

Thursday, Aug 25, 2022



Report of the Expert Committee on Small Enterprises

**Chairman
Abid Hussain**

New Delhi
January 27, 1997

Chairman's Introduction

I. THE CASE FOR POLICY INTERVENTION TO PROMOTE SMALL SCALE ENTERPRISES

- [1.1 Introduction](#)
- [1.2 The Factor Price Distortion Argument](#)
- [1.3 The Distribution of Income Argument](#)
- [1.4 Other Reasons for Promoting SSEs](#)
- [1.5 The Need for Selectivity in SSE Promotion](#)
- [1.6 Conclusions](#)

II. POLICIES TO PROMOTE SMALL SCALE ENTERPRISES

- [2.1 General and Pervasive Policies to Encourage SSEs](#)
- [2.2 Policy of Reservation for the Small Scale Sector: A Critique](#)

III. THE EXISTING POLICY, INSTITUTIONAL AND LEGAL FRAMEWORK

- [3.1 Definition and Scope of Small Industry](#)
- [3.2. Policy Framework](#)
- [3.3 Incentives for Small Scale Enterprise Development](#)
- [3.4. Institutional Credit to Small Scale Industry Sector](#)
- [3.5. Institutional Framework for SSI Support](#)
- [3.6. State Level Institutions](#)
- [3.7. District Industries Centres \(DICs\)](#)
- [3.8. Summary](#)

IV. STRUCTURE, GROWTH AND PRODUCTIVITY OF THE SMALL SCALE SECTOR: AN OVERVIEW

- [4.1. Size of the SSI Sector: Employment](#)
- [4.2. Size of the SSI Sector: Value Added](#)
- [4.3. Growth Rate](#)
- [4.4. The industrial composition of SSI and its change over time](#)
- [4.5. Size Structure within the Small Scale Sector](#)
- [4.6. Trends in Employment, Investment and Productivity in the SSI Sector](#)
- [4.7. Spatial Distribution of SSEs](#)
- [4.8. Economic Ratios](#)

[4.9. Conclusions](#)[ANNEX TO CHAPTER IV: STATISTICS ON SMALL SCALE INDUSTRY IN INDIA](#)[INTRODUCTION](#)[MSME-DO DATA](#)[ANNUAL SURVEY OF INDUSTRIES \(ASI\)](#)[DIRECTORY AND NON-DIRECTORY MANUFACTURING ESTABLISHMENT SURVEYS](#)[DATA LIMITATIONS AND ALTERNATIVES](#)[TABLE](#)[V. THE IMPACT OF NEW ECONOMIC POLICY ON SMALL ENTERPRISES IN INDIA](#)[5.1 Capital Markets](#)[5.2. Financial Markets](#)[5.3 Trade Policy](#)[5.4 Transaction Costs](#)[5.5. Business Services](#)[5.6. Technology](#)[5.7. Excise Concessions](#)[5.8. Conclusions](#)[VI. NEW POLICY DIRECTIONS](#)[6.1. Introduction: The premises](#)[6.2. Role of Government](#)[6.3. Reservation Of Products And Investment Limits](#)[6.4. clusters](#)[6.5. financial Support](#)[6.6. Support Services For SSIs](#)[6.7. Infrastructure Development](#)[6.8. Institutional And Legal Innovation](#)[APPENDIX I: POLICY FOR RESERVATION OF ITEMS FOR EXCLUSIVE MANUFACTURE IN THE SMALL SCALE SECTOR](#)[Appendix II: List of Clusters of Small Scale Industries in India](#)[BIBLIOGRAPHY](#)**EXECUTIVE SUMMARY**

- THE PREMISES:** The Expert Group recommends that the guiding principle of the future course of small scale enterprise (SSE) development policy should be their accelerated growth and competitiveness. Hitherto, the accent of small enterprise development policy was infant industry protection predicated on the assumption that new enterprises cannot withstand predatory competition from large companies. Moreover government focus has exclusively been on small-scale industries. The concept of the small-scale sector should now be widened to include small-scale business and service enterprises. The principle of protection of fledgling enterprises at the stage of their formation will remain valid in the future as well. Beyond their initial state of development, incontrovertible evidence exists of the capacity of SSEs to survive competition from large companies in India and elsewhere in the world. SSEs typically survive on the strength of their flexible managements, prompt response to market demands and customised products. SSEs should, therefore be expected to fend for themselves aided by a supportive business environment. A change in the orientation of the policy for SSEs is inescapable since other domains of economic policy in the country have been liberalised.
- MECHANISMS OF PROMOTION:** In consonance with the stated goals of growth and competitiveness of SSEs, the Expert Group recommends that the policy of protection be replaced by promotion as the cornerstone of future policy. Adequate supply of credit, services, technology assistance, infrastructure and low transaction costs are the hallmarks of the proposed strategy for promotion of SSEs. This can be achieved by developing a variety of linkages between enterprises and their support institutions, partnerships between the private sector and the government, greater information flows and by streamlining the legal and institutional framework.

- FOCUS ON CLUSTERS:** The centrepiece of the new approach is an increasing public private partnership in setting up support systems for small scale enterprises. Such public private partnership would thrive particularly in clusters of small scale enterprises. Agglomeration of SSEs is a source of informational economies, accretion of skills and economies in infrastructure development. As a matter of fact, spontaneous growth of over 300 clusters has already taken place in the country mostly unaided by the state. This growth has been fuelled by access to domestic and international markets and cheap labour. However, further progress in clusters is hamstrung by decrepit infrastructure, environmental degradation, technological obsolescence and meagre skills of the workforce. World wide experience confirms that growth in clusters can be buttressed by institutional development, and aided by the abundant provision of services and infrastructure development. The thrust of the future policy for SSEs should be to bolster growth in existing clusters by redirecting current investments in regional development (i.e. backward areas) to such centres of growth which are spreading to less developed regions. The Export Group therefore recommends that state governments identify the existing SSE clusters and then promote new types of organisations which are joint ventures between the state governments or local authorities and business associations in these clusters.
- The Experts Group recommends that the 9th Five year Plan should include funds to be provided for funding and running these organisations on this basis. The Clusters Small Enterprise Associations (CESAs) should be autonomous and the government should only support them if the local business associations are willing to provide some level of matching funding. The level of matching funding would have to differ between different locations depending on the size and strength of clusters.
- DEVELOPMENT ROLES FOR CENTRAL AND STATE GOVERNMENT:** The Expert Group is proposing that policy support must be broadened from the current support of only small scale industries to all small scale enterprises. Historically, the Central government has taken the initiative to foster an array of institutions that have catered to the needs of the small scale industry. Subsequently, the state governments have created an administrative infrastructure to address the needs of the SSEs in the future, therefore, the development of SSEs should be largely the responsibility of state governments. The development of SSEs is an aspect of regional development that is best pursued by state governments. The Central Government's tasks should be confined to policy formulation, legal and institutional development. In view of the expanded coverage of the small scale sector to include business and service enterprises, the Expert Group recommends that the responsibilities of the Department of Small Scale Industries and Agro Related Industries be expanded to cover all small scale enterprises. Accordingly, its nomenclature should now be changed to "Department of Small Scale Industries and Business Enterprises" Other residual tasks such as data collection, linkages between SSEs and universities and co-operation between Indian and overseas clusters can also be the domain of the Central Government. In particular, the Central Government needs to restore confidence in the quality of statistical information currently riddled with contradictions. The Expert Group therefore recommends that the Central Statistical Organisation and the Ministry of Industry form a group to improve the quality of statistical information on small scale industry as well as to identify additional needs of the industry and other users of this information.
- REVITALISING DISTRICT INDUSTRY CENTRES:** District Industry Centres will play a pivotal role on account of the regional focus in small enterprises development. So far they have been ineffective due to administrative overload inflicted by a gamut of regulatory functions. The Expert Group therefore recommends that a completely new look be taken on the functioning of the District Industry Centres in order to make them more promotional rather than regulatory. DICs need to be redesigned as autonomous District Enterprise Promotion Agencies (DEPAs) with participation from business associations, government agencies, banks, etc. DEPAs should help weave a web of relationship between clusters and their support institutions and be the conduits for flow of information for dissemination to SSEs. DEPAs can be supported by local councils which will be forums for participants in SME development such as business associations banks etc, to air their views on contentious issues and to discuss problems. The newly proposed DEPAs must have a special focus on the assistance of tiny units.
- CORPORATION OF GOVERNMENT EXTENSION AGENCIES:** Over the last four decades, the Central Government has sponsored a myriad organisations for the delivery of business services to small enterprises. In recent years, private sector consulting firms have emerged to meet the same needs. Whereas government institutions are either unable to keep pace with modern technological developments or are incapable of prompt delivery, private companies are preferred for their speedy response even though their price is higher. The Expert Group therefore recommends that government extension agencies be corporatised. They should also specialise in a few core activities to develop their competitiveness. Government should facilitate the transition by part funding the corporatised institutions. Similarly, enterprises should have the option of sourcing services from the private sector with part funding from the state. It is recommended that SIDBI open a special window for the funding of technical consultancy organisation and other business support services aimed mainly at small scale enterprises.
- ABOLISH RESERVATIONS:** One of the most important planks of the policy for the development of small scale enterprises has been the reservation of products which can be manufactured only by them. The existence of reservation policy has also provided an illusion to the government and the country at large that adequate protection/promotion was being provided to small scale industries. Past experience leads to the conclusion that reservation does little for the promotion of small enterprises and play only a negative role of keeping out large enterprises. This policy is now inconsistent with the current trade reform which allows the free import of the large majority of goods and most of the remaining consumer goods can be imported under special import licenses. In any case, the large majority of products manufactured by the small scale sector are not reserved at all. Conversely, a large number of reserved products are either not manufactured at all by the small scale sector or their sales turnover is insignificant. On the other hand, the opportunity cost of the reservation policy is extremely high since important sectors like light engineering and food processing have not been able to grow due to the limitations imposed by it. Moreover, the pace of expansion of exports in such important sectors as textiles and leather is threatened because India is unable to supply large enough volumes of adequate quality within the required delivery time. The problem will be accentuated when quantitative restrictions on imports in developed countries, such as those under the MEA, are withdrawn. The Expert Group believes that this is the most powerful argument for the abolition of small scale industry reservations forthwith. The existing small scale units as well as new entrants in these industries must be provided an opportunity to investment in appropriate size and technologies to be able to compete with imports in the coming years. It is therefore, imperative for future export growth to remove such small scale industry reservations so that adequate new investment and technology upgradation take place in these industries and that existing units are allowed to upgrade.

It is on all these considerations that the Export Group has concluded that the policy of reservation be entirely abolished. We have considered the option of a phase abolition

{PAGE 3 OF 246}

in order to give time to industry to adjust. However, in view of the overwhelming evidence that the reservation policy is now serving no purpose in the promotion of the small scale sector, we are recommending a complete abolition. However, the government must

make simultaneous transitional arrangements to assist small scale units affected by this dereservation.

- **Transitional Arrangements for Small Scale Industries Affected by Dereservation:** The Expert Group recommends that the Ministry of Industry should immediately set up a joint mechanism between the government and industry representatives to identify specific industries/items in which small scale units are likely to be affected by the proposed dereservation. These are perhaps among the 68 reserved items which accounts for more than 80% of the total value of production of reserved products. Subsequent to this identification the geographical areas where such affected units are concentrated could also be identified. The Expert Group recommends that the government should provide annual resources of the order of Rs. 500 crore over the next five years, thereby totalling Rs. 2500 crore, to the Ministry of Industry for providing the proposed support. These resources would be used to leverage greater resource from SIDBI, banks and other financial institutions to provide concessional funding in terms of equity support an interest rate concession to such units for expansion, technology upgradation, modernisation and training. It is also suggested that, as a transitional measure for a period of 5 years, fiscal concessions may be extended for existing units which manufacture reserved items. For such units complete exemption may be granted upto a turn over of Rs. 50 lakh, partial exemption for turnover between Rs. 50 lakh and Rs. 1 crore. The eligibility turnover limit may remain for these units at Rs. 3 crore.

