



The Evolution and Challenges of the Small & Medium Enterprises Sector in India

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The composition of the Indian economy is rapidly changing. From a dominant agrarian economy at the time of independence, Indian economy had evolved and has presently placed the nation at the doorstep of economic super powerdom. These are not windfall benefits or something that has come by the nation's way through luck. It was the era of planned economy in the first couple of decades that has helped India to achieve its present status. As part of the great British Empire, India always held its crowning position, not merely by its size and population, but by its contribution

through economic means, first to the East India Company and later to the English rulers. The rich mineral wealth of India, the climatic diversity leading to opportunities to grow a wide range of agricultural inputs to power the industrial revolution and the subservient nature of its people were the key factors behind the position held by India. The labour was cheap as well as skilled enough to tap for the plantations of the Empire across the globe.

The system of education that was given by the British to India and later sustained in independent India was another notable feature. It is not just that the millions of Indians got the grounding in English language, but the scientific and technical skills were also developed. Independent India invested in its engineering colleges, the IITs, the RECs, the medical institutions and the management schools.

The initial plan periods, apart from setting up many large scale industrial establishments, generated many technocrats who took to entrepreneurship. Many industrial estates were set up in the country, with development of infrastructure, common facilities, providing the entrepreneurs with assistance, guidance and inputs of various kinds. These initiatives of the Government in the post-independence era saw the setting up of many Small Scale Industries (SSI), which were linked to major industries and formed a sound platform for capital investment from the private sector, tapping technical skills of hundreds of graduates and generating millions of jobs across various fields. The economy was steered from an agrarian one to an industrial economy. The primary sector gave way to the secondary manufacturing sector as the dominant component of Indian economy.

With the advent of the twenty first century, the knowledge power of the nation had other contributions to offer, in the form of services support to the entire world. Be it the software segment or other soft skills like the outsourcing of processing and knowledge skills. If any developed nation needs to update their records or educate their children, the support now comes from India. India has become a BPO-centric economy. Thus the tertiary sector of the economy has risen to the front in the current decade, completing the evolution of India as an economic power house.

In this background of the economic phase, we need to analyse the present state of Small and Medium Enterprises (SME) sector. The SME sector in India is no longer the dominant SSI sector as it was in the 60s and 70s, but a mature SME sector, with components of manufacturing, trade and services equally competing and contributing to the SME pie.

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With globalization, there were fears that the SSI sector in India will face very adverse conditions. The sickness in this sector was always a worrying factor. Even now, if any industrial estate across the nation is surveyed, a chunk of the sheds in the estates would be found closed with unused and rusting machinery. The liberalization era brought in by the early 90s was expected to further challenge the viability of the SSI units in the country. But the adaptability, flexibility and suppleness of the SSI sector combined with the new material management concepts adopted by the industry majors for maintaining near zero inventory, have given fresh lease of life to this sector.

SSIs or the manufacturing component of the SMEs in India continues to be vibrant. There are various verticals within this sector which are performing to their potential. Global pressures arising out of the WTO guidelines, IPR regime, etc. are indeed affecting this sector. Be it in the textile area or the pharmaceutical sector or the food processing segment, the manufacturing SMEs are constantly meet with beneficial as well as adverse pressures on different counts. The internal efficiencies and the adaptability of the sector keep them alive. If India has to become a global manufacturing hub, the manufacturing SMEs need to become highly conscious of the quality standards, update their skills in technology management and break away from the shackles of a protected environment of subsidy and quota 'raj'.

Trade and services are also part of the SMEs. But the definition of an SME as spelt out by the parliamentary act and other guidelines issued by various governing bodies, link SMEs to investment in plant and machinery, which shuts out the vast trade and services segment of the SMEs. Take the case of trade – it is no longer the street corner *kirana* merchant who is dominating trade in the country. Even retail trade has become highly organized with the mall culture taking firm root in India. If you take other elements of trade, be it the dealer networks of various FMCGs or the automobile manufacturers or any other sector-specific trade, the maturity of the market is such that 'trade' has become a strong link in a much bigger value chain. The role of SMEs in trade is substantial and the policy makers can no longer ignore this fact by linking the definition of SMEs to the investment in plant and machinery.

If an island nation like Singapore is having such a large share in the global economy, it is mainly because of the share of global trade that the city state has captured. India, with its vast coastline, long maritime history and well respected legal framework can become a big trade hub too. The East India Company set shop in India to tap the mineral and other

resources of the nation. Even now, the iron ore in India is attracting substantial investment in India. Trade and export of iron ore has made the small town of Bellary into a gold mine for investors. But, if India has to develop into a major trade hub, with the strong SME base in this sector, it has to go beyond mere exploitation of its natural resources for export. Located logistically in a convenient position between the west and the far-east, India can gain a lot from the trade segment too. Infrastructure at our ports should improve to tap this potential. Even our present estimates for augmentation of these capacities do not reckon the needs for becoming a global transit point for trade but has been projected only for supporting our global trade. The planners need to factor in the possibilities of India becoming a global transit point in trade and provide infrastructure support for the same.

Services sector, as we saw earlier, is presently booming. The outsourcing concept has taken such deep roots that most of the back end tasks of offices in the western world are presently being done in India. The legal and ethical standards have to keep pace with these developments, to instill the necessary confidence in the user world, for sustaining the growth in the outsourcing services. In addition to the above externally driven growth in the services sector, India has other potential for SMEs in the services sector – tourism is still not fully exploited by us; healthcare is an area which offers tremendous potential for growth from both internal and external demand; education too is outpacing as a service sector with both Indian schools of repute establishing their credentials globally and world leaders in various educational fields setting shop in India to cater to the teeming middle class population of the country. The potential for SMEs in India in the services sector is vast with very little exploitation of the financial sector so far.

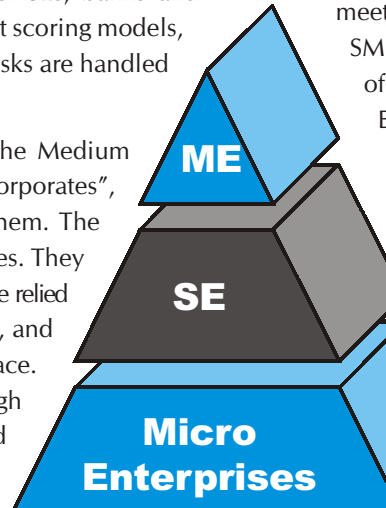
Within the SME sector, there is a wide diversity. Whichever way we define them, there is a wide range of enterprises that constitute the SMEs. Their behaviour, needs, and characteristics are all different. In fact, there is very little homogeneity in this sector that is clubbed together as SMEs. To understand them better and to evolve policies and strategies towards the SMEs, the sector needs to be dissected into groups that behave in similar ways. There is a large chunk of micro enterprises at the bottom of the SME pyramid. Be it the street corner trader or the small lathe operator or the taxi owner providing logistic link, these microenterprises are omnipresent. The micro enterprises are not easily amenable to regulation, quality standards or other measures for assessment of their role in the economy. They do not follow any standard accounting practices. Their records and balance sheets are not very reliable. This micro-enterprise market is

huge and yet poses great challenge to anyone dealing with the SMEs. In well developed nations like the US, UK, Japan, etc. there are credible credit bureaus that give information on any kind of SME. In these countries, financial institutions do not distinguish between the individual behind a microenterprise and the microenterprise. His personal credit history is reckoned to assess the financial needs of the enterprise. Products designed for microenterprises by banks and financial institutions are not very different from personal banking products. The annual income or cash flow guides the decision making process and not much importance is given to the balance sheet of such enterprises.

The SME pyramid has the Small Enterprises (SEs) above this segment. These SEs have more credible financial information. Even then, decisions on these SEs are backed by information from business bureaus. The audited financial statements too can be relied upon. In respect of SEs, banks and financial institutions build strong credit scoring models, based on statistical methods and the risks are handled through such scoring methods.

At the top end of the pyramid lies the Medium Enterprises (MEs) or the “Emerging Corporates”, as some banks would prefer to call them. The MEs behave more like bigger corporates. They have strong financial systems that can be relied upon. Often, they have public investments, and proper corporate governance put in place. Such MEs cannot be addressed through scoring models but would need individual credit assessment like any other corporate loan products. The MEs avail multiple facilities from the financial institutions and often banks need to work out structured products for the MEs as in the case of larger corporates.

Banks in India which have been comfortable to lend against the asset build up of the SMEs, as the most preferred means, need to realize that the SMEs are just not SSIs called differently. While the SSIs still have asset buildup in the form of raw material, stock-in-process, finished goods, etc., the other segments of the SMEs are not amenable to similar treatment. The Nayak Committee thumb rules cannot be extended across the board to all the SMEs. As the SMEs in India mature, the requirements for the banks and financial institutions are (i) stabilization of credible credit bureaus (ii) establishment of identities of businesses and individuals (iii) building of strong statistical scoring models (iv) understanding cash flows of the SMEs and (v) capturing the cash flow cycle appropriately.



As the Indian economy is poised for healthy growth and with India on the way to becoming an economic superpower, the SMEs are also placed on the path of high growth trajectory. But the policy makers need to unshackle the SMEs from the quota regime and nurture the sector to grow on its strengths. Likewise the banks and financial institutions need to put the history of their dealings with the SSI sector behind and evolve methodologies of capturing the cash flow cycle of SMEs to handle their accounts and not merely depend upon the asset buildup. The manufacturing, trade and services sectors need to be dealt with distinctly by the policy makers and their growth potential properly harvested for the benefit of the economy.

State Bank of India and the SMEs – The Current Story

State Bank of India (SBI) has been a long-term player in meeting the multifarious needs of the SSIs and later the SMEs. The business opportunities and growth potential of the SMEs was recognized in 2004 and a Strategic Business Unit (SBU) was set up for exclusively meeting the needs of the SMEs. The SME SBU of the bank is addressing the requirements of the SMEs from various aspects. Simple and easy to use products have been designed by the SBU for both asset and liability needs of the SMEs. Documentation procedures have been simplified. Credit processing capabilities within the bank has been enhanced. Training modules have been chalked out to upgrade the skills of the bank officials handling the SME business. Growth engines within the broad

SME spectrum have been identified and capacity within the bank has been augmented for handling more SME customers from such growth centers.

Consequent upon the renewed focus brought about by the formation of the SME SBU, asset growth from the SME segment has been very encouraging. The bank has grown this portfolio in excess of 30% annualized growth since the formation of the SBU. The SBU has also forged alliances with various stakeholders for offering channel finance and other products to the SMEs based upon the needs of the specific target groups. SBI is confident that with the continuance of the healthy growth in the economy, the SMEs too will progress and the benchmark of doubling the SME credit can be possible in shorter span than the 5 years set by the Reserve Bank and the Government of India. ■