Financing Small and Medium Enterprises

The Indian Experience

June 2013
Financing Small and Medium Enterprises

The Indian Experience

June 2013
Foreword

The small and medium Enterprises (SMEs) play a catalyst role in the development process of most economies as they constitute a major part of the industrial activity in such economies. This is reflected in the form of their increasing number and rising proportion in the overall product manufacturing, employment, technical innovations and promotion of entrepreneurial skills.

The contribution of SMEs in the development of India economy has been significant, both in terms of contribution to GDP and creation of employment opportunities. The main reason behind choosing India in the third publication of the SME unit is its competency that carved out a niche in facilitating access to finance to MSMEs as well as creating the enabling environment for the sector to perform better.

Compared to India, Egypt's economy is relatively small and hence the challenges are less. However, depending on the resemblance of the Egyptian and Indian environment in terms of high population and being developing countries, it is an opportunity to grasp some of the lessons learned and present success stories in the study.

Dr. Mohamed Zakaria
Director, SME Unit
Acknowledgments

The SMEs Experience in India” is the third study to be published by the SME Unit at EBI, reviewing best practices and success stories to reach a mode which can be applied at the Egyptian economy. The contribution of SMEs in the socio-economic development programs of Indian economy has been significant. Since the 1960s, India has been following promising programs to enhance access to finance and support SMEs from a different prospective.

India was opted for being the target of two SMEs Study Tour organized collaboratively by: the SME Unit of the Egyptian Banking Institute (EBI) and the Indian Institute of Banking and Finance (IIBF). One was conducted as the practical part of the “SME Banking Certificate” and the other was mainly designed for senior level management, where mainly the SME unit heads at the Egyptian banking sector to get more acquainted with the strategy and policy issues. Moreover, the main common objectives of the two study tours were to share knowledge, enhance mutual cooperation, acquaint with SME banking international best practices as well as observe various applications of SME banking services and success stories.

This study is an integrated effort of the SME Unit team represented by all its members. Special gratitude goes to the Indian Institute of Banking and Finance unit that exerted much effort in designing and preparing useful study tours to get acquainted with the two sides of MSME access to finance as well as micro levels.

Special thanks to Dr. Mona El Baradie, EBI Executive Director, for her permanent support and strong focus on improving performance quality of EBIs activities as well as her guidance towards the concept of applied research which has positive impact on work environment. Also a debt of gratitude goes to SME unit at EBI and specially Ms. Shahira Nassouf and Ms. Nihal Hassan for their splendid efforts exerted to produce this study.
# Table of Contents

List of acronyms ........................................................................................................... 6  
Executive Summary ...................................................................................................... 7  
Introduction ................................................................................................................... 9  
I. India's Economy ........................................................................................................ 10  
   Major Sectors of Indian Economy ........................................................................... 14  
   Agriculture ............................................................................................................... 14  
   Industry .................................................................................................................. 14  
   Source: Reserve Bank of India, Economic Survey, 2012-2013 .............................. 15  
   Services .................................................................................................................. 15  
   Banking and Finance ............................................................................................ 16  
II. History of SME Sector and its Development in India ............................................. 18  
   SMEs definition in India ....................................................................................... 22  
   Characteristics of Micro, Small and Medium Enterprises: .................................. 24  
   Institutional Framework for MSMEs ..................................................................... 26  
   The Micro, Small and Medium Enterprises Act, 2006 .......................................... 26  
III. Access To Finance ................................................................................................ 30  
   Indian Government Interventions to SMEs .......................................................... 30  
   Specialized Institutions Formed to Support SMEs Sector in India ....................... 31  
   Ministry of MSME .................................................................................................. 31  
   Small Industries Development Bank of India (SIDBI) ........................................... 32  
   SME Rating Agency of India (SMERA) ................................................................. 34  
   Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) ........... 35  
   India Reserve Bank ................................................................................................ 36  
   Securities and Exchange Board of India (SEBI) ................................................... 37  
   A specialized stock exchange for SMEs ............................................................... 38  
   SME venture capital fund ..................................................................................... 39  
   National Commission for Small Industries (informal sectors) ......................... 39
IV. Cluster Approach for Development of Small Industries ...................... 43

Cluster Development: Concepts & Issues .............................................. 43
Cluster Development in India .................................................................. 44
Cluster Financing ................................................................................ 45
Banks in India & SMEs Access to Finance ............................................ 47
Norms of lending to SMEs ................................................................... 47
Union Bank of India ........................................................................... 49
Bank of India (BOI) ........................................................................... 53
Bank of Baroda .................................................................................. 55
ICICI Bank ......................................................................................... 58

V. Issues Facing SMEs in India ................................................................. 61
   A. Lending Facilities to SMEs ............................................................. 61
   B. Marketing .................................................................................... 63
   C. Technological Up-gradation .......................................................... 63
   D. Sickness in SSI Sector ................................................................. 63
   E. Complicated Procedures and Inspector Regime ............................. 64

Conclusion and Recommendations ....................................................... 67
Policy Implications and Lessons learned for Egyptian SME sector ....... 68
References ....................................................................................... 70
### List of Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AEPC</td>
<td>Apparel Exports Promotion Council</td>
</tr>
<tr>
<td>AIMA</td>
<td>All India Management Association</td>
</tr>
<tr>
<td>BDS</td>
<td>Business Development Services</td>
</tr>
<tr>
<td>CART</td>
<td>Credit Appraisal and Rating Tool</td>
</tr>
<tr>
<td>CDE</td>
<td>Cluster Development Executive</td>
</tr>
<tr>
<td>CDP</td>
<td>Cluster Development Program</td>
</tr>
<tr>
<td>CFC</td>
<td>Common Facility Centre</td>
</tr>
<tr>
<td>CGTMSE</td>
<td>Credit Guarantee Fund Trust for Micro and Small Enterprises</td>
</tr>
<tr>
<td>DPR</td>
<td>Detailed Project Report</td>
</tr>
<tr>
<td>EDI</td>
<td>Entrepreneurship Development Institute</td>
</tr>
<tr>
<td>EEPC</td>
<td>Engineering Export Promotion Council</td>
</tr>
<tr>
<td>FYP</td>
<td>Five Year Plan</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GOI</td>
<td>Government of India</td>
</tr>
<tr>
<td>IIE</td>
<td>Indian Institute of Entrepreneurship</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>ISARC</td>
<td>India SME Asset Reconstruction Company</td>
</tr>
<tr>
<td>KBIP</td>
<td>Kerala Bureau of Industrial Promotion</td>
</tr>
<tr>
<td>LNA</td>
<td>Local Network Agent</td>
</tr>
<tr>
<td>LVS</td>
<td>Least Viable and Sustainable</td>
</tr>
<tr>
<td>MFIs</td>
<td>Microfinance Institutions</td>
</tr>
<tr>
<td>MOU</td>
<td>Memorandum of Understanding</td>
</tr>
<tr>
<td>MSE-CDP</td>
<td>Micro and Small Enterprises Cluster Development Program</td>
</tr>
<tr>
<td>MSME</td>
<td>Ministry of Micro, Small &amp; Medium Enterprises</td>
</tr>
<tr>
<td>MVS</td>
<td>Most Viable and Sustainable</td>
</tr>
<tr>
<td>NBFCs</td>
<td>Non-Banking Financial Companies</td>
</tr>
<tr>
<td>NMCP</td>
<td>National Manufacturing Competitiveness Program</td>
</tr>
<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
</tr>
<tr>
<td>PGBC</td>
<td>Primary Goods Based Cluster</td>
</tr>
<tr>
<td>S&amp;T</td>
<td>Science and Technology</td>
</tr>
<tr>
<td>SGCBC</td>
<td>Secondary Goods Based Cluster</td>
</tr>
<tr>
<td>SICDP</td>
<td>Small Industries Cluster Development Program</td>
</tr>
<tr>
<td>SIDBI</td>
<td>Small Industries Development Bank of India</td>
</tr>
<tr>
<td>SMERA</td>
<td>SME Rating Agency</td>
</tr>
<tr>
<td>SPV</td>
<td>Special Purpose Vehicle</td>
</tr>
<tr>
<td>SSI</td>
<td>Small Scale Industry</td>
</tr>
<tr>
<td>TAT</td>
<td>Turnaround Time</td>
</tr>
<tr>
<td>UPTECH</td>
<td>Technology Up-gradation and Management Program</td>
</tr>
<tr>
<td>VDS</td>
<td>Viable but Difficult to Sustain</td>
</tr>
</tbody>
</table>
Executive Summary

This study focuses on the Indian experience in MSME sector and its access to finance, the sector encompasses a wide spectrum of Indian economy from traditional manufacturing sector (textile, leather, ceramics, forging, jewelry, handicrafts, etc.) to modern technology & knowledge based sectors(IT, biotec, telecom, logistics, etc.). The MSMEs have been the growth driver of the Indian economy as their growth has been higher than the overall industrial and then economic growth rate. Thus sustainable development of MSMEs is critical to the overall economic development of the country.

The study falls into five main parts in addition to the executive summary, introduction and conclusion. The first part illustrates the Indian economy in general, with a brief description of major SMEs sectors in India. This part reflects the strengths of the Indian economy, being one of the largest economies in the world as measured by the purchasing power parity (PPP) with a GDP growth rate about 7.2%\(^1\) which makes it the third-biggest economy after the United States and China. The second part of the study defines the MSME sector in India, whereas the MSME sector has emerged as dynamic and vibrant sector of Indian economy, it contributes almost 40% to the entire output of India, occupies 90% of the industry and 35% of the industrial exports.

The third and fourth parts of the study display/express Access to Finance including government interventions and the efforts exerted in this province. Extensive achievements have been done by establishing numerous specialized institutions and formal entities that support the SMEs sector in India. Moreover, the adoption and implementation of the cluster approach in the development of SME sector is extremely unique in India, where it assisted in improving the manufacturing competence, in addition to applying the cluster based approach to lending intended to provide a full-service approach to cater to the diverse needs

\(^1\) Source: Index Mundi_ data portal facts and statistics, 2010
of the MSE sector. The fourth part emphasizes more on the schemes of finance followed by a number of banks in India which facilitate the access to finance by SMEs sector with attention to the cluster approach.

The fifth part demonstrates the issues and challenges faced by MSMEs in India, even though SMEs have fostered the Indian economy's competitiveness in an increasingly challenging global economic picture. Common challenges facing MSME sector as other developing countries such as; lack of finance, technology, planning and marketing assistance are main ones that hurdle SMEs from access to continued development and success.
Introduction

SMEs are the fundamental part of the economy in developed as well as developing countries, and they play an important role in furthering growth, innovation and prosperity. Unfortunately, they are strongly restricted in accessing the capital required to grow and expand, with nearly half of SMEs in developing countries rating access to finance as a major constraint. This results in the absence of a well-functioning SME lending market, and impediment of the growth of SMEs, with negative consequences for innovation, economic growth and macro-economic resilience in developing countries.

Micro, small and medium sized enterprises (MSMEs) have usually been perceived as a dynamic force for sustained economic growth and job creation in developing countries. From a social point of view, SMEs secure livelihood for a large and ever expanding segment of the population. In Egypt, there are around 2.5 Million SMEs representing 75% of the total employed workforce and 99% of non-agricultural private sector establishments. Furthermore, SMEs contribute to the investment of local savings and capital and because of that they help in activating the needed local investment.

