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Confederation of Indian Industry
Since 1895

Creating Competitive SMEs

Foreword

The Indian SME sector plays a pivotal role in the overall industrial economy of the country. With its agility and dynamism, the sector has shown admirable innovativeness and adaptability to survive the recent economic downturn and recession.

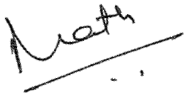
Indian SMEs have moved up the value chain from manufacture of simple goods to manufacture of sophisticated products like electronic control systems, medical equipment and microwave components. In line with the overall growth in Indian economy, SMEs have entered the services sector as well.

Government of India and State Governments has adopted a cluster approach to development of SMEs. Clusters are defined as sectoral and geographical concentration of enterprises, particularly, small and medium enterprises, faced with common opportunities and threats which give rise to external economies. Clustering and networking has helped the small and medium enterprises in boosting their competitiveness.

In an effort to maintain their competitiveness Indian SMEs are looking to adopting information and communication technologies in a big way. New generation IT models including Software as a Service (Saas) and Infrastructure as a Service (IaaS) are helping SMEs overcoming the technological divide by through innovative IT delivery and pricing models. While the extent of IT penetration in small enterprises is low, many medium sized enterprises have adopted technology in a big way to differentiate themselves from their competitors.

Financing for SMEs continues to be an area for improvement notwithstanding the increased options available to SMEs today to fund their growth. New products available from the banking system for working capital loans as well as availability of risk capital through private equity / venture capital have enabled SMEs to reach higher levels of growth

Appropriate technology investments and adequate financing options are the twin engines which will fuel the growth of SMEs. To this end, the Confederation of Indian Industry (CII) and PricewaterhouseCoopers (PwC) have co-authored this report to understand ways of creating competitive Indian SMEs.



Rachna Nath
Executive Director
PricewaterhouseCoopers

Gurpal Singh
Deputy Director General
Confederation of India Industry (CII)

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01 Executive Summary

Small and Medium Enterprise (SMEs) 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. In India too, the SMEs play a pivotal role in the overall industrial economy of the country. SMEs are thus important for the national objectives of growth with equity and inclusion.

The process of liberalization and market reforms since 1991 has brought about intense competition for SMEs both in domestic and overseas markets. This has made it imperative for the Indian SMEs to overcome the challenges that they face and maintain, improve and sustain competitiveness through lower cost, improved quality, making available wider choice by initiating various measures including innovation and up-gradation of technology.

Having realized the need to preserve, protect and promote SMEs, the Indian government is also committed to the growth and development of the SMEs and to enhance their competitiveness. The government seeks to fulfill its mission by formulating policies and designing/implementing support measures in the field of credit, technological upgradation, marketing, entrepreneurship development etc. and undertaking effective advocacy for these purposes.

The SMEs that are successfully competing today are the enterprises that have developed a culture of success through appropriate ICT interventions that has enabled them to stay ahead of others. The SMEs with heavy infusion of technology are much better adapted to meet the business needs and compete in the domestic as well as global markets.

Finance is one of the critical inputs for the promotion and development of the micro and small enterprises. Recognizing the importance of easy and adequate availability of credit in sustainable growth of the SME sector, the Government has been announcing various policy measures. Faced with increased competition on account of globalization, SMEs are beginning to move from a reliance on bank credit to a variety of other specialized financial services and options.

The role of government policies, technology interventions and financial measures for creating competitive SMEs has been discussed in detail in this background note.

02 Overview of the Indian MSMEs

Overview of the Indian MSMEs

Micro Small Medium Enterprise (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. In India too, the MSMEs play a pivotal role in the overall industrial economy of the country. In recent years the MSME sector has consistently registered higher growth rate compared to the overall industrial sector. With its agility and dynamism, the sector has shown admirable innovativeness and adaptability to survive the recent economic downturn and recession.

In accordance with the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified in two Classes:

A) Manufacturing Enterprises:

The enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the industries (Development and regulation) Act, 1951). The Manufacturing Enterprise are defined in terms of investment in Plant & Machinery.

B) Service Enterprises:

The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment.

The limit for investment in plant and machinery / equipment for manufacturing / service enterprises, as notified, vide S.O. 1642(E) dtd.29-09-2006 are as under :

Manufacturing Sector	
Enterprises	Investment in plant & machinery
Micro Enterprises	Does not exceed twenty five lakh rupees
Small Enterprises	More than twenty five lakh rupees but does not exceed five crore rupees
Medium Enterprises	More than five crore rupees but does not exceed ten crore rupees

Service Sector	
Enterprises	Investment in equipment
Micro Enterprises	Does not exceed ten lakh rupees
Small Enterprises	More than ten lakh rupees but does not exceed two crore rupees
Medium Enterprises	More than two crore rupees but does not exceed five crore rupees

As per the quick estimates of 4th All-India Census of MSMEs, for reference year 2006-07 the number of enterprises is estimated to be about 26 million and these provide employment to an estimated 60 million persons. Of the 26 million MSMEs, only 1.5 million are in the registered segment while the remaining 24.5 million (94%) are in the unregistered segment. The state-wise distribution of MSMEs show that more than 55% of these enterprises are in 6 States, namely, Uttar Pradesh, Maharashtra, Tamil Nadu, West Bengal, Andhra Pradesh and Karnataka. Further, about 7% of MSMEs are owned by women and more than 94% of the MSMEs are proprietorships or partnerships.

MSMEs contribute 8 per cent of the country's GDP, 45 per cent of the manufactured output and 40 per cent of our exports. The labour and capital ratio in MSMEs and the overall growth in the MSMEs are much higher than in the larger industries. The non-homogenous structure in terms of range of produce/service as well as size of industry adds to its dynamism. Thus, MSMEs are important for the national objectives of growth with equity and inclusion.

The MSME sector has slowly come into the limelight, with increased focus from government and other government institutions, corporate bodies and banks. It is viewed as one of the greatest agents of growth. Policy based changes, investments into the sector; globalization and India's robust economic growth have opened up several latent business opportunities for this sector.

Considering the importance of the MSME sector in the overall growth of the economy, the Indian Prime Minister announced the setting up of a Task Force on MSMEs in August 2009. Accordingly, a Task Force was set up in September 2009 under the chairmanship of the Principal Secretary to Prime Minister to look into the issues and concerns of the MSME sector in a holistic manner. The Report submitted in January 2010 provided a roadmap for the development and promotion of the MSMEs in the country. It recommends an agenda for immediate action to provide relief and incentives to the MSMEs, accompanied by institutional changes and detailing of program to be achieved in a time bound manner. In addition, it suggests setting up of appropriate legal and regulatory structures to create a conducive environment for entrepreneurship and growth of MSMEs in the country. The Task Force has laid emphasis on timely implementation of the recommendations and has set up a system for its continuous monitoring in the Prime Minister's Office. A Council on MSMEs under the chairmanship of Hon'ble Prime Minister has been constituted to lay down the broad policy guidelines and review development of the MSME sector. The Task Force in its Report has also stressed on the need for strengthening the technological capabilities of the MSMEs and recommended setting up of a 'Technology Fund' for supporting MSMEs to undertake technology up-gradation, acquisition, adaptation and innovation to enable them to move up the value chain.

The sector itself has also started taking itself seriously. Initiatives from within the sector to lobby for favorable policies and increasing credit flow are credible. The sector has also realized the need for technological and modernization initiatives. However with economic liberalization and changes in the trade policy, MSMEs have now started facing increased competition from foreign companies. There is a huge market out there where many other countries such as China, Korea, Thailand etc are well established. As global competitiveness becomes intensive, MSMEs are transitioning to a new business environment with emergence of global supply chains. MSMEs form an integral part of almost every value chain and there is a symbiotic relationship between the large corporations and their relatively smaller sized suppliers. However in a liberalized world, the relationships between the suppliers and buyers are undergoing dynamic changes with dissolution of existing relationships and formation of new trade linkages that transcend the barriers of nationality and boundaries.

Even the domestic market is no more an insulated zone in a controlled economy; the competitive pressures of a free market economy are catching up in India. The domestic market has been flooded with many low cost, reasonable quality, bulk produced products giving tough competition to MSMEs. With the opening up of the economy, the MSMEs have to catch up with global standards of excellence in order to remain competitive and profitable. MSMEs are increasingly having to adapt to new standards in technology, quality and pricing to be able to survive in the marketplace.

To gain the competitive edge, enhance efficiency and manage communication, this sector is very seriously looking for ICT enablement. Small scale industries as of now because of their organization and structure face limited needs for ICT but the medium scale has started restructuring themselves to accommodate these changes. Possibility of international trade has forced many to build an online presence as well as building e-mail facilities. E-Commerce and enterprise management solutions are also been looked at by many.

03 Opportunities for MSMEs in India

Opportunities for MSMEs in India

Government of India has developed key strategies to promote and support the MSME sector to promote competitiveness, quality upgrading, finance, technology, etc. This has resulted in a dramatic positive change in the sector. Over the years, this sector in India has progressed from the production of simple consumer goods to the manufacture of many sophisticated and precision products like electronics control systems, micro wave components, electro medical equipment, etc. MSMEs in India are considered to be important members within the supply chain and are established in almost all major sectors in Indian industry such as:

- Food Processing
- Agricultural Inputs
- Chemicals & Pharmaceuticals
- Engineering; Electricals; Electronics
- Electro-medical equipment
- Textiles and Garments
- Leather and leather goods
- Meat products
- Bio-engineering
- Sports goods
- Plastics products
- Computer Software, etc.

Key characteristics of Indian MSMEs such as high contribution to domestic production, significant export earnings, low investment requirements, operational flexibility, location wise mobility, capacities to develop appropriate indigenous technology, import substitution, contribution towards defense production, technology – oriented industries, and competitiveness in domestic and export markets help them tap opportunities in various sectors.

The process of economic liberalization and market reforms has exposed these enterprises to increasing levels of domestic and global competition. To combat competition, private and public sector institutions, both at the central and state levels are increasingly undertaking cluster development initiatives.

Clusters are defined as sectoral and geographical concentration of enterprises, particularly, small and medium enterprises, faced with common opportunities and threats which give rise to external economies. Clustering and networking has helped the small and medium enterprises in boosting their competitiveness. India has over 400 SME clusters and about 2000 artisan clusters that have created a conducive ground for the development of inter-firm cooperation to promote local production, innovation and collective learning. It is estimated that these clusters contribute 60 per cent of the manufactured exports from India. Some of these cluster stories and opportunities the clustering approach has provided are discussed below:

Tirupur Garment Cluster

The Tirupur Garment Cluster story is one of India's most successful cluster stories. This cluster consists of 2000+ apparel units involved in several value chain activities like knitting, dying and C.M.T. and contributes significantly to both domestic and export market. More than 50% cotton knitwear exports from India are contributed by this cluster. The cluster's turnover is currently estimated to be over Rs.11000 Cr.