Raising Investment Limits: First, the definition of the small scale enterprises (SSEs). Incentives, credit facilities, and promotional facilities should then be available to all small scale enterprises. To begin with, the concept of the SSE sector, should include all business enterprises in the service sector which provide services to industrial enterprises. Taking into account all these factors, an investment limit provide services to industrial enterprises. Taking into account all these factors, an investment limit of Rs. 25 lakh for tiny units is adjudged to be most appropriate. For small scale enterprises, the there should level should be immediately raised to Rs. 3 crore for the same reasons.

- **Excise Incentives for Graduating Tiny and Small Scale Unites:** Some, modification is required, as already suggested for units that currently manufacture reserved items. Second, some modification may also be made to remove the disincentive for tiny units to grow beyond their investment limits. It is therefore proposed that tiny units which graduate beyond the investment limit of Rs. 25 lakh be permitted a higher total exemption limit of turnover to Rs. 50 lakh, for a period of 5 years after crossing the tiny sector investment limit. Similarly the total turnover limit of Rs. 3 crore may be expanded to Rs. 5 crore after the SSI crosses the proposed new investment limit of Rs. 3 crore, but only for a period of 3 years from such graduation. In order to encourage franchising, ancillarisation and to promote closer complementary links between small scale enterprises and large scale enterprises, it is recommended that excise exemption withdrawn earlier for branded goods should be restored.

• RESTRICTURING OF FINANCIAL SUPPORT

The financial system also need to be reformed to increase access of small scale units to term loans and working capital and to lower the costs of credit. Available evidence suggests that the access of small scale enterprises to credit is generally inadequate. The existing institutional structure for delivering credit to SSEs needs a through overhaul. State Finance Corporations(SFCs) and State Industrial Development Corporations (SIDCs) have suffered from very poor recovery rates. Moreover, they have also been characterised by heavy political and bureaucratic interference in their functioning. Further, as a result of interest rate deregulation and the poor recovery rate of financial institutions lending to SSEs, the cost of credit for small enterprises has risen as they are considered risky propositions. The Government had appointed the Nayak Committee to review the credit requirements of SSEs. The Expert Group endorses the recommendations of the Nayak Committee and urges the RBI to implement them. In particular, all effort must be made to achieve the prescribed target of providing working capital of a minimum of 20 percent of the projected turnover of small scale enterprises.

- **Restructuring of SFCs and SIDCs:** It is necessary that the distinction between term lending and working capital institutions be done away with and banks and SFCs increasingly get into making composite loans. The Expert Group recommends that the IDBI in association with SIDBI devise a new scheme to revitalise SFCs and SIDCs. The approach should be to make these institutions autonomous by reducing government equity to less than 50%. The rest of equity could be held by other financial institutions, commercial banks, private banks, including industries and other private interests which have particular interest in the specific states.
- **Specialized Commercial Bank Branches and Local Area Banks:** The Expert Group further endorses the plan for local area banks and specialised branches of commercial banks to service the needs of SSEs. A special emphasis should be given to this scheme so that special training for appraisal, evaluation and monitoring can be given to the staff in these branches. These local area banks can become the storehouses of information about credit risk of investment in small enterprises in their region. The costs of credit will decline if banks and financial institutions can increase the rate of recovery of loans. Therefore, the mechanisms for credit recovery should be strengthened by community guarantees, credit rating and creation of data bases on the credit record of companies. Now that commercial banks are also allowed to do term lending, these special branches must provide term loans and working capital to the small scale enterprises within their jurisdiction. The Expert Group recommends that the Reserve Bank of India should promote the speedy establishment of these local area banks in the districts where SSI clusters have been identified. The Expert Group also recommends that the Reserve Bank of India should initiate action to provide support for special training schemes for the staff of these new local area banks so that appropriate expertise is built up quickly in these new financial institutions. The Expert Group recommends that the Board composition of these LABs would benefit from the participation of representatives from local business associations.
- **Reducing Credit Costs for SSEs: Extending credit ratings Services to SSEs:** The Expert Group recommends that SIDBI in co-operation with the national credit rating agencies should promote the establishment of local credit rating agencies in the identified SSE clusters. This would require some level of equity participation by existing financial institutions including commercial banks and the national credit rating agencies. The government could provide a small seed fund to help in kick starting this process. We, therefore, recommend that cluster associations be allowed to stand as guarantors and their co-operation should be enlisted for this purpose.
- **Other Fundings Sources for SSEs :** Other sources of financial can also be tapped if the 24 percent ceiling on equity participation by large companies and foreign direct investment in SSEs is removed. The national equity fund would function much better if it is disbursed by local base of venture capital funds can be increased considerably if FIs are allowed to invest in them and private pension funds and insurance companies are allowed in the country. The Limited Partnership Act, if it is implemented, would also enable access to an additional source of funds and skills brought forth by management partnerships. The Delayed Payments Acts has not been too effective so far in helping SSEs collect their dues. A more practical approach would be to encourage a bills culture and to expand factoring services. We also recommend that in the annual accounts of large companies, information be

provided on a statutory basis on the extent of accounts payable to small enterprises. The Expert Group recommends that the Department of Company Affairs explore this possibility.

- **Addressing the Credit Needs of tiny Enterprises:** For ensuring that the tiny sector is not bypassed by the commercial banking system, the Expert Group proposes that it should earmark a minimum of 70 per cent of the priority lending allocated to the small scale sector to the tiny sector. To help those entrepreneurs without sufficient collateral towards procuring bank loans, it is suggested that a Revolving Collateral Reserve be created at the intermediary level.
- **INTEGRATED SUPPORT SERVICES:** Support institutions for SSEs in India are largely government owned and do not provide a package of services. International experience suggests that technical assistance, market assistance and information have to be available as a package to have the desired results. Moreover, enterprises should have the choice to access services from the source most suited for them and not just state-sponsored institutions. Government should withdraw from direct delivery and partly fund the cost of services accessed from the most efficient source. Technological support is an obvious need of clusters since they have so far survived on the strength of low prices. The main reason for slow technological progress is that clusters do not have access to related infrastructure for testing, quality control etc. It is, therefore, suggested that assistance institutions preferred by industry. Since small companies cannot by themselves finance large expenditures, research associations will be an effective means to pool together resources for research and development. New technology can be effectively commercialised in incubation centres and science parks. Training of manpower has to also take place to enhance human capability to absorb new technology. East Asian countries have successfully experimented with training schools jointly sponsored by large companies, small companies and the government. Private participation is a more effective means to transfer skills from one firm to another. Tax waivers should, therefore, be available for private sector investments in training institutes.

SUPPORT FOR TECHNOLOGY DEVELOPMENT IN SSEs

- The Expert Group recommends that the government should provide funds to the Bureau of Industrial Standards (BIS) in the Ninth Plan to fund a special exercise for providing technology support to SSEs to achieve prescribed technical standards.
- **Financing for Technology Upgradation :** The Expert Group proposes that the scope of the existing TDMF Scheme of SIDBI which is presently linked to 25% export obligation be enlarged to cover all modernisation proposals including those which involve the improvement of capabilities and competitiveness in the domestic market. Further assistance should be provided out of this fund to support service institutions / enterprises engaged in technology transfer, technology-oriented research and development and the like. To encourage increased availment by SSEs under the scheme, the assistance under TDMF could be provided at a concessional rate of interest. SIDBI and other financial / banking institutions which opt to take up this scheme may be compensated for such soft lending under a Special Revamped Scheme for Technology Development and Modernisation of SSEs. This assistance would be particularly relevant to tiny units.
- **Support for Research and Development:** Once again, the Expert Group is of the view that such services could be provided most effectively through institutions based around clusters of similar industries so that they are able to specialise as well as reap economies of scale. The Expert Group recommends that the government should establish fund(s) at both central and state level in order to design schemes which provide matching funds as incentives to clusters industry associations to establish the required technology support institutions. The Expert Group recommends that the Department of Science and Technology initiates a new scheme in the 9th five-year plan to form R&D associations based around identified clusters of industries which may be identified as those which are in urgent need of technology upgradation. At least 10 such clusters should be identified within the first year and the aim should be to establish at least 50 such industrial R&D associations for assisting SSEs, within 5 years. We recommend that these links between these existing technical institutions and existing industries on the one hand, and with the new proposed technology support institutions could best be forged by the national level industry associations through their members.
- The Expert Group recommends that a **National Research Institute for Small Scale Industries** be established it is proposed that this institutes should be promoted jointly by the central government and apex industry associations.
- **Training:** Technology upgradation in the small scale sector will throw up large requirements for training of entrepreneurs, managers and employees. The Ministries of Industry, Labour and Education should set up a special Task Force to work out the modalities for a special training scheme for SSEs and provision should be made in the Ninth Five Year Plan for the provision of seed capital for this scheme which must be designed to elicit equivalent contributions from the private sector. The Expert Group also recommends that state government should make provision for matching funds to be provided for establishing skills development centres.
- **Marketing Assistance :** The Expert Group suggests that on the lines of Marketing Development Assistance Fund set up earlier in EXIM Bank with World Bank assistance, a fund be created and operated through SIDBI for assisting a targeted SSE exporting units numbering around 5000 in the 9th plan period. The Expert Group also recommends that a suitable mechanism be evolved to promote marketing outlets specialising in marketing the products manufactured by the tiny sector. Efforts may also be made to develop common brand names for such products. We do, in fact, have a few such successful initiatives in India by NGOs like Sarva Shanti Ayog (SASA), Calcutta ad Orissa Rural ad Urban Producers' Association (ORUPA). Franchising must be promoted as a concept.
- **INFRASTRUCTURE DEVELOPMENT IN CLUSTERS:** In the future, integrated development of infrastructure will be essential in industrial estates. Moreover, the convenience of doing business in industrial estates can be considerably enhanced if they are supported by high quality services. The Expert Group therefore recommends that both central and state governments redirect their existing growth centre and other infrastructure development schemes to the infrastructural development of existing SSE cluster. The Expert Group recommends that the private sector be encouraged to develop industrial estates as infrastructure projects. The State should form State Industrial Park Authorities to facilitate the entry of the private sector. These agencies would have to formulate the regulatory framework for entry of the private sector into industrial park Authorities to facilitate the entry of the private sector. These agencies would have to formulate the regulatory framework for entry of the private sector into industrial parks. Government should also share the risks of large investments in infrastructure to facilitate their rapid development. The decayed industrial centres in some of the major industrial cities can be reused for the development of SSEs. A major source of delay in the implementation of infrastructure projects is the acquisition and sale of land so obtained. This problem can be solved if landlords are granted development rights to benefit from the upside potential of project development. Government can also contribute land in its possession in lieu of its share of equity in infrastructure development projects.

- **Business Associations As Partners:** The participation of business associations is critical if private investment in infrastructure is to be successful. Recent experience suggests that progress in infrastructure projects is often stalled because of conflict of interest issues. Greater participation of business associations will help to avert such problems. In recent times, some business associations have shown an inclination to participate in social projects and this should be encouraged by the Government. The government, particularly at the state level must initiate action to activate the city / cluster level business associations so that they can participate actively in the many activities recommended in this report. The Expert Group recommends that the Ministry of Industry should initiate a programme of technical assistance from the European Union or other bilateral sources to bring this about.
- **INSTITUTIONAL N LEGAL INNOVATION:** The Expert Group recommends a separate law for small enterprises. The objective of the law would be to define the small enterprise sector and outline the broad framework for the promotion of the sector. A new single business law called the "**Basic Law for Small Enterprises**" should be enacted.
- **End To Inspector Raj:** A major restructuring of social legislation is essential to lower the transaction costs of doing business for SSEs. Currently, the inspector raj thwarts small enterprise. The single law for small enterprises should help to reduce the number of officials visiting factories. Furthermore, employers should have the option of voluntarily paying a charge for medical insurance an public provident fund in exchange for a waiver from corresponding public schemes. Similarly, the labour laws should be waived for enterprises employing up to 50 workers with power and 100 without power if employers agree to pay for unemployment insurance. To the extent that certain kinds of social and regulatory legislation is necessary for social welfare, a certain amount of inspection would have to continue. The Expert Group recommends that transparency be introduced in such inspection arrangements. Inspectors for different laws could be "clustered" and then inspection of units made on an open random basis, on random drawing of units in defined clusters. Finally, environmental targets should be determined for an entire cluster and business associations held responsible for implementing them in the best manner possible.
- **Monitoring of The New Policy Approach :** Expert Group recommends that the Ministry of Industry set up a Steering Committee under the chairmanship of the Industry Minister to oversee the evolution of the new policy approach suggested.