SMEs are important to almost all economies in the world, but especially to those in developing countries with major employment and income distribution challenges. SMEs from the “static” front, contribute to output and to the creation of jobs, while on the dynamic front they are a foundation for the larger firms of the future, and the next step up for expanding micro enterprises. They contribute directly and often significantly to aggregate savings and investment.

The international best practices especially in similar developing environments are one of the crucial steps in accelerating the development of SMEs. The exposure to such practices provides a different experience that enables getting acquainted

---

2 Small and Medium Enterprises Landscape in Egypt: New Facts from a New Dataset, Dr. Hala El Said, 2013
with success stories and lessons learned of such countries. India is considered one of the leading countries in applying the international best practices in Micro, Small, and Medium Enterprises industry. A lot of learned lessons can be adopted from the Indian Model to support the Egyptian environment.

I. India's Economy

India is referred to as Bharat or Hindustan, the largest democracy in the world, is a land of unparalleled majesty, comparable in size to entire continent of Europe, and home of nearly 16% of the world population. India Southern Asia, bordering the Arabian Sea and the Bay of Bengal, between Burma, China and Pakistan with a population of 1.27 billion. Although modern images of India often show poverty and lack of development, India was the richest country on earth until the early 17th century when the British conquered it. Christopher Columbus was attracted by its wealth as well as numerous countries have plundered the wealth of India. It is not only the material wealth that makes India rich but also the achievements, history, culture and geography.

![India Map](https://www.cia.gov/library/publications/the-world-factbook/geos/in.html)
India's economy today is a varied mix of small village farming, modern large scale agriculture as well as modern industries. The service sector is also an incredibly large part of India's economy as many foreign companies such as call centers are located in the country. In addition to the service sector, India's largest industries are textiles, food processing, steel, cement, mining equipment, petroleum, chemicals and computer software. India's agricultural products include rice, wheat, oilseed, cotton, tea, sugarcane, dairy products and livestock.

The standard of living in India is constantly improving. The single most common indicator which is used to quantify standard of living is the per capita purchasing power parity (PPP) adjusted gross domestic product (GDP). With one of the fastest growing economies in the world, data just released by the International Monetary Fund (IMF) shows that India's gross domestic product in purchasing power parity (PPP) terms stood at $4.46 trillion\(^3\) in 2011, making it the third-biggest economy after the United States and China.

The average standard of living of the Indian is low but definitely rising and, if current trends continue, will grow to be approximately one third that of the developed world (in PPP dollars) by the middle of the 21st century. In the field of technology, India has entered the industry earning a good reputation, as well as a positive stereotype.

More attention is given to MSME in a package with a clear strategy and vision to reach a welfare economy in such promising country. India can be followed as a model utilizing its resources in the most appropriate and economic way. Technology and producing software are one of the solid pillars of the Indian development programs.

India is a mixed economy combining features of both capitalist market economies and socialist command economies. Thus, there is a regulated private sector (the regulations have decreased since liberalization) and a controlled public sector.

\(^3\) Source: IMF Report 2011
(controlled almost entirely by the government). The public sector generally covers areas which are considered too important or not profitable enough to leave to the instability of capitalistic markets. Therefore, such services as railways and postal system are carried out by the government. Since independence, various phases have witnessed nationalization of such areas as banking. The country's economy encompasses agriculture, handicrafts, industries and a multitude of services. Services are the major source of economic growth in India today, though two-thirds of the Indian workforce earns their livelihood directly or indirectly through agriculture. In recent times, India has also capitalized on its large number of highly educated people who are fluent in the English language to help them to become a major exporter of software services, financial services and software engineers.

India has adhered to a socialist-inspired approach for most of its independent history, with strict government control over private sector participation, foreign trade, and foreign direct investment. Since the early 1990s, India has gradually opened up its markets through economic reforms by reducing government controls on foreign trade and investment. Privatization of public-owned industries and opening up of certain sectors to private and foreign players has proceeded slowly amid political debate.

Population growth and its relation to economic growth has been a matter of debate over a century as one of the socio-economic problems India faces are a burgeoning population and lack of infrastructure, as well as growing inequality and unemployment. The Poverty also remains a problem although it has witnessed a decrease of 10% since the 1980s.

The early Malthusian view was that population growth is likely to impede economic growth because it will put pressure on the available resources, result in reduction in per capita income and resources; this, in turn, will result in deterioration in quality of life. Contrary to the Malthusian predictions, India as several of the East Asian countries has been able to achieve economic
prosperity and improvement in quality of life in spite of population growth. This has been attributed to the increase in productivity due to development and utilization of innovative technologies by the young educated population who formed the majority of the growing population. India has been able to exploit the dynamics of demographic transition to achieve economic growth by using the human resources as the engine driving the economic development. Improved employment with adequate emoluments has promoted saving and investing which in turn stimulated economic growth.

Up to 1980, India's low average growth rate was derisively referred to as the Hindu rate of growth, because of the contrasting high growth rates in other Asian countries, especially the East Asian Tigers. The economic reforms that surged economic growth in India after 1980 can be attributed to two stages of reforms. The first is the pro-business reform of 1980 initiated by Indira Gandhi and carried on by Rajiv Gandhi. It eased restrictions on capacity expansion for incumbents, removed price controls and reduced corporate taxes. The second one is the economic liberalization of 1991, in response to a macroeconomic crisis ended public sector monopoly in many sectors, thereby allowing automatic approval of foreign direct investment in many sectors. Since then, the overall direction of liberalization has remained the same, irrespective of the ruling party at the center, although no party has yet tried to take on powerful lobbies like the trade unions and farmers, or contentious issues like labor reforms and cutting down agricultural subsidies.

The governments of backward regions are trying to reduce disparities by offering tax holidays and cheap land, and focusing more on sectors like tourism which in spite of being geographically and historically determined, can become a source of growth and develop faster than any other sectors. In fact, the economists fail to realize that the problem of equitable growth or inclusive growth is intricately related to the problems of good governance and transparency.
Major Sectors of Indian Economy

Agriculture

Agriculture and similar sectors like forestry, logging and fishing accounted for 15.7% of the GDP in 2009–2010, employed 52.1%\(^4\) of the total workforce. Despite a steady decline of its share in the GDP, it is still the largest economic sector and plays a significant role in the overall socio-economic development of India. The Eleventh Five Year Plan (2007-12) witnessed an average annual growth of 3.6% in the gross domestic product (GDP) from agriculture and allied sector against a target of 4%\(^5\). Yields per unit area of all crops have grown since 1950, due to the special emphasis placed on agriculture in the five-year plans and steady improvements in irrigation, technology, application of modern agricultural practices, and provision of agricultural credit and subsidies since the green revolution. However, international comparisons reveal that the average yield in India is generally 30% to 50% of the highest average yield in the world. Illiteracy, general socio-economic backwardness, slow progress in implementing land reforms and inadequate or inefficient finance and marketing services for farm produce.

Industry

Concerted efforts at industrialization by the government, aiming at self-sufficiency in production and protection from foreign competition, for nearly four decades since independence, have encouraged a broad industrial base, both in the public and private sectors. In year 2011, the private and public sectors together account for 26.4% of the GDP and employ 14% of the total workforce\(^6\). Economic reforms bought foreign competition, led to privatization of certain public sector firms, opened up sectors hitherto reserved for the public sector and the small scale sector and led to an expansion in the production of durable consumer goods.

\(^4\) Source: India Ministry of Finance, Economic Survey 2010
\(^5\) Source: India Ministry of Finance, Economic Survey 2012-13
\(^6\) Source: CIA Fact Book, Index Mundi, 2012
Several specific initiatives have been initiated by the government to strengthen industry and in particular the manufacturing sector in the country. The Twelfth Five Year Plan document lays down broad strategies for spurring industrial growth and recommends sector specific measures covering micro, small, medium and large industries in the formal as well as informal sector. As shown in Figure (1), the share of the industry sector from the banks’ credits gradually increases across successive Five Year Plans, with the Twelfth Five Year Plan being the highest (slightly below 50%).

![Figure 1](image)

**Figure 1**

Data source: RBI

Source: Reserve Bank of India, Economic Survey, 2012-2013

**Services**

India has set up Special Economic Zones and software parks that offer tax benefits and better infrastructure to set up business. The service sector provides employment to 23% of the work force. It is considered the fastest growing sector, with a growth rate of 11.3% and 9.7% in 2009-10 and 2010-11. Also, as shown in Figure (2), service sector always has the largest share in the GDP, however, this share has slightly decreased in the past two years but still preserving being the largest share. Business services (including information technology (IT) and IT enabled services), communication services, financial services, hotels and

---

7 Source: Reserve Bank of India, Economic Survey, 2012-2013
restaurants, community services and trade (distribution) services are among the fastest growing sectors contributing to one third of the total output of services in the year 2000. The growth in the service sector is attributed to increased specialization, availability of a large population of highly-educated and fluent English-speaking workers on the supply side and on the demand side, increased demand from domestic consumers resulting from growth in personal incomes and from foreign consumers interested in India’s service exports or those looking to outsource their operations.

Figure 2


Banking and Finance

The Indian money market is classified into: the organized sector (comprising private, public and foreign owned commercial banks and cooperative banks, together known as scheduled banks); and the unorganized sector (comprising individual or family owned indigenous bankers or money lenders and non-banking financial companies (NBFCs). The unorganized sector and microcredit are still preferred over traditional banks in rural and sub-urban areas, especially for non-
productive purposes, like ceremonies and short duration loans.

Indira Gandhi nationalized 21 banks by 1980 and made it mandatory for banks to provide 40% (since reduced to 10%) of their net credit to priority sectors like agriculture, small-scale industry, retail trade, small businesses, etc. to ensure that the banks fulfill their social and developmental goals. Since then, the number of bank branches has increased from 10,120 in 1969 to 98,910 in 2003 and the population covered by a branch decreased from 63,800 to 15,000 during the same period. The total deposits increased 32.6 times between 1971 to 1991 compared to 7 times between 1951 to 1971. Despite an increase of rural branches, from 1,860 or 22% of the total number of branches in 1969 to 32,270 or 48%, only 32,270 out of 5 lakh (500,000) villages are covered by a scheduled bank.

Since liberalization, the government has approved significant banking reforms. While some of these reforms relate to nationalized banks (like encouraging mergers, reducing government interference and increasing profitability and competitiveness), others have opened up the banking and insurance sectors to private and foreign players.

In the revised 2007 figures, based on increased and sustaining growth, more inflows into foreign direct investment, Goldman Sachs predicts that "from 2007 to 2020, India’s GDP per capita in US$ terms will quadruple", and that the Indian economy will surpass the United States (in US$) by 2043. In spite of the high growth rate, the report stated that India would continue to remain a low-income country for decades to come but could be a "motor for the world economy" if it fulfills its growth potential. According to the official estimates, Indian economy is expected to grow at 7.6% (+/- 0.25%) in the fiscal year 2012–2013.
II. History of SME Sector and its Development in India

SMEs played strategic roles in private sector development in Asia, especially in the aftermath of the 1997 Asian Financial Crisis. As economies modernize and industrialize, SME provide the much-needed interim linkages required to support large companies to ensure that they remain competitive in the world markets. SME are also the main generator of employment in Asia, creating employment of up to 90% of the domestic workforce in many countries. With all stakeholders support in addition to the financial sector, a competitive and innovative SME sector will hold out considerable gains in terms of higher income growth, gratified domestic employment, further integration into the global economy and greater equity in terms of wealth distribution.

