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# STRENGTHENING SMES TO MAKE EXPORT COMPETITIVE

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## ABSTRACT

The importance of SMEs in any economy cannot be overlooked as they form a major chunk in the economic activity of nations. India has nearly three million SMEs, which account for almost 50 per cent of industrial output. However, SMEs which form the backbone of industrial development in India are not export competitive and contribute only about 34 percent of exports. It is this feature of the SMEs that make it an ideal target to realize its potential export competitive. Drawing from the experiences of countries that have successfully promoted the export competitiveness of SMEs, this paper has identified ways in which SMEs in India can have an access to external markets through exports, which include simplification of procedures, incentives for higher production, preferential treatments to SMEs in the market development fund, linking up SMEs with Transnational Companies or large domestic exporting firms; and formation of clusters and networks in order to reinforce their external competitiveness.

**Key Words:** Small and Medium Enterprises (SMEs), SWOT Analysis, Export, India.

## INTRODUCTION

The Small and Medium Enterprises (SMEs) play a vital role in the industrial development of any country. The importance of the SME sector is well recognized worldwide due to its significant contribution to gratifying various socio-economic objectives, such as higher growth of employment, output, promotion of exports and fostering entrepreneurship. India has nearly three million SMEs, which account for almost 50 per cent of industrial output. They are an essential employment-generating sector with 50 per cent of the private sector employment and 30–40 per cent of value-addition in manufacturing. They produce a diverse range of products (over 8000), including consumer items, capital and intermediate goods. However, SMEs in India which constitute more than 80 per cent of the total number of industrial enterprises and form the backbone of industrial development are not export competitive and contribute only about 34 per cent of exports.

Keeping this in mind, this paper makes a modest attempt to identify ways in which SMEs can have an access to external markets through exports. The present study is structured into four parts. The first part besides highlighting the current scenario, makes a SWOT analysis of SMEs in India, the second part examines the potential of Indian SMEs and constraints faced by them to become export competitive, the third part assesses the experiences of countries that have successfully promoted the export competitiveness of SMEs, and the final part suggests the policy recommendations to be addressed by the government, the private sector and the international community to make SMEs in India export-competitive.

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## **CONTEXTUALIZATION OF SMEs**

SMEs have been defined on the basis of various criteria such as the number of workers employed, volume of output or sales, value of assets employed, and the use of energy, etc. Organization for Economic Cooperation and Development (OECD) defines establishments with up to 19 employees as 'very small', between 20 and 99 employees as 'small, from 100 to 499 employees as medium and over 500 employees as large enterprises. However, many establishments in some developing countries with 100 to 499 employees are regarded as relatively 'large' firms. Multilateral Investment Guarantee Agency (MIGA) has recently developed a guarantee program, called the Small Investment Program (SIP) that is specifically designed for SMEs. MIGA defines SMEs, for coverage under this program, as firms with not more than 300 employees, value of assets not exceeding US \$ 15 million and annual sales not exceeding US \$ 15 million.

The European Union defines SMEs as enterprises that have employees of less than 250, with a turnover not exceeding Euro 50 million. In India the SMEs are not well defined. The internal group set up by the Reserve Bank of India has recently recommended that the units with investment in plant and machinery in excess of small scale industries (SSI) limit and up to Rs. 10 cores may be treated as medium enterprises. As per 'Prudential Regulations for Small Enterprises Financing (First Edition - 2004)' prepared by the Focus Group Team of Bangladesh Bank, a small enterprise means an entity, ideally not a public limited company, which does not employ more than 60 persons (if it is a manufacturing concern) and 20 persons (if it is a trading concern) and 30 persons (if it is a service concern) and which also fulfills the following criteria:

- a) a service concern with total assets at cost excluding land and buildings, investing from BDT 50,000.00 to BDT 3,000,000.00.
- b) a trading concern with total assets at cost excluding land and buildings, investing from BDT 50,000.00 to BDT 5,000,000.00.
- c) a manufacturing concern with total assets at cost excluding land and buildings, investing from BDT 50,000.00 to BDT 10,000,000.00.

In many banks, small enterprises are considered as business enterprise where banking financing ranges from BDT 25,000.00 to BDT 500,000.00. Thus the definitions of 'small' and 'medium' sized enterprises differ from one country to another that is very much apparent in Appendix - A. There is every room for defining SMEs from a country perspective as the definition depends on the regulatory environment, economic structure, availability of capital and suitable investment alternatives, employment level and so many other factors.