PREFACE

The Department of Small Scale Industries and Agro & Related Industries constituted an Expert Committee on Small Enterprises in Decembr 1995 (see Annex P. 1)

Shri S.A.T. Rizvi, Development Commissioner, Small Scale Industries, was a member until December 16, 1996 and was then replaced by Shri K.V. Irniraya, who succeeded him as Development Commissioner. Shri J.V. Shetty resigned as Member of the Committee on September 1, 1996 when he retired as Chairman and Managing Director of Canara Bank. Shri Brahm Dutt Joint Secretary, Ministry of Industry was co-opted as member of the Expert Committee effective October 28, 1996

The Expert Committee held a series of meetings at New Delhi and in various state capitals through its existence. The Committee held consultations with representatives of state governments and of industry associations in all the regions of the country. The Committee would like to place on record its appreciation for the hospitality provided by the governments of Tamilnadu, Gujarat and maharashtra for arranging these meetings during its visits. The merchant's Chambers of Commerce, Calcutta, the Indian Merchant's Chamber in Bombay, the punjab Haryana and Delhi Chamber of Commerce and Industry (PHDCCI) in New Delhi, the Tamilnadu Tiny and Small Industry Associations, Chennai, and the Gujarat Chamber of Commerce and Industry, Ahmedabad graciously organised the Committee's interaction with representatives of industry associations in their respective regions and provided warm hospitality. The Committee found its interaction with state government representatives, both at the political and official levels, to be extremely enlightening. We benefited greatly from their practical experience in the promotion of small scale enterprises. The representatives of industry associations provided first hand information to the committee on the problems being faced by small scale enterprises and indications for their solutions.

We would like to record a special debt of gratitude to Dr. C. Rangarajan, Governor, Shri R. V. Gupta, Deputy Governor, Reserve Bank of India an their colleagues for having found the time to meet with the Expert Committee and share their views with us.

I would like to particularly record my appreciation for the generous support given to the Expert Committee through out its existence by Shri Brahm Dutt. Joint Secretary, Department of SSI&ARI in the ministry of Industry. He was ably supported by Shri M. Sahu, Director, Shri Beni Ram, Under Secretary and Shri S.Hariharan, Section Officer in the Department of SSI&ARI.

The Committee was fortunate to receive the assistance from the National Small Industries Corporation (NSIC) in making all arrangements for its visits to Calcutta, Mumbai, Ahmedabad and Chennai. Shri M.Ahmed, Chairman and managing Director, NSIC was extremely generous in placing at the committee's disposal the services of his organisation's staff and resources. We would like to acknowledge the assistance received from Shri Rajiv Bhatnagar, Shri O.P Sharma, Shri N.S. Padmanabhan, Shri S.K. Ahluwalia, Shri H.C. Sharma, and Shri S.P. KAINTH of the NSIC during its various visits.

The Office of the Development Commissioner (Small Scale Industries) is the key organisation at the central level looking after the interest of small scale industries. Shri S.A.T. Rizvi and Shri K.V. Irniraya shared their views and experience with the Committee and generously provided additional support from the staff. We would like to acknowledge the help in particular of Shri C.S.Prasad, Additional Development Commissioner, DC(SS)I and Shri Raju Sharma, Director, who provided specific contributions regarding the existing policy framework for Small Scale Industries Special assistance was also received from Dr. (Mrs.)V.S. Bharucha, Economic Adviser, Ministry of Industry for the work on extreme focus products identified by the Ministry of Commerce.

Secretariat an research support was provided to the Expert Committee by the National Council of Applied Economic Research under the direction of Dr. Rakesh Mohan. In his capacity as member Secretary of the committee Dr. Rakesh Mohan contributed extensively both in terms of ideas and policy initiatives to be undertaken. His interactions with the local industry associations specially contributed towards evoking positive responses from the non officials. His knowledge of economics and the experience in the Ministry of Industry was extremely valuable for the work of the committee. The Expert Committee has deeply appreciated the very scholarly research contribution of prof. Deepak Mazumdar in providing the theoretical base for support of small scale enterprises and in the analysis of the structure and performance of small scale industries. Shri K.R.Pandit has provided meticulous research and overall support to the Expert Committee's work in the NCAER. His particular contribution has been in documenting

the various aspects of policy on reservation of items for Small Scale Industries, Computerisation and software assistance has been provided by Mrs. Kiran Dutta and Shri Ashok Kumar thakur. A special word of appreciation goes to Shri Ajay Kumar Gupta and Shri Rakesh Kumar Srivastava for performing the arduous task of word processing in this relatively large report an organising the collation of its various segments. I would specifically like to thank to Shri Niral Maru of SEBI who made the final production of this report possible through the use of his specialised information technology skills. Mrs. Simi Kumar Chawla provided overall organisational assistance at the NCAER. Shri Kishore Jethanandani has provided us the benefit of his critical, writing and editing skills without whom it would have been difficult to compile this report.

I would also like to acknowledge special contributions by the member of the committee Dr. H.C. Gandhi, Dr. Shailendra Narain and Dr. V.G. Patel provided major contributions in arriving at many of the policy recommendations for credit policies for the small scale sector an special support needed by the tiny sector Dr. Mashelkar has contributed to the ideas regarding the technology upgradation requirements of small scale industries. Prof. J.C. Sandesara contributed to the analysis of structure and performance of small scale industries. I am extremely grateful to all the members of the Expert Group for generously giving their valuable time to the work of the Expert Committee.

It is my hope that this report will contribute to a significant improvement for the policy support required by small scale enterprises in the country. I hope that our recommendations would receive adequate consideration by the government and would be debated widely by the general public.

Abid Hussian

Chairman

Annex p.1

F.No. 13(24)/95-SSI(P)

Government of India

Ministry of Industry

Department of Small Scale industries

and Agro and Rural Industries

New Delhi , 29th December, 1995

ORDER

An elaborate set of policies, programmes an institution has evolved over the past four decades for providing government support for the promotion of small industries in India. The Government have in the meantime implemented a programme of economic reforms including industrial and trade policy reforms whose objectives have been to eliminate bureaucratic control and protectionist measures, allow greater play to the market forces in shaping entrepreneurial decision making and promote competition. Globalisation and change in technology are also emerging as the major forces that will modify and mould the environment for small business an entrepreneurship over the next decade and beyond, Small enterprises in many barriers of the service sector, are fast emerging as provider of employment and contributors to exportdevelopment which necessitates reconsideration of the view that the policies for small enterprise development should concentrate on the manufacturing sector. It is thus, necessary to address the need for reforms in the existing policies and design new policies for small and medium enterprises (SME) development which will facilitate the growth of viable an efficient enterprises that can adjust to technological change and remain internationally competitive.

It has, therefore, been decided to constitute an "Expert Committee on Small Enterprises" which will go into these issues in depth and make is recommendations to the Government. The Committee will consist of the following:

1. Shri Abid Hussain Chairman
(Former Member
Planning Commission)
2. Dr. R.A.Mashelkar Member
Director General
Council of Scientific
And Industrial Research
3. Shri H.C. Gandhi Member
(Former Secretary, Technical
Development, Ministry of Industry
Government of India)
4. Shri J.V. Shetty, Chairman and Member
MD. Canara Bank
5. Dr. J.C. Sandesara, Hony, Professor Member
Department of Economics, University
of Bombay

6. Dr. V.G. Patil, Director Member
Entrepreneurship Development
Institute, Ahmedabad

7. Dr. Sailendra Narain Member
Managing Director
Small Industries Development
Bank of India

8. Shri S. A. T. Rizvi Member
Development Commissioner
Small Scale Industries
Government of India

9. Dr. Rakesh Mohan Member-Secretary
Director General
National Council of Applied
Economic Research

- i. To examine the promotional and protective policies and direct assistance programmes for small industry development, assess their impact and efficacy and in the light of international experience and recent economic policy reforms, suggest appropriate changes with the objective of creating an efficient viable and dynamic small enterprise sector in the Indian economy.
- ii. To review the definitions, legal framework and the heterogenous composition of the small industry sector and make recommendations for bringing about changes as may be appropriate for the realisation of the objectives outlined above, and in particular advise if the different segments of the small firms (such as village industries and modern small industries) may be covered by the same policy package or separate sets of policies may be prescribed keeping in view their different characteristics and requirements.
- iii. To examine the efficacy and desirability of the small industry reservation policy, assess its impact on the growth of small enterprises from the point of view of viability, efficiency, competitiveness and exposure to technical changes and progress and make appropriate recommendations.
- iv. To advise, in the light of international experience, if the small enterprise development policies should be restricted to the manufacturing sector or these should also cover small enterprises in the business and service activities.
- v. To examine the present arrangements and sources for the collection, compilation, dissemination and analysis of the data on small enterprises with a view to assessing their quality, consistency and reliability and make appropriate recommendations.
- vi. To review the present institutional arrangements for the transfer and dissemination of technological and technical information to small and medium enterprises (SMEs), assess the quality of the available advisory and extension services, examine the necessity and possibility of placing these more and more in non-governmental organisations and private service (constancy) sector and make appropriate recommendations.
- vii. To examine the existing institutional arrangement and the policies and programmes for meeting the long term and short term financial requirements of the small enterprises examine their effectiveness, particularly in meeting the requirements of the innovative and technology oriented firms and the first generation entrepreneurs and in the light of the practices followed and instruments adopted in other successful economies, make appropriate recommendations.
- viii. To view the impact of various fiscal policies and tax concessions on small enterprise development examine their role in enabling the small firms to exploit their potential and grow into medium/large enterprises and make suitable recommendations.
- ix. To examine the impact of various regulatory laws and procedures such as the labour laws, the Factories Act, the Industrial Disputes Act and the Environment Protective Act on the small forms and the ability of these enterprises to meet various requirements under these laws and procedures and make appropriate recommendations.
- x. To consider and make recommendations on such other matters as the Committee considers relevant for small enterprise development including changes in legislation where necessary.

The Committee will adopt its own procedure of work and may take evidence from any interested party, as deemed proper. It should submit its report to the Government within three months.

BRAHM DUTT,

Jt Secy.

Chairman's Introduction

The small scale sector occupies an important place in the country's economy. The existence of small scale units is essential to encourage the spread of industrial entrepreneurship throughout the country. It is therefore necessary for the small scale sector to be provided a proper environment for growth an efficiency. The objective of policy for Small Scale Enterprises (SSEs) must be to nurture such an environment.

For setting this objective, it much be recognized that there is an organic growth potential gets developed in the right policy environment, this potential gets developed. Further the imperatives of market and technology enable a healthy small scale operation to grow into a medium scale unit just as a medium scale unit becomes large, and a large national company aspires to emerge a an international business. There will always be industrial activities which are best done in the tiny, small or medium units rather than in large units. An efficient industrial system is so organised that the interlinkages between the small, medium and large sectors are mutually reinforcing and not competitively erosive.

The existing framework of policy support for the small scale sector evolved essentially in the environment of the 1950s an 1960s and then continued until the present time. The economic and social framework was quite different at the these policies were designed. Almost all industrial activity was controlled by the industrial licensing system; trade was controlled through the export import control system; foreign investment and technology were heavily controlled as well. In this framework, since industrial activity depended on the attainment of different government approvals, mostly at the central level, it was particularly difficult for small industries to enter into the industrial sector. At the time same, during the 1950s, and 1960s, during the first two decades after independence there was a great need to encourage entrepreneurship which had been kept dormant during the colonial era, Government activity was also marked by missionary zeal and different kinds of extension activities in both he rural and urban areas were started successfully by government agencies.