With the advent of planned economy from 1951 and the subsequent industrial policy followed by the Government of India, both planners and Government earmarked a special role for small-scale industries and medium scale industries in the Indian economy. Due protection was accorded to both sectors, and particularly for small scale industries from 1951 to 1991, till the nation adopted a policy of liberalization and globalization. Certain products were reserved for small-scale units for a long time, though this list of products is decreasing due to change in industrial policies and climate.

Small industry has been one of the major pillars of India's economic development strategy since Independence. India accorded high priority to small and medium enterprises (SMEs) from the very beginning and pursued support policies to make these enterprises viable and vibrant and over time, these have become major contributors to the GDP. SMEs that have technological base, innovative business outlook, competitive spirit and constant willingness to restructure them can face the present challenges and come out successfully.

Indian SMEs represent the model of socio-economic policies of Government which emphasized job creation at all levels of income stratum and diffusion of economic power in the hands of few, discouraging monopolistic practices of
production and marketing; and contributing to growth of economy and foreign exchange earning with low import-intensive operations. Despite numerous protection and policy measures for the past years, SMEs have remained mostly small, technologically backward and lacked competitiveness. The opening of the Indian economy in 1991 added problems to the SMEs. At the beginning, small scale enterprises found it difficult to survive. In the last decade, the economic environment has changed in favor of SMEs. Recently, the SMEs in India were at a crossroad and intense debate and centered on questions like what would be the future of the small enterprises? How these enterprises can survive in the international trade arena?

However, today, small and medium industry occupies a position of strategic importance in the Indian economic structure due to its significant contribution in terms of output, exports and employment. Figure (3) shows the total employment in the MSMEs sector in India. As shown, the number of employees in this sector increases through years. The estimates compiled for the year 2006-07 was 595.66 lakh persons (59,600 mm), and increased to reach 732.24 lakh persons (73,200 mm) in 2010-11.

The small scale industry accounts for 40% of gross industrial value addition and 50% of total manufacturing exports. More than 3.2 million units are spread all over the country producing about 8000 items, from very basic to highly sophisticated products. The SMEs is the biggest employment-providing sector following agriculture, providing employment to 29.4 million people. However SMEs, which constitute more than 90% of total number of industrial enterprises, are now facing a tough competition from their global counterparts due to liberalization, change in manufacturing strategies, technological changes, and turbulent and uncertain market scenario.
Small industry in India has been confronted with an increasingly competitive environment due to: (1) liberalization of the investment regime in the 1990s, favoring foreign direct investment (FDI); (2) Formation of the World Trade Organization (WTO) in 1995, forcing its member-countries (including India) to drastically scale down quantitative and non-quantitative restrictions on imports, and (3) domestic economic reforms. The cumulative impact of all these developments is a remarkable transformation of the economic environment in which small industry operates, implying that the sector has no option but to 'compete or perish'.

The SME sector differentiates itself by making use of local resources, trying to inject innovativeness in products and services, and creating transformational change at each level.

---

On a broader level, the strategy of the SMEs is to provide a solution to under-employment and divert the surplus resources in the agricultural sector by deploying them in the SME sector. Encouraging agricultural laborers to turn entrepreneurs will yield an increase in agricultural productivity, increase income of the rural strata and provide a boost to industry growth. However, due to its small size, the SME sector gets entangled in difficult situations, while trying to tap the right kind of markets, procuring raw materials, and accessing credit and consulting services. Figure(4) presents the common MSME products that originally exceed 6000 different types. As shown, SMEs have been established in almost all-major sectors in the Indian industry. About quarter of the MSMEs produces other products. The second highest products are food and beverages (14.2%) and wearing apparel (13.7%). Products such as fabricated metals,
textiles, and furniture are produced by less than 10% of the MSMEs. For any other product, it is produced by less than 5% of the MSMEs.⁹

It can be observed that SMEs in India met the expectations of the Government in this respect. SMEs developed in a manner, which made it possible for them to achieve the following objectives:

• High contribution to domestic production
• Significant export earnings
• Low investment requirements
• Operational flexibility
• Location wise mobility
• Low intensive imports
• Capacities to develop appropriate indigenous technology
• Import substitution
• Contribution towards defense production
• Technology – oriented industries
• Competitiveness in domestic and export markets

**SMEs definition in India**

A well-debated issue, the definition of small and medium enterprises in India was very recently settled. The Micro, Small and Medium Enterprises Act, 2006, defines enterprises on the basis of investment in plant and machinery.

According to the new Act, the MSMEs are defined as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Investment (Plant &amp; Machinery)</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro Enterprises</td>
<td>Less than 25 lacs¹⁰</td>
<td>Less than 10 lacs</td>
</tr>
<tr>
<td>Small Enterprises</td>
<td>Less than 5 crores¹¹</td>
<td>Less than 2 crores</td>
</tr>
<tr>
<td>Medium Enterprises</td>
<td>Less than 10 crores</td>
<td>Less than 5 crores</td>
</tr>
</tbody>
</table>

¹¹ Source: - Final Report of the Fourth All India Census of Micro, Small & Medium Enterprises 2006-07: Registered Sector
¹⁰ Lacs : 1 lakh is 100,000 rupees
¹¹ Crore: 1 Crore is 10,000,000 rupees
These enterprises can be rightly called as the backbone of the GDP of India. The SME sector in India is growing at an exceptionally fast rate due to which it is proving to be beneficial to the Indian Economy.

This sector is ideally suited to build on the strengths of the traditional skills and knowledge, by infusion of technologies, capital and innovative marketing practices. This is the opportune time to set up projects in the sector. It may be said that the outlook is positive, indeed promising, given some safeguards. This expectation is based on an essential feature of the Indian industry and the demand structures. The diversity in production systems and demand structures will ensure long term co-existence of many layers of demand for consumer products / technologies/processes. There will be flourishing and well-grounded markets for the same product/process, differentiated by quality, value added and sophistication.

This characteristic of the Indian economy will allow complementary existence for various diverse types of units. The promotional and protective policies of the Government of India have ensured the presence of this sector in an astonishing range of products, particularly in consumer goods. However, the bottleneck of the sector has been the inadequacies in capital, technology and marketing. The process of liberalization coupled with Government support will therefore, attract the infusion of these in this sector.

Figure 5 shows the number of small and medium enterprises in India according to the Annual report of MSME Ministry of India.
Characteristics of Micro, Small and Medium Enterprises:

The SMEs can be classified into two categories: Manufacturing enterprises and Services enterprises. Further classification is as follows:

(a) Enterprises engaged in the manufacture or production, processing or preservation of goods as specified below:

i. A micro enterprise is an enterprise where investment in plant and machinery does not exceed Rs. 25 lakh; (INR 250,000 = USD 5000)

ii. A small enterprise is an enterprise where the investment in plant and machinery is more than Rs. 25 lakh (INR 250,000 = USD 5000) but does not exceed Rs. 5 crore (INR 50 Million = USD Million); and

iii. A medium enterprise is an enterprise where the investment in plant and machinery is more than USD s.5 crore (INR 50 Million =USD 1 Million) but does not exceed Rs.10 crore.( INR 100 Million = USD 2 Million)

As for the above mentioned enterprises, investment in plant and machinery represent the original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification No. S.O. 1722(E) dated October 5, 2006

(b) Enterprises engaged in providing or rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act, 2006) are specified below and clarified by Figure (6).

i. A micro enterprise is an enterprise where the investment in equipment does not exceed Rs. 10 lakh (INR 1 Million = USD 20,000);

ii. A small enterprise is an enterprise where the investment in equipment is more than Rs. 10 lakh (INR 1 Million = USD 20,000) but does not exceed Rs. 2 crore (INR 20 Million = USD 400,000); and

iii. A medium enterprise is an enterprise where the investment in equipment is more than Rs. 2 crore (INR 20 Million = USD 400,000) but does not exceed Rs. 5 crore (INR 50 Million = USD 1 Million).

Figure 6

Source: The micro, small & medium enterprises development (MSMED) act, 2006

---

The SMEs sector has grown rapidly over the years. The growth rates during the various periods have been very impressive. This is quite obvious in the number of small scale units which has increased year by year. In addition to viewing the performance of this sector against growth of the manufacturing and industry sector as a whole, it encourages confidence in the resilience of such a sector.

**Institutional Framework for MSMEs**

There are multiple institutions in the public, private and cooperative sectors of the Indian economy that cater to the credit needs of the SMEs sector, both for fixed assets creation as well as for working capital. Consequent to the nationalization of major banks in 1969, banking policy mandated that at least 40% of bank credit should be directed towards the priority sector constituting agriculture, SMEs and individual service and business sectors.

According to the Fourth All-India Census of Micro-Small and Medium Enterprises (reference period 2006-07), the size of the registered MSMEs was estimated to be 1564000 units. This comprises 67% of manufacturing enterprises and 33% of services enterprises. About 45% of the units were located in rural areas. Out of the total working enterprises, the proportion of micro, small and medium enterprises were 94.94%, 4.89%, and 0.17%, respectively. About 90% of the registered enterprises in the MSME sector were proprietary concerns, about 4% were partnership firms, and about 3% were running as private companies and The balance was owned by public limited companies, cooperatives, trust etc. The total share of women enterprises was around 14%.

**The Micro, Small and Medium Enterprises Act, 2006**

Given the fact of the importance of SMEs sector in India, the government has explicitly recognized the dynamic role to be played by the MSMEs in an increasingly globalized world and accordingly enacted the Micro, Small and

---

13 Source: Ministry of Micro, Small & Medium Enterprises, 2006
Medium Enterprises Act, 2006. The Act is geared towards promoting and enhancing the competitiveness of Micro, Small and Medium Enterprises. It tries to accomplish many long-standing demands of multi stakeholders in the MSME sector.

Such Act provides the first-ever legal framework for recognition of the concept of “enterprise” which comprises both manufacturing and service entities. For the first time, it defines medium enterprises and seeks to integrate the three tiers of these enterprises, namely, micro, small and medium. The Act also provides for a statutory consultative mechanism at the national level with a balanced representation of all sections of stakeholders, particularly the three classes of enterprises; and with a wide range of advisory functions.

The policy gives importance to networking with stakeholders both upstream and downstream in the entire global value chain, from raw material procurement to processing/manufacturing, marketing and customer services. The Government of India passed “The Micro, Small and Medium Enterprises Development Act” in June 2006 after wide consultation with more than 300 industry associations, different government departments and multiple stakeholders across the country.

**The salient features of the Act include:**

- Setting up of a National Board for MSMEs
- Classification of enterprises
- Advisory Committees to support MSMEs
- Measures for promotion, development and enhancement of MSMEs
- Schemes to control delayed payments to MSMEs
- Enactment of rules by State Governments to implement the MSMED Act, 2006 in their respective States.

The Act establishes a National Board for Micro, Small and Medium Enterprises. The main function of the Board is to oversee and regulate the development of MSMEs in India. The Board’s duties include monitoring cluster development, training enterprise, developing infrastructure and promoting financial access to the MSME sector in the country. The Act supplements representations from the
government, industry, finance, civil society organizations on the Board and Advisory Committees. The Act defines the MSMEs by the level of investment in plant and machinery for the first time in India. The new definition seems to eliminate all confusion and different categorization by government and financial institutions.