### **SMES IN INDIA: *CURRENT SCENARIO***

The current scenario of SMEs in India can broadly be discussed in terms of different factors from the point of view of contextualization as follows:

- a) The amount of investment in fixed capital assets,
- b) The extent of employment generation,
- c) The contribution to gross domestic production (GDP), and
- d) Their contribution towards exports.

#### **The Amount of Investment in Fixed Capital Assets**

From Table 1, it is observed that the total number of Small Scale Industries in India has increased from 1.948 million in 1990-91 to 3.572 million in 2002-03. During the same

period, the fixed investment (at current price) has increased from Rs. 35.376 billion in 1993-94 to Rs. 90.450 billion in 2002-03.

Year	Number of Units (in million)	Fixed investment (at current prices) (Rs. in Bn.)	Production (At current prices) (Rs. in Bn.)	Employment (Nos. in million)	Exports (Rs. in Bn.)
1990-91	1.948	N.A	1553.40	12.530	96.64
1991-92	2.082	N.A	1786.99	12.980	138.83
1992-93	2.246	N.A	2093.00	13.406	177.84
1993-94	2.388	35.376	2416.48	13.938	253.07
1994-95	2.571	40.799	2988.86	14.656	290.68
1995-96	2.658	49.620	3626.56	15.261	364.70
1996-97	2.803	54.698	4118.58	16.000	392.48
1997-98	2.944	60.549	4626.41	16.720	444.42
1998-99	3.080	86.106	5206.50	17.158	489.79
1999-00	3.212	72.633	5728.87	17.158	542.00
2000-01	3.312	79.703	6390.24	18.564	697.97
2001-02	3.442	84.329	6903.16	19.223	712.44
2002-03	3.572	90.450	7420.21	19.965	860.12

**Table 1:** Time Series Data for SSIs in India

**Source:** Development Commissioner (SSI), Ministry of Small Scale Industries, Government of India.

This significant rise in the number of SMEs reflects:

- It has been comparatively easier to establish a small and medium enterprise as it requires a relatively less amount of investment both in fixed and flexible capital assets.
- The small and medium enterprises are growing at a much faster rate and thereby creating potentials for output, employment and exports.
- The scope for their growth has been enhanced greatly due to the adoption of more liberalized policy measures.

### **The Extent of Employment Generation**

The small enterprises sector is a vibrant segment of the Indian Economy which has contributed over 39 percent of the industrial output and 34 percent of the nation's exports and provided employment to over 19.965 million persons through 3.572 million units (2002-03) spread both in the urban and in the rural areas of India. It has been estimated that 100,000 rupees of investment in fixed assets in the small-scale sector generates employment for four persons.

Along with agriculture, the SME sector provides the largest employment generation potentials in the country. During 2003-04 the small sector registered a growth rate of 8.6 percent as against 7.0 percent for overall industrial growth. The significance of SMEs in employment generation can be noted that while in 1990-91 the sector provided employment opportunities to around 12.53 million of people which over the decade has gone up to 18.56 million in 2000-01 and to 19.96 million by 2003-04. In a steady growing populated country like India this huge contribution to the tune of almost 80 percent in fifteen years is definitely a significant benchmark in the growth process.

### **Contribution to Gross Domestic Product**

By analyzing the SMEs' contribution to the GDP for the period 1990-91 to 2003-04, it is noted that in the year 1990-91 the GDP from this sector was Rs.68295 crore (at Constant

1993-94 prices) which has increased to Rs.184428 crore in 2000-01 and further to Rs.228730 crore (constant prices at 1993-94) reflecting an overall growth rate of 3 times a decade and 4 times in fourteen years, though in terms of percentage their share has been reduced from 14 to 8 of GDP for the same period.

### **Contribution to Export Performance**

SSI Sector plays a vital role in India's present export performance. About 45%-50% of Indian Exports are contributed by this sector. Direct exports from the SSI Sector account for nearly 45% of total exports. Besides direct exports, it is estimated that small-scale industrial units contribute around 45% to overall exports. The SMEs' contribution has gone up from Rs.13883 crore in 1991-92 to Rs. 69796 crore in 2000-01 and to Rs. 86013 crore in 2002-03 (Table 2) with respect to exports. In terms of percentage, the share of SSI in Indian exports has raised from 31.5 in 1991-92 to 34 in 2002-03. It is this inter-sectoral transformation which is a significant reason for the present study.