In such a framework it was logical to provide support for small scale industries on a protective basis by providing subsidies, concessions, small scale industry reservations and direct government support to SSI units. The basic structure of industrialisation has evolved over time and therefore the policy framework for small scale industry policy needs to change alongwith the new economic and social framework which now exists in the country.

We now have to recognise that government over time has become more bureaucratic and rule bound and can no longer be characterized as mission oriented. Many of the earlier systems for supporting small scale industries have instead emerged as bureaucratic bottlenecks which tend to restrict their growth rather than helping in their entry or in their expansion. The new framework for supporting small scale industries must therefore be much less dependent on the government and be more market oriented. Such a framework should derive support from non official sources and derive its strength from market imperatives.

The basic accent of India's policy for small scale industries has been defensive, aiming to insulate the small-scale sector from the dynamics of competitive growth. In the world of today, such insulation is not practicable.

To begin with, the definition of a small-scale unit is in financial and not economic terms. Not only is that definition misplaced but in these times of inflationary pressures it soon becomes meaningless as assets become more and more expensive. In fact, a common practice, as a consequence, consists of dividing up assets between different small units. Indeed, quite often these latter exist only on paper undermining the futile basis of such policy.

Again, instead of focusing on areas that should be the province of the small scale sector by economic rationale, the SSI policy has traditionally concentrated on exclusive reservation of activities for this sector. In this process, it has lost sight of the simple but determining logic of a market system that it can not make business sense for a large company to do anything that can be done more competitively by a small unit. A policy of exclusive reservation for small-scale industry therefore is at best unnecessary and at worst inefficient.

Much of the existing policy framework was designed to assist individual units. These units were seen as free standing units with little relationship to others. Thus direct services were provided to individual units through government agencies, through fiscal incentives, and through financial subsidies. With the success of many of these measures the small scale sector has expanded greatly and it is no longer possible for the government to provide direct individual assistance in the way that has been done in the past. With the changes that have taken place in economic policies since 1991 many of the older restrictions no longer exist. Few clearances are required from the central government level. Consequently some of the biases against small scale industries have been removed. A great deal of entrepreneurship has emerged in the country. They now need to be nurtured for growth. The new policy framework must recognise this new economic environment and should now be designed to be much more promotional rather than protective.

India being such a large country the existing centralised approach can no longer be effective. The states will now have to handle most of the programmes of policy support for small scale industries. In addition, states also have to recognise the existence of concentrations of small scale units in readily identifiable areas and design their support programmes accordingly.

Small scale enterprises will continue to need exceptional support in terms of financial resources, technological development and infrastructure. It is much easier to organise such support systems in clusters where industries of similar characteristics exist together to reap the benefits of agglomeration economics. State governments will have to explore innovative ways of creating public private partnership with industry associations, business associations, and others to provide the kind of support that small scale industries need. The Expert Group's recommendations have been based on this general view of the small scale sector.

This report presents a comprehensive analysis of the economics of small-scale industries in general terms, followed by a detailed look at the Indian case. In Chapter 1 the basic theoretical case for policy interventions to promote the development of SSE's is presented having regard to the working of factor markets in developing countries. The general directions of interventions suggested by this analysis are outlined in Chapter 2 and the need to move away from the traditional Indian policy of reservation is stressed.

We have then examined the Indian experience in terms of policies and outcomes. Following a discussion in Chapter 3 of major policy measures adopted to help SSEs in India, Chapter 4 draws on a variety of available statistical sources to present a comprehensive view of the SSE sector in India, and how it has evolved in the last three decades. We discuss the size and growth of the SSI sector, its regional distribution, as well as the evidence on its relative efficiency. The next chapter traces the implications of the new economic environment for SSIs and provides pointers to the kind of policy changes that should be made in Chapter 6 we provide an analysis of the shortcomings of the existing policies and recommend the new directions that policy for small scale enterprises should take.



I. THE CASE FOR POLICY INTERVENTION TO PROMOTE SMALL SCALE ENTERPRISES

1.1 Introduction

The arguments advanced in the literature for promotion of small-scale enterprises (SSE) involve both certain desirable characteristics of such enterprises (e.g. their labour intensity and related positive distribution effects, their flexibility, their potential contribution to decentralization, their promotion of entrepreneurship etc.) and a common belief that that under normal market conditions either too few, or the wrong combination of resources will be employed in such enterprises it is important to distinguish between the reasons why one hopes to see a flourishing small scale industry (SSI) sector (having to do with its positive features) and the need for sector specific support programs. Such programs are necessary if and when market imperfections may impede the sector's full flowering in the sense that the size of the sector is below the 'optimum' which might be reached in the absence of such imperfections. If markets and more general policies worked adequately, SSI might live up to its potential without any special support programs.

The basic imperfection which might lead to a less than optimal size of SSI lies in the area of factor markets – of both labour and capital. It is argued below that in most economics – and in developing countries in particular – capital market imperfections are more basic to the non-optimal size of the SSI than labour market imperfections. *The factor market distortion argument* developed in section 12 might suggest that the correct inference to be drawn from the discussion is that the problem of less than optimal size of SSI is best tackled by confronting it at its source – enacting policies to remove capital market distortions. This is indeed that first best solution, but it will emerge from the discussion in this section that the reasons for capital market segmentation are such that they are hard to remove through direct interventions. Hence the need to adopt supportive policies for SSI development as a second best solution.

The argument is extended to considerations of distribution of income, and we conclude that equity objectives provide additional support to the argument based on efficiency objectives for selective policies of assistance to SSI. We then explore some additional reasons for promoting SSI growth over and above the basic reasons based on factor market imperfections.

While the basic argument for supporting SSI is established in the following three sections, we then turn to a cautionary note about indiscriminate support of SSI. Efficiency and growth objectives economies of scale or attaining technical efficiency. The discussion in this section points to the adoption of policies of support which enable SSIs to exploit available opportunities for efficient economic performance and growth.

1.2 The Factor Price Distortion Argument

It is commonly argued that, for various institutional reasons, labor used in large enterprises (LEs) is priced well above the levels at which it is used in small enterprises (SEs). At the same time capital is generally much cheaper for the larger firms it might appear that the price differences for the two factors between LEs pull in opposite directions and would compensate each other, so that the relative profitability of the two types would not be greatly affected. However, we shall now develop the argument that price differences affecting the use of capital are much more important in affecting the relative costs of factors than the differences in wages per worker. If this is the case, there are two ways in which the economic outcome left to itself would be produce a sub optimal situation from the efficiency point-of-view first, the SSI sector which uses more labour and less capital per unit of output will have relatively higher costs and hence have an over-all size in the economy which is less than optimal. Secondly, if the price of labour facing large firms is too high compared to the true economic (opportunity) cost of labour, and the price of capital too low, then large firms would be using a higher ratio of capital to labour than would be socially optimal.

1.21 Why Capital Market Segmentation is More Important

The basic reason why differences in the price of capital are more important for the cost structures of large and small enterprises than the differences in wage per worker is that a higher wage facing the large firm could be, and is generally compensated for by higher efficiency of the workforce – so that the wage cost per efficiency unit of labour is much less than the observed difference in the price of capital. Labour is a factor of production, which can be applied at varying quality levels. Large firms with higher wage could, at least upto a point, attain higher efficiency of their workforces through better selection and also internal skill formation. Capital or finance, however is a factor of production without this extra dimension to its supply. A rupee is a rupee and there is nothing to compensate for the higher cost of a rupee available to smaller firms.

In fact, in some scenarios it might be more appropriate to hypothesize that it is not the institutionally determined higher wage, which causes the capital-labour ratio, and hence labour productively to be higher in large firms, but rather the line of causation runs the other way round. Capital market segmentation makes the price of capital relatively low for large firms, and this encourages a higher capital intensity and labour productivity – which is its turn enables the large firm to pay higher wages per man and select a body of workers more appropriate to its organizational style and skill requirements.

1.22 Non-Institutional Factors Causing Labour Market Segmentation

While both labour legislation and trade union action have been an important part of the urban labour market scene, more so perhaps in South Asia compared to other parts of the continent, it would be extreme and unhistorical to suggest that the origin of labour market segmentation could be found primarily in these types of institutional factors. Detailed studies of labour markets and their evolution in developing countries have suggested that a number of factors, other than labour legislation operate singly or in combination to cause wage levels in the large scale sector to be set at higher levels than in the small scale sector. These can be listed as follows:

- i. Large factories, acting on their own, try to select a stable body of workers with strong firm attachment to industrial work, and they were prepared to pay a wage premium to attract this workforce. There is a wide variety of migrants from the rural areas seeking work in the urban labour market. Factories in the formal sector would prefer to attract more stable migrants, who are attached to urban work and tend to settle in town with their families for a long time. They would be prepared to pay a higher wage to attract such migrants with a higher supply price, because their higher productivity over the long run would more than compensate for the higher wage. Small enterprises make greater use of the unstable labour with high turnover because in their case the stability-efficiency relationship for the workforce is much weaker. They use much less expensive, often second-hand, machines which need less training to use, and whose cost of damage from misuse is less.
- ii. Large firms often want labor which is not just stable, but also which is attached to the individual firm. Skill development and efficiency of the workers are often firm-specific, and large firms interested in long-run productivity might be prepared to pay a higher wage relative to their competitors in order to develop their own body of committed workers.
- iii. A third group of factors is the high labour productivity in large firms which enable the firm-specific labour force to claim a share of the profit or rent created. The motivation of an exclusive labour force can only be sustained if management is sympathetic to profit sharing ideas. At the same time such a body of workers, tied to the enterprise is extremely suitable for unionisation, and in fact in many cases management has been known to encourage unionisation in the interest of industrial stability. A telling piece of evidence suggesting that productivity differences rather than labour legislation are at the heart of wage differences by firms size comes from a detailed study of wage differentials carried out in Mumbai in 1979. It was found that after accounting for human capital attributes and other considerations, the importance of the employment size of the enterprise for the earnings level of the workers was very large, as was the extent of the differential – workers in the largest factories (1,0000+) earned twice as much as those in small estate establishments, and three times as much as

casual workers. But contrary to expectations the boundaries of the Factories Act did not distinguish the high and low wage sectors. Earnings per worker went up with increasing size classes even within the "factory sector" i.e., the firms covered by the prevailing labour legislation. Only at the employment size of 500-999 workers did the earnings level seem to have reached a plateau. Evidently there are factors other than institutional wage determination which play a significant role in the wage-size relationship. Attention should then focus on the explanation of difference in labour productivity between large and small firms. When we begin to do so we must bring into consideration the segmentation in the market for the other major factor of production – capital.

1.23 Capital Market Segmentation

Capital market segmentation is a natural outgrowth of some basic characteristics of the economy. First, the administrative, selection and insurance costs of loans from the banking system have pronounced economies of scale with respect to the loan size. The information cost for assessing an SSE project is often a substantial lump sum amount which works out much cheaper per unit of credit as the size of the loan increases. In addition, the ready availability of relevant data might be a problem for SSEs. Secondly, the size of acceptable collateral which reduces lenders' risk obviously increases with firm size. For small firms, particularly newly established ones, the only security available for a potential lender is its personal credit evaluation of the entrepreneur himself. Formal lending institutions are unlikely to have easy and reliable access to detailed information about a small entrepreneur. Thirdly, the unequal distribution of wealth and savings implies that the supply of potential capital from 'friends and family', which figure prominently in the financing of small enterprises is necessarily limited.

Because some of these factors causing capital market segmentation are endemic to the working of modern societies – both developed and developing – most economies have adopted various measures to intervene in the financial sector to make capital more easily available to SSEs. However, as the problem has very deep roots, such measures have by themselves been inadequate. Governments have generally been induced to supplement policies of financial market intervention with more direct measures to promote the SSEs. Some of these are reviewed in the next chapter.