The Act simplifies the registration process for new MSMEs by submitting simplified Memoranda. The Act stipulates that Central Government may, from time to time, for the purpose of facilitating and promoting the competitiveness of Micro, Small and Medium Enterprises, develop employees skills, management and entrepreneurs, provision for technology up gradation, market assistance, infrastructure facilities and cluster development with a view to strengthening backward and forward linkages which is necessary for the development of MSMEs in the rural areas. The Act provides for constituting a fund by the Central Government for providing necessary credits to the MSMEs.

The Act sets the agenda for specific policies that will create and implement, the procurement preference policy, that will guide Government bodies on how much of their supplies should be purchased from MSMEs. Another important policy is the closure of business or excise policy, which will regulate the liquidation of sick units. Another policy is penal provisions for delayed payments to Micro and Small Enterprises. The Act compels big manufacturers and buyers to make payments within 45 days. If the buyer fails to make payments in time, he will be liable to pay compound interest from the due date. Any dispute with regard to the amount or payment will be referred to Micro and Small Enterprises Facilitation Council which has the power of an Arbitrator to deal with the dispute. The State Governments have to notify the constitution of Micro and Small Enterprises Facilitation Councils in each State.
The clear thrust of such policy initiatives has been three-fold:

i. Enhance competitiveness through encouraging an innovative firms and being quality conscious

ii. Increase links with multiple stakeholders with a view to benefit from networks both nationally and globally; and

iii. Strive for larger market presence beyond the domestic.

Arguments about the Act
The finalization of the new Act raises many questions and controversies among the industry as well as the government. First, the expansion of the investment limits extends the priority sector. Banks have to lend up to 40% of their priority lending to this sector. Too many banks use the methodologies of “Pick and Choose” by looking at safest borrowers, most of which are larger companies with better financial capacity and strength. Indirectly, this will be a disadvantage to small enterprises and the priority lending will go to the largest enterprises among MSMEs.

Second, any Indian business enterprise, with net worth of less than 10 crores, (INR100 Million = USD 2 Million) cannot raise capital from the stock market. The larger companies can bargain with banks on interest rates and lower lending rates. The smaller enterprises have no other choice of finance and they will be forced to borrow on higher interest rates and some will end-up in closure and sickness.

Third, the Act provides for need for procurement preference policy, which is yet to be formulated under Section 11 of the Act. The Government proposed a policy of 20% of annual value of purchases by PSEs, Central government departments etc. from MSMEs.
III. Access To Finance

Indian Government Interventions to SMEs

The MSME sector in India had special emphasis of the government, where its development has been considered a national goal. In this respect, several initiatives have been taken to support and develop the sector, however the sector still faces some problems which could be summarized in the following points:

Problems of SMEs

- SMEs have inadequate accession to the monetary institutions due to the inadequate or absence of any financial information. They fail to reach the private equity and venture capital and they are confined only to the secondary financial instruments.
- SMEs are generally fragmented and are more prone to market fluctuations.
- Their area of business is limited only to the national territory. They fail to harness booming international trading opportunity.
- In the absence of any technical know-how, SME's witness a major struck in their business.
- Small and medium enterprises counter to huge problems when it comes about settling monetary issues with big scales of buyers.

There are various schemes run by the Indian Government to boost the SME’s in the country so as to help them become more innovative, efficient and competitive. The enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 was a landmark taken by the Government of India to enable the SMEs’ competitive strength, address the issues and challenges and reap the benefits of the global market. SME policy initiatives at

---

14 Source: Results of interviews and discussions conducted in India Study Tours by Egyptian delegates, 2011
the national and state level aim at strengthening the role of SMEs at the base as well as at the higher level.

Specialized Institutions Formed to Support SMEs Sector in India

Ministry of MSME

In May 2007, the Government of India decided to merge Ministry of Agro and Rural Industries and Ministry of Small Scale Industries into a single Ministry, namely, “MINISTRY OF MICRO, SMALL AND MEDIUM ENTERPRISES. The ministry designs policies and promotes/facilitates programs, projects and schemes and monitors their implementation with a view to assisting MSMEs and helps them scale up.

The role of the Ministry of Micro, Small and Medium Enterprises and its organizations is to assist the States in their efforts to encourage entrepreneurship, employment and livelihood opportunities and enhance the competitiveness of MSMEs in the changed economic scenario.

The schemes/programs undertaken by the Ministry and its organizations seek to facilitate/provide\textsuperscript{15}:

- Adequate flow of credit from financial institutions/banks;
- Support for technology upgradation and modernization;
- Adequate integrated infrastructural facilities;
- Modern testing facilities and quality certification;
- Access to modern management practices;
- Entrepreneurship development and skill upgradation through appropriate training facilities;
- Support for product development, design intervention and packaging;
- Marketing assistance to better access to domestic and export markets

\textsuperscript{15} Source: Ministry of Micro, Small & Medium Enterprises, Strategy, 2009
• Cluster-wise measures to promote capacity building and empowerment of the units.
• Level playing field at par with the large industrial sectors.

Ministry of Small Scale Industries is primarily responsible for promotion and development of SMEs in India. It has evolved several policies, institutional and support measures, in order to enable SMEs to meet their changing needs.

Small Industries Development Bank of India (SIDBI)\(^{16}\)

Small Industries Development Bank of India (SIDBI) set up on April 2, 1990 through an act of parliament to be an independent financial institution aimed to aid the growth and development of micro, small and medium-scale enterprises (MSME) in India. It is considered as the principal financial institution for promoting, financing, coordinating efforts of other institutions engaged in similar activities. Beginning as a refinancing agency to banks and state level financial institutions for their credit to small industries, it has expanded its activities, including direct credit to the SME through 100 branches in all major industrial clusters in India. Besides, it has been playing the developmental role in several ways such as support to micro-finance institutions for capacity building and on-lending. Recently, it has opened seven branches launched as Micro Finance branches.

SIDBI Foundation identifies nurtures and develops select potential MFIs as long term partners and provides credit support for their micro credit initiatives. The eligible partner institutions of SIDBI Foundation, therefore, comprise large and medium scale MFIs having minimum fund requirement. Large and medium scale MFIs having considerable experience in managing micro credit programs, high growth potential, good track record, professional expertise and committed to viability are provided financial assistance for on-lending. Under the present dispensation, annual need based assistance is provided to enable MFIs to expand their scale of operations and achieve self-sufficiency at the earliest.

\(^{16}\) Source: Visits and discussions conducted in India Study Tours by Egyptian delegates, 2011
SIDBI also considers assistance to women entrepreneurs, on a selective basis, developmental assistance by way of soft loans/grants for organizing group activities and programs such as trade fairs, exhibitions, buyer-seller meets, seminars, workshops, training programs, etc. promotes marketing of products manufactured by women entrepreneurs.

Given the fact that more than 90% of the SMEs are in non-corporate structure hence they cannot absorb equity. SIDBI, based on the best international practices, has come out with various risk capital products which are provided on the backing of cash flows from the business rather than asset cover/ collaterals. Risk capital is offered in flexible manner with respect to the structuring of return and repayments to the risk capital provider, thereby ensuring greater chances of success of the ventures.

In this backdrop, SIDBI decided to develop a tool which would make easy and timely availability of credit for the MSMEs, by way of faster processing of loan processing of loan proposals in a comprehensive and simple manner with reduced Turnaround time (TAT). This tool is intended to simplify the appraisal process without compromising on its quality. Keeping in mind the Basel requirement, a simplified Rating Model was also added in the tool. To leverage the strength of IT, the tool was developed in Lotus Notes Application Software and was named as CART (Credit Appraisal and Rating Tool). The tool is featured as user-friendly, paperless environment and auto workflow to enable the credit officers work more easily.

SIDBI has also floated several other entities for related activities. Credit Guarantee Fund Trust for Micro and Small Enterprises provides guarantees to banks for collateral-free loans extended to SME. SIDBI Venture Capital; is a venture capital company focused at SME. SME Rating Agency of India (SMERA) provides composite ratings to SME. Another entity founded by SIDBI is ISARC - India SME Asset Reconstruction Company in 2009, as specialized entities for NPA resolution for SME
SME Rating Agency of India (SMERA)\textsuperscript{17}

India’s premier credit rating agency in the micro, small, & medium enterprise segment focuses primarily on the Indian SME segment. The primary objective is to provide ratings that are comprehensive, transparent and reliable. It takes into account the financial condition and several qualitative factors that have bearing on credit worthiness of the SME.

SMERA is considered an independent third party assessment; it comprises a composite appraisal and a size indicator. It conducts a comparison of strength and weaknesses of the SME whereas banks offer concession in pricing of (0.25%-0.050%) for credit.

The credit guaranty fund and credit linked capital subsidy scheme has been built in order to support the SMEs. Credit rating helps in cost efficiency and innovation to be undertaken by SMEs, and helps the bank to go for less riskier lending venture, provided the credit rating is done in a scientific way.

Brief on SMERA’s Features
- Only Rating Agency dedicated to Micro, Small and Medium Sector
- MOUs with 36 banks /NBFC / Corporate covering a large section of Indian banking sector with 13 Banks extending interest rate benefits to well -rated SMERA units
- Completed 5 years of operation & more than 11000 Ratings
- Empanelled under the Central Government Performance and Credit Rating Scheme ( NSIC)-75% subsidy for Micro/Small Units
- Technical assistance under the World Bank/DFID led multi-lateral SME Financing & Development Program.
- Received accreditation from SEBI in years 2010-11

Highlights of SMERA Ratings

\textit{Independent:} Neutral Risk Assessment

\textit{Comprehensive:} Conducts as exhaustive due diligence process

\textit{Transparent:} Rating rationale discussed with rated entities.

\textsuperscript{17} Source: \url{www.smera.in}, 2012
Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)

The Ministry of MSME, Government of India and SIDBI set up the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) with a view to facilitate flow of credit to the MSE sector without the need for collaterals/third party guarantees. The main objective of the scheme is that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. 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 85 per cent of the outstanding amount in default.

The CGTMSE would provide cover for credit facility up to IRS10 Million = USD 200,000 which have been extended by lending institutions without any collateral security and/or third party guarantees. A guarantee and annual service fee is charged by the CGTMSE to avail of the guarantee cover. Presently the guarantee fee and annual service charges are to be borne by the borrower.

CGTMSE has adopted multi-channel approach for creating awareness about the Credit Guarantee Scheme (CGS) amongst all the stakeholders including banks, industry associations, entrepreneurs, etc. through various forums like print and electronic media, conducting workshops, seminars etc... Moreover reconstructing the website makes it user-friendly and more informative with useful hyperlinks.

The effectiveness of the CGS was reviewed by a committee (Standing Advisory committee) on credit flow to MSME sector in 2009. In addition to various SMEs in their representations and submissions to Reserve Bank of India had also expressed concerns about the unsatisfactory performance and reluctance of banks to avail guarantee cover under the schemes. Accordingly, the schemes have been reviewed and improvements have been done to it.
India Reserve Bank

India Reserve Bank plays a vital role in directing and supporting SMEs access to finance. The Reserve Bank of India has, from time to time, issued a number of guidelines/instructions/directives to banks in the matters relating to lending to Micro, Small & Medium Enterprises Sector to enable the banks to have current instructions at one place.