Year	Total exports (Rs. in crore)	Exports from SSI sector (Rs. in crore)	Share of SSI (%)
1991-92	44040.00	13883.00	31.50
1992-93	53688.00	17785.00	33.10
1993-94	69547.00	25307.00	36.40
1994-95	82674.00	29068.00	35.10
1995-96	106353.00	36470.00	34.20
1996-97	118817.00	39249.00	33.40
1997-98	26286.00	44442.18	35.19
1998-99	41603.53	48979.23	34.59
1999-00	59561.00	54200.47	33.97
2000-01	202509.70	69796.50	34.47
2001-02	207745.56	71243.99	34.29
2002-03	252789.97	86012.52	34.03

**Table 2:** Growth of SSI exports

**Source:** Total Exports - Economic Surveys – Various Issues

### **SMES: MAJOR COMPOSITIONS AND THEIR SHARE IN EXPORTS**

The small scale industrial sector of Indian economy encompasses almost all of the products (including a large number of services) produced by the Indian industries within the economy. Most of the times the products produced by the small and medium enterprises comprise the intermediary products produced by the large scale industries.

They include:

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

Major sectors contributing to SSI exports include readymade garments (27%), engineering goods (14.5%), chemicals & pharmaceuticals, electronics & computers, and processed foods (11% each).

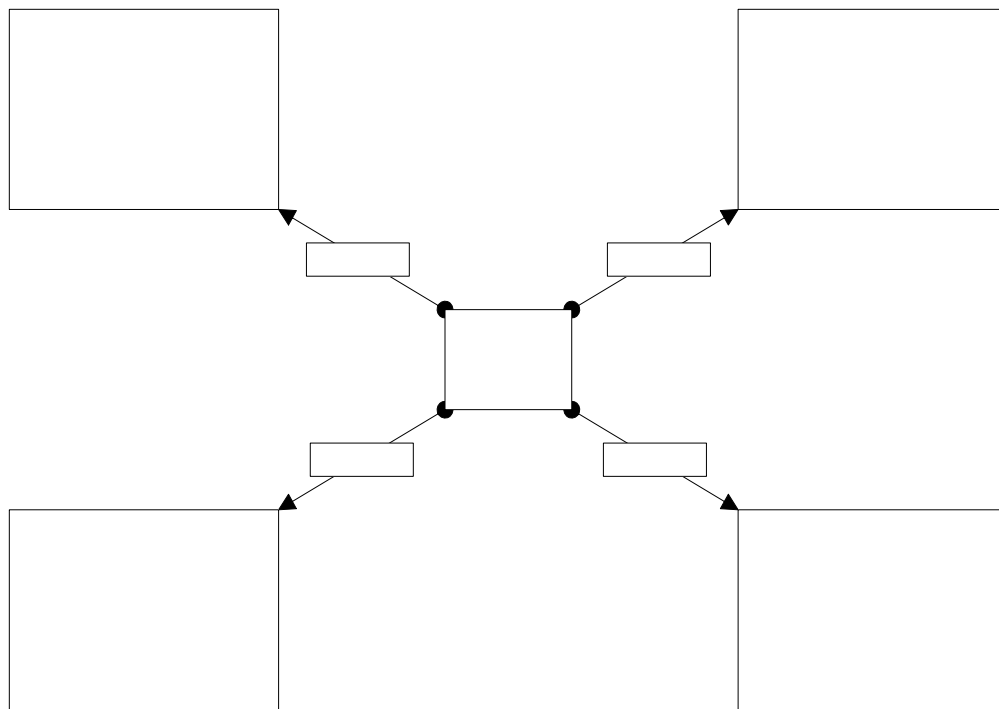
## OUTLOOK FOR INDIAN SMEs

Outlook towards the SMEs is very much important to strengthen it. The premises for such an outlook that is essential for Indian SMEs to combat the challenges ahead, are outlined below:

- a) SMEs continue to be the thrust area for Government policies.
- b) The growing economy and the tremendous market potential of the country promise well for the sustained growth of SMEs in the country.
- c) Avenues for employment and decentralized industrial development.
- d) Latest policy package for SMEs envisages 20 percent annual growth in credit to SME sector from FY 2005, to be doubled by 2010.
- e) With the enactment of MSME Act, the sector is set to emerge as the most vital contributor to the national economy.
- f) SIDBI as the apex institution will continue to play its key role in facilitating timely and adequate credit besides meeting the developmental needs of the sector.