To say that capital market problems take precedence over those of the labour market is *not to deny that the latter are without importance*. Unions and labour legislation have in recent years increased the level of wages facing LEs beyond the levels established by economic forces (Little, mazumdar and page, Chapter 7; lieberman 1990). At the same time job security legislation has sought to protect workers in LEs from lay layoffs and plant closures (ILO-STAT 1996). It might appear at first sight that these institutional pressures in the labour market redresses the balance against SSEs arising from capital market segmentation, but if they do so, they do it in a distortionary way by inducing LEs to be even more capital intensive – further away from the socially optimal capital – labour ratio.

Furthermore, an important way in which such developments in the labour market damage the healthy growth of SSEs is by acting as impediments in their vertical mobility. SSEs might be wary of growing beyond a threshold size which would bring them under the purview of labour legislation or subject them to union pressure. They might lack the financial resources to graduate to the higher capital intensity needed. Also, while established LEs might over time be able to develop a system of labour utilization which increases labor efficiency to compensate at least partly for the higher wages, SSEs might not be able to bear the costs of transition while the more efficient labour system is being developed within the firm but they are still required to pay the higher wages. Job security legislation, while it encourages subcontracting to SSEs, adds to labour costs and reduces the turnover of efficient LEs. This reduces the opportunity for graduation of efficient SSEs as much as it discourages expansion of more competitive LEs.

1.3 The Distribution of Income Argument

Considerations of equity would strengthen the general direction of the conclusion reached above. There are three ways in which an economy with a larger presence of SSEs would have a more equal distribution of income:

- i. smaller units with a lower capital-labour ratio would generally have a larger share of value added accruing to the workers;
- ii. entrepreneurial income could be expected to be more widely distributed; and
- iii. the typically large wage differential between the small and large firms implies that when the former have a larger share in total output, more of the income accruing to labour goes to lower wage groups, i.e. there is a more equitable distribution of *labour earnings*.

The last point is particularly relevant in the light of the discussion above about the nature of wage differentials between SSEs and LEs. It was argued that the difference in the efficiency wage would generally be much smaller than the difference in wages per worker. Take a hypothetical example where the difference in wages per worker is completely offset by differences in worker efficiency – whether through the employers

adopting a selection process of workers acting on their own or reacting to institutionally imposed wage differentials. In this case there is no difference in wage cost per efficiency unit, and there is no problem of allocative inefficiency as far as the labour market is concerned. But left to itself the economy will be split between an LE sector with a relatively small workforce of high efficiency and high wages, and a large SE sector in which a large portion of the manufacturing workforce will be employed at low levels of efficiency and wages. This scenario presents a highly unequal distribution of labour earnings. Equity considerations require that SSEs should be promoted. But a point of some importance should be noted here. The distribution of labour earnings will not be improved if the SE sector merely expands horizontally at the unchanged level of earnings. *It is important that there is increase in labour productivity and / or upward mobility of the SSEs so that a larger percentage of the labour force could graduate to the middle rungs of the earnings distribution.* Thus promoting development of SSEs for its own sake without regard to its potential productivity is self-defeating. Growth of inefficient SSEs is undesirable from the point of view of both equity goals within the manufacturing sector (and the urban labour market), and of increasing output and its growth rate. We shall come back to this point late in the Chapter. But for the moment let us look at some other arguments which have been advanced for the encouragement of the SE sector.

1.4 Other Reasons for Promoting SSEs

1.41 Product Differentiation

There has been some emphasis on the idea of product heterogeneity and product differentiation within the same broad 'product group' as an additional reason for the coexistence of small and large firms. Even when firms of different sizes produce ostensibly the same product (for example, a bar of washing soap), the qualities which are contained in different brands of soap will differ markedly. Small firms generally cater to the low income groups and will, therefore, tend to concentrate on brands which emphasize basic product attributes such as cleaning power over more cosmetic properties such as fragrance. Simple technologies could be more appropriate in the production of the basic attributes meeting with demand from low income consumers. Small or micro enterprises may be able to use such technologies successfully with low capital-labour ratios, while larger capital intensive firms which cater to the high income segment of the market may use more mechanised technologies to produce the attributes demanded by the wealthier consumers. On the other hand, small enterprises sometimes produce luxury products, making intensive use of skilled labour, which essentially cater to the luxury segment of the market and which the large firms cannot supply. Elements in the market structure, such as monopoly pricing, advertising and barriers to entry, accentuate product market segmentation which increases the economic distance between large and small firms. It is possible that in many lines of production, this type of product market segmentation helps to perpetuate industrial dualism.

It has sometimes been argued that the welfare of low income groups is best served by promoting the 'low quality' products, without the additional attributes. This, it has been argued, would not only meet the basic needs of poor consumers, but the less mechanised techniques used in the manufacture of these products would produce more income for the very same consumers because of the higher labour intensity of such techniques. However, if the products made with less mechanised techniques are priced cheaper, then they would obviously be bought by poor consumers. Therefore, the argument for further intervention can then only be that such groups should be induced to buy more of such products, or not so poor groups should also buy these products. But before they embark on such a course of intervention policy makers should be aware of the full implications of this argument. First, it is tantamount to paternalistic overriding of the principle of consumer sovereignty. It is in effect being argued that the low income consumers, if they are buying products with additional attributes which the more mechanised processes can supply at higher prices, they do not know what they are doing, and policy makers know better about what the poor people's preference ought to be. Secondly the protection of non-mechanised technique, beyond the point which market prices support, perpetuates outmoded technology and lead to general technological stagnation in the economy. Clearly these types of protection do not prepare the economy for international competitiveness. Lack of technological progress leads to slower growth of productivity and wages in the long-run hence hurt the welfare of low income earners whose interests are supposedly being promoted.

It is possible to admit one specific exception to the above argument. The luxury attributes being produced by more mechanised techniques might be priced more competitively because the cost of capital and finance is lower for the larger mechanised establishments as discussed at length above. The financial market intervention is supposed to correct for this capital market segmentation. Additionally, excise taxes on luxury goods have been always been accepted as a legitimate fiscal tool of redistribution provided it is not overdone.

1.42 Flexibility

An advantage adduced more frequently in the last few years is that small firms are better able to adapt to changing, and sometimes disruptive, economic circumstances.

The 1970s and 1980s have produced several shocks demanding a flexible response from industrial firms. According to some authors, traditional mass production units have been less successful in this regard than have small establishments based on a modern version of the craft principle that 'flexible tasks and machines augment the craftsmen's skill's and ability to produce ever more varied products' (Schmitz 1982:4).

The most influential work embodying these ideas is that by Piore and Sabel (1984). Their paradigm of successful 'flexible adjustment' comes from the recent appearance in Italy, Germany and Japan of a 'new' type of industrial unit: flexible, small, and better able to respond to the challenges of the last two decades than the giant plants of the older industrial countries like the United States.

In particular, the development of a vast network of very small enterprise is impressive, spread through the villages and small cities of central and northern Italy. These little shops range across the entire spectrum of modern industry, from shoes, ceramics, textiles and garments to motorcycles, agricultural equipment, automotive parts and machine tasks. The firms perform an enormous variety of the operations associated with mass production, excluding only the kind of final assembly involved in the automobile production line' (Piore and Sabel 1984).

Average size varies by industry, but is generally extremely small, with shops of ten workers or fewer not uncommon. The flexibility which has been viewed as a hallmark of Taiwanese small firms certainly seems to fit this pattern (Levy 1991). Although there is considerable anecdotal evidence from other countries, organized information remains limited.

It should be noted that the flexible and quick response to changing economic conditions which is often the special advantage of SSIs is much more feasible in an economy which is undergoing liberalization. The importance of this point could then be expected to increase in the Indian conditions, and will be strengthened with better access of business to information technology.

1.43 Contribution Export Potential

Chen (1986) concludes that the experiences of Japan, Hong Kong, South Korea, Singapore and Taiwan suggest that a strong and viable small industrial sector is necessary for successful export oriented growth. In the early stages of manufactured export growth, small-scale industry can play a significant role since products are labour intensive, there are rapid changes in demand, due in part to world economic fluctuations, and output growth is demand driven. Small firms have the advantage of low overheads and the capacity to respond quickly to changing conditions. There is a growing international preference for high quality personalized items, often skill-intensive, in place of mass-produced ones. Such products require flexibility, which often gives the smaller firm the advantage.

According to Beng (1988), a reliable supporting sector has been important in attracting high technology foreign investment to Singapore. Otherwise the foreign firms either would have to bring in their own subcontractors or import foreign workers, neither of which was in line with the long term objectives of government policy. In Japan, and more recently in Hong Kong, Singapore, Taiwan, and elsewhere, subcontracting with small producers has allowed the export sector to keep costs down and flexibility high. Small firms' absorptive capacity can also be an important determinant of technology transfer, in Singapore, for instance, a major channel involves skilled personnel, previously trained by a multinational company, who then take up employment in smaller local firms or start their own (Beng 1988).

The Indian experience of SSIs has not been disappointing as far as the export potential is concerned. But as with the recent Asian developing countries just mentioned the continuing success of this sector will depend on their ability to move into technologically more advanced and sophisticated product lines. The 'flying geese' paradigm of industrial growth is as applicable to SSIs as to large-scale industries. Traditional industries with low levels of technology reach their peak and unless enterprises graduate to new generations of products the dynamism of growth slows down.

1.44 Other Economic and Social Advantages

Small-scale industry is also expected to perform better than larger firms in two other areas: contribution to decentralization and the fostering of entrepreneurship. Support for SSI has often been based in part on the hope of reducing the excessive infrastructure and social costs associated with large assembly plants and large urban agglomerations. Ho (1979, 1980) contrasted the regional dispersion of industry in Taiwan (with its prominent SSI sector) with Korea (with its dominant large firms). In general, it appears that very small (mainly household) enterprise is much more widely dispersed, including a fairly high density in rural areas, than are small-medium plants (World Bank 1978).

Another major objective has been the promotion of a widely based class of small entrepreneurs. We refer in a succeeding chapter to the case of Taiwan where, at the outset of the period of export-led industrialization, Japanese trading companies led the

way by promoting subcontracting and exporting through a network of small and medium manufacturers and export traders.

1.5 The Need for Selectivity in SSE Promotion

The arguments considered so far have implicitly assumed that all firms – large or small – are equally efficient in the utilization of the factors of production, though they might be using different combinations of capital and labour due to factor market distortions. But there are two classes of situations in which this assumption might not be valid.

1.51 Economies of Scale

Clearly the case based on allocative efficiency will be dampened if there are sufficiently strong economies of scale in production. The claims of large scale industries since the Industrial Revolution in Europe have been based on the importance of increasing returns to scale in mechanised production, and have been strengthened by the development of "Fordist" industries of mass production. More recently, as mentioned above, recent developments in technology and the market for consumer goods have to some extent devalued the older sources of increasing returns. Industrial economists are talking about a "third industrial revolution" which has ushered in an era of technology and market specialisation which favour a much smaller optimum size of the firm even in the developed economies. It is important to make the point here that in some line of industry economies of scale would be important and to impose administrative controls on the expansion of large units in such industries with a view to promoting the small scale sector would be welfare reducing. This is obviously a matter for empirical investigation. In any case this underlines the danger of blanket policy measures which seek to promote small-scale units without reference to the production technologies in individual industries. Equally, the argument strongly supports the need for the formulation of support policies for SSEs which does not discourage growth. Policies which merely seek to protect SSEs err on the side of encouraging stagnation and ultimately high costs for both producers and consumers.

1.52 Technical Efficiency

While allocative inefficiency arises when a firm is operating at a point on its production function which is inappropriate at the optimal factor price ratio prevailing in the economy, technical inefficiency arises if the firm is operating below the production frontier i.e. if it is not attaining the maximum level of production which it is in fact enjoying. Only a few firms in any group of firms we consider would in fact attain or be close to attaining maximum technical efficiency. The average productivity per unit of factor input of the firms in the group being considered would be below the level of the maximum achieved by the firms at the frontier. The ratio of the average to the 'frontier' productivity is an index of technical efficiency for the group. When we say that small firms as a group have higher technical inefficiency than large firms, we hypothesize that the index of average to 'frontier' productivity for the small, after allowing for the appropriate ratio of capital to labour, will be lower than that for the large. Clearly this is a matter for empirical investigation which can be undertaken with firm level analysis of micro data. But even if such analysis reveals higher levels of technical inefficiency for small firms, it does not signal policy conclusions biased against the small scale unless we examine the causes of the higher incidence of technical inefficiency.

For example, such inefficiency might be caused by general conditions of the economy which make it difficult for small firms to obtain necessary inputs or marketing services. Thus small firms are often hampered by the absence of reliable, continuous sources of raw materials or electricity. This was particularly important in the earlier license / quota regime in India.

More generally, small firms as a group might suffer from technical inefficiency relative to larger enterprises if one more of the following factors are present in an important way:

- i. competition between firms of large and small sizes, and within forms of each size group is weak;
- ii. there is limited vertical mobility among small firms due to institutional or policy related factors, so that small enterprises do not have either the opportunity or incentive to graduate towards more productive modern "best practice" technology; and
- iii. there is little incentive for modern large scale enterprises to transfer their superior "know-how" to smaller firms working for them as ancillary units. In our review of the Indian policies to the small-scale sector we would indeed have occasion to point out that these policies were often conceived and implemented in a way that created some of these problems.

1.6 Conclusions

This chapter has argued that there is a strong case for adopting support policies which would encourage the development of SSIs beyond the point which the sector might attain left to free market forces. From the point of view of allocative efficiency, equitable distribution of incomes and several desirable objectives of healthy social and economic

growth, we have seen that the size of the sector would be less than optimal in the absence of such policies.

The argument developed above on factor markets suggests that the apparent 'distortion' in labour markets could be exaggerated if one just looks at the difference in earnings per worker in small and large firms. This is because large firms could and generally do develop a workforce of higher efficiency to suit their specific organisational needs, so that the wage cost per efficiency unit of labour is not nearly as great. On the other hand, capital does not have an extra dimension in quality, and hence the significantly higher price of capital available to small firms constitutes a genuine disincentive.

The appropriate solution to correcting this important disadvantage to the small scale sector is to intervene directly in the market for finance to remove the impact of capital market segmentation. But, as will be pointed out at greater length in the next chapter, most governments have found that only a limited amount can be achieved through policies impacting directly on the financial structure. This is because capital market segmentation is endemic to the working of most economies, and is particularly serious in developing countries with their relatively weak financial institutions.

There is thus a case for direct support for the small scale sector to bring it nearer to its optimal size in the economy. Some of these measures are discussed in the next chapter. But it is equally clear from the discussion above that support policies would be self defeating if they merely aim at *protecting* the existence of small enterprises. All the objectives of policy require that the measures enacted to promote SSEs must aim at their *development* - which implies they must be encouraged to grow.



II. POLICIES TO PROMOTE SMALL SCALE ENTERPRISES

Given that the development of small – medium enterprises is desirable on both allocative efficiency and equity considerations, particularly in the new technological and market scenario, what are the major policy instruments available to governments to promote the small-medium sector? A conclusion was reached at the end of the last chapter that policy instruments need to be developed which do not just protect SSEs indiscriminately, but which help them develop in a dynamic and changing environment. This would result in more efficient firms which are able to exploit the opportunities for growth. Further, these instruments must ensure that firms with different efficiencies and potential for growth derive differential benefits from the assistance which is available. This implies that such instruments should have a general and pervasive in impact, rather than be specific to particular industries or groups within the SSI sector.

The reservation of specified product line for the small scale sector has been central to Indian policies for development this sector. In India, policies based on reservation have persisted in the manufacturing sector over a long time, and India is almost unique in its dependence on and persistence with such policies. A large number of product groups – defined at a fairly detailed level using the National Industrial Classification Code – are reserved for the exclusive production by SSEs which are defined on the basis of value of fixed investment in plant and machinery. Once a product line is reserved, those firms with levels of investment exceeding the SE limit are restricted to the level of production equal to their installed capacity at the time of reservation. This method of fostering the growth of SSEs was first introduced in 1967 and the list of items has been progressively increased until today it comprises a total of around 830. The value of the limit in plant and machinery has been increased over time in nominal terms but the increase in value of this limit after allowing for inflation has been small.

This line of approach had its value in the initial stages of encouraging the SSI sector. Large numbers of new SSI units were encouraged to establish themselves and protected from competition from the large-scale sector. But the problem with the continuation of such policies is that it is not sufficiently discriminatory in favour of small enterprises which show potential for growth. Industry based policies of reservation overlook the fact that small enterprises which show potential for growth. Industry based policies of reservation overlook the fact that small enterprises is not confined to specific product lines, and that their importance in different product groups are constantly changing. In view of this, there is a need to implement policies for the development of SSEs which are generally and have a pervasive effect in the sense that all small enterprises, no matter in what product groups, could potentially take advantage of the assistance measures available. Secondary, it is important that such policies do not discourage the growth of small into medium enterprises.

2.1 General and Pervasive Policies to Encourage SSEs

- i. In many instances the removal of bias in policies discouraging the small – medium sector should help considerably. The regulatory framework, including elaborate licensing procedures affecting outputs, inputs, and urban land rights, has been widely discussed as severe constraints on the Latin American literature (e.g. de Soto) and is relevant to Asian countries,

although perhaps to a smaller extent. A large literature has focused on the impediments to SE success which come from trade and foreign investment policies which are implemented. It has frequently been concluded that the protective structure has been biased against SSEs in the sense that effective protection rates are higher for those industrial sectors where the SE share of output is relatively low (Pitt 1981 for Indonesia; von Rabenau 1976 for Malaysia; Anderson and Khambata 1981 for the Philippines). The era of import substituting industrialisation, with its regime of rationing of foreign exchange for importers of machinery and material inputs, an overvalued exchange rate which reduced the effective price of capital equipment, has been traditionally viewed as a source of bias against SSEs. But in more recent years, when export promotion policies (import tax drawbacks, special credit facilities, other tax breaks based on the level of exports, etc) have been used as a substitute for lower exchange rates, the performance of the SE sector might have been adversely affected, since such assistance is less accessible to them for more or less the same reasons that quantitative restrictions are biased against them (Bruch and Heimenz 1984; Marsden 1984). Similarly, policies to encourage direct foreign investment, would favour large firms, because lumpiness of investment and the high management cost of dispersal are likely to encourage foreign investors to enter the LE sector.

Protective macro-economic policies have particularly hurt SSEs in creating scarcity of good quality raw materials for these units. While LEs get access to raw materials at low regulated prices (in some cases on account of their export potential), SSEs have to scramble for materials in the open market. This is one, though not the only reason for SSEs producing at the lower end of the quality scale.

In the Indian context, in spite of the concerns with SSE development in government policies there are many instances of both regulatory and macro policies being discriminatory to the small sector. The Committee on Simplification of Procedures for SSIs appointed by the Ministry of Industry (the Mhapatra Committee) pointed out that a small scale unit had to deal with about 20 Departments of government both Central and State – and that an entrepreneur had to interact with 50 inspectors. They ranged from Labour laws to Environmental, Excise and Developmental regulations some of them actually meant to provide subsidised services to SSEs. While large units can assign special staff for the purpose of filing returns to numerous bodies, the burden is quite disproportionate on small entrepreneurs. It has been mentioned above that a major item in the cost structure of SSEs is often the payments to a large body of inspectors who need to be induced to look the other way.

- ii. Of the Asian countries for which we have information, Hong Kong comes closest to a free market model of development. It is observed that "within the proclaimed *laissez faire* environment in Hong Kong the government does not seem to have a policy towards manufacturing not to mention any policy towards the SSIs" (Beng 1988:58). An obvious hypothesis emerging from the Hong Kong experience is that, in the absence of the usual sort of policy biases which protect both capital and labour in large firms, the most successful enterprise size for an export oriented economy would be in the SME range (under 100 workers), and the wage and productivity differentials with respect to larger units will be small. It might be objected that the compact geographical size of the colony is unique and does not allow for generalisation to other types of countries.

Industrial units are much more spatially dispersed in Taiwan. The important role played by SMEs in this economy needs to be studied more carefully. Like Hong Kong the adaptability of relatively small units seems to have been an important contributor to overall export success. The role of financial institutions in helping the SME sector in Taiwan is an important element of their success. Taiwan developed a widely distributed structure of manufacturing enterprises, many of which had low start-up capital like in Hong Kong. One study has stressed the importance of government supported financial institutions specialising in "Venture capital" lending in this process (Scitovsky 1985).

- iii. The most commonly used supply side intervention to support the SME sector is the program of subsidised credit put in place by governments with or without the help of multilateral or bilateral donors. The World Bank has championed SME lending projects for almost a decade. Typically a central development bank of the borrowing country acts as the wholesale borrower for these loans and as a lender to commercial banks which retail them against a guarantee given by the central development bank. Although these schemes have had a positive effect on the promotion of enterprises outside the corporate sector their cost-benefit ratio varies enormously, and it is not altogether clear that the potentially most efficient enterprises or groups of enterprises are helped most. The conclusion which emerges from the evaluation of such schemes is that such programmes are generally successful if they are backed up by associated programmes of technical and marketing assistance. A further relevant point is that the provision of subsidised credit is meant to address the problem of capital market segmentation which makes the cost of capital relatively high for SSEs. Accordingly its success depends very much on the effectiveness of other policies to help develop the financial structure which provides easier access to finance for SSEs. In the absence of such developments in the banking and other lending institutions, government efforts to provide subsidised credit can only have a limited effect and are likely to get stalled.
- iv. One of the major ways in which economies with a substantial presence of large scale industry have successfully developed a small sector component is subcontracting. Japan is, of course, the most cited example, where in spite of powerful economic and institutional factors favouring LEs, small industrial units have continued to provide a large share of employment and value added in manufacturing (43 percent of the former and 28 percent of the latter in the

mideighties, with small units being defined as those with less than 50 workers). Many of the large units in several branches of industry found it profitable to contract out some parts of the production process to smaller firms. The economic logic of vertical subcontracting lies in the fact that economics of scale are important in some areas of the production and marketing process, and not in others. It is significantly helped by the flexibility which is introduced in the use of labour. The Japanese labour system in large factories is that of lifetime employment so that fixed costs of labour are very much reduced by passing on the burden of demand fluctuations to subcontractors.

The last point is of relevance to many countries of Asia which have had to cope with increasing job security of factory workers due to institutional and economic pressures. While subcontracting is obviously the most efficient way of increasing greater labour market flexibility, its successful development is critically dependent on large firms being able to transfer the know-how for quality production to the ancillary units, and to build up a relationship of healthy co-operation rather than dominance. The experience in several Asian countries has not been very satisfactory from this point of view. In countries and sectors like garments, in which some elements of production are "put out" to small, often household enterprises, the labour market system is better described as "casualisation" to take advantage of depressed wages and working conditions. Skill formation is minimal among the subcontractors, who have little hope of branching out in other activities led by the parent company.

One country which has successfully developed its sub-contracting in recent years is Korea. "In 1990 probably half of the output of small establishment was subcontracted. The radical change in industrial size structure wrought between 1975 and the early 1990s was partly a result of the changing composition of industrial output by sector but was also directly sought by policy, with a view to spreading the fruits of industrial growth more widely" (Berry 1996, basing himself on Baek 1992 and Cho 1995). The process was helped by the post-1987 changes in labour behaviour with rising worker militancy and labour costs, even as Korean industry faced increasing competition

v. An important point to mention in the context of subcontracting is that the nature of indirect taxation might have an important effect on the growth of the subcontracting system. If the revenue system depends on excise taxes based on the gross value or quantity of the final product, firms will be discouraged from subcontracting out part of their operations. A system of MODVAT / VAT taxation (taxing value added at each stage of production) would remove the disincentive to subcontracting.

While subcontracting involves vertical inter-firm co-operation, much interest has been expressed recently on the development of horizontal small-small co-operation. The idea that networks or "clusters" of mainly small firms, interacting themselves through specialisation and sharing of services, have been the key to the success of many industrial areas in developed countries, dominates the discussion of clusters. In a well-known work Piore and Sabel (1984) argued that the vitality of small firms in the "Third Italy" lay in the co-operative competition among communities of enterprises, and on the broad skill of the labouring communities.

In the Asian context favourable note has been taken of Trippur, a district in Southern India which became a major centre of cotton knitwear for both the export and home market in the decade after 1975 (Cawthorne 1995). In spite of considerable competitive rivalry among the large number of small-medium firms there was dense inter-firm linkages in production, signs of collective activity involving sharing of information about markets and design capability, and external economies reaped from the growing market for outputs and inputs, including labour. Cawthorne, however, makes the pertinent point that Tiruppur had been an industrial cluster for a long time before it embarked on its recent dynamic phase. This dynamism "is to a large extent a function of its having successfully entered export markets for high volume / low-to-medium quality knitwear goods...This suggests perhaps a more general point, that it is not clustering per se which makes for industrial success, but clustering in a propitious macroeconomic context" (Cawthorne p.54). One might add that policy

Help on the demand side of the market is probably more fundamental. Governments may provide some assistance in providing services which help the economics of clusters, but the major effort has to come from the entrepreneurs' own initiatives, in Asia as in Italy. The role of the government would be to make provisions for assistance – financial, technical and marketing – which will be available to all members of the "cluster". Furthermore central provision for labour training, control of pollution and other control facilities carries important external economies, and hence can be provided more economically in "clusters"

- vi. A major role of institutions like subcontracting and "clusters" is to facilitate the provision of technology support for SSEs. It has already been remarked that financial assistance – such as directed credit facilities – have often had only limited effect in India and elsewhere because of the lack of suitable measures to follow up on the credit measures with technical help. Officials concerned with banking operations are generally not the most suitable or knowledgeable in the provision of technical help. But without active support in this area SSEs, even if they get financial help, tend to get mired in low levels of productivity with little potential for growth. It is not clear that public agencies are the ideal bodies to carry the brunt of transferring technical know-how to SSEs. The more successful cases of development in this area, in Italy as in Taiwan, have come from trade and manufacturing association who are near to changing market conditions. Nevertheless public support is needed in the encouragement of such activities, particularly in the early states. Of special interest is the constitution of funds

earmarked to helping the organisation of contacts between potential suppliers and customers through trade fairs, periodic visits and so on.

- vii. A continuing concern in the literature on urbanisation in developing countries has been the problem of over – expansion of large urban conglomerations, and what are called megacities. Even with the spiralling costs of real estate and money wage costs which such developments entail, external economies enjoyed by firms locating in these areas encourage continued concentration of private capital and investment. Enough has been said in the migration literature to show that excessive rural - urban migration or an uncontrolled migration of people in search of "city lights" is not the basic problem. Rather it is the distribution of public capital – investment in infrastructure, and services like health, education and utilities – which favours large conglomerations, and this in turn raises the marginal productivity of private capital and labour in these areas leading to a concentration of both capital and labour. The implication of this type of urban concentration for poverty alleviation and the development of the small scale sector is profound. No doubt the informal sector and small enterprises are an important part of the economic landscape of large conglomerations. But it can be maintained, with some empirical justification, that the type of informal sector activities which develop in these areas are not of the type that could promote dynamic skill formation and technological progress in the sector. Rather, it is biased toward small – scale trade and services, and even within manufacturing, enterprises providing ancillary or repair services would predominate. The high costs of land and labour, and the relatively low cost of financial services in the large cities favour production with relatively high capital intensity and economies of scale. The type of decentralised development of a network of small, dynamic and flexible manufacturing enterprises, like we have seen in Germany and Italy in recent years, is only possible if there has been widespread distribution of public capital creating infrastructure facilities in small and medium towns. In the history of developing countries, the development of manufacturing in Taiwan approaches this model Ho (1978, 1980) contrasts the regional dispersion of industry in Taiwan (with its prominent small-scale sector) with the experience of Korea with its dominant large firms and high concentration in large cities.

The spatial distribution of public investment can hardly be divorced from the welfare of specified classes in society whose interests are promoted by such investment and hence cannot be meaningfully disentangled from income distribution considerations. For example, the welfare of the middle or upper classes in most developing countries may be served most efficiently by concentrating public investment in large urban centres, whereas policies designed to promote the well being of the mass of low income people might be better served by a more widely dispersed pattern of public investment. The economic and social costs of growth of megacities cannot then be divorced from the income distribution goals and the political economy of the State.

India's attempts to help "backward areas" by offering subsidies of various kinds to entrepreneurs who locate in these regions, is no substitute for more determined policies to develop infrastructure. According to Vepa (1983), 50 percent of the central subsidy has gone to developed states – and even in the backward areas much of the subsidy finds its way to larger units who can better access the limited infrastructure facilities. The creation of conditions which would attract SSSI a surely a more cost-effective way of promoting decentralised development than subsidies for dispersion.

2.2 Policy of Reservation for the Small Scale Sector: A Critique

The policy of reservation for the small scale sector has been a central element of government policy for SSE development. The impact of this policy on the distribution of employment between the small and the large sectors will be examined elsewhere in a later chapter. It will be shown there that India did not achieve a particularly large portion of the modern manufacturing employment in small enterprises compared to many other countries of Asia. At the same time the rather large productivity and wage differential between SEs and LEs in India probably has made the distribution of earnings in the urban labour market more unequal than in some of the East and South East Asian countries. In this chapter we are concerned more with the general difficulties of the policy of reservation for achieving economic efficiency, and hence the potential growth of the manufacturing sector, and indeed the economy at large.

The fundamental difficulty with reservation as an instrument of policy is that it does not discriminate between production units on the basis of their efficiency – current or potential. We saw at the end of the last chapter that although there is a prima facie case in most developing economies for promoting the SSEs so that their share of the economy is greater than what they would have had under free market conditions, the efficiency of the economy is likely to be adversely affected even if the capital – labour ratio is pushed towards its socially optimal level, because of the prevalence of significant economies of scale in the particular line of production, or a significant degree of "technical inefficiency" in the group of SSEs concerned.

Maximising the labour – capital ratio for a unit of production is not the objective of promoting economic welfare in any meaningful way. For example, employing a group of workers to dig up holes in the ground and filling them up again adds little to national output, although the labour intensity of this operation is close to infinity. Product lines have widely different production functions – showing the possible set of techniques of production techniques at different capital-labour ratios. This distinction is not made in reservation policies as they are being implemented. In some products the minimum

capital – labour ratio which is appropriate even at relatively low implicit (socially optimal) price of labour may require investment in fixed capital which is above the limit prescribed in the reservation policy. If the policy limits production to enterprises which use a technique with a lower capital – labour ratio than this socially optimal, then output is reduced below its potential. While the producers who are protected by this policy would enjoy exceptional rent or profits (as a group), the consumer surplus or welfare is reduced, so that the redistribution is the opposite of what was desired-from consumers who have lower income levels to producers who are richer.

There is no evidence to suggest that any detailed information was collected about the spectrum of production techniques used in the different product lines to determine if the "optimal" capital-labour ratio in the reserved product line was indeed below the declared limit. A more fundamental point is that this type of information is impossible to collect even for an all-seeing computerised super-machine with access to an infinite array of reliable input-output data. In a changing vibrant economy, production techniques are constantly evolving, often due to small changes made by enterprising entrepreneurs to their basic blueprint and the list of blue gets even more complicated and longer.

The last point suggests a reason why we have no explanation in official documents anywhere how the list of reserved items have been selected, and on what basis additional items have been added. The changes over time gives the impression that the choice of products was somewhat arbitrary. Eighty percent of the reserved items are concentrated in 11 three-digit NIC categories. The remainder are spread over 90 three-digit categories. This heavy concentration of policy incidence, together with a long tail demonstrates, to some extent, successful lobbying for reservation by special interest groups. In the absence of a well defined and rational criterion for product selection – which, we have suggested, is impossible in practice – the scope for such action remains large, and its potential for welfare loss to the consumers and the economy increases commensurably.

The concentration of reserved items in a narrow group of three digit industries suggests that an attempt might have been made to pick up the most promising sectors. There is no evidence of this, or if these sectors are particularly labour intensive. But two specific points might be made in this context to complement the general point made above about the near impossibility of selecting product lines on the basis of optimal labour intensity. These refer to the distinction between labour intensive enterprises and labour intensive industries, and the variations in product quality within the same product line.

2.21 Labour Intensity in Enterprises and Industries

Small enterprises are generally more labour intensive than large ones, especially if size is defined in terms of fixed investment rather than employment (see Chapter 4 below). But it does not mean that they are concentrated in industries where the mean capital – labour ratio is particularly low. SSEs are found in most industries. There is no reason that in any economy the number employed (or the proportion of total output or investment) in SSEs would be larger in those industries which have a less than average capital – labour ratio than in those in which the ratio is above the average. This is because there is a spectrum of techniques within each industry, and enterprises of different sizes and capital intensities will be found in most of them.

Little, Mazumdar and Page analysed the Korean Industrial Census of 1971 at the five digit level, and classified the industries by the percentage of workers in SSEs defined as those employing less than 50 workers. The distribution of employment in SSEs among the different industries groups were as given in Table 2.1 (LMP, Table 6-4, p 79)

Table 2.1

Percentage of Number of industries Percentage

Workers in units of employment

Of less than 100 in SSEs

Workers

75% to 100% 114 17

50% to 74% 61 24

25% to 49% 86 39

1% to 24 % 112 20

Total 373 100

The conclusion is that the correct and generally meaningful way of encouraging SSEs (and labour intensity) is to adopt policies which will correct bias against such units in all industries, not just in the few which appear at a certain level of desegregation to be labour-intensive.

2.2 Product Quality

A great deal of variation in the quality of the product is possible even when the product line is defined rather narrowly. A product has many attributes and it is possible to vary the composition of the attributes depending on the price at which the product is sold. What I more, the technique of production employed determines to some extent the bundle of attributes, which is contained in the particular brand of product being manufactured.

We can discuss the set of issues involved with the example of washing soap. The basic attribute of washing soap is its cleaning power. But there are many other attributes, which are desired by some consumers. These include smoothness of the lather, perfume, packaging etc. In an economy with varying income levels of the consumers, soap with different combinations of these attributes will be produced. The brand with cleaning power as its only (or nearly so)

Attribute will be offered at a low price and will be consumed by low-income groups. Richer consumers will demand more of the other attributes, and will be prepared to pay a higher price for it.

Technically speaking, non – mechanised methods of production (with a low capital – labour ratio) are generally able to produce basic soap without too many of the other attributes. We need non-mechanised techniques (the mazzoni process) to produce soap with the additional attributes of smoothness, fragrance etc.

Consider what will happen if, as is the case in India, the reservation of the product for the small-scale sector resulted in a situation in which only the non – mechanised technique of production could be used for producing washing soap, because the investment required for the non - mechanised process exceeded the limit prescribed. Most of the output of washing soap demanded would now be produced only by the non-mechanised technique. The enterprises with mechanised plants would find their capacity frozen. Their reaction as profit seeking entrepreneurs would be to exaggerate the contents of the extra attributes in their brand of product. They would try to create a niche for themselves in the market for rich consumers by incurring large selling costs to advertise these brands. Thus the gap between different quality grades of the product is exaggerated. Consumer welfare is decreased for both poor and rich groups, because the former cannot now afford to buy the soap with "finer" attributes, and their cost to the latter is increased.

A second important point is that the SSEs are excluded from the opportunity of technological upgrading and have to compete among themselves on a much narrower spectrum of quality variation. The negative impact on technical progress and quality improvement could be serious. Ultimately, it has a detrimental effect on market development, and in an export context allows other countries (with similar factor endowments) to develop markets abroad in high growth product areas at the expense of technological laggards. We have extensive evidence of this happening in a number of product lines in India – the most notable examples being diesel engines, garment finishing, consumer electronics and leather products.

The fact that in some lines of production reserved for the small scale sector, LEs are permitted to produce capital – intensive brands for the export market only does not really provide a serious counter argument. First, development of a base and experience in the more secure and familiar home market is often a necessary per – condition for the expansion into export markets for manufacturing firms. Secondly, continuation of low technology perpetuates an industrial sector with low labour productivity (and hence) low wages, and dampens the expansion of the domestic market by slowing down income growth. It should be emphasised that maximisation of employment at low wages at a point of time is not the ultimate objective of development policy. (Recall the example of digging holes and filling them up gain). Technological progress sustains productivity growth and expanding incomes in the long run- which indeed provides more employment over time.

2.23 Polarisation of the industrial Structure

The discussion about the dual structure based on product quality is only a particular example of a general tendency to a polarisation of the industrial structure which has been noticeable in India- and to which the policy of reservation has contributed significantly. A useful study by Guhathakurta (1993) of the metal manufacturing industry can be used as an example to elucidate the major points involved Guhathakurta found large, medium and small units in the rapidly expanding industry in course of his survey.

- i. The large sector clearly had a market leader who was generally perceived to have a superior product and enjoyed a special status among consumers. Along with this leading producer there were about half a dozen large-scale manufacturers who are now engaged in production on "carry on business" licenses when the reservation for the small-scale went into effect. In spite of the limitation on their capacities these large scale units have been able to increase sales by increasing capacity utilisation as we shall soon see. The demand for their products is so strong because of the perception of higher qualities that they have long waiting lists, and are able to charge high prices

bolstered by expensive sales campaigns. The existing reservation policy favors an oligopolistic market structure for these large producers since no other competitor is able to join their ranks.

- ii. At the other end of the spectrum are small artisans and units started by small entrepreneurs who switched from previous jobs in industry, and many of them continue to be involved in industrial jobs while managing their business only on a part time basis. There is an intensely competitive market faced by these producers in spite of the expanding demand. This is because the conditions of production are often dismal discouraging quality. Further, these small entrepreneurs are dependent for their profits on middlemen who are often dealers from middle and large units. These small unit in many cases are able survive only because of the subsidies they enjoy from some government policies relating to financial etc, and the payment of very low wages, use of child labour (dubbed as "apprentices") and matching their use of labour to fluctuations of demand because of the high turnover rate. The small scale sector policies do not all help them. Important costs are imposed by inspectors who have to be paid off regularly for looking the other way when production and labour conditions are below standard, and by their dependence on the open market for their raw materials which are 20-30 percent higher than the regulated price at which mainly the large or medium size units are able to buy.
- iii. A few of the smaller unit started in the decade of the sixties and the seventies have managed to graduate to medium scale status, often depending on government subsidies and mandatory government purchases from the small scale sector. They were reported to be growing slowly, targeting the lower end of the consumers or rich markets like hospital furniture. They are slow to commit major investments or undertake product improvement through more mechanised processes, because the required capital investment would push them over the inviolable investment ceiling. In sum, the reservation policy has created a small segment of large units with high productivity, and a competitive low productivity sector, very few from whose ranks are able to grow sufficiently to challenge the market dominance of the large scale. A second important aspect of the polarisation is that wage levels reflect productivity levels, and a very large difference exists in the wage levels between the large and the small sectors, with the medium units paying widely varying rates.
- iv. Guhathakurta also analysed trends in productivity, capital investment and value added from a number of secondary sources. The ASI sector showed a high rate of growth of 3.1 percent per annum of value added at constant prices in spite of a 1.6 percent rate of decline of the number of units. There was a substantial growth rate of fixed capital per factory (5.7 percent), employment actually declined (at a rate of 1.4 percent) while wages per worker increased at a staggering rate of 9.8 percent per annum. Evidently, the economic forces, reacting to the reservation policies, have accentuated the polarisation in the industry. A select group of workers have benefited from the high increase in productivity in the large scale sector. The driving force behind this has been the striking growth in capital intensity, as the large units sought to beat the limits on expansion of capacity by upgrading the equipment quality and productivity. The loss of jobs in the well paid sector has, unfortunately, been set off with jobs in the low wage sector with adverse effects on the distribution of labour earnings.

2.24 Conclusion

The crux of the argument in this chapter has been that in order to serve the needs of a dynamic SSE sector much more reliance is needed on pervasive measures which help small enterprises in all industries. The policy of reservation concentrated on the protection of reservation concentrated on the protection of SSEs in individual industries which had not been selected on the criterion of superior efficiency of SSEs in these product lines. At its worst this policy created opportunities for vested interests, and at its best it threatened to create a protected SSE sector with low productivity and little opportunity for dynamic growth.

In this chapter we have reviewed a variety of measures which are pervasive in nature. From the discussion in the last chapter it emerged that the central point of interventions is the capital market, India, along with other countries have experimented with financial sector measures to help SSEs including directed credit at subsidised rates. But enough has been said to suggest that, while innovative measures such as equity subsidies are possible to add to the armoury of financial intervention, the impact of this type of assistance will continue to be limited in the absence of other types of needed help in the SSE sector particularly transfer of technology and knowledge of markets. We have reviewed the importance of institutions like subcontracting and clusters which have been successful in marrying financial and non financial assistance in other countries.

The commendable goal of decentralisation has also been addressed earlier. At one level there might be an apparent conflict between the economies of "clustering" and dispersion which is needed for decentralised industrialisation. But such a conflict could be reduced if emphasis is placed on infrastructure investment aiding the formation of "clusters" rather than direct subsidies to SSEs willing to operate in backward areas.



III. THE EXISTING POLICY, INSTITUTIONAL AND LEGAL FRAMEWORK

The policy, institutional and legal framework governing small industry in India is founded on the presumption that implements generation of paramount importance in a labour surplus economy. Its leitmotif is an equitable spread of welfare benefits of industrial growth to the large majority of people. Small enterprises manufacturing labour-intensive products make an economical use of capital and draw on abundant labour supplies which characterise an underdeveloped economy. On the other hand, large capital intensive enterprises reward a small minority of their promoters and a small section of labour which is skilled and urban.

The germ of the vision of small industry development was Mahatma Gandhi's clarion call for protection of handicrafts devastated by imports of factory made products. It was the touching plight of hapless craftspeople overwhelmed by mass manufactured factory products that steered the resolve to protect small enterprises. In the years thereafter, Gandhi's vision crystallized into an elaborate structure of institutions to nurture craft enterprises and small enterprises. India made the deliberate choice not to wait for a phase of industrial development propelled by large companies before encouraging the growth of small enterprises.

Although Mahatma Gandhi had conceived a program for the development of craft enterprises, small industry development was seen as its natural corollary. After independence, the specific role of small industries was recognised by the Industrial Policy 1948 which stated that cottage and small scale industries are particularly suited for better utilisation of local resources and for the achievement of local resources and for the achievement of local self-sufficiency in respect of certain types of essential goods. After the formulation of First Five Year Plan, a Committee was appointed by the Planning Commission with Professor D G Karve as Chairman. The Committee recommended that any development programme for small industry should be decentralised, should aim at gradual improvement in techniques without reducing job opportunities, should assure marketing through cooperatives, and aim at positive promotional support. Later on, in the 1950s a structure for the administration of small industries was proposed by a Ford Foundation team which recommended a Small Scale Industries Board. Its other suggestions were to establish small industry service units (for technical assistance and industrial extension) under the Central Small Industries Organization and a Small Industries Corporation (for marketing).

The culmination of the policies initiated in the second five year plan was the industrial policy statement of 1977. It was then decided that the sole criteria for reservation of products in the small scale sector would be its ability to physically manufacture them. Other measures such as the participation of state governments in small industry development were also taken at that time. The regime for small industry development has remained virtually uncharged after that.

The key planks of India's policy for the development of small industry have been reservations, fiscal concessions by way of lower excise duties, extension of business services by the government and preferential procurement by government. Small industry was sought to be protected from the competition of big companies by earmarking a large number of products for exclusive manufacture by them. Fiscal concessions are meant to be a subsidy for fostering infant enterprises. Extension of business services by the government was considered necessary in the absence of an equivalent private sector providing such services. The objective of government procurement from the SSI sector was to share the risk of first entry into the market by a small entrepreneur.

The policy, institutional and legal regime for the governance of the small industries in India is described below. We will begin with the various explicit and implicit definitions of small industry in India as they underpin the policy regime. Thereafter, we will review the policy regime and incentives instituted for the development of small scale industry. This will be followed by a description of the agencies providing business services to aid small industry development. A brief review of the legal structure surrounding the small scale sector and its deficiencies conclude this chapter.

3.1 Definition and Scope of Small Industry

The best known definition of small scale industry in terms of investment ceilings, has been etched into the minds of people by frequent use. This is understandable since investment limits are used as a guide to extend promotional assistance. However, two other methods of classification, by employment and turnover, are implicit in the Factories Act registration requirements and excise duty waivers available to small scale industry. The data on investment limits, for a variety of small industry segments, is tabulated below (Table 3.1) and this is followed by a description of provisions under the Factory Act and the tax laws which define small scale industry.

Table 3.1: Investment Ceilings for Small Scale Industry

Type of small scale industry	Investment limit	Remarks
Small scale industry	Rs 60 lakh	Historical costs of plant and machinery
Ancillary	Rs 75 lakh	At less 50% of its output should go to other industrial undertakings.
Export oriented	Rs 75 lakh	Obligation to export 30 percent of production
Tiny enterprise:	Rs 5 lakh	No location limits
Service and business enterprise	Rs 5 lakh	No location limit
Women enterprises		51 percent equity holding by women

Notes:

i. Small Scale Industry cannot be owned, controlled or be a subsidiary of another industrial undertaking. The policy framework for all segments is the same except for some incentives.

ii. The limits have been periodically revised upwards (see Table 3.2)

Small scale industries were recognised as a sector of special importance in the industries (Development and Regulation) Act, 1951, a central Act that provides for the regulation and development of industries. The industries licensing policies are determined under this Act. The important provisions of the Act are highlighted below.

- Section 11-B provides the power to specify the definition of SSI in consideration of factors relating to:
 - investment of unit in fixed assets
 - nature of ownership
 - the number of workers employed
 - Nature, cost and quality of products, etc.
- Section 29 B provides for reservation of products for exclusive production in the small scale industries sector.

The definition of small scale industries had undergone changes over the years in terms of investment limits. This is illustrated by Table 3.2.

Table 3.2: Evolution of Investment Limits for Small Scale Industries

Year	Investment Limits	Additional Condition
1950	Upto Rs. 5 lakh in fixed assets	Less than 50 / 100 persons with or without power.
1960	Upto Rs. 5 lakh in fixed assets	No condition
1966	Upto Rs. 7.5 lakh in plant and machinery	No condition
1975	Upto Rs. 10 lakh in plant and machinery	No condition
1980	Upto Rs. 20 lakh in plant and machinery	No condition
1985	Upto Rs. 35 lakh in plant and machinery	No condition
1991	Upto Rs. 60 lakh in plant and machinery	No condition

The small scale sector is a part of the large Village and Small Industries (VSI) Sector, which consist of small-scale industries and traditional industries. The administrative and developmental framework is constituted along sectoral divisions and is shown in Table 3.3 below:

Table 3.3: Administrative Structure for Governance of Small Scale Industries

Industry	Agency	Administrative Dept / Ministry
Large / Medium Industries		Dept. of Industrial Policy and promotion and Dept of Industrial Development
Small Scale Industries	Small Industries Development Organisation	Dept of Small Scale Agro & Rural Industries.
Powerlooms	Textile Commissioner	Ministry of Textiles.
Traditional Industries		
Khadi and village Industries	Khadi and Village Industries commission	Dept of Small Scale, Agro & Rural Industries
Handlooms	Development Commissioner (Handlooms)	Ministry of Textile
Sericulture	Central Silk Board	Ministry of Textile
Handicrafts	Development Commissioner (Handicrafts)	Ministry of Textile
Coir Fiber	Coir Board	Dept of Small Scale, Agro & Rural Industries

In practice, the small scale industries sector serves as a residuary sector in the sense that all units that fall within a prescribed investment limit and are not recognised in a particular subsector are included in the small scale industries sector.

3.11 Other Definitions

The classification of the size of companies by employment levels is implicit in the registration requirements of the Factories Act as well as the labour laws. Enterprises are obliged to register themselