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