## SWOT ANALYSIS

A detailed SWOT analysis paves the foundation stone for taking strategic decisions. It helps identify the areas where proper care should immediately be taken and at the same time, identifies the areas of competitive edge. In figure 1 below, the respective strengths, weaknesses, opportunities and threats are identified for Indian SMEs that will be a guideline for the policy makers.



**Figure 1:** SWOT analysis of Indian SMEs

## CAN INDIAN SMEs BE EXPORT COMPETITIVE?

In developing countries like India, making the SMEs more export competitive is particularly pressing as trade liberalization and deregulation increase the competitive pressures and reduce the direct subsidies and protection that Governments offer to SMEs. Nevertheless, with their dynamism, flexibility and innovative drive they are increasingly

focusing on improved production methods, penetrative marketing strategies and management capabilities to sustain and strengthen their operations. The capability of Indian SME products to compete in international markets is reflected in its share of about 34 per cent (Table 2) in national exports. In the case of items like readymade garments, leather goods, processed foods, engineering items, the performance has been commendable both in terms of value and their share within the SME sector.

In view of this, export promotion from the SME sector has been accorded high priority in India's export promotion strategy, which includes simplification of procedures, incentives for higher production of exports, preferential treatments to SMEs in the market development fund and simplification of duty drawback rules. They are thus poised for global partnership to absorb and more importantly to impart latest technologies in diverse fields.

### **CONSTRAINTS OF SMEs IN INDIA**

The constraints those come across by the SMEs in India to be export competitive include product reservations, regulatory hassles– both at the entry and exit stages, insufficient finance at affordable terms, inflexible labor markets and infrastructure related problems - like high power tariff, and insufficient export infrastructure. These are briefly elaborated below:

- a) Lack of entrepreneurial, managerial and marketing skills
- b) Bureaucracy and red tape
- c) Lack of accessibility to information and knowledge
- d) Difficulties accessing financial resources/Lack of capital
- e) Lack of accessibility to investment (technology equipment and know-how)
- f) Non-conformity of standardization, lack of quality awareness and lack of mutual recognition schemes
- g) Product and service range and usage differences
- h) Language barriers and cultural differences
- i) Risks in selling abroad
- j) Competition of indigenous SMEs in foreign markets
- k) Inadequate behaviors of multinational companies against domestic SMEs/Lack of government supply-supporting programs
- l) Complexity of trade documentation including packaging and labeling
- m) Lack of government incentives for internationalization of SMEs
- n) Inadequate intellectual property protection

The table above highlights the 14 greatest obstacles to the internationalization of SMEs as identified by UNECE.

### **INDIAN SMEs - STRATEGIC THRUSTS FOR THE FUTURE**

Drawing from the experiences of countries that have successfully promoted the export competitiveness of SMEs, the following section lays down the strategy for Indian SMEs to achieve their export potential and make them increasingly export oriented. Promoting the export competitiveness of SMEs needs the active involvement of various stakeholders – government, the private sector and the international community. This section has addressed policy recommendations for them.

## **ROLE OF GOVERNMENT**

**Creating a business-friendly environment:** The points for the creation and further development of a business-friendly environment enabling SMEs to start exporting, or to help consolidate the activities of SMEs that are already exporting are outlined below:

- a) Combating of corruption and redtapism that hinder the growth and export potential of SMEs.
- b) Creation or reform of administrative and legal institutions in order to guarantee SMEs a stable legal framework in which to operate, and to facilitate an anti-monopolistic and competitive business environment.
- c) Delivery of an appropriate public infrastructure, especially in transportation, power, telecommunications and other infrastructure needed to enable domestic and external trade (e.g. testing and certification laboratories).