The Reserve Bank in 2005 set special guidelines for SMEs as follows:

**Guidelines for SMEs**

- Every Bank is required to set up its own policies for providing monetary assistance to the SME.

- Banks may start taking important steps for rationalizing the cost of loans granted to the SME sector. They should adopt a transparent rating system. SIDBI has its own Credit Appraisal & Rating Tool (CART) and Risk Assessment Model (RAM) along with a rating model. These have been developed for assessing risk involved in SMEs projects. The National Small Industries has their own Credit Rating Scheme, which in turns boost up the Small scale enterprises for getting their credit rated by the eminent credit rating agencies.

- For making formal credit possibilities accessible to the small and medium enterprises, all banks including regional and rural banks are required to take up concrete steps for providing credit facilities to an average of at least 5 micro, small and medium enterprises (MSME’s).

- Reserve Bank has issued a notification to all banks for detailing out their procedures of disposition of loan applications of MSME’s including of the extent to which banks are permitted to grant collateral free loans etc.
Reserve Bank has made special arrangements in institution for analyzing credit requirements of such units. Like the Standing Advisory Committee in Reserve Bank and cells at head office and regional centers of the bank, check and review the credit flow to SME.

Also certain targets have been prescribed for banks for lending to the Micro, Small enterprises (MSE) sector. The targets for domestic banks and foreign banks are slightly different keeping in mind the limited presence of the foreign banks. The domestic banks are expected to enlarge credit to priority sector advances which include the micro and small enterprises sector.

The Reserve Bank’s initiatives are summarized as follows:

- Banks to operate specialized SME branch in every district.
- Collateral free advances up to around $25 thousands.
- Assessment of working capital requirement simplified.
- Higher Foreign Direct Investment (FDI) in SME allowed.

Securities and Exchange Board of India (SEBI)

Indian financial markets regulator, the Securities and Exchange Board of India (SEBI) have decided to frame out plans and policies for developing small and medium enterprises. The move of SEBI in progressing SMEs is considered as a concrete step taken in the direction of improving condition of this segment. While discussing its plans, SEBI ruled out the concern areas of SMEs, which it has outlined during its regular interactions with the different market participants. High cost involved in rising of capital is doted out to be a major problem. To facilitate more capital inflow into the small and medium enterprises, SEBI has come up with an idea of creating a separate stock exchange for the small & medium enterprises in India.
Some of the measures and new initiatives to promote SMEs include:

**SME development fund**

- A specialized stock exchange for SMEs
- Encouragement for patenting and ISO Certification
- SME venture capital fund
- National Commission for Small Industries (informal sectors)
- National Small Industries Corporation
- Small Industries Development Organization
- Credit Rating Agency
- SME development bill
- Promoting special venture capital companies and risk financing companies for SMEs
- Improve the working of credit guarantee and export promotion institutions
- Progressively reduce protection measures and simplify implementation policies and control mechanisms
- SME Development Centers at SIDBI and IIFT
- Considering liberalizing FDI in SMEs and encouraging their linkages with TNCs and large companies
- Promoting industrial growth centers/clusters, EOUs, district industry centers, business incubators and business parks
- Market assistance and export promotion
- Limited Liability Partnership Bill 2006

**A specialized stock exchange for SMEs**

The trend of stock markets for small businesses in India has been initiated by the Bombay Stock Exchange (BSE), which is among the oldest of its kind in the continent. It has started operations with the inclusion of BCB Finance Limited, which is based in Mumbai. In the meantime, Emerge, the stock exchange
platform for the small and medium enterprises of the National Stock Exchange of India (NSE) has started its operations as well.

**SME venture capital fund**

Traditionally, Venture Capitalists in India have shied from the MSME sector. The non-corporate structure and small size of majority of MSMEs in India makes the Venture Capitalists and Private Equity Players reluctant to investing in them due to higher transaction costs and difficulties in exits out of such investments. However, the VC scenario in India is rapidly changing. Alternative funding like VC is picking up in the India, including in the MSME sector. Moreover, the VCs are expanding their reach into areas besides the traditional VC sectors like Information Technology (IT); nowadays interest in sectors like clean energy, healthcare, pharmaceuticals, retail, media, etc. is also growing.

In recent years, the government controlled financial institutions have initiated positive and progressive measures to provide MSMEs access to funds at a reasonable and affordable costs without any usual hurdles. Venture capital funding institutions have been floated to induct fund at low cost, share the risk and provide management and technology up gradation support to these enterprises. Government-funded schemes exist at both the national and the state levels. They tend to be relatively small — they typically do not exceed US$ 5million.

As mentioned above the Small Industries Development Bank of India (SIDBI) is the main public financial institution involved in VC funding operations.

**National Commission for Small Industries (informal sectors)**

The National Commission for Small Industries has been set up for addressing the wide range of issues affecting the productive potential of the unorganized micro and small productive units. Besides, there are three national level ‘Entrepreneurship Development Institutes (EDIs)’ for the development of training modules, undertaking research and providing consultancy services for entrepreneurship development in the small scale sector
National Small Industries Corporation

The National Small Industries Corporation was established by the Government with a view to promote, aid and foster the growth of micro, small and medium enterprises in the country, with a focus on commercial aspect of their operations. It implements several schemes to help the MSMEs in the areas of raw material procurement, product marketing, credit rating, acquisition of technologies, adoption of improved management practices, etc.

Small Industries Development Organization

It is also known as Micro, Small and Medium Enterprises-Development Organization (MSME-DO). It is the apex body for assisting the Government in formulating, coordinating, implementing and monitoring policies and programs for micro, small and medium enterprises (MSMEs) in the country. MSME-DO provides a comprehensive range of common facilities, technology support services, marketing assistance, entrepreneurial development support, etc.

At the heart of all agencies dealing with the development of small industry is the CSIO—now renamed as Small Industries Development Organization (SIDO), SIDO has grown into vast organization with:

- Network of more than 33 SISIs
- Branch Service Institutions (37)
- Extension Centre’s (37)
- Regional Testing Centre’s
- Process-cum-product Development Centre’s
- Training centers
- Production Centre’s
- Field Testing Stations
SIDO is as apex body and nodal agency for formulating, policy-making, coordinating and monitoring agency for the development of small scale entrepreneurs.

It is headed by Additional Secretary and the Development Commissioner, small Scale Industry; that maintains a close liaison with government, financial institutions and other agencies involved in the promotion and development of small scale units.

SIDO is the nodal agency that advises the Ministry of Industry (and other Ministries) in formulating policies and programs for the development of SSIs.

It also oversees the "package of services" rendered by the SISIs at field level and provides comprehensive range of consultancy services and technical, managerial and marketing assistance to SSI units over the years, it has sun its role evolve into an agency for advocacy, hand holding and facilitation for the small industries sector.

It has over 60 offices and 21 autonomous bodies under its management. SIDO provides a wide spectrum of services to the small industries sector like testing, training for entrepreneur’s preparation of projects and product profiles, technical and managerial consultancy, export assistance, etc.

SIDO provides economic information services and advises to the government in policy formulation for the promotion and development of SSIs.

**Functions of SIDO**

- Formulating policies regarding the promotion and development of SSI at national level.
- Implementing those plans, programmers and policies of the government in respect of industrial development of the country.
- Coordinating the activities of all departments, institutions and agencies involved in promoting the SSI.
• Rendering all way support and encourage the entrepreneurs to set up and sort out the hurdles.

• Conducting regular and ad hoc training courses through SISI's, Branch SISI's and extension/production centers;

• Organizing EDPs, motivational campaigns etc. for rural artisans, educated unemployed, women entrepreneurs, and physically handicapped persons;

• Securing reservations of certain products to be manufactured only by SSI's.

• Assisting and encouraging entrepreneurs to set up industrial units in rural and industrially backward areas and industrially backward areas;

• Estimating the requirements of raw materials of SSI units and to arrange their supplies.

SIDO keeps its officers abreast of the latest developments in their respective fields of specialization. Global trends and national developments have accentuated SIDO’s role as a catalyst of growth of small enterprises in the country.
IV. Cluster Approach for Development of Small Industries

Cluster Development: Concepts & Issues

Small and medium enterprises operating in the same or inter-related industrial sectors tend to concentrate in specific geographic locations. This phenomenon has been observed in all parts of the world. There are sound economic reasons for this phenomenon (Krugman 1991). Micro and small units operating in such clusters derive a clear competitive advantage from:

- The proximity to sources of raw materials and other inputs,
- The availability of suitably customized business development services (BDS),
- The abundance of clients attracted by the cluster tradition in that industry, and
- The presence of a skilled labor force.

A ‘cluster’ may, therefore, be defined as the agglomeration of SMEs producing same/similar products/services or engaged in the same line of manufacturing activities or services, located within an identifiable and, as far as practicable, contiguous area.

Not all the clusters are however characterized by the same dynamism or indeed by the same economic success. The literature on the so-called Italian industrial districts (Piore and Sabel 1984, Best 1990, Porter 1990) describes SSE clusters that have reached high levels of growth and leadership in profitable niches of world markets (e.g. leather goods, textile, jewelry, ceramic tiles, and spectacle frames). Similar accounts exist from other developed countries such as Germany (Semlinger 1993), the USA (Saxenian 1989), Japan (Friedman 1988), and increasingly from low-income countries (Schmitz 1995, World Development 1999).

---

18 Source: V. P. Kharbanda is in the National Institute of Science Technology and Development Studies, Dr K.S. Krishnan Marg, New Delhi 110 012, India. (e-mail: kharbandavpk@yahoo.com)
Cluster Development in India

The National Strategy for Manufacturing has recognized the need for a focused project on advances technology products and has recommended the constitution of a special group to study the potential for manufacture and export of such products. It has also recommended the establishment of technology parks around institutions of higher technological learning on the lines of those existing in USA. Another important recommendation is related to setting up a "Global Technology Acquisition Fund" to enable Indian industry to acquire very high technology intensive companies abroad. (National Manufacturing Competitiveness Council, 2006)

The strategy suggested a cluster approach for improving the manufacturing competence. New and innovative approach to cluster development was adopted to encourage a small scale sector as breeding ground of innovation and technology development where it became the technology sources for large companies. A National Manufacturing Competitiveness Program (NMCP) was developed which included objectives to support SMEs. A Design Clinic approach was suggested to bring Indian manufacturing sector and design expertise on to a common platform and to provide expert advice and cost effective solution, resulting in continuous improvement and value addition for existing products. Emphasis was also laid down to enable SMEs to be competitive through quality management standards and quality technology tools.