Majority of the products produced by this cluster are cotton based knitwear products for gents, ladies and children. These products are primarily focussed on summer and spring garments.

Ahmedabad Pharmaceutical Cluster

The Ahmedabad Pharmaceutical cluster is India's most significant pharmaceutical cluster. It commands a share of over 40% of Indian drug production and contributes to over 17% of total drug exports. This cluster includes between 400 to 500 small, medium and large pharmaceutical units around Ahmedabad and its turnover is currently estimated to be around Rs.8000 Crores.

Majority of the products in this cluster are the pharmaceutical drug formulations and include wide range of dosage forms including tablet, capsule, liquid or orals and externals like ointment, lotions and parenterals.

Chennai Leather Cluster

Tamil Nadu holds a place of prominence in Indian Leather Industry. There are group of leather clusters spread over in Chennai and surrounding places like Ranipet, Ambur, Pernambur, Vaniyambadi, Erode, Tiruchirapalli and Dindigul.

The cluster size is currently estimated over 1000 small, medium and large units. This cluster contributes to 42 % to India's leather exports which is estimated to be around Rs. 13000 Crores. Major focus of this cluster is on finished leather and footwear and majority of the product units are 100 % Export Oriented Units.

Many other core industry sectors present numerous opportunities for MSMEs. To help the MSMEs tap these opportunities, the government is looking at ways to facilitate, incentivize and support the technology transfer and provide other supportive measures at individual as well as collective levels. Linkages with Research & Development Institutes, rewarding innovation and new technology, creation of Technology Development Fund, etc. are some of the suggestions being considered at present. Few of the opportunities presented by some of these sectors are discussed below:

Railways

Indian Railways has traditionally been a bulk-buyer from the MSME sector. Specifically, the potential for MSME involvement is in areas of:

- Quality metal fabrication of mild steel and mild stainless steel base, forging
- Polymers, plastics products, rubber gasket
- Specialty paints, floor cleaning chemicals and deodorants
- Construction industries, products and services
- Agro and food processing.

Other areas where SMEs / MSMEs can participate significantly include:

- 50 World class stations planned by Indian Railways
- 375 'Adarsh Stations' –stations having basic facilities such as drinking water, etc.
- Construction of Multi Functional Complexes (MFCs) - complexes having facilities like shopping, food stalls, restaurants, book stalls, PCO / STD / ISD / Fax booths, medical stores, variety stores, budget hotels etc.
- Component supplies for the Dedicated Freight Corridor Project
- Factories for new coaches, diesel and electric locomotives, high speed bogies
- Electrification & overhead line equipment
- Safety & Security Systems
- Railways Hospitals upgradation etc

Defence

India is one of the top 10 countries in the world in terms of military expenditure. Indian defence companies hitherto catered to only one buyer – the government. New defence procurement policies in 2006 and 2008 changed that due to the mandatory offset clause. The growth potential, coupled with the procurement policy, creates a multi-billion dollar opportunity for the Indian private sector defence companies.

The increase in spending on defence procurements as well as the requirement of offsets will open up significant business opportunities for Indian SMEs. To make the most of this increased spending, SMEs can integrate themselves into the supply chains of national and international defence majors.

Indian SMEs have some inherent advantages such as innovative capabilities in niche manufacturing, ability to absorb new technologies and lower overhead costs - while the offset requirements propel global OEMs to work in close coordination with SMEs. The defence sector is thus emerging as a lucrative market for the SMEs.

Automotive

The Indian automotive industry is one of the fastest growing industries in the world today – paralleled only by China. Although the total output in the industry declined marginally in 2008-09 as compared to 2007- 08, volumes have surged again in H2 of 2009-10 and prospects for the industry look bright again. The Indian automotive industry (OEMs and components) is concentrated in certain regions of the country – the traditional hub has been the National Capital Region (NCR). Recently, there has been a shift towards relocating the automotive production to Pune, Chennai and Gujarat, as these places offer better incentives to the industry and also serve as better shipment hubs for export purposes.

The government is leaving no stone unturned in expediting and encouraging the flow of investment into the automotive sector and it is almost certain that the country's automotive output will increase in the years to come.

The Indian government has been aggressively supporting the growth of MSMEs through development of the industrial clusters, industry-focused investment regions, introduction of reforms and flexible labour laws, promotion and development of MSMEs through various innovation initiatives and introduction of cluster development measures to support and strengthen the growth of the sector. Some of other opportunities that lie ahead for Indian MSMEs in various sectors include:

Metallurgy

- Blast furnaces, sinter plants
- Steel melting shop equipment
- Boilers
- Switchgear and control gear
- Turbines, transformers and generators

Dairy machinery

- Evaporators
- Milk and cream deodorizers
- Milk refrigerators and storage tanks
- Spray dryers and heat exchanges

Industrial machinery and machine tools

- Modern cement and textile machinery
- Material handling equipment
- Oil field equipment and services, mining machinery
- Precision machine tools and renewable energy equipment

Auto and auto ancillary

- Auto ancillary SEZ/parks
- Assembling and manufacture of automobiles
- CNG kits for automobiles, industrial automotive bearings
- Manufacture of auto components for all types of vehicles
- Automobile design centre

Many more lucrative opportunities can be tapped by Indian MSMEs in the foundry industry, electronics industry, chemicals industry, leather industry, textiles industry etc. These opportunities, amongst others, have arisen as a result of increased government focus on the MSME sector, bigger investments in R&D and technology upgradation, thrust towards international collaborations, imposition of anti-dumping duty on competing nations etc.

04 Key challenges faced by Indian MSME sector

Key challenges faced by Indian MSME sector

Despite its strategic importance in any industrialization strategy, the opportunities that the Indian landscape presents and its immense potential for employment generation the MSME sector confronts several challenges. They face problems at every stage of their operation, whether it is buying of raw materials, manufacture of products, marketing of goods or raising of finance. Some of the challenges Indian MSMEs face have been briefly discussed below:

High cost of credit: Access to adequate and timely credit at a reasonable cost is the most critical problem faced by this sector. The major reason for this has been the high risk perception among the banks about this sector and the high transaction costs for loan appraisal. While the quantum of advances from the public sector banks (PSBs) to the MSEs has increased over the years in absolute terms, from Rs.46, 045 Crores in March 2000 to Rs.1, 85,208 Crores in March 2009, the share of the credit to the MSME sector in the Net Bank Credit (NBC) has declined from 12.5 percent to 10.9 percent during the same period

Collateral requirements: Players in MSME sector are not in a position to provide collateral in order to avail loans from banks and hence denied access to credit.

Limited access to equity capital: This is common challenge faced by this sector in spite of the fact that overall capital inflows have witnessed significant increase in the recent years. 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.

Problems in supply to government departments and agencies: Majority of government tenders prescribe high eligibility criteria such as annual turnover, past experience etc which deters entity to MSME sector

Procurement of raw materials at a competitive cost: This is a growing challenge faced by this sector as procurement for raw materials is carried out within local territory due to their financial constraints and procurements are much smaller in scale as compared to industry at large.

Problems of storage, designing, packaging and product display: MSMEs face problems of storage, display and designs for their products. Non availability of selling outlets for their products is a serious constraint. In addition, MSEs also face problem of inadequate infrastructure for marketing of their products to interior/ remote parts of the country.

Lack of access to global markets: With the liberalization and globalization of the Indian economy, the small enterprises in India have unprecedented opportunities on the one hand, and face serious challenges, on the other. While access to global market has offered a host of business opportunities in the form of new target markets, possibilities to exploit technological advantage, etc., the challenges in this process have flowed mainly from their scale of operation, technological obsolescence, and inability to access institutional credit and intense competition in marketing.

Inadequate infrastructure facilities, including power, water, roads, etc: To ensure competitiveness of the MSMEs, it is essential that the availability of infrastructure, technology and skilled manpower are in tune with the global trends. MSMEs are either located in industrial estates set up many decades ago or are functioning within urban areas or have come up in an unorganized manner in rural areas. The state of infrastructure, including power, water, roads, etc. in such areas is poor and unreliable.

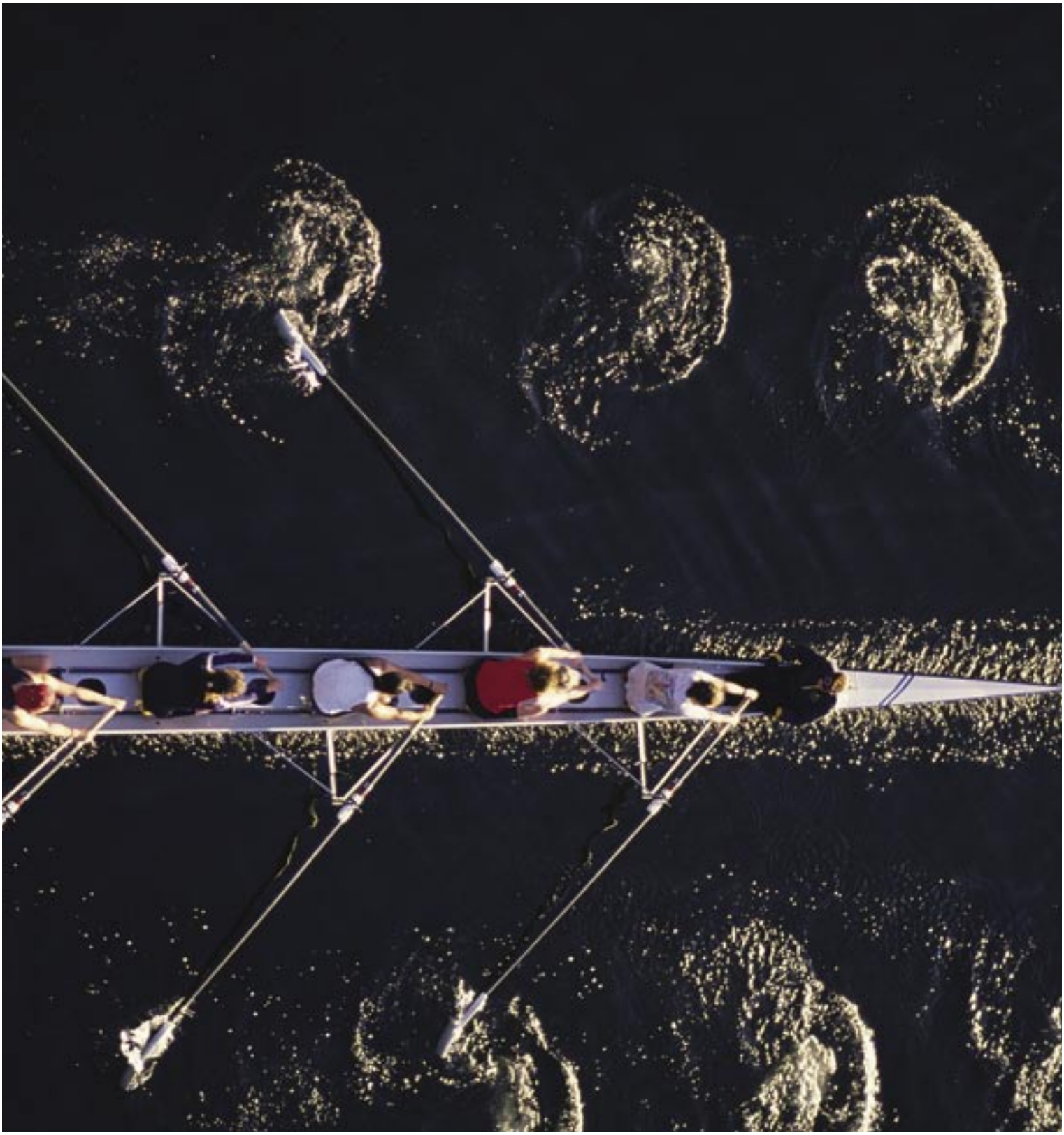
Low technology levels and lack of access to modern technology: The MSME sector in India, with some exceptions, is characterized by low technology levels, which acts as a handicap in the emerging global market. As a result, the sustainability of a large number of MSMEs will be in jeopardy in the face of competition from imports.

Lack of skilled manpower for manufacturing, services, marketing, etc.: Although India has the advantage of a large pool of human resources, the industry continues to face deficit in manpower with skills set required for manufacturing, marketing, servicing, etc.

Absence of a suitable mechanism which enables the quick revival of viable sick enterprises and allows unviable entities to close down speedily; and

Branding and Marketing: Due to very high cost of business acquisition, Low media budget, non participation in International events, the MSME branding and visibility is extremely poor.

05 Creating Competitive MSMEs



Creating Competitive MSMEs

The process of liberalization and market reforms since 1991 has brought about intense competition for MSMEs both in domestic and overseas markets. This has made it imperative for the Indian MSMEs to overcome the challenges that they face and maintain, improve and sustain competitiveness through lower cost, improved quality, making available wider choice by initiating various measures including innovation and up-gradation of technology.

Having realized the need to preserve, protect and promote MSMEs, the Indian government is also committed to the growth and development of the micro, small and medium enterprises and to enhance their competitiveness so that these enterprises contribute to accelerate the expansion of productive employment in the country. The government seeks to fulfill its mission by formulating policies and designing/implementing support measures in the field of credit, technological upgradation, marketing, entrepreneurship development etc. and undertaking effective advocacy for these purposes. The Government has also identified three thrust areas for increasing competitiveness of MSMEs, namely technology (including quality), skills development and finance.

The MSMEs that are successfully competing today are the enterprises that have developed a culture of success through appropriate ICT interventions that has enabled them to stay ahead of others. The MSMEs with heavy infusion of technology are much better adapted to meet the business needs and compete in the domestic as well as global markets. Interestingly, MSMEs are paying more attention to processes and systems than plant and machinery. This includes ICT systems like ERP and the like. More importantly it includes connectivity, communications, agile HR & Information systems that allow free and timely flow of information across the organization. The organizations that have succeeded are also those that have demonstrated both the willingness as well as the competence to improve their offerings over a period of time through appropriate technology interventions.

Finance is one of the critical inputs for the promotion and development of the micro and small enterprises. Recognizing the importance of easy and adequate availability of credit in sustainable growth of the MSE sector, the Government has been announcing various policy measures. In addition to the policy packages, the Indian government has also introduced schemes like the Credit Guarantee Scheme and the Performance & Credit Rating Scheme to ensure better availability of credit to the Indian MSMEs. However, despite all the efforts, the number of MSMEs having accounts with the banks has been only around 4 million. Taking this into account the fact that a majority of the MSMEs at the lower-end of the sector are outside the ambit of institutional finance, concerted efforts are being made by the SIDBI to promote micro finance across the country to enable the unemployed persons to set up their own ventures. Faced with increased competition on account of globalization, MSMEs are beginning to move from a reliance on bank credit to a variety of other specialized financial services and options. In recent years, the country has witnessed increased flow of capital in the form of primary/secondary securities market, venture capital and private equity, external commercial borrowings, factoring services, etc. Some of the measures required for promoting these emerging sources of finance are:

- Setting up of a separate trading exchange exclusively for the MSMEs
- Provision of special incentives for encouraging larger flow of Venture Capital & Private Equity funds into the sector
- More liberal “All-in-Cost Ceilings” for SMEs to raise low-cost funds through the External Commercial Borrowing route
- Bringing legislation on ‘Factoring Services’

The role of government policies, technology interventions and financial measures for creating competitive MSMEs has been discussed in detail in the following sections.

06 Policy Initiatives & Measures taken by the Indian Government

Policy Initiatives & Measures taken by the Indian Government

The Indian government realizes the crucial role played by MSMEs in the economic and social development of the country. The employment potential as well as the overall growth in the MSME sector is much higher than in the large industries. This sector has been consistently registering higher growth rates (10.8% between 2002-07) than the overall Industrial Growth rate (7.7%), thus demonstrating high degree of resilience and adaptability.

The government, over the years, has taken various measures to support and ensure growth and development of Indian MSMEs. Some of these measures have been briefly discussed below:

- 'Udyami Helpline', the Call Centre of Ministry of Micro, Small and Medium Enterprises (MSME), has been created by the Indian government to satisfy the long felt need of a single point facility for MSMEs for a wide spectrum information and accessibility of banks and other MSME-related organizations. It has also improved public access to the government, particularly from the rural and remote areas of the country, and made the government more responsive to the public needs. Udyami Helpline provides information to first generation entrepreneurs regarding project profiles available in the website of Ministry of MSME/ KVIC and other Ministries, other formalities required in setting up of an enterprise, formalities required for getting loans from banks, availability of subsidy under various schemes of the Ministry etc.

- Under the Indo-Africa Forum Summit in 2008, the National Small Industries Corporation (NSIC) had been mandated to set up Vocational Training Centres (VTCs) in African countries. Ministry of MSME has entered into long term agreement (Memorandum of Understanding/ Joint Action Plan) with 11 countries viz. Tunisia, Rwanda, Mexico, Uzbekistan, Lesotho, Shri Lanka, Algeria, Sudan, Cote d'Ivoire and Egypt. Such kind of cooperation opens up doors of new opportunities for Indian MSME sector by way of new markets, joint ventures, sharing of best practices and technology collaborations etc

- A proposal has been submitted to the chairman of Khadi and Village Indutries Commission (KVIC) to link the 'Charkhas Scheme' of Khadi and Village Indutries Commission (KVIC) with the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), that will definitely help the small weavers. This will help in solving the issue of unemployment to a great extent.

- The Government has taken several initiatives and measures for enhancing the competitiveness of SMEs in the present global environment. The most important among them is the enactment of the 'Micro, Small and Medium Enterprises Development Act, 2006', which aims to facilitate the promotion and development and enhance the competitiveness of MSMEs.

- The Government has also announced a comprehensive package for promotion of micro and small enterprises. The package comprises of several proposals/schemes for providing requisite support to the MSMEs in the areas relating to credit, fiscal, cluster-based development, infrastructure, technology and marketing. The package also provides thrust on capacity building of MSME associations and support to women entrepreneurs.

- For enhancing the competitiveness of the Indian manufacturing sector, the Government has also launched the National Manufacturing Competitiveness Programme (NMCP). The NMCP is the nodal programme of the Government of India to develop global competitiveness among Indian MSMEs. There are ten components under the NMCP targeted at enhancing the entire value chain of the MSME sector. It includes programmes like establishment of new tool rooms, benchmarking of the global competitors, enhancing of product and process quality, cost reduction through lean manufacturing techniques, etc.

The Programme is to be implemented through Public Private Partnership mode with close physical and financial participation of the MSME sector.

- The first component that was made operational under the Programme was "Marketing Assistance/ Support to MSEs". The objective of the scheme is to popularise the Bar Code registration and motivate the micro and small manufacturing enterprises to adopt the Bar Code Certification on large scale and to sell their value added products worldwide and enable higher export price realization. It also helps in domestic marketing (wholesale & retail). Under the Scheme, 75% of annual fee (recurring) of Bar Code certification for the first three years are reimbursed to micro and small entrepreneurs. Under the scheme, Rs.5.64 lakh have been reimbursed to 133 MSEs during the year 2008-09. In order to motivate and encourage more and more MSEs for use of Bar Codes, 34 one-day seminars have been conducted by MSME Development Institutes (DIs) throughout the country during 2008-09.

- The scheme for "Building Awareness on Intellectual Property Rights" (IPR) was launched to enable Indian MSMEs to attain global leadership position and to empower them in using effectively the tools of Intellectual Property Rights (IPR) of innovative projects.

- "Providing Support for Entrepreneurial and Managerial Development of MSMEs through Incubators" aims at nurturing innovative business ideas (new/ingenious technology, processes, products, procedures, etc), which could be commercialized in a year. Under the scheme, various institutions like Engineering Colleges, Research Labs, etc. are provided funds up to Rs.6.25 Lakhs for handholding each new idea/entrepreneur. The incubators provide technology guidance, Workshop and Lab support and linkage to other agencies for successful launching of the Business and guide the entrepreneur in establishing the enterprise. Under the scheme, twenty five institutions have been approved for nurturing innovative business ideas from individuals/MSEs that are near commercialization stage.

- Under the NMCP, the Government has also launched a scheme, namely, "Enabling Manufacturing Sector to be Competitive through Quality Management Standards (QMS) and Quality Technology Tools (QTT)" in order to improve quality and productivity in the MSME sector.

- Under the scheme, "Mini Tool Rooms under PPP mode", 15 Mini Tool Rooms will be set up during the 11th Plan period. Competitive bidding from entrepreneurs and associations will be invited to set up Tool Rooms with Government support up to Rs.9 Crores.

- In July 2009, the sixth component of the NMCP, namely, "Lean Manufacturing Competitiveness Programme for MSMEs", was launched. Under the Lean Manufacturing Programme (LMP), MSMEs will be assisted in reducing their manufacturing costs, through proper personnel management, better space utilization, scientific inventory management, improved process flows, reduced engineering time and so on.

- The remaining four components of NMCP seek to address issues of Information and Communication Technology (ICT), Marketing and Energy Efficiency relating to the MSME sector and are at various stages of approval. The salient features of these components:

  The component on "Promotion of Information & Communication Tools (ICT)" in Indian MSME sector envisages identifying some of those clusters of SMEs, which have quality production and export potential, and assist them in adopting ICT applications to achieve competitiveness in the national and international markets.

  The main objective of "Design Clinics Scheme for MSMEs" is to bring the MSME sector and design expertise on to a common platform and to provide expert advice and solutions on real time design problems, resulting in continuous improvement and value-addition for existing products. It also aims at value-added cost effective solutions.

  The "Marketing Assistance and Technology Upgradation Scheme for MSMEs" aims at improving the marketing competitiveness of MSME sector by improving their techniques and technology for promotion of exports.

  The objective of "Technology and Quality Upgradation Support to MSMEs" is to sensitize the manufacturing MSME sector in India to upgrade their technologies, usage of energy efficient technologies to reduce emissions of Green House Gases, adoption of other technologies mandated as per the global standards, improve their quality and reduce cost of production, etc., towards becoming globally competitive.

- A Task Force was set up by the Prime Minister in August 2009 to reflect on the concerns & issues regarding MSMEs and formulate an agenda for action. The Task Force classified the common issues into 6 major thematic areas and constituted separate Sub-Groups for detailed examination. These thematic areas covered (i) credit, (ii) marketing, (iii) labour, (iv) rehabilitation and exit policy, (v) infrastructure, technology and skill development and (vi) taxation. A separate Sub-Group was also constituted to look into the development of MSMEs in the North-East and Jammu & Kashmir. Each of the Sub-Groups examined the specific issues over a series of meetings, and after detailed deliberations with all the stakeholders, including MSME associations, submitted their reports to the Task Force. The recommendations of the previous committees, working groups and study groups, which are relevant in the current context, have been taken into consideration by the Task Force and its sub-groups.

The summary of the recommendations provided by the Task Force is provided below:

A. Measures that need immediate action

i. The government should extend, for a further period of one year, beyond March 31, 2010, the components of the 'stimulus package' which are specific to MSMEs.

ii. The government should ensure strict adherence to the stipulated targets by the commercial banks for the micro enterprises (viz. 20% year-on-year growth for micro and small enterprises lending with 60% apportionment for micro sector).

iii. A separate fund may be created with SIDBI, using the shortfalls, if any, against the MSE credit targets set for the commercial banks. This fund named 'Special Fund for Micro Enterprises' should be utilized exclusively for lending to the micro enterprises.

iv. A Public Procurement Policy for MSMEs as envisaged in the Micro, Small and Medium Enterprises Development Act, 2006 may be introduced at the earliest. The policy may set a goal for government departments and PSUs to reach, over a stipulated period, a target of at least 20% of their annual volume of purchases from micro and small enterprises (MSEs), and mandate them to report their achievements in this regard in the annual reports.

v. The Offset policy of the government, particularly in the defence and aviation sectors, should give priority to MSMEs. A permanent guidance mechanism under the Raksha Utpadan Rajya Mantri (RURM) with Secretaries of Defence Production, MSME and Civil Aviation and CEOs of Defence PSUs should be considered for this purpose.

vi. The government should earmark additional public spending to the tune of Rs.5, 000- 5,500 crore over the next 3-5 years to specifically target deficiencies in the existing infrastructure and institutional set up. These funds may be used to: (a) support the establishment of Rehabilitation Funds in the States for the revival of potentially viable sick units; (b) assist MSMEs in the acquisition and adaptation of modern clean technologies as well as creation of Technology Banks and product-specific Technology Development Centres; (c) promote establishment of business incubators in educational institutions of repute; (d) renovate existing industrial estates and develop new infrastructure for MSME sector, with sustainable urban governance mechanisms; (e) re-engineer, strengthen and revitalize District Industries Centres to enable them to play a more active role in advocacy and capacity building for MSMEs and as appropriate, in their rehabilitation; (f) strengthen NSIC's equity base for enhanced market support to MSMEs; and (g) up-scale the existing programmes of entrepreneurship and skill development targeted at MSMEs. It is further recommended that while the detailing of the schemes would be done on the basis of further examination, to avoid procedural delays in implementation of these schemes, a line entry may be incorporated in the Annual Plan 2010-11 of the Ministry of MSME.

vii. The government should take steps to create an overall enabling environment using appropriate legal and fiscal instruments, to incentivize the transition of MSMEs from the unorganized to the organized sector as well as for their corporatization as entities. It should also encourage higher investments for innovative and knowledge based ventures as well as for research and development through greater partnership between the industry and academic institutions.

viii. The ongoing exercise to introduce a new Direct Tax Code and GST should specifically seek to achieve these policy objectives through appropriate provisions for graded corporate tax structure, tax pass through for angel and venture capital funds and incentives for R&D.

B. Medium Term Institutional Measures

The overall approach suggested above should be accompanied by institutional changes and detailing of programmes, to be achieved within a year or so. These include:

i. Government should set up an independent body at the national level for the promotion and development of MSMEs. This body may provide financial and managerial support for setting up of industrial estates/common facilities in partnership with the private sector, administer schemes for the unorganized sector, promote technology development (including clean technologies), provide marketing support and coordinate & disseminate information relevant to MSMEs.

ii. Currently, the Development Commissioner (MSME) is the focal point for all policy matters, formulation of various promotional and developmental schemes as well as channelizing certain incentives and subsidies to the MSME sector, the Small Industries Development Bank of India (SIDBI) is the principal financial institution for financing and related promotional and development work for MSMEs, while the National Small Industries

Corporation Limited (NSIC) has been set up to facilitate MSMEs in procurement of raw material and helping in marketing of their products.

iii. In addition, various Ministries/Departments of the Government have promotional policies and developmental schemes for the MSMEs in their specific sector.

iv. The proposed independent body could use the existing structures of aforesaid organizations with appropriate changes in their charter and mandate. The experience of other countries with such institutions (such as the Small Business Administration, in the United States) may be considered while deciding on the mandate and structure of the National level institution.

v. As institutional re-building is an intricate task, an Expert Group may reflect on this and come up with suitable recommendations on the structure and mandate of this body within a timeframe of three months and submit these to the Prime Minister. This Expert Group may be headed by Member, Planning Commission, and comprise of Deputy Governor, RBI; Secretary (MSME); Secretary (DFS); DC (MSME); CMD SIDBI; and CMD NSIC.

vi. A Standing Review Committee under Member (Planning Commission) should be set up to monitor flow of credit to MSME sector and its apportionment to the more vulnerable sections like micro enterprises and the unorganized sector.

vii. Government should encourage Micro Finance Institutions (MFIs) to form self-help groups and finance micro enterprises in unbanked/identified excluded rural/ semiurban areas at reasonable rates. Banks may also be encouraged to formulate schemes for refinancing loans taken by the MSEs from non-institutional sources/ moneylenders. Financial outreach is likely to prove an effective means to formalize the unorganized sector. Suitable incentives, including tax concessions, should be extended to MFIs to encourage them to work as business correspondents and business facilitators for banks to service micro enterprises.

viii. The District Industries Centres (DICs) should be strengthened with provision of modern IT-enabled communication facilities and re-training of human resources available with these institutions. As the DICs form the bedrock of MSME promotion, they should be urgently strengthened, revitalized and transformed to play a more active role in advocacy and capacity building for potential and existing entrepreneurs. Wherever viable, active involvement of the private sector for revamping the DIC network should be considered. Such re-engineering of the DICs may be supported by the Central Government.

ix. States should be supported by the Central Government to set up Rehabilitation Funds and operationalise appropriate schemes for the rehabilitation of units temporarily rendered sick due to circumstances beyond their control. It is recommended that the state governments may establish a mechanism at the district level, in the DICs, to re-examine the viability of sick units in coordination with the banks and implement rehabilitation packages in a time bound manner.

x. It must be ensured that the rehabilitation package is made binding on all stakeholders, including banks and financial institutions. The RBI/Finance Ministry should issue necessary orders in this regard so that discretion at the field level, whether by the field formations or by banks is ruled out.

xi. The government should infuse industrial estates which are currently in a state of decay and neglect, with fresh capital and upgrade them to 'Industrial Townships'. The latter concept has constitutional recognition. This will permit effective municipal administration and a single-stop mechanism for the provision of municipal services.

xii. New clusters for MSEs should be created to meet the requirements of planned development and growth, consistent with the policy of progressively organizing the MSEs. Development of new infrastructure for the MSME sector should be substantially augmented with the government stepping in with viability gap funding to encourage private sector participation.

xiii. Government should strengthen NSIC's equity base to give a demand side impetus to MSME enterprises in addition to preferential procurement and volume stipulations enunciated earlier. This shall help remove bottlenecks in procurement of raw materials and also step-up marketing support and provide better backward and forward linkages to the sector.

xiv. Government should consider earmarking funds to the tune of Rs. 1500 crore, within the enhanced investment package proposed, to support clean technology initiatives of different Ministries involved with MSME growth, particularly in the context of the National Action Plan for Climate Change (NAPCC). This amount should be utilized by up-scaling existing schemes or by evolving new schemes to assist existing MSMEs in acquisition, adaptation and innovation of modern clean technologies as well as creation of a Technology Bank/product specific technology centres to enable them to move up the value chain.

xv. The concept of business incubators in educational institutions of repute should be encouraged by setting aside Rs.1000 crore within the overall package (public spending package to the tune of Rs.5, 000- 5,500 crore over the next 3-5 years). Business incubators currently in place in the premier management institutions of the country have facilitated new enterprises with innovative ideas.

C. Legal and Regulatory Structures

The legal and regulatory structures and provisions affecting the MSME sector that should be taken up in the medium term (1-3 years) are as follows:

i. Government should expedite the establishment of a SME Exchange which is already under consideration.

ii. Workable legal options should be developed for the securitization of trade credit receivables and for the promotion of factoring services.

iii. Wide publicity should be given to new formats like Limited Liability Partnerships and Single Person Companies, which provide MSMEs with an interim solution in the move from the informal to the formal economy.

iv. The insolvency legislation should be comprehensively reviewed in recognition of the reality of the global market where enterprises continuously get created and destroyed.

v. Labour laws should be simplified, especially those applicable to enterprises in the MSME sector, since the transaction costs for complying with these laws is disproportionately high for these units. While some steps have been taken by the Labour Ministry in this regard, it is recommended that a single and comprehensive legislation for MSEs with 40 workers may be worked out. At the same time, keeping in view the large size of the unorganized sector within MSMEs, the labour related issues for this sector should be focused more on welfare rather than legislation by, inter alia, use of the recently promulgated unorganised Workers Social Security Act, 2008.

D. North-Eastern States and J&K

While the Government has introduced special packages and policies for the NER and J&K, there have been intra-state and intra-regional asymmetries in utilization which need to be looked into by the respective state governments. Additionally,

i. Some modifications in the capital subsidy scheme should be made, so as to allow MSMEs to avail of subsidy for their expansion.

ii. The budgetary provisions which have been reportedly inadequate to meet subsidy claims under these schemes may be supplemented so as to clear all pending claims for MSEs up to 31.3.09.

iii. The J&K Government has been demanding that the incentives available for MSMEs in the State be brought on par with the modified NEIIPP of NER. This demand appears to have some merit. The J&K package may be enhanced and brought at par with the modified NEIIPP of NER for MSMEs.

iv. A Fund of Rs.100 crore within the corpus may be earmarked for implementing a special rehabilitation package on easier terms for identified sick units in J&K.

The above listed recommendations of the Task Force are presently in the process of being implemented. The recommendations of the Task Force could be broadly categorized into:

(i) Those where the action need to be completed within 3 months,

(ii) Action need to be completed in a period of 6 months-1 year, and

(iii) Long-term measures involving longer time duration.

On several of the recommendations where the action need to be completed in 3 months, the Department/agencies have already completed the action. On the remaining recommendations actions have already been initiated and the same is expected to be completed within the time frame laid down in the report.

The recommendations of the task force that have already been acted upon cover credit and capital access, infrastructure development, market development and technology adoption.

Keeping in mind the recommendations of the Task Force, the government has made many positive provisions for MSMEs in the budget for the year 2010-2011:

- Firstly, the allocation for this sector has been raised from Rs.1,794 crore to Rs.2,400 crore for the year 2010-11.The interest subvention of 2 per cent on pre-shipment export credit has been extended for one more year for exports covering handicrafts, carpets, handlooms and small and medium enterprises. Moreover, there have been many provisions for the unorganized sector including setting up a National Social Security Fund for unorganised

sector workers with an initial allocation of Rs.1,000 crore. Further, to encourage R&D across all sectors of the economy, the weighted deduction on payments made to National Laboratories, research associations, colleges, universities and other institutions, for scientific research has been enhanced from 125 per cent to 175 per cent.

- As far as issues related to taxation are concerned, the budget enhanced turnover limit for businesses to Rs 60 lakh for auditing of accounts and for presumptive taxes. Moreover, to facilitate the conversion of small companies into LLPs, this process will not be subject to capital gains tax.

- To ease the cash flow position for small-scale manufacturers hard hit by the economic slowdown, MSMEs have been permitted to take full credit of Central Excise duty paid on capital goods in a single installment in the year of their receipt. Secondly, they would be permitted to pay Central Excise duty on a quarterly, rather than monthly basis.

During a meeting with the State Ministers and Secretaries, Secretary MSME announced setting up of three groups - Revamping of District Industries, Rehabilitation of Sick MSMEs and Infrastructural Issues, for detailed examination of the Task Force Recommendations. Each of these groups will comprise of 5 to 6 States.

RBI has recently taken several measures to enhance credit delivery to the employment intensive micro and small enterprises (MSE) sector. One of the major concerns of the MSE sector is the inability to arrange for collateral security and or third party guarantee. As a result, new entrepreneurs find it difficult to access credit from the banking system. Accordingly, RBI have issued guidelines from time to time thereby advising banks to grant collateral free loans up to Rs. 5 lakh sanctioned to the units of MSE sector (both manufacturing and service enterprises). Further, banks have also been advised to lend collateral free loans up to Rs.25 lakh, based on good track record and financial position of the units.

A Working Group was set up by Reserve Bank of India to review the Credit Guarantee Scheme of the Credit Guarantee Fund Trust for Micro and Small Enterprises and suggest measures to enhance its usage. The Group has submitted its final report which was released on March 6, 2010 .Some of the main recommendations of the Working Group include mandatory doubling of the limit for collateral free loans to micro and small enterprises (MSEs) sector to Rs.10 lakh from the present Rs. 5 lakh, increase in the extent of guarantee cover, absorption of guarantee fees for the collateral free loans by CGTMSE subject to certain conditions, simplification of procedure for filing claims with CGTMSE and increasing awareness about the scheme, etc. On the other recommendations the CGTMSE has been advised to initiate appropriate action. The implementation of the recommendations of the Working Group is expected to result in enhanced usage of the Credit Guarantee Scheme and facilitate increase in quality and quantity of credit to the presently included as well as excluded, MSEs, leading eventually to sustainable inclusive growth.

The Reserve Bank had constituted a Working Group on Rehabilitation of Sick SMEs and based on the recommendations of the Working Group, banks have been advised to undertake a review and put in place a Loan Policy governing extension of credit facilities, Restructuring/ Rehabilitation policy for revival of potentially viable sick units/ enterprises and a Non-discretionary One Time Settlement scheme for recovery of non-performing loans.

Till May 2010, 41 scheduled commercial banks have reported to have complied with the requirement of setting up a dedicated loan policy on MSE, 40 scheduled commercial banks with the requirement of setting up a rehabilitation/restructuring policy and 39 scheduled commercial banks on setting a non-discretionary One Time Settlement scheme for recovery of non-performing loans. Among the 39 scheduled commercial banks who have reported to have complied with the requirement of setting up of a non-discretionary One Time Settlement scheme for recovery of non-performing loans, 30 banks have indicated to have placed the policy on their respective banks' websites.

As the progress in rehabilitation of sick units was found to be tardy, the Regional Directors who head the Empowered Committees set up by RBI at its Regional Offices have been advised to ensure that banks strive for timely action for rehabilitation of sick units in the MSE sector, and put in place a credible, pro-active and a functional monitoring mechanism to review the progress in actual concrete outcomes. The same is being monitored at the Central Office level.

The size of the corpus set up under the Credit Guarantee Scheme has been gradually increased to Rs. 1,906.55 crore by the end-March 2010. This has helped in greater participation of the Members Lending Institutions (MLIs) under the scheme. During 2009-10, about 1.51 lakh proposals for an amount of Rs. 6875.11 crores were approved under the scheme which is higher than the cumulative proposals approved in the preceding nine years. Cumulatively, over 3 lakh proposals for an amount of Rs.11,559.61 crores has been approved under the scheme upto March 2010. Further, based on the feedback received from MLIs, several modifications have been undertaken for making the scheme more user friendly. To facilitate expedient settlement of claims under the scheme, the lock-in-period under the scheme has been reduced from 24 months to 18 months.

The CII National MSME Council works closely with the Ministry of MSME. For the implementation of the Task Force report recommendations, the Chairman, CII MSME Council for the year

2010-11, has outlined a twelve point agenda. These 12 points have been briefly discussed below:

- In order to encourage ICT use by MSMEs, there is need for enhanced depreciation on IT products. This would greatly enhance their competitiveness. It is recommended that the government consider according 100% depreciation, once in a block of three financial years, for an annual investment in IT equipment and software up to a limit of rupees twenty five lakhs, to the MSMEs.

- Providing tax benefits to companies to source from MSMEs and adhere to the payment schedule, as per the terms of the contract, agreed upon with their vendors. This would ensure the growth progression & upgradation of the vendors, in line with the requirements of the vendee and also help to address the issue of payments (delayed), through out the supply chain.

- The promotion of climate friendly energy technologies is important to enhance the self-reliance on energy and also be responsible towards the environment. There is a need to create Central Climate Friendly Technology Fund to help MSMEs to adopt such technologies.

- Facilitating the establishment of SME Exchange while ensuring product innovation and without compromising on risk management - this will reduce credit requirements on one hand, and broad base equity funding on the other.

- There is a need for the formulation of the Purchase preference policy, as per Section 11 of Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, that enables the Central Government and the State Governments to notify from time to time, preference policies in respect of procurement of goods and services, produced and provided by Micro and Small Enterprises.

- There is a need for a reduction in the number of litigations through simplification of regulatory framework for the MSMEs. The various employee related regulations such as the Provident Fund Act, The Employees State Insurance (ESIC) Act, the Factories Act, the Industrial Disputes Act, the Contract labour Act etc. are seriously impairing the growth of the MSME sector. Hence, the recommendations made by the Working Group or Labour Laws by the Planning Commission and referred in the Report of the 2nd National Labour Commission must be discussed with the Industry, and the various labour regulations be suitably amended.

- Efforts should be made to adhere to schedule of introduction of GST and for this purpose, announce time schedule for each important step such as issuing a White Paper on model and rate of GST for public comments, placement of draft GST Bill for clearance by the Parliament & finalizing the GST legislation and Rules. Most preferred option is a unified, single rate of 12% for GST. This would be the biggest stimulus package for economic revival and the first step towards unification of the Indian market.

- There is a need for policy guidelines to encourage FDI participation by NRIs in the SME sector - this would include no export obligation and continuing Small Industry status even if FDI is more than 24%, separate platform for facilitation, automatic approval for 100% FDI from NRIs, and other promotional measures.

- There is the need for revamping the credit rating system for MSMEs. It would be highly desirable, if the RBI could constitute a group along with the Indian Banks Association and the credit rating agencies to work out a uniform credit rating format and processes to bring about transparency and speed to this important issue.

- Earmarking 15% for MSEs (Micro & Small Enterprises) within the overall priority sector lending, as recommended by the Working Group on Micro & Small Scale Enterprises for the eleventh Five Year Plan (2007 - 2012). The need to enhance the availability of credit to the MSEs from the commercial banks and other institutional sources is well recognized and fixing a sub-target for this sector would go a long way in improving the scenario;

- All registered enterprises graduating from 'Micro & Small' category to 'Medium' category to be treated at par, for the applicability of all promotional schemes, announced & implemented by the Office of the Development Commissioner (MSME).

- With a view to enhance the competitiveness and linkages with the large industry for the MSMEs, capacity building would assume priority. CII through its L M Thapar Centre for Competitiveness for the SMEs would work upon twelve (12) new clusters impacting approximately 100 MSMEs and also take the number of clusters from 200 to 212.

07 Importance of ICT in the MSME sector

Importance of ICT in the MSME sector

Today the role of technology has transformed from an being enabler of productivity and quality through process automation and quality control to a more strategic role as a key influencer of competitive advantage. The last decade of the twentieth century has witnessed rapid technological advances especially in the areas of ICT. Increase in ICT adoption and knowledge infrastructure can provide a boost to the growth and maturity of MSMEs. ICT has today presented enterprises with possibilities of enhancing their efficiency in all segments. Diagram below gives some idea as to how and where ICT can make a difference.

ICT adoption by Indian MSMEs can increase the efficiency of their internal as well as external business processes. Efficiencies brought about by the use of ICT tools in Finance and Accounting can ensure easy and transparent client service. This reduces consolidation and reconciliation efforts to a great extent which have been issues with this sector consistently. Managing production and projects with IT aids are an excellent way of handling production as well as IT issues. Procurement and supply chain management become much more organized when managed systematically with appropriate IT intervention. Human capital management and development might not be an immediate concern with many of these enterprises but their effects are well seen once these processes are streamlined and automated.

ICT intervention can also help MSMEs get better access to real time market information and help them understand what kind of products and services are actually needed by the market, how big/small is the market for these products and services, provide an understanding of an opportune time to launch these products and services in the market and how are they to be delivered. Online presence and other ICT tools can also ensure access to

wider market and audience for these MSMEs. Appropriate usage of ICT tools can also aid MSMEs in their business dealings with large scale players.

Another area where ICT intervention can assist MSMEs is in improving internal communication and customer management. With the increasing focus on customer service and customer management, the importance of CRM systems cannot be underestimated. These systems have proved successful in providing cost savings and efficiency in customer development and customer retention activities. Usage of Internet and e-commerce solutions help reduce transaction costs and increase the speed and reliability of transactions.

Bharath Beedi is a classic example of an MSME that graduated from using to MS excel and desktop based solutions to adopting cloud based CRM to drive business benefits. Bharath Beedi Works Ltd. is a market leader in the tobacco business with sales coverage of over 2000 towns in India. The company has 50,000 staff strength with pan-India presence. They also export products to over 16 countries across the globe. It caters to a vast clientele demanded a strong, wide-spread and decentralized sales team. This, in turn, necessitated close coordination across various internal and external divisions. The organization was facing the following challenges:

- Simplification of highly transactional sales cycle
- Synchronization between production, logistics and transportation, warehousing, sales and distribution management
- Tracking market scenarios and easy monitoring of sales volume fluctuation
- ROI on marketing campaign
- Reduction in duplication and ease communication flow across the sales and distribution network

The organization then decided to adopt a CRM that captured all production information, transportation and logistics details and sales data right from the wholesalers to the last mile resellers and provided inputs to different stakeholders using email and SMS reminders. RFID integration was also carried out with the CRM for ease in uploading data. Customized online reporting to management and staff process leads was facilitated by the solution and innovative practices to automate task flow, competition information, market details, product feedback and marketing campaign monitor were adopted. This majorly helped improve the sales channel productivity.

Sophisticated ICT applications such as KMS (Knowledge Management System) and ERP (Enterprise Resource Planning) allow firms to store, share and use their acquired knowledge and know-how.

Appropriate ICT usage can also ensure productivity enhancements, improvements in quality and operational cost reduction for these MSMEs.

A. Current Usage of ICT in Indian MSMEs

Inspite of numerous benefits of adopting ICT, very few micro, small and medium business are able to access efficient and affordable IT solution that can work for them. Penetration of ICT in Indian MSMEs is still quite low. ICT adoption in Indian MSMEs can be divided into the following 4 stages:

Stage I of ICT Adoption: Companies in the nascent of IT adoption having only the basic IT infrastructure in place, such as the basic level computerization, LAN, etc can be categorized into this stage of ICT adoption. These companies use IT only for basic communication and data processing.

Stage II of ICT Adoption: Companies that have computerized certain standalone functions without any cross functional linkages can be categorized in this second stage of ICT adoption. Firms at this level would be having several point applications aimed to automate selective functions. There will be islands of information with little or no integration between the applications.

Stage III of ICT Adoption: Companies that have automated their core business functions, achieved complete process automation and integration are considered to be in the third stage of ICT adoption. This will include firms which have integrated transaction processing environments with automation of core business processes and functions. The firms will be using an enterprise level resource planning application (ERP) which integrates various business processes across functional departments.

Stage IV of ICT Adoption: Companies that have achieved computerization in business networks and are using decision support systems, e-commerce etc to drive their businesses are considered to be the fourth stage of ICT adoption. Companies in this stage of ICT adoption are the most matured in terms of ICT adoption. These companies use IT innovatively and are integrated across the industry value chain.

Surveys have shown that the ICT penetration within the more matured medium sector enterprises is far more than in small scale enterprises that are still using IT majorly for communication and promotion purposes. Medium scale enterprises have started automating their business functions to increase effieciency and effectiveness within the business operations.

Auto Component Sector:

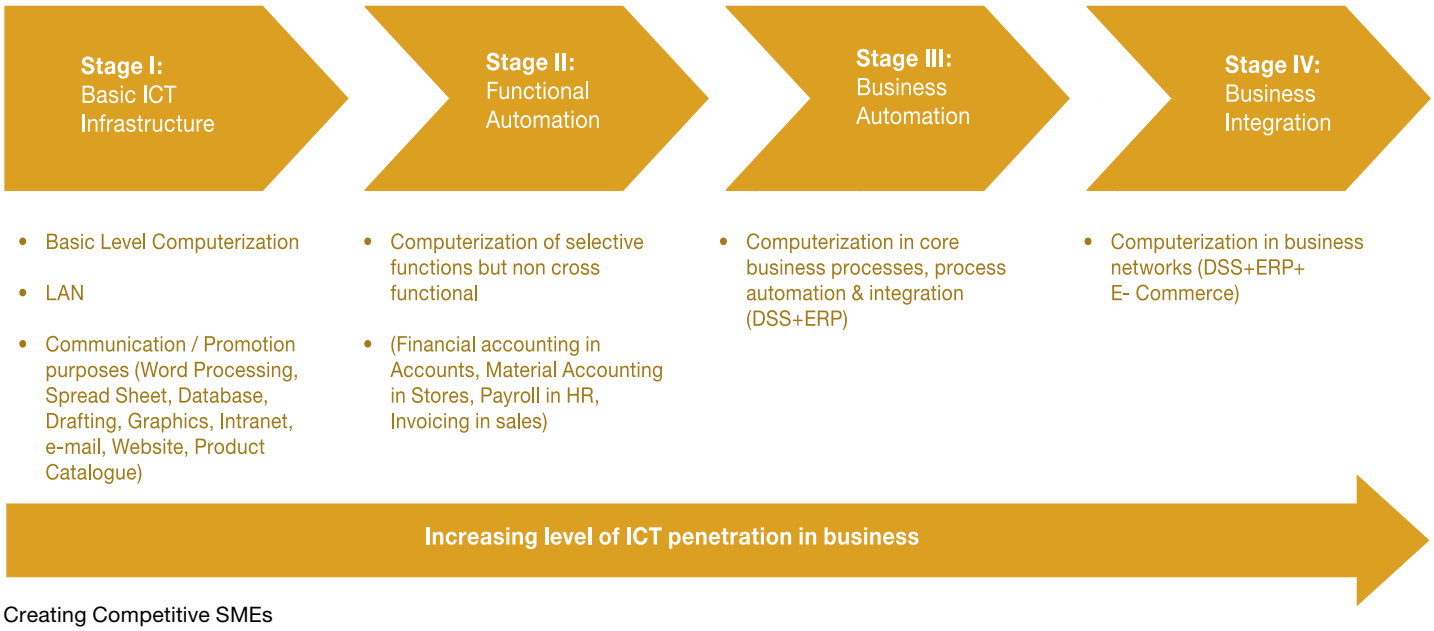
- As per PwC's studies, within small scale sector of India's auto component industry, majority of the companies have only the basic level computerization and hence fall within stage I of ICT adoption. Computerization of standalone functionalities and integration within different functional departments has started within some of the small scale enterprises. However, none of the companies in the small scale sector of India's auto component industry have started using IT innovatively to drive their business.
- Within the medium sector of India's auto component industry, majority of the companies fall under stage I of ICT adoption, with just the basic level computerization in place.For a large number of medium scale enterprises, standalone functions such as Material Accounting in Stores, Payroll in HR, Invoicing in sales etc have been automated. Very few medium scale enterprises in the Indian auto sector are using IT innovatively and can be assumed to have reached the fourth stage of ICT adoption,

Garment Sector:

- The current usage of ICT in this sector is at a very basic level, but because of its unique cluster pattern, it has a very high scope of ICT adoption.

Drugs & Pharma Sector:

- The ICT penetration is quite low for small scale units of India's drugs and pharma industry. Only about 10-30% companies have the basic IT infrastructure in place and



fall under stage I of ICT adoption. A few enterprises within this segment have started using point applications aimed to automate selective business functions.

- For medium scale units of India's drugs and pharma industry, 30-50 per cent companies are having ICT enabled accounting systems and a small number of companies are moving towards using IT systems innovatively to drive their business.

Leather Sector:

Surveys conducted by PwC show the following status of ICT usage in the Leather Sector in India:

- None of the small scale units are into Stage III and Stage IV of ICT adoption. Only basic IT infrastructure is being used within small scale units in the Indian leather sector

- Within the medium scale sector only about 10% units are in Stage III of ICT adoption. There is a huge scope for usage of ICT in medium scale industries in this sector particularly in the area of e-Business.

Surveys conducted under Project Vikas (a five year project to make SMEs more competitive, started by Microsoft, along with the NMCC and other stake holders) for various clusters also show huge gaps in ICT deployment for the MSME sector. Areas such as supply chain management, designing, customer relations, order management, resource and capacity planning, marketing, managing inventory etc could specifically benefit from ICT intervention. The following observations were made during the various cluster surveys:

- Ahmedabad pharma cluster has been observed to be slow adopters of ICT being extremely price sensitive due to their size and lack of requisite infrastructure and budgets

- Footwear industry in Agra doesmost of the work by hands and hardly any mechanization exists. All process control is manual and all records are kept manually

- Tirupur Knitwear cluster was found to lack the ICT vision for an integrated business and there was a limited knowledge on latest technologies

- Ludhiana textiles cluster was found to be abysmally low in ICT investments due to lack of ICT knowledge, high software costs, high skilled personnel salaries etc

- Pune Auto Cluster showed that tier I suppliers are providing greater emphasis on e-business interventions to demand planning and management, engineering design and procurement. However tier II and III suppliers use computers only for accounting, stores, orders and delivery related activities

B. Barriers to the adoption of ICT by Indian MSMEs

As can be noticed from the above listed data for ICT adoption in various sectors, the penetration of ICT in Indian MSMEs is quite low. This can be attributed to many reasons. Some of these reasons are stated below:

- Limited internal IT expertise and Managerial Knowledge: Very few employees of a typical MSME gain relevant expertise in IT during their education (largely vocational training)
- ICT budget: Most SME firms do not have a formal IT budgeting process and hence don't plan for ICT investments.
- Affordable solutions: While hardware prices have been declining recently, software and IT service costs have not shown any downward bias.
- Developing and maintaining e-Business solutions: The cost of developing and maintaining e-Business solutions is quite high
- Customization of ICT solutions: Currently available applications especially in the area of core manufacturing processes often require extensive customization before deployment and involve significant changes to the existing business process of the firm.
- Network Infrastructure Issues: Reliability and affordability are key network infrastructure concerns for majority of MSMEs
- Qualified ICT service providers: The large technology service providers who possess a national coverage capability typically do not service the smaller MSME market segment directly, as it increases their cost of sales.
- Awareness of ICT benefits: The management in most SME firms possesses a manufacturing background and is often without a good understanding of ICT and its benefits.
- Local language software: Most of the manufacturing work-force in smaller firms is composed of rural migrants who are predominantly non-English speaking.
- Training Issues: Very few MSME employees undergo IT training during the course of their employment.

As per the National Association of Software and Services Companies (NASSCOM), Indian small and medium-sized enterprises (SMEs) lack proper strategies to remove the impediments which constrain them to adopt Information Communication Technologies (ICT). Most MSME firms lack formal ICT decision making structures and in majority of the firms, the responsibility for ICT decision making is often with the firm's owner.

C. Cloud Computing: Boon for the MSME Sector

The challenges faced in ICT adoption by MSMEs have several dimensions including suitability of applications, price affordability, availability of support systems and skill sets and training issues. This has given way to IT firms thinking out-of-the-box to create products and services which are more relevant, affordable and address the real-life challenges of the MSME users.

Faced with similar challenge of addressing the needs of low income consumers and converting them into customers, FMCG firms examined the usage characteristics, needs, lifestyle patterns and paying capacity of the low income consumers. These insights made the FMCG firms realize that converting low income consumers into customers required a radical shift from

the traditional 'low price — low quality' paradigm of low income consumer products. This re-think gave birth to the creation of sachets of their products.

In the same way, telecom firms did a good job of tapping low-income customers who needed to gain control over their spending, by introducing pre-paid connections and schemes such as 'pay per second' tariff plans to cater to their needs.

Following the league, the big and giant web based companies like Google, Amazon, Salesforce.com similarly came up with a model named "Cloud Computing " the sharing of web infrastructure to deal with the internet data storage, scalability and computation for catering to customers like MSMEs looking for more affordable IT solutions.

According to the definition by NIST "Cloud computing is a model for on-demand network access to a shared pool of configurable computing resources that can be rapidly provisioned and released with minimal management effort or service provider interaction".

Cloud computing is an online service model by which hardware and software services are delivered to customers depending upon their requirements and pay as an operating expense without incurring high cost. Basically cloud computing is a set of services that provide software and infrastructure resources using Internet media and data storage on a third party server. It has three dimensions known as Software level service, Platform level service, Infrastructure service.

The main cloud computing attributes are pay per use, elastic self provisioning through software, simple scalable services, virtualized physical resources. Models, such as cloud computing based on Virtual technologies enables the user to access storage resources and charge according to the resources access. Cloud computing platforms are based on utility model that enhances the reliability, scalability, performance and need based configurability and all these capabilities are provided at relatively low costs as compared to the dedicated infrastructures. Benefits provided by cloud computing ranges from cost savings to speed and flexibility to enhanced performance.

Apt target customer bases of such an arrangement are MSMEs that cannot afford a full-blown on-premises software system but would like to take advantage of such systems if they are available to them. The features described above make Cloud Computing an attractive model for using IT services for MSMEs that want high performance and effective services at affordable prices. The solutions specific to this sector have to necessarily have:

- Simple but necessary functions
- A quick learning curve, user friendly UI and of easy to maintain
- A short implementation period incorporating best practices and at the same time allowing flexibility.
- A low demand for hardware (not very hardware intensive)
- Possibility of being used as a service/ licensed model
- Possibility of being run over shared hardware infrastructure

Cloud computing provides cost effective ways of automating their organizational processes by allowing the MSMEs to share software (SaaS), platform (PaaS) as well as Infrastructure (IaaS). These have been briefly described below:

Software as a Service: SaaS allows individuals to use applications that have been developed and deployed on the Web as a service without having to buy the package. Models such licensing as well as those similar to monthly rentals is popular. This considerably reduces the capital expense, a

MSME has to incur in using these applications to manage their business. Salesforce, CRM on demand, enterprise spend management, ecommerce, workforce performance management (WPM) are some such popular applications apart from the basic Google Apps package of word processing, spreadsheet and presentation software which are available for SMEs to begin with. These are the most commonly used application on SaaS model. Enterprises are fast ramping themselves up to match the efficiencies of big industries using such facilities. These applications are efficient, can be implemented quickly and doesn't mandate additional hardware need to permit user access. The systems are scalable as well as reliable and maintenance costs can be completely saved. Business benefits of SaaS for MSME segment include:

- Faster deployment time and reduced time-to-market
- Reduced IT infrastructure acquisition and maintenance costs
- Greater ease of use and added business value
- Reliability and scalability

Platform as a Service: Platform as a Service (PaaS) is a model in which a computing platform is made available over the web/cloud. This might not very often be very useful to SMEs as very few are involved in software development activities. In case they do, hassles like setting up hosting, servers, databases, user interaction process and frameworks are prepackaged and taken care of.

Business benefits of PaaS for MSMEs include:

- Requires no up-front investments
- Minimize operational costs
- Centralized information management
- Enhanced productivity
- Easy collaboration
- Secured and customized access

Infrastructure as a Service: Virtualization is the key word here. Complete infrastructure can be outsourced to a service provider. Clients can access and use network equipment, servers, data center space etc without having to make any large investment. MSMEs will have access to high quality ICT infrastructure with limited investment. MSMEs will have to concern themselves with only accessing the service. All activities such as maintaining the underlying hardware, operating system and network Infrastructure resources etc are managed. Billing mechanism is easy and convenient. Business benefits of IaaS include:

- Dynamic scaling
- Usage-based pricing
- Reduced capital and personnel costs
- Access to superior IT resources

Cloud Computing thus holds the potential to alter the MSME landscape and overcome some of the barriers of ICT adoption by the silent drivers of a nation's economy.

08 Financing Options

Financing Options

The importance of appropriate financing for ensuring sustainable growth of SMEs has been emphasized in the earlier sections of this report. Government of India has laid down several guidelines which if implemented would enable an entrepreneur with the right business idea to get access to right kind of finance, of the right quantum, at the right time and at the right cost. Reserve Bank of India has also laid down credit disbursal guidelines which banks are expected to adhere to. In spite of the large number of schemes available, disbursal of credit to SMEs is not as strong as it should be. This to a large extent, limits the growth of SMEs or makes them less competitive in the market place.

Financing through Banks

Traditionally banks have been the largest source of finance for SMEs. Bankers in India who have been part of a conservative lending system based on prudent norms designed to minimize non-performing assets (NPAs) have been risk averse in their approach to lending. Credit is usually extended only against collateral equivalent to 100% of the loan amount. Many of the SMEs especially those in the start up phase are unable to provide sufficient assets as collateral for lending. This makes the banking system inaccessible for SMEs especially first generation entrepreneurs.

Banks also take a decision on lending based on the financial ratios of the borrowing organization. Many SMEs have rudimentary accounting processes which makes the task of generating clean financial statements a task in its own right. Even in cases where the financial statements are clean, the very nature of the business environment in which the SMEs operate, means that the financial ratios are always under stress.

SMEs are part of the priority sector lending for banks along with agriculture, rural markets and microfinance. As per RBI guidelines, priority sector lending should be 40% of total credit lending of banks. There are however no sub targets within the priority sector lending requirements – this has limited the quantum of credit which banks have extended to SMEs. The recent years have seen significant growth in microfinance institutions. Banks have increased their lending to the microfinance institutions which in turn lend money to self-help groups. This arrangement allows banks to achieve the priority sector lending targets with very low levels of risk – the fall side of this arrangement is that the quantum of credit disbursed by banks directly to SMEs has fallen as illustrated in an earlier section of this report

Realizing that risk averse lending practices of banks were hampering credit disbursal to SMEs, Reserve Bank of India permitted collateral free lending upto a limit of Rs.5 Lakhs for all enterprises which are covered under the definition of MSMED Act 2006. In an effort to minimize the impact of default on the loans, Government of India with SIDBI launched the Credit Guarantee Trust for SMEs. The Credit Guarantee scheme (CGS) seeks to reassure the lender that, in the event of a MSE unit, which availed collateral free credit facilities, fails to discharge its liabilities to the lender, the Guarantee Trust would make good the loss incurred by the lender up to 75 / 80/ 85 per cent of the credit availed

Rating SMEs

One of the main reasons for poor disbursal of credit to MSME sector in spite of the initiatives outlined above is the information asymmetry between the lender (the banks) and the borrower (the entrepreneur). Reducing this information asymmetry is therefore key to reducing the trust deficiency between the two parties. One way for MSMEs to signal their credit worthiness is to acquire a credit rating from an independent credit ratings agency.

SME Ratings Agency of India Ltd has been set up with assistance from SIDBI, Dun and Bradstreet and many Indian PSU, Indian Private and MNC Banks. SMERA is the country's first Rating agency that focuses primarily on the Indian Micro, Small and Medium Enterprise (MSME) segment. SMERA's primary objective is to provide Ratings that are comprehensive, transparent and reliable. This would facilitate greater and easier flow of credit from the banking sector to MSMEs. SMERA has till date rated more than 7000 companies. SMERA ratings help the MSME reduce the cost of capital and obtain faster access to credit. In an effort to incentivize MSMEs to go in for SMERA ratings, subsidies are provided for upto 75% of the ratings fee under the "Performance & Credit Rating Scheme of NSIC" In order to avail the 75% subsidy, the eligible SSI units should possess an valid SSI Registration Certificate / Entrepreneur Memorandum Number (Permanent / Provisional) & should not have availed any rating subsidy in the past from NSIC

Working Capital

Funding Working Capital requirements is another expectation that entrepreneurs have from banks. MSMEs typically have long cash conversion cycles especially if they are dependent on large corporates for a bulk of their business. The recent economic crisis saw many large organizations looking to squeeze their supply chains in an effort to improve their operating efficiency.

Cash Credit Limits and overdraft limits have been the conventional instruments through which banks have provided for working capital loans. The cost of working capital loans however has seen a steady increase in recent months as RBI has increased the repo rates in an effort to combat inflation. Even when the repo rates were as low as 4.75% (as during the economic crisis), cost of working capital loans still remained high at 12% as banks became averse to lending to businesses and preferred to park their excess liquidity with RBI earning an interest equal to the then low reverse repo rate of 3.25%

Bills discounting, invoice discounting & factoring have been very common & traditional sources of working capital finance. In the existing mode of receivables financing credit risk is taken on the supplier's (MSME) financial strength and not on the buyer's (large corporates). The suppliers are not very financially strong and credit worthy vis a vis their large corporate buyers and hence the utility of these methods of working capital finance was limited.

SIDBI has put in place an Receivables Finance Scheme for MSMEs supplying components, raw materials, products and services to large corporate. The scheme was aimed at solving the chronic problem of delayed payments by large corporate to MSMEs. The MSMEs raise bills of exchange on large corporate on the supplies they make to them, the bills of exchanges are accepted by the large corporate and SIDBI pays directly to MSMEs by discounting the bills. The RFS has been structured to suit the requirements of various corporate and MSMEs based on their internal practices and procedures.

SIDBI in collaboration with NSE have now launched to launch an e-platform called NTREES, or Trade Receivables Engine for E-Discounting and its pilot was done in December 2009. NTREES is basically an electronic exchange for e-discounting of bills / invoices. There are for the present seven large corporate registered on the platform and there are over 100 MSME beneficiaries. At the moment, the first phase of the project is on and SIDBI is the sole financier. More financiers and corporate would be added on the platform after receiving regulatory approvals. NTREES is expected to go a long way in addressing the liquidity issues of MSMEs.

Risk Capital

As MSMEs grow in size, they begin to feel the need for capital to fund their growth aspirations. Capital is typically needed for additional plant and machinery, physical infrastructure, investments in information technology infrastructure and applications as well additional working capital for inventories, payroll etc. It is under these circumstances that availability of risk capital becomes important. Companies which are able to access risk capital at this inflection point in their growth curve are better equipped to make the transition to the next higher level.

Access to risk capital was a challenge in the pre-liberalization era. The capital markets were themselves not very well developed and there was no access to venture capital / private equity funding. With the economic reforms of the 1990s, came about an increase in capital inflows both in the form of foreign direct investment as well as portfolio investment. Opportunities also became available for Indian firms to form joint ventures with some of the world's leading companies. In recent years, many venture capital and private equity firms have raised funds for setting up India specific funds to capitalize on the Indian growth story. Many of these funds have invested in medium scale enterprises which they believe have the potential to be the potential stars of tomorrow.

Venture Capital / Private Equity

For the SME sector, availability of risk capital in the form of venture capital and private equity, presents new options. Capital is now more freely available albeit with loss of some control over the organization. In addition to providing capital, the venture capital / private equity firms also provide valuable advice on the growth strategies by being a member on the Board, increase access to newer markets through their network of contacts and assist with running the operations in the most cost effective manner through streamlining the supply chain.

SIDBI set up a wholly owned subsidiary SIDBI Venture Capital Ltd in 1999. SVCL currently manages two funds viz National Venture Fund for Software and Information Technology (which is now in the divestment stage) and a 8 year close ended SME Growth Fund in association with other leading commercial banks such as Punjab National Bank, State Bank of India, Bank of Baroda, Bank of India, Central Bank of India, Union Bank of India, Oriental Bank of Commerce and Corporation Bank in 2005 with a corpus of Rs. 500 Crores. SME Growth Fund focuses on a wide range of growth sectors, such as life sciences, retailing, light engineering, food processing, information technology, infrastructure related services, healthcare, logistics and distribution, etc.

The main objective of the fund is to invest in companies at early stage as well as in second round financing for those with a track record of proven technology or business model and opportunities for growth and earnings.

Other private sector investors like IDFC and ICICI have also set up mutual funds to focus exclusively in investments in SMEs.

Special forms of capital like mezzanine capital are also available in certain markets. Mezzanine capital offers convertible loan or convertible bond financing, loans with equity options or warrants attached, loans with profit-sharing arrangements and high-yield loans, which charge higher interest rates than usual, but offer a borrower funds that would not otherwise be available.

SME Exchange

Initial Public Offerings through listing on the stock market provide enterprises with additional funding options through risk capital. IPOs also provide an exit option for investors like private equity funds. While access to the capital markets provides enterprises with unprecedented access to risk capital, they are also expensive given the costs of employing merchant bankers, conducting road shows, meeting listing requirements, receiving credit ratings etc. Listing on the stock markets also increases the need for transparency in business operations, instituting corporate governance mechanisms and complying with accounting and reporting standards. While Indian entrepreneurs do continue to have reservations on ceding control of their businesses, they have also begun to realize that the capital markets continue to be the source of large quantities of low cost risk capital.

A proposal to set up a SME specific stock exchange / trading platforms has been in circulation for a couple of years now. This is no doubt a welcome development since the listing requirements of the existing stock exchanges are too stringent for SMEs to participate. Recognizing the need to have separate rules for SME exchanges / platforms, SEBI modified its Issue of Capital and Disclosure Requirements Regulations by inserting a Chapter XA on "Issue of specified securities by small and medium enterprises", through notification dated April 13, 2010. In addition, to facilitate listing of specified securities in the SME exchange, "Model Equity Listing Agreement" to be executed between the issuer and the Stock Exchange, to list/migrate the specified securities on SME Exchange was issued vide Circular No. CFD/DIL/6/2010, dated 17-5-2010. Certain relaxations are provided to the issuers whose securities are listed on SME exchange in comparison to the listing requirements in Main Board, which inter-alia include the following:

a. Companies listed on the SME exchange may send to their shareholders, a statement containing the salient features of all the documents, as prescribed in sub-clause (iv) of clause (b) of proviso to section 219 of the Companies Act, 1956, instead of sending a full Annual Report;

b. Periodical financial results may be submitted on "half yearly basis", instead of "quarterly basis" and

c. SMEs need not publish their financial results, as required in the Main Board and can make it available on their website.

SEBI has also advised all stock exchanges in India to disseminate the amended guidelines on their website for easy access to the Issuers and investors. SEBI has also asked stock exchanges to communicate to SEBI, the status of the implementation of the provisions of the May 2010 circular in their Monthly Development Report

Export Lines of Credit

SMEs especially in areas like leather, gems and jewellery, textiles etc are heavily dependent on exports. Several instruments are available from Exim Bank for the benefit of the exporters. Examples include Export Lines of Credit to overseas financial institutions, regional development banks and foreign governments and their agencies and Buyers' Credits (BC) to foreign corporates. LOCs serve as a market entry mechanism to Indian exporters and provide a safe mode of non-recourse financing option to Indian exporters. LOCs/BCs are particularly relevant for Indian SME exporters as the payment risk is borne by Exim Bank without the need for insurance from Export Credit Guarantee Corporation

Indian SMEs require business advisory services to enhance their international competitiveness in a highly competitive globalising world. Exim Bank of India provides a suite of services to its SME clients. These include providing business leads, handholding during the process of winning an export contract and thus assisting the generation of export business on success fee basis, countries/ sector information dissemination, capacity building in niche areas such as quality, safety, export marketing, etc. and financial advisory services such as loan syndication, etc.

Exim bank has recently received funding of US$ 150 Million from International Finance Corporation and Bank of Tokyo Mitsubishi UFJ Ltd to help Indian exports to Africa. Several Indian exporters are looking to Africa as a destination for exports. India's exports to African nations are mainly from the pharmaceuticals and automotive sectors, apart from chemicals and steel among

other commodities. Many Indian infrastructure companies are also engaged in executing large-scale turnkey projects in Africa.

Hedging Instruments

Debt constitutes a significant part of the total capital of SMEs. RBI has been revising key interest rates upwards in an effort to keep inflation under check. Significant increases in interest rates will impact SMEs as their debt servicing costs will increase as the interest rates increase. Hedging in the form of interest rate derivatives helps SMEs guard themselves against interest rate increases by converting floating rates loans pegged to prime lending rates / base lending rate to fixed interest rate securities

In an era of increasing global trade, Indian SMEs need to factor in impact of currency risks also. A range of hedging options including forward contracts, currency options, currency futures, currency swaps are available for Indian SMEs against forex volatility. Judicious use of such instruments will help protect SME exporters from an appreciating rupee. It would however be advisable for Indian SMEs to tread with caution on the issue of derivative products. SMEs should use these products only after a complete understanding of the risks involved. Derivatives when used should be for hedging purposes only and not for speculative purposes.

09 Way Forward

India has over 26 million MSMEs producing a diverse range of products from very basic to highly sophisticated products. MSMEs contribute 8 per cent of the country's GDP, 45 per cent of the manufactured output and 40 per cent of our exports. Despite some of their inherent strengths in uniqueness and cost competitiveness and MSMEs are facing tough challenges at every stage of their operation. The process of liberalization and market reforms since 1991 has brought about intense competition for MSMEs both in domestic and overseas markets. Hence it is imperative that SMEs become globally competitive and usher India into double digit growth figures.

Continual focus on development of the MSME space is critical to sustain the value generation process in any supply chain and for the larger economical health of the country. It is thus important that the government takes various measures to support and ensure growth and development of Indian MSMEs and government policies for MSMEs adapt to the dynamic changes in the market place.

ICT also has a key role to play in driving innovation and competitiveness for MSMEs and will be much more of a priority in the coming years. It can help reduce costs, enable more efficient development processes and bring products to market more quickly than in the past. Increase in ICT adoption and knowledge infrastructure is imperative to provide a boost to the growth and maturity of MSMEs. ICT presents enterprises with possibilities of enhancing their efficiency in all segments. The new "pay as you use" models can go a long way in helping the MSMEs adopt the appropriate ICT solutions at affordable prices by reducing the capex cost for them.

The importance of appropriate financing for ensuring sustainable growth of MSMEs cannot be overemphasized. Steps should be taken to allow banks to achieve the priority sector lending targets with very low levels of risk. Reducing information asymmetry is the key to reducing the trust deficiency between the banks and the MSMEs. One way for MSMEs to signal their credit worthiness is to acquire a credit rating from an independent credit ratings agency. Steps like creation of e-platform called NTREES also need to be taken to ensure availability of working capital for MSMEs. Availability of venture capital and private equity and setting up of SME specific stock exchanges can also aid MSMEs with additional funding options through risk capital.

While initiatives of the kind mentioned above are necessary, it is also important for the beneficiaries i.e the SMEs to be made aware of the facilities / concessions / incentives available to them. It is also important to give wide publicity to stories of successful companies and the challenges overcome by them so that budding entrepreneurs can be both motivated to give their best and be aware of the obstacles ahead in their journey. We sincerely hope that the MSME Summit being organized by CII will provide a forum for vibrant exchange of ideas to further the growth of the SME sector

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About Confederation of Indian Industry

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the growth of industry in India, partnering industry and government alike through advisory and consultative processes.

CII is a non-government, not-for-profit, industry led and industry managed organisation, playing a proactive role in India's development process. Founded over 115 years ago, it is India's premier business association, with a direct membership of over 8100 organisations from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 90,000 companies from around 400 national and regional sectoral associations.

CII catalyses change by working closely with government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sectoral consensus building and networking. Major emphasis is laid on projecting a positive image of business, assisting industry to identify and execute corporate citizenship programmes. Partnerships with over 120 NGOs across the country carry forward our initiatives in integrated and inclusive development, which include health, education, livelihood, diversity management, skill development and water, to name a few.

CII has taken up the agenda of "Business for Livelihood" for the year 2010-11. Businesses are part of civil society and creating livelihoods is the best act of corporate social responsibility. Looking ahead, the focus for 2010-11 would be on the four key Enablers for Sustainable Enterprises: Education, Employability, Innovation and Entrepreneurship. While Education and Employability help create a qualified and skilled workforce, Innovation and Entrepreneurship would drive growth and employment generation.

With 64 offices and 7 Centres of Excellence in India, and 8 overseas offices in Australia, China, France, Germany, Singapore, South Africa, UK, and USA, as well as institutional partnerships with 223 counterpart organisations in 90 countries, CII serves as a reference point for Indian industry and the international business community.

For further details, contact

Confederation of Indian Industry
The Mantosh Sondhi Centre
23, Institutional Area, Lodi Road, New Delhi – 110 003 (India)

Tel: 91 11 24629994-7 • Fax: 91 11 24626149
Email: ciico@cii.in • Website: www.cii.in
Reach us via our Membership Helpline: 00-91-11-435 46244 / 00-91-99104 46244

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