**Measures to improve SMEs' access to finance:** This may include,

- a) Providing credits directly from state owned banks to SMEs;
- b) Liquidity incentives to commercial banks that provide loans to SMEs (lowering of reserve requirements, access to discount lines, etc.);
- c) Interest rate subsidies;
- d) Guarantee programs; and so on and so forth.

**Measures to encourage TNCs to create linkages with SMEs:** Provided the local suppliers' capacities are sufficient to meet the needs of foreign investors efficiently, these measures include:

- a) Prescriptive measures like high tariffs on imports or local content requirements, Incentives: benefits such as tax exemptions, the possibility to treat costs related to linkages formation as tax-deductible expenses and granting foreign investors a special status that entitles them to various types of fiscal or financial incentives.
- b) Contractual arrangements with foreign investors, such as privatization transactions and license concessions.

**SME trade promotion through public-private partnerships:** Governments may approach domestic and foreign large corporations to design specific institutions or tools to provide exporting or promising SMEs with specific services. Such partnerships can take various forms, including:

- a) Training facilities,
- b) Technology upgrading centers,
- c) Research and testing labs,
- d) Scientific hubs,
- e) Investment funds,
- f) Incubators, etc.

## **ROLE OF PRIVATE SECTOR**

A wide range of measures could also be considered at the B2B level to boost the export capacities of SMEs in India. Key factors and possible measures include:

**TNCs:** In manufacturing, TNCs and their foreign affiliates can do more to drive or guide the competitiveness upgrading of selected local SMEs suppliers and subcontractors.

**Clusters:** SMEs should be encouraged to work in a cluster environment ensuring complementarities, common activities, collective goods and institutional stability. This strategy requires sector specific actions, aimed at increasing the competitiveness of the cluster, promoting networks and cooperation amongst firms.



National governments, local authorities, TNCs and SMEs associations should be involved in efforts to identify the optimal division of labor among individual SMEs, large firms and central/local governments in developing countries so as to enable duplication of the successes of the best exporting SME clusters and industrial districts (like those in Italy and Taiwan).

**Financial and non-financial business development services (BDS):** Smooth access to financial and non-financial services can play a role in supporting some SMEs aiming at exporting or to consolidate regular foreign orders.

**Combination of financial and non-financial support services:** The rigid separation between financial and technical service providers should be reduced to improve proximity to the real multi-level needs of SME exporters. The combination and teamwork of financial and technical services should be much more systematically explored both by banks and by BDS providers to match SME export needs.

#### **ROLE OF INTERNATIONAL SOCIETY**

**TNCs' business linkages for exporting SMEs should be part of the UN agenda:** TNCs and other large firms could play a more driving role in enhancing local SME development, and SME export competitiveness in particular, through various forms of FDI and business linkages.

**National policy versus international commitments:** An important issue is the choice between incentives and subsidies for exporting SMEs, their compatibility and legality with existing international agreements needs further exploration.

**SMEs' access to finance:** The international community should play a more active role in facilitating SMEs' access to finance. This can be achieved in the following ways:

- a) **Enhancing SME export credit and long-term finance:** Facilitating SME access not only to short-term export credit but also to long-term loans for the expansion of SME export capacity. The issue of credit collateral and guarantees should be revised. Foreign buyers, TNCs and other business linkage makers should be invited as facilitators or guarantors.
- b) **Coordination between financial and non-financial support institutions:** Agreements with selected financial institutions to enable SMEs to quickly access medium- to long term finance at preferential interest rates; and export development and investment funds (EDIF) designed to improve the export competitiveness of SMEs at low comparative interest rates.

#### **CONCLUSION**

SMEs which constitute more than 80 per cent of the total number of industrial enterprises and form the backbone of industrial development in India now are not export competitive and contribute only about 34 per cent of exports. Boosting the contribution of small and medium enterprises in total exports of India is vital to India's future economic growth, which can be promoted in the following manner:

- a) Independent SMEs specializing in specific niches and highly profiled productions; SMEs that link up with TNCs or large domestic exporting firms; and SMEs that are part of clusters and networks in order to reinforce their external competitiveness be encouraged.
- b) Special emphasis should be put on linkages between TNCs and SMEs as a way to enhance the export competitiveness of SMEs. Linking up with TNCs is increasingly perceived as a way for SMEs to solve their traditional problem of access to certain

critical resources, the most important of which are finance, technology and managerial skills, as well as to new markets.