The Ministry of Micro, Small & Medium Enterprises laid special emphasis for development of clusters and launched a scheme for technology up-gradation and management called UPTECH in 1998. Although it was having a cluster based approach for development of MSEs, it was mainly technology-focused comprising of a diagnostic study, setting-up of a demonstration plant and organizing workshops, seminars, etc. for quicker diffusion of technology across the cluster of small enterprises.
In August 2003, the scheme of the Ministry of Micro Small and Medium Enterprises was renamed as Small Industry Cluster Development Program (SICDP) and made broad based by adopting a holistic pattern of development of the cluster encompassing marketing, exports, skill development, setting up of common facility centers, including technology up-gradation of the enterprises, etc. SICDP guidelines were comprehensively revised in March, 2006 making the cluster program more broad-based by facilitating substantial economies of scale in terms of deployment of available resources in the medium to long term. As per the Promotional Package announced by the Government, SICDP was renamed as Micro & Small Enterprises - Cluster Development Program (MSE-CDP) to make it more attractive, though the basic features of this scheme have been retained as such. The proposals for setting up new clusters shall now be considered under MSE-CDP and the quantum of grant has been raised to 75% of the cost and the project cost.

**Cluster Financing**

Cluster based approach to lending is intended to provide a full-service approach to cater the diverse needs of the MSE sector in India which could be achieved through extending banking services to recognized MSE cluster. A cluster based approach is clearly more beneficial in India by:

a. dealing with well-defined and recognized groups;
b. availability of appropriate information for risk assessment;
c. monitoring by the lending institutions; and
d. Reducing costs.

Accordingly, banks have been advised to take appropriate measures to improve the credit flow to the identified clusters of micro and small entrepreneurs from the minority’s communities residing in the minority concentrated districts of the country. Also banks have been advised to open more MSE focused branch offices at different MSE clusters which can also act as counseling centers for MSEs.
Advantages of cluster approach for development of small industries

- Forming and financing clusters is a risk mitigation strategy.
- Clusters reduce infrastructure cost.
- Common opportunities and threats are determined on geographical and sector concentration of MSMEs.
- Specialized infrastructure, labor markets and services are identified.
- Cluster approach tries to mitigate some of the inherent disadvantages of MSME sector like economies of scale, sourcing and acquisition of technology, specialized production functions and inadequate marketing organization.
- Clusters help accelerating innovation and improving the ability of small producers to respond to external market developments.
- Clusters facilitate providing various types of technical, commercial and legal services at affordable cost and without delay.
- Clusters enhance MSME competitiveness
- Cluster approach has been very successful in India. Some of the examples are:
  - Knitwear cluster of Ludhiana which was implemented by UNIDO assistance, produces 95% of Indian woolen products
  - Gems and Jeweler clusters in Surat (Gujrat) and Mumbai
  - Cotton hosiery cluster in Tirupur- Tamilnadu
  - Cottage footwear cluster in Agra- Uttar Pradesh
  - Seafood processing cluster in Kochi- Kerala
  - Blankets production cluster in Panipat- Haryana
Banks in India & SMEs Access to Finance

Among bank categories, public and private sector banks have registered impressive growth of 35.28% and 36.14% in MSE lending in year 2011. However, Public Sector Banks (PSBs) account for a major share compared to private and foreign banks. During 2011, total priority sector advances by PSBs grew by 19.1% than year 2010. Total advances provided by the PSBs to the MSE sector for year 2011 grew by 35.3%. Advances to MSE formed around 37% of the total priority sector advances of PSBs, versus the 32% share during year 2010. Moreover, the share of MSE credit to net bank credit stood at 9.9 % in 2011 against 13.4% in 2010 as shown in Figure (7).

Figure 7

Bank Category wise outstanding credit to MSMEs

<table>
<thead>
<tr>
<th>Year</th>
<th>PSBs</th>
<th>Private Sector Banks</th>
<th>Foreign Banks</th>
<th>All SCBs</th>
<th>Y-o-Y growth for All SCBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY07</td>
<td>1000</td>
<td>500</td>
<td>300</td>
<td>2000</td>
<td>0</td>
</tr>
<tr>
<td>FY08</td>
<td>2000</td>
<td>700</td>
<td>400</td>
<td>3500</td>
<td>10%</td>
</tr>
<tr>
<td>FY09</td>
<td>3000</td>
<td>800</td>
<td>500</td>
<td>4500</td>
<td>20%</td>
</tr>
<tr>
<td>FY10</td>
<td>4000</td>
<td>900</td>
<td>600</td>
<td>5500</td>
<td>30%</td>
</tr>
<tr>
<td>FY11</td>
<td>5000</td>
<td>1000</td>
<td>700</td>
<td>6500</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: Economic Survey in India 2011–12

Norms of lending to SMEs

- Banks normally insist on a margin depending upon the merits of each case. Generally, it is 20-25% for SMEs.

- Banks create legal charge over the assets created/purchased/acquired with bank finance in the form of mortgage, pledge, hypothecation, assignment or lien.
• Banks also obtain collateral security/personal guarantee of third parties, if available.

• No collateral security is insisted if the loan amount is up to $25 thousands.

• There are a few institutions/schemes, which provide risk cover to banks/entrepreneurs, e.g. DICGC, ECGC, Credit Guarantee Fund Trust Scheme.
Union Bank of India

The Union Bank of India was built up in the twentieth century and declared open by the Father of the Nation, Mahatama Gandhi. The bank with its efficient value-added services, sustained growth, consistent profitability and development of new technologies bank has ensured complete customer delight, living up to its image of, “GOOD PEOPLE TO BANK WITH”. The Bank offers credit cards, home loan, union demat, Kisan ATM, International debit card, online tax payment facility, Railway e-ticketing kiosk, etc., services to its customers through core banking solution. The Union Bank of India has 2261 branches, presently 939 ATMs spread out across India both Onsite and Offsite.\(^{19}\)

Initiatives for Development of MSME Sector

A. Organization Design

B. Efficient Process, Delivery Channels and Specialized Manpower

C. Product Innovation

D. Knowledge & Training to Entrepreneurs

E. Accessible to Entrepreneurs

A. Organization Design

The bank designed the *Focused Vertical* for MSME

- Well-defined MSME Policy
- Objectives, scope, ownership and compliance in line with MSMED Act 2006

B. Efficient Process, Delivery Channels and Specialized Manpower

- Simpler processes - SME SARAL
  
  To improve credit flow to MSMEs, Central Processing Centers (CPCs) are established for focused marketing and to have minimum response time for

\(^{19}\) Source: Visits and discussions conducted in India Study Tours by Egyptian delegates, 2011
sanction of SME proposals. The Bank has identified 17 SARALs directly controlled by MSME vertical at corporate office

- **Dedicated Outlets - Business Banking Branches [BBB]**
  Identified 250 BBBs are directly monitored by corporate office apart from their controlling offices for business growth. 100 more branches are identified [FY 2011-12] and added making thereby total number of 350 branches.

- **Dedicated Pool of Credit Officers**
The Bank has taken a conscious decision to form a cadre of credit officers for skill developments in credit marketing and appraisal of the proposals. Credit Officers are identified and given intensive training of five phases such as in-house, on the job and external training etc. These credit officers are deployed at the BBBs/SME SARALs involving the job of credit marketing and processing of the proposals.

**C. Product Innovation**

- **Promoting Cluster-based Approach**
The Bank has adopted Cluster Based Approach for financing SME sector, which offers possibilities of reduction of transaction costs and mitigation of risk. Based on specific concentration of activity, Bank has developed 12 cluster specific schemes at different centers across the country. This pertains to Automobile sector, Rice Mills, Iron & Steel Sector, Carpet artisans, Handloom weavers etc.

- **Channel Financing**
The Bank has entered into MOU with the leading Automobile Manufacturers i.e. Ashok Leyland Ltd. and Tata Motors Ltd. for dealer financing and individual financing for purchase of their vehicles

- **CGTMSE Finance**
The Bank has entered into MOU with Credit Guarantee Fund Trust for Micro & Small Enterprises [CGTMSE] for extending Guarantee cover for advances up to IRS.100.00 lacs, granted without collateral security or
personal Guarantee. These are termed as Collateral free and without personal Guarantee loans. This provides hassle free loans to MSME borrowers.

D. Knowledge & Training to Entrepreneurs

- **R-SETIs (Rural/Self-employment Training Institutes)**
  There are 13 RSETIs set up across the country for imparting training to entrepreneurs in Micro & Small sector. Whereas the bank arranged Credit linkages to be also provided to the trainees after completion of training

- **Specialized Training Institute in alliance with SIDBI**
  Established a Training Institute at Jangipur (West Bengal) in association with India’s premier financial institution for development of small scale sector, SIDBI (Small Industries Development Bank of India. The main purpose to establish such an institute is to impart training to unemployed and help them develop skills. Also extending financial assistance for the profession/trade in which he/she is trained.

- **Research Program at IIM Ahmedabad**
  The bank also cooperated with IIM, Ahmedabad for Research Program to look into issues pertaining to Small and Medium Enterprises

E. Accessible to Entrepreneurs

- Dedicated Service Centers & help lines.
  a. SME helpline is set up at Bank’s website.
  b. All Regional Offices of Bank are designated as ‘MSME Care Centers and Regional Heads are identified as nodal officers for these care centers. The nodal officers are advised to take care of SME grievances and further undertake handholding of SME customers

- **MSME Call center** is set up in Mumbai, which provides assistance to the customers for their queries.
- The Bank has a dedicated MSME link on its website. This link helps the client in knowing the various MSME products and procedure for availing MSME financial assistance. Bank’s MSE policy is also displayed on this link.
- Bank’s commitment to Micro and Small Enterprises as per Banking Codes and Standards Board of India
- Common Loan Application Form for MSE Borrower also available on website

**Cluster Based Approach**

Union Bank of India has adopted Cluster Based Approach for financing SME sector, which offers possibilities of reduction of transaction costs and mitigation of risk. Based on specific concentration of activity, Bank has developed 12 cluster specific schemes at different centers across the country. This pertains to Automobile sector, Rice Mills, Iron & Steel Sector, Carpet artisans, Handloom weavers etc.

**Union SME plus Product**

Union SME Plus is a credit product tailored to meet the temporary short term working capital requirements of Micro, Small & Medium Enterprises (MSME) sectors.

The loan is availed for the following purposes:

- All kind of genuine credit needs of temporary nature to tide over liquidity crunch
- Repayment of high cost short term borrowings
- Meeting Working Capital needs arising out of bunching of orders
- Temporary delay in shipment / realization of book debts
- Sudden increase in raw material cost
- Mismatch in Cash Flow
Bank of India (BOI)

Bank of India was founded on 7th September, 1906 by a group of eminent businessmen from Mumbai. The Bank was under private ownership and control till July 1969 when it was nationalized along with 13 other banks. The Bank has made a rapid growth over the years and blossomed into a mighty institution with a strong national presence and sizable international operations. In business volume, the Bank occupies a premier position among the nationalized banks.

The Bank has 4038 branches in India spread over all states/union territories including specialized branches. These branches are controlled through 50 Zonal Offices. There are 29 branches/offices (including five representative offices) and 3 Subsidiaries and 1 joint venture abroad.

While firmly adhering to a policy of prudence and caution, the Bank has been in the forefront of introducing various innovative services and systems. Business has been conducted with the successful blend of traditional values and ethics and the most modern infrastructure. It pioneered the introduction of the Health Code System in 1982, for evaluating/rating its credit portfolio.²⁰

Structural strategy at BOI

Bank of India has separated the SME as business vertical and headed by a General Manager at HO, assisted by a DGM, two AGMs, one Chief Manager, two senior managers and five managers, whereas the Head Office looks after policy, new product development, cluster development, specialized schemes, MOUs with OEMs, liaison with MSME agencies such as SIDBI, NSIC, CGTMSE etc.

Moreover the territory is divided into 5 National Banking Groups headed by GMs with 51 zones under the National banking Groups headed by DGMs as well as branches under the zones.

²⁰ Source: Visits and discussions conducted in India Study Tours by Egyptian delegates, 2011
• Bank of India has adopted regulatory definition for ensuring accelerated credit flow to Micro & Small Enterprises.
• BOI has adopted the expanded definition of SMEs on the basis of Sales Turnover for its SME business vertical
• MSMED Act does not accord the status of SME to whole sale trade, where the expanded business turnover definition includes trading activity besides manufacturing and services

Strategies for SMEs Business growth
• All the zones grouped into 5 national banking groups
• All the 5 National banking Groups headed by General Managers with adequate delegation for business growth
• SME City Centers being rolled out to act as processing hubs for all SME credit business of limits above Rs.1 crore
• 12 SME City Centers have become operational before 31-03-2011
• Credit origination and processing segregated in the City Centers as a risk management measure
• Dedicated team for credit processing and outbound sales team for lead generation and follow up for business acquisition put in place
• Credit processes delayer and delegation revised upward to ensure shorter TAT
• Four new products launched to customize Bank’s offering to SME customers
• Pre disbursement risk mitigation processes simplified to ensure faster disbursement
• Simplified Application Form introduced for all SME customers irrespective of the size of limit
• Master Check List formulated for obtaining information required for processing customer requests in one go
• Tracking and Performance Management Systems introduced in the SME City Centers to bring about greater transparency in business processes
Bank of Baroda

Bank of Baroda is a pioneer in various customer centric initiatives in the Indian banking sector. Bank of Baroda is amongst first in the industry to complete an all-inclusive rebranding exercise wherein various novel customer centric initiatives were undertaken. The initiatives include setting up of specialized NRI Branches, Gen-Next Branches and Retail Loan Factories/ SME Loan Factories with an assembly line approach of processing loans for speedy disbursal of loans. Bank of Baroda has nearly 4264 branches all over India.21

Bank of Baroda offers various products and services that meet specific requirements of such enterprises and help them to grow. The micro and small (service) enterprises include small road & water transport operators, small business, professional & self-employed persons, retail trade i.e. advances granted to retail traders dealing in essential commodities (fair price shops), consumer co-operative stores and advances granted to private retail traders with credit limits not exceeding Rs. 20 lakh and all other service enterprises, as per the definition under MSMED Act. Therefore a special focus has been given to SME segment.

Key Benefits

The loans and advances offered by Bank of Baroda for SSI Units can be used for the basic needs of:

- Acquisition of factory, land and construction of building spaces.
- Purchasing of plant and machinery including lab equipment, testing equipment, etc.
- Meeting working capital requirements, like raw materials, stock-in-progress, finished goods and for purchase or discounting of bills.
- Temporary additional assistance for meeting the urgent needs of raw material.
- Additional monitory assistance for any eligible purpose.

21 Source: Visits and discussions conducted in India Study Tours by Egyptian delegates, 2011
To promote the growth of SME Sector, the Bank has launched a special and novel delivery model, viz. SME Loan Factory, which is presently functioning in 34 centers of the Bank and is well accepted in the market. The SME Loan Factory is an innovative model for streamlining processes and for timely sanctions of SME loan proposals. The model comprises of the Central Processing Cell for speedy appraisal and sanctioning of proposals within the stipulated deadline.

A team of Relationship Managers stationed at different branches of the Bank spread over micro segments of the city reaches out to customers to facilitate completion of pre-sanction formalities in a hassle free manner. The Relationship Managers would also be marketing, not only various SME products of the Bank, but also other products and services including the Third Party products like Life Insurance, Mutual Funds, Equity Trading, etc. The above model operates on an assembly-line principle with simplified processes using latest technology and in-house, skilled and trained man-power. The Bank has SME Loan Factories at all major business centers across the country.

**New Initiatives in the SME Business**

- The Bank entered into MOU with some of the vehicle manufacturers for financing their dealers/road transport operators desirous of purchasing their vehicles.
- It entered into MOU with CGTMSE for extending collateral free loans under Risk Sharing Facility scheme launched by CGTMSE.
- It also entered into MOU with Ministry of MSME for financing under the scheme, viz. Trade Related Entrepreneurship Assistance and Development (TREAD) for economic empowerment of women.
- It introduced seven new customer centric area specific products to suit the local cluster needs.
- It organized awareness programs for SME borrowers to enlighten them about various products, services and precautionary steps to be taken in view of global financial crisis.
- It took proactive steps by announcing various measures to assist the borrowers under stress due to global recession.
- It organized Management Development Program with Institute of Business Management of repute for familiarizing the SME customers with current trends in business areas.
- The Bank took up sponsoring of SME Page in all editions of Economic Times, which is expected to give popularity to various products designed for SME Sector and boost SME business.

**Strategic Initiatives for Year 2012**

Bank of Baroda took several initiatives under MSME Business. It opened ten New SME Loan Factories and eight New SME Specialized Branches during FY12. Also, it introduced five new customer-centric area specific products to suit the local cluster needs. Bank introduced a new asset side product named as “Baroda Channel Financing” on a pilot basis.

In addition the bank sponsored workshop on “Management Skills to Source Financing and Management of Technology by SMEs” for entrepreneurs arranged by All India Management Association (AIMA) at Hyderabad, Ahmedabad and Jaipur. As well as introduced “Baroda Entrepreneur Awards” for Micro & Small enterprises.
ICICI Bank

ICICI bank is the second largest bank in India by assets and third largest by market capitalization. It offers a wide range of banking products and financial services. ICICI recognizes that SME needs are far beyond loans, as it represents 95% of the bank's SME customers are non-borrowers. ICICI's strategy includes profitability serving and complete needs of its SME customers. In Indian market, where almost 80 banks are accessing SME space, ICICI claims a market share of 4-9% depending on customer classification. The Bank has a network of 2,906 branches and 10,088 ATMs in India, and has a presence in 19 countries, including India.  

There are 3 keys for success at ICICI:

- "Beyond Lending" approach
- Effective segmentation
- 360-degree credit risk evaluation

"Beyond Lending" approach
ICICI's part of its success is its dedication to the SME client group, by offering SME clients products and services that meet full gamut if needs. This has been done through the use of technology-enabled low-cost alternative channels. These channels and applications help the bank to serve SMEs in their day to day business and meet their transactional needs more efficiently with low turnaround times.

Effective segmentation
ICICI divides its SME clients into three groups; 1) Corporate Linked Business, which is MSEs linked to ICICI's current corporate clients, 2) Cluster Banking Group, consisting of pre-selected and pre-defined customer industry clusters that represent promising opportunity markets within India, and 3) Business Banking Group that includes the remaining clients.

Source: Visits and discussions conducted in India Study Tours by Egyptian delegates, 2011
This segmentation enables ICIC to address challenges such as risk management and knowledge development. *360-degree credit risk evaluation.* ICICI Bank uses a "360-degree" approach to evaluating credit risk for SMEs, where it uses trade references, business profiles, transactional histories and other non-traditional mechanisms to help compensate for SMEs' lack of financial statements.

**ICIC Bank Initiatives for SMEs**

**SME Workshops**

ICICI Bank's SME Workshop Series is an initiative to impart crucial know-how to premium SME members of the Apparel Exports Promotion Council (AEPC) & Engineering Export Promotion Council (EEPC). Never before has a Bank in India collaborated with the AEPC and EEPC, India's most influential trade councils in the apparel segment and engineering segment respectively. Approximately 50-60 SME promoters and owners attend each workshop. The SME Workshop Series has focused on providing information on technology upgrade and discussing other relevant issues. Issues that have been highlighted in past workshops include importance of SME ratings, financing opportunities, impact of telecom solutions on business productivity are also discussed.

**CEO Knowledge Series**

ICICI Bank's SME CEO Knowledge Series is a series of seminars for the CEO/CFO profile of SMEs. Through the SME CEO Knowledge Series, ICICI Bank has created an opportunity for SMEs to interact with experts on issues like taxation, marketing and branding, finance and HR. The Knowledge Series has been held across 26 cities, addressing leading clusters and sectors.

**Key Benefit**

- Attendance as delegates (ideal for liability products)
- Provides opportunity to interact and seek advice from industry experts on a one-to-one-basis. (ideal for asset products like secured / unsecured loans)
• Access expert advice on strategic business growth areas like IPO, debt financing, PE, M&A, etc. (ideal for W/C loans, PE leads, etc). SMEs being offered this advice are pre-selected through a screening process.

**SME Dialogue**

A milestone initiative by ICICI Bank, SME Dialogue has positioned ICICI bank as a thought leader in SME Banking and an opinion maker in the SME space. For the first time in its history, The Economic Times created a special mast-head within the main edition (pan India) for its partner sponsor, ICICI Bank.

This campaign which lasted for 52 weeks consisted of a full page presence in The Economic Times every week. The page contained insightful articles on the SME sector, senior management's views and ICICI Bank advertisements. ICICI Bank in association with The Economic Times, followed-up the campaign with ground events across multiple locations through dedicated SME forums.

ICICI Bank's SME Dialogue succeeded in servicing the SME sector by highlighting best practices of successful SMEs and enabling sharing of business-critical sector. This initiative also made ICICI Bank synonymous with the issues concerning SMEs and placed it as a thought leader in SME Banking among the banking fraternity. The role of ICICI Bank's SME Dialogue has been acknowledged by stakeholders like other banks and IT multinationals as well as regulators like the RBI.

**The SME Toolkit**

The SME Toolkit India includes comprehensive information, which serves as a business consultant offering valuable business advice and tips for every SME. It is truly a one-stop resource for small businesses in India, constantly providing guidance to help them reach higher levels of professional management also provides SMBs with inputs on and facilities like; (business planning, accounting, operations, human resources, marketing, technology).
V. Issues Facing SMEs in India

A. Lending Facilities to SMEs

The mindset of banks towards SMEs have somewhat changed in the recent past. With the entry of private banks, increased competition has led to a rush for lending to prime customers. The multiple financial options from the capital market have also compelled banks to take more risks in case of SMEs. The increased lending to SMEs is propelled by the compulsion of the market as well as by the rapid expansion of these companies.

There was no agreement among the banks on what constitutes an SME. This confusion was removed by the new Act. But private and foreign banks have their own definition of SMEs. They follow the International standard of turnover between Rs. 10 crore (USD 2 Million and USD 13 Million). The lending to the SME sector grew by 69% between 2000-01 and 2005-06.

However there exists a stark disparity amongst small players and big players within the SMEs sector. Loans to bigger companies are growing at a faster pace than loans to the SSI sector. By the end of 2006, the proportion of SSI loans to total loans has remained small at 6%.

Presently, private banks are adopting new methodologies for priority lending to SMEs. In the past, loans were made without proper study of the viability of the project and mostly bankers in this sector had no expertise in handling small loans. Now private banks like ICICI and Kotak Mahindra Bank have separate SMEs division. Today, most of the lending are concentrated on priority sectors like auto ancillaries, pharmaceuticals and IT sector where India had a proven record of competitive advantage. The SMEs sector is still facing an acute

23 KD Raju “Small and Medium Enterprises (SMEs): Past, Present and Future in India”
shortage of capital. It needs more pumping of money into capital investment for further growth and competitiveness of SMEs.

The Small Industries Development Bank of India (SIDBI) as mentioned before was established mainly to be the principal financial institution for promotion, financing, development of industry in the small sector and coordinating the financial activities of other institutions engaged in similar activities, has not proved to be sufficient to meet the requirement of SMEs in India. This can be mainly attributed to the governmental controls on the banks.

The main identified sources of finance to SSI units are:

- Public Sector/Commercial banks
- State Financial Corporations
- Small Industries Development Bank of India
- Informal sources

Out of these financial resources, banks are a preferred source of financing by virtue of their better reach and accessibility. Two-thirds of the small entrepreneurs meet financial requirements from their own funds and informal sources. They have to resort to other sources of finance because raising finance from the financial institutions has the following draw backs:

- The rate of interest charged is higher
- Insufficient collateral
- Restrictive and conditional working capital limits
- Time consuming and cumbersome procedures
- Indifferent attitude of the branch manager/staff
- Non-availability of assistance at banks for completion of forms and formalities
- The terms of credit are hard
- Improper assessment of requirements
- Arbitrary curtailments of credit limits
- Repeated and time consuming visits to banks
- Release of limits sanctioned in installments
B. Marketing

Next to finance, marketing is the big problem area for small entrepreneurs. The survival of small entrepreneurs very much depends on sound marketing techniques. One of the most important tools in the hands of small entrepreneurs for promoting their sales is low prices coupled with credit to buyers, which give rise to number of problems at a later stage.

Marketing as a profession has not yet developed in the SME sector. Professional agencies are not engaged by small entrepreneurs on account of paucity of funds. The concept of marketing is not known to the majority of small entrepreneurs. For majority, marketing means advertisement or personal contacts. There are many ad-hoc initiatives taken by the Government to promote marketing of products/services of small units but no concrete action plan has been chalked out or targets made.

C. Technological Up-gradation

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

D. Sickness in SSI Sector

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

E. Complicated Procedures and Inspector Regime
One of the major grievances of the small scale sector is that the frequent inspections by multiple government agencies are a source of annoyance. At present, 55 inspectors of different levels are visiting the small scale units, which is a cause of major concern to the small scale units. It is suggested that the government should streamline the inspection procedure. It should also include repeal of laws and regulations applicable to the sector that has become redundant.

Indian SMEs are finding it difficult to sell their products in domestic and international markets because of the increasing competition. To make their products globally competitive, Indian SMEs need to up-grade their technology and put more emphasis on innovation per se. In India SSI Sector manufactures more than 7500 items. Since its inception, it continued to maintain more than 8% growth rate. At present there exist about 3.2 million registered and approximately 6.5 million are unregistered units. Among these units 97% are tiny. These units contribute 50% of production, 40% export and 65% of labor employment in manufacturing sector.

It is estimated that there are 400 modern SME and 2000 rural and artisan based clusters exist in India. These contribute to 60 % of India’s manufacturing exports. Some of the clusters are so big that they produce 70 to 80 % of the total volume of that particular product produced in India. For example, Panipat produces 75 % of the total woolen blankets produced in the country; Tirupur produces 80% of the country’s cotton hosiery.

Despite its importance, the SME sector has long faceted extreme obstacles in accessing finance and markets. Some of these obstacles include inability to access finance and working capital loans from banks, inability to access capital
from other sources, mistreatment by large procurement companies, difficult bureaucratic procedures for registration, and lack of management skills, etc. The increasing availability of cheap foreign imports has further hindered the development of Indian micro, small and medium enterprises. These obstacles have compelled the SME lobbies and the Government of India to develop government intervention to ensure the continued growth and success of SMEs.

The problems faced by the SMEs, particularly in accessing technology and maintaining competitiveness have been formidable. It has been found that sharing of information at local and national clusters are mostly informal. Information regarding the latest development and competency understanding is much less. Work sharing is not seen in the local and national clusters, as it is a fight for the same customer, in the same market.

Even though the product and technology used by the entrepreneurs are similar, the tendency to share is less among the cluster participants. The concept of cluster development offers new insights into the potential role of SMEs, in enhancing their access to new technology. Characteristics of a successful cluster are inter-firm cooperation, cooperation blended with competition, the importance of local value systems, flexibility and innovative capacity, geographic proximity, sectorial specialization, a local pool of skilled labor and the presence of a large number of firms. It also includes willingness to work together to resolve potential clashes of interest, widespread entrepreneurial spirit and ability, promotion of a social compromise.

SMEs find it difficult to match the wage rate, job security and career development opportunities, available in larger organizations and therefore are not in a position to hire skilled and competent manpower. Often, as a result a bottleneck is developed in the SME organization, it may result in just one or two people controlling the organization, whether at the decision making level or at the operational level. Even in moderately large sized firms employing several
hundred workers, these bottleneck points seem to exist. The decision makers at the bottleneck points are obviously busy people. They must handle many day-today problems that demand immediate attention, e.g., payroll, inventory, finances, personnel, suppliers, and customer demands. These problems must be solved quickly, or the company will be unable to function. Clearly, there is little chance for them to think about making major changes or risk taking, which is essentially required for innovation process.

Small traditional enterprises, with poor support system and little exposure face difficulties in the new e-business environment. SMEs are usually diffident about adopting IT or solutions based on it. Limited human resources, especially those familiar with IT or corresponding backend processes, place these SMEs in an unfavorable position and in an ecommerce environment where the preferred physical channels of distribution and delivery still favor large enterprises. Further, adding to the limitations of SMEs is lack of formalized contractual relations and the reliance on cash payments.

Today organizations are knowledge based and their success and survival depend on creativity, innovation, discovery and inventiveness. An effective reaction to these demands lead to innovative change in the organization, to ensure their existence. The rate of changes is accelerating rapidly, as new knowledge idea generation and global diffusion are increasing. Creativity and innovation have a bigger role in this change process for survival.
Conclusion and Recommendations

Many countries counted on SMEs as a central and main pivot of development until it became one of the most powerful tools of socio-economic development programs. It is considered as one of the most strategic elements in the growth and development processes in developed as well as developing countries. The study reflects a plenty of learning lessons and success stories of SME in India.

The banking reform in India has begun since 1969. An integrated system is followed by having a special entity, Ministry of Micro, Small, Medium Enterprises, has taken the responsibility of coordinating and amalgamating all policies and programs to follow a promising strategy and achieve the National entire objectives. Reserve Bank of India is raising directions to all Banks to be followed in terms of allocating 40% of the finance at banks to SME annually. In case of not covering the allocated percentage, the reserve bank direct the remaining to finance one of the priority sectors like agriculture and textiles with interest rate never exceed 3 – 4%.

Banks are providing non-financial services, training and advisory services, in a free of charge bases to the entrepreneurs via specialized training and consultancy institutions. A separate National Commission for bringing about improvement in productivity of SME Sector in the Unorganized / Informal Sector also constituted. SIDBI has been established as the Apex Institution for promotion, financing, and development of Small Enterprises.

Egypt as well as other developing countries tended to encourage and support SMEs as one of the quick solutions to address the problems of unemployment and poverty alleviation to achieve comprehensive development. Given the current circumstances facing the Egyptian economy as the prolongation of deficit in the state budget, economic and social development is the only way to counteract these imbalances. Small and Medium Enterprises (SMEs) as well as microfinance sector in Egypt represent the greatest share of the productive units
of the Egyptian economy, there are around 2.5 Million which representing 75% of the total employed workforce and 99% of non-agricultural private sector establishments. Despite the economic importance of SMEs, access to finance represents one of the most significant challenges for entrepreneurs and for the creation, survival and growth of small businesses.

Shove steps have been taken to enhance and facilitate access to finance for SMEs sector in Egypt by CBE, such as the exemption of the reserve requirement with the proportion lent to the sector as well as conducting the National SME Census in Egypt to provide timely and accurate data about the sector to support bankers toward better planning to boost SMEs. In spite of that, the Indian model could be replicated in Egypt especially post 25th of January revolution to assist in economy revival.

**Policy Implications and Lessons learned for Egyptian SME sector**

- Applicable Strategy for SME in Egypt is extremely important with a promising vision and clear action plan;
- A unified definition should be adopted among the banking sector to have common understanding and measurement for encouraging access to finance for SME in addition to formulating the appropriate incentive packages and directions via the Central Bank of Egypt;
- Programs for changing banks' management as well as entrepreneurs mindset to get engaged in the concept of developing SMEs sector;
- Establish sole entity, Ministry- Council-Authority, to deal with SMEs responsibilities :"Strategy and Policies";
- Specialized Bank for Small and Medium Enterprises is also suggested to be handled as a mechanism to provide appropriate SME financial services in addition to specialized sector at the entire banks for financing SMEs;
- Mandates to be set by Government and Central Bank of Egypt to enforce the environment towards “Banking” with SMEs and setting “Priority” sectors and cluster industries;
Various financing products & services have to be developed to cover most of the promising economic sectors such as agriculture, manufacturing, etc.

A similar organization has to be established like SIDBI as the Apex Institution for promotion, financing, guarantee schemes and development of Small Enterprises;

Adopt the cluster approach for SMEs to encourage the sector and facilitate finance by banks to be able to provide a full banking services to recognized SMEs clusters;

Support banks to develop adequately viable SME risk management and credit scoring mechanisms;

Encourage initiatives of financial inclusion and promulgate the significance of such initiatives among banks as well as entrepreneurs;

Conduct awareness campaign and building capacities of entrepreneurs and bankers through specialized institutes in SME issues;

Adequate methods of imparting flexibility to the overall SME policy and programs;

Assign rewarding advantages to well-performing Banks and entrepreneurs;

Create funding facilities for innovation and technology upgrading; and

Linkages between banks and industrial centers for supporting technologies such as "IMC".

EBI can play a vital role of providing technical, managerial, marketing and financial advisory services to the entrepreneurs to be bankable and succeed in business. Since EBI is considered the training arm of the CBE, it provides SME database in addition to its continuous development in assisting planners and policy makers at banks to enable them set the reinforcing procedures to support facilitating access to finance as well as conveying guidance and incentives packages from CBE to banking sector to extend the financial services to this segment.
References


[10] Conference paper on SMEs in logistics: Bringing value to the changing Indian landscape, 2009


[13] Increasing Returns and Economic Geography, Paul Krugman (Krugman 1991), Massachusetts Institute of Technology
EBI Contacts

Headquarters
Nasr City
22A Dr. Anwar El Mofty St., Tiba 2000 Bldg, Nasr City, Cairo
Tel.: (+202) 24054472
Fax: (+202) 24054471  P.O. Box: 8164 Nasr City

Auxiliaries

MOHANDESEEN
56 Gameat Al Doual Al Arabia St., 10th and 11th floor, Mohandeseen, Giza
Tel.: (+202) 33363594 / 97 - 33386436 / 51
Fax: (+202) 33363592

ALEXANDRIA
3 Mahmoud Azmy St., Formerly Tosson St, Central Bank of Egypt Bldg
Tel./ Fax: (+203) 4878745

PORT SAID
23 Gomhoria St., Central Bank of Egypt Bldg
Tel./ Fax: (+2066) 3329553

SME UNIT: 24054472  Mobile: 010000 41499 Email: SMEunit@ebi.gov.eg

www.ebi.gov.eg