

The role of finance for employment generation and small and medium scale enterprises in India

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Abstract

This study examines the Contributions of Small and Medium Scale Enterprises (SMEs) to employment generation in India. Past efforts at providing solution to this malaise facing developing nations of the world are often faced with stiff opposition sometime right from conception. The aim of this paper therefore; was to provide a sectorial analysis of the efficacy of SMEs as a vibrant tool for employment generation in the country. The Binomial Logistic Regression Analysis was employed as tools for statistical analysis. The study observes that the sector was unable to achieve this goal due to its inability to obtain adequate business finance for the sector. It was observed that virtually all the SMEs that were sampled relied on the informal sources of finance to start their business. As a way out, the study suggests the need for the integration of the activities of the formal with that of the informal financial institutions. Also, government should as a matter of urgency, provide the needed infrastructure such as roads, water, electricity and the needed enabling environment. The paper is of the view that these efforts will reduce the cost of doing business, increase retained earnings of the SMEs, their average monthly income and poverty on the long run.

Keywords: small & medium enterprises (SME); growth potential; challenges; market linkages; employment; business finance; environment

Introduction

Small and medium enterprises (SMEs) in India and abroad has demonstrated considerable strength and resilience in maintaining a consistent rate of growth and employment generation during the global recession and economic slowdown. Indian economy during the recent years has shown an appreciable growth performance by contributing to creation of livelihood opportunities to millions of people, in enhancing the export potential and in increasing the overall economic growth of the country. Prompt and appropriate fiscal stimulus, effective monetary policy and huge capital inflows were greatly instrumental in the bounce back situation of the economy. As a catalyst for socio-economic transformation of the country, the MSME sector is extremely crucial in addressing the national objectives of bridging the rural-urban divide, reducing poverty and generating employment to the teeming millions. It is therefore, essential that India adopts a suitable policy framework that provides the required impetus to seize the opportunities and create an enabling business environment in order to keep the momentum of growth and holistic development. It is equally important that the MSME sector must address the infrastructural deficiencies and is well empowered to meet the emerging challenges for its sustainable growth and survival in a globally competitive order.

Review of Literature: Small and Medium Enterprises Development (SMEs) has continued to be a popular phrase in the Business world. This is because the sector serves as a catalyst for employment generation, national growth, poverty reduction and economic development. SMEs world over can boast of being the major employers of labor if compared to the major industries including the multinationals. According to Wahab (2006), SMEs both in the formal and informal sectors employ over 60% of the labour force in India. More so, 70% to 80% of daily necessities in the country are not high-tech

product, but basic materials produced with little or no automation. Most of these products come from the Small and Medium Enterprises. Onwumere (2000), and Nnanna (2001) all supports that SMEs help in the achievement of improvement in rural infrastructure, improved living standard of the rural dwellers thereby creating employment utilization of indigenous technology, production of intermediate technology and increase in revenue base of the private individuals and government (Wahab and Ijaiya, 2006). China has tenaciously understudied these facts and aggressively capitalizes on it. The SMEs with fewer than 300 workers account for 99.5% of the factories in Tokyo and employs 74 percent of work force there. Korea and Taiwan prospered as both countries manufacture and export with the aid of its SMEs. In the United State of America, the SMEs account for 87 percent of the countries workforce. The German SMEs employs about 72.6 percent of its labour force. SMEs employ a large percentage of workers in these countries.

Although the MSMEs continue to dominate the industrial sector in most of the countries including India, the literature and the studies on their varied functioning are not many especially with reference to changing perspectives. The available research literature rather indicates some missing gaps that need to be addressed appropriately.

Christopher J. Green, Colin H. Kirkpatrick, and Victor Murinde, (2006) in their paper have examined the ways in which financial sector development policy might contribute to poverty reduction, particularly by supporting the growth of Medium and small enterprises (MSEs). This paper highlights on the changing role of MSEs in the development process and the access of MSEs to informal and formal finance, including the role of finance. Nanda, Ramana & William R.Kerr (2009) have expressed the view that financing constraints are one of the biggest concerns impacting potential entrepreneurs around the world.

De, Sankar (2009) in his article has viewed that SME's in India face many challenges, but perhaps none are as difficult as the challenge of financing, both short term and long term. K, Vasanth, Majumdar M., K. Krishna (2012) in their paper have stated that since several successful models of the sustainable SME are gradually evolving, networks of SMEs would become essential for addressing the systemic problems under lying the industrial ecology, enterprise resilience, and global supply chain sustainability. Export-Import Bank of India, (2012) has critically analyzed the present situation of MSMEs and support systems available in India as well as in the global context. It has suggested that MSMEs in India should have access to alternative sources of capital like angel funds/risk capital etc. and that existing laws should effectively address issues like insolvencies / bankruptcies; need to redefine the ceiling limits to encourage MSMEs to move up the value chain and need for cluster development approach to increase the level of competitiveness. Srinivas K T, (2013) has studied the performance of small and medium enterprises, and their contribution in India's economic growth and concluded that MSMEs play a significant role in inclusive growth of Indian economy.

Msmes- An Indian Perspective: Small and Medium Enterprises in India offer a heterogeneous and varied nature of fabric in terms of the size and structure of the units, variety of products and services, scale of production and application of technology. These enterprises are quite complementary to the large scale industries as ancillary units. They contribute to the socio-economic development of the country quite significantly. The MSMEs in India constitute about 80% of the total number of industries and produce about 8,000 value added products.

An appropriate definition of Small and Medium Enterprises and their proper classification in a national or international context offers a varied perspective. The term 'MSME' is normally used to describe small industrial or business units in private sector. MSMEs have been classified differently in different contexts in terms of their nature of assets and scale of production etc. while others have defined those units in term of employment generation, shareholder funds, scale of investment or sale of products etc. The definition according to the World Bank is that, a business classified as MSMEs when it meets two of the three criteria – employee strength, size of assets or annual sales.

Medium	<300	<USD 15 Million <INR 750 Million	<USD 15 Million <INR 750 Million
Small	<50	<USD 3 Million <INR 150 Million	<USD 3 Million <INR 150 Million
Macro	<10	<USD 10,000 <INR 500,000	<USD 10,000 <INR 500,000

Source: International Finance Corporation (IFC) World Bank

The enactment of Small & Medium Enterprises Development (MSMED) Act, in 2006 by the Government of India (GOI) gave a legal basis and framework to the small and medium enterprises by defining and classifying these enterprisers on a

uniform basis. This classification covers industries both under manufacturing and service sector and the above limits are excluding the cost of land, building and other specified items.

Enterprises	Micro	Small	Medium	Remarks
Manufacturing Sector	Up to Rs.25 lakh	Above Rs.25 lakh- up to Rs.5 crore	Above Rs.5 crore up to Rs.10 crore	Investment in plant & machinery
Service Sector	Up to Rs.10 lakh	Above Rs.10 lakhs up to Rs.2 crore	Above Rs.2 crore- up to Rs.5 crore	Investment in equipment

Source: MSME Annual report

The growth and development of MSME sector in our country has been consistent and remarkable over the preceding decades. Statistics show that the number of such enterprises has increased from about 1.1 crore in 2001-02 to 4.1 crore units in 2009-10 and again to 4.48 crore enterprises in 2014-15. The MSMEs produce more than 7,500 products and also contribute to about 35% of the India's exports. MSMEs contribute 8% of the country's GDP, 45% of the manufactured output and 40% of exports (Prime Minister's Task Force on MSME, 2010).

The Government of India has introduced several major policy initiatives for support and promotion of small & medium enterprises in the country. These include; establishment of Small Industries Development Bank of India (SIDBI) in 1990 for promotion and financing of MSME sector, Credit

Guarantee Fund Trust of Medium and Small Enterprises (CGTMSE) was in 2000 to offer credit facilities to eligible borrowers and the Prime Minister's Employment Generation Programme (PMEGP) in 2008 to generate employment opportunities in rural and urban areas through new self-employment ventures / projects / enterprises. Available data from the Fourth All India Census of MSME in 2006-07, indicate that around 60 % of these enterprises are based in rural areas of the country and 45% of total manufacturing output is contributed by the MSME sector. The share of MSME sector in the total exports of India is about 40%. Statistics reveal that the number of such enterprises set-up, employment generated and the investments made in the MSME sector in India has shown an increasing trend over the years as evident from Table - 1.

Table 1: Performance of MSME sector in India

Sl. No.	Year	Total Working Enterprises	Employment Generated (In Lakh)	Market Value of Fixed Assets (Rs. in crores)
1	2006-07	361.76	805.23	868,546.79
2	2007-08	377.36	842.00	920,459.84
3	2008-09	393.70	880.84	977,144.72
4	2009-10	410.80	921.79	1,038,546.08
5	2010-11	428.73	965.15	1,105,934.09
6	2011-12	447.64	1,011.69	1,182,757.64
7	2012-13	447.54	1,061.40	1,268,763.67
8	2013-14	488.46	1,114.29	1,363,700.54
9	2014-15	510.57	1,171.32	1,471,992.94

The contribution of MSME sector towards GDP and total manufacturing output has been depicted in Table – 2. It is clear that the share of service sector MSMEs to the GDP has

been increasing indicating robust growth and changing nature of economy.

Table 2: Contribution of Manufacturing Output of MSME in GDP (at 2004-05 Prices)

Year	Gross Value of Output of MSME Manufacturing Sector (Rs. in Crores)	Share of MSME sector in total GDP (%)			Share of MSME output in total Manufacturing Output (%)
		Manufacturing Sector MSME	Service Sector MSME	Total	
2006-07	1198818	7.73	27.40	35.13	42.02
2007-08	1322777	7.81	27.60	35.41	41.98
2008-09	1375589	7.52	28.60	36.12	40.79
2009-10	1488352	7.45	28.60	36.05	39.63
2010-11	1653622	7.39	29.30	36.69	38.50
2011-12	1788584	7.27	30.70	37.97	37.47
2012-13	1809976	7.04	30.50	37.54	37.33

Flow of credit or availability of finance from banking institutions is a major factor contributing to the growth and success of MSMEs. Available information on flow of credit to this sector indicates a declining trend from 17.34% in 2010 to

10.20 % in 2013. The credit flow by the Scheduled Commercial Banks to this sector in subsequent years has however, shown an increased trend as depicted in Table-3.

Table 3: Flow of Credit by Scheduled Commercial Banks (SCBs) to MSME Sector in India

Year	Outstanding in Rs. crore		Share of MSME to Gross Credit (%)
	Credit to MSMEs	Gross Credit	
March, 2009	431350	2647368	16.3
March, 2010	506166	3088569	16.4
	(17.34)	(16.67)	
March, 2011	561759	3749500	15.0
	(10.98)	(21.40)	
March, 2012	623414	4371400	14.3
	(10.98)	(16.59)	
March, 2013	687000	4964200	13.8
	(10.20)	(13.56)	
March, 2014	878508	5657200	15.5
	(27.88)	(13.96)	

MSMEs sector plays a major role in contributing to India's export performance. This sector contributes 45%-50% of the Indian exports out of which direct export accounts for nearly 35% and indirect 15% to the total exports. Needless to emphasize that while the organized industrial sector with large scale industries requires substantial amount of investment for generation of employment, the MSME sector creates larger employment opportunities with less or same investment.

Potentialities for Growth: Opportunities: Small and Medium Enterprises have substantially contributed to the economic development of our country. The MSME sector in India occupies the second position next alone to agriculture in terms of employment generation. This sector accounts for about 95% of the industrial units, 45% of manufacturing output, 40% of exports total exports of the country. MSMEs have greater opportunities to grow as ancillary industries to unleash higher industrial growth. MSMEs being less capital intensive and more employment-friendly have easier access to raw materials, subsidies and other incentives under cluster programs. The country has huge growth potential to create and enhance the capacity of enterprises both in the manufacturing and service sector by using the available resources. There are huge opportunities for the MSMEs to grow as ancillary industries to unleash greater industrial growth. Development of the sector is therefore extremely important as it holds the key to inclusive growth and plays a pivotal role in holistic development of the country.

India is the fourth largest economy in the world (in terms of PPP mode, and the second largest in developing Asia) which accounts for 22% of GDP, 33.8% population and 32.5% of the potential workforce in developing Asia. The incidence of growth is evident from the increased investment in infrastructure, abundant job opportunities, emergence of a robust private sector with small and big companies/ corporate houses and high rise in consumerism. The MSME sector has the potentialities to emerge as the backbone of Indian economy and to continue as an engine of growth provided an environment-friendly policy framework and enabling infrastructural support are made available for its functional operations.

MSMEs in India consistently feed the domestic and the international value chain as manufacturers, suppliers, distributors, retailers, contractors and service provider by accounting for a substantial segment of our industrial units. This sector has been performing appreciably better than the overall rate of GDP (average 8% growth per annum) and the overall industrial output (measured by Index of Industrial Production-IIP). Availability of adequate financial resources, a supportive policy framework to address the areas like entrepreneurial skill development, a competent pool of human resources, application of latest technology and new innovations, adequate international market linkages and bilateral trade agreements etc. would make the Indian MSME sector globally competitive to address the emerging challenges and help ensure their sustainability.

The roadmap for MSME development should include a target for increase in the share of their contribution from the present 8% to 15% by 2020, a substantial increase in generation of employment avenues up to 50%, an enhancement in MSME contribution in the key public and private industry sector by meeting the growing domestic demand, indigenization and

important substitution and growth in foreign exports¹⁵. The recent 'Make in India' initiative by Government of India would make a substantial impact in the area of indigenization and would also attract sizable foreign investment. Similarly, the 'Digital India' program offers huge opportunities to MSMEs to participate in big way in the Information and Communication Technology (ICT) sector.

Issues and Challenges: Despite the pivotal role and strategic importance in the context of industrial development and economic growth of the country, the MSME sector experiences several constraints and challenges. Several key issues remain to be addressed properly and measures yet to be taken in the interest of sustainable industrial development. The Committee on financial architecture of MSME sector in their Report submitted in the February, 2015 has identified some key issues. These include; i) Equity as a source of financing is underutilized and the prevalence of investment by venture capital and angel investors is low, ii) MSMEs face the problem of delayed payments from their buyers which adversely impacts their working capital as well as their next cycle of production, iii) MSMEs lack adequate information about various schemes and benefits available by the government, iv) Financial institutions/Banks face challenges in credit risk assessment of MSMEs, v) The utilization of the available credit guarantee and insurance schemes by banks has been low.

Conclusion: The purpose of this study was to examine the contributions of SMEs towards employment generation in order to reduce poverty in India. Over the years, considerable attention has been paid to the issue of poverty reduction in the country. Contentious issue often was which poverty reduction strategies should be adopted in the country. This became pertinent considering the fact that most policies and programmes die as soon as they were formulated. Our literature review observes that SMEs remains a potent tool that can guarantee employment generation in the country. Available Statistics also show that poverty has continued to increase in the country at alarming rates due to unemployment in the country. To avert the ugly trend; current wisdom now tends towards the belief that contribution from the small and medium scale enterprises must be energized. The sector was adjudged by scholars as a reliable means and catalyst for job creation, enhanced household income, wealth creation and poverty reduction. The SME sector has moved some Asian countries into world leaders with unprecedented economic and industrial expansion. MSMEs over the years have assumed greater significance in our burgeoning national economy by contributing to employment generation and rural industrialization. This sector possesses enough potential and possibilities to pushbutton accelerated industrial growth in our developing economy and well poised to support national programme like 'Make in India'. This sector has exhibited enough resilience to sustain itself on the strength of our traditional skills and expertise and by infusion of new technologies, capital and innovative marketing strategies. Appropriate strategies should be evolved for creation of an enabling ecosystem where these enterprises are able to access the benefits meant for them under a formal and friendly ecosystem and are further capable of meeting the emerging challenges of a globally competitive order.

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