- c) Policy intervention for SMEs could be particularly export-effective when it is based on the Triple C (Customer oriented, Collective and Cumulative)

However, it is also essential to create and sustain a business environment that reinforces the international competitiveness of the export sector as a whole. This can be achieved by active collaboration between governments, the private sector and international agencies with a view to reaping the significant potential benefits of exports through SMEs.

## Appendix – A Definitions of SMEs

### **World Bank**

Micro-enterprise: up to 10 employees, total assets of up to \$100,000 and total annual sales of up to \$100,000; small enterprise-up to 50 employees, total assets of up to \$3 million and total sales of up to \$3 million; medium enterprise-up to 300 employees, total assets of up to \$15 million, and total annual sales of up to \$15 million.

### **Albania**

Micro-enterprises: < 10 employees;  
Small enterprises: 10-40 employees.  
Medium-sized enterprises: 50-250 employees.

### **Azerbaijan**

Small enterprises: < 50 employees in industry; < 15 employees in transport; < 25 employees in construction; and < 10 employees in retail trade and servicing.  
Medium-sized enterprises: 51-250 employees in industry; 16-75 employees in transport; 26-150 employees in construction; and 11-50 employees in retail trade and servicing.

### **Bulgaria**

Small enterprises: < 50 employees and max. assets in balance sheet BGL 20 million.

### **Belarus**

Small enterprises: < 200 employees in industry with maximum annual turnover < Rbl 20 million; < 100 employees in innovation with maximum turnover < Rbl 5 million; < 50 employees in construction and other production spheres with max. turnover < Rbl 5 million; < 50 employees in catering and public services with max. turnover < Rbl 2 million; < 25 employees in retail trade; and < 25 employees in other non-production spheres with max. turnover < Rbl 1.5 million.  
Medium-sized enterprises: No definition exists.

### **Hungary**

Small enterprises: 11-50 employees; maximum turnover < HUF 500 million and maximum balance sheet total < HUF 200 million.  
Medium-enterprises: 51-250 employees; maximum turnover < HUF 2 billion and maximum balance sheet total < HUF 1.25 billion.

### **Uzbekistan**

Small enterprises: < 300 employees.  
Medium-sized enterprises: 300-1,000 employees.

### **Malaysia**

Annual sales turnover no exceeding RM25 million and fulltime employees not exceeding 150.

### **EU**

Micro-enterprises: < 10 employees;  
Small enterprises: 10-49 employees with maximum turnover up to 7 million euros.  
Medium-sized enterprises: 50-250 employees with maximum turnover up to 40 million euros.  
Maximum balance sheet total is 5 million for small euros and 27 million for medium size enterprises.

### **Latvia**

Small enterprises: < 25 employees; max. turnover < Lats 200,000; and max. balance sheet total < Lats 70,000.

### **Lithuania**

Small enterprises: < 50 employees and max. turnover < litas 500,000.

### **Moldova**

Micro-enterprises: with employees < 20;  
Small enterprises: with employees between 20 and 75 persons. Medium-sized enterprises: No definition exists.

### **Romania**

Small enterprises: 1-20 employees and turnover between LEI 10 million and 2 billion.  
Medium-sized enterprises: 21-200 employees and turnover between LEI 10 million and 2 billion.

### **Russian Federation**

Small enterprises: < 100 employees in industry and construction; < 60 employees in agriculture; < 60 employees in science; < 50 employees in wholesale trade; < 30 employees in retail trade and household services; and < 50 employees in other production and non-production spheres.  
Medium-sized enterprises: No definition exists.

### **Estonia**

Small enterprises: < 80 employees and max. turnover < EEK 15 million.

### **Tajikistan**

Small enterprises: < 50 employees in industry and construction; < 15 employees in other economic spheres.  
Medium-sized enterprises: No definition exists.

### **Ukraine:**

Small enterprises: < 200 employees in industry and construction; < 50 employees in other production spheres; < 100 employees in science; < 25 employees in non-production spheres; < 15 employees in retail trade.  
Medium-sized enterprises: No definition exists.

**Source:** Compiled from UNECE (2002), "Definition of SMEs in Countries in Transition", World Bank website, and SMI Business Directory 2002 of Malaysia.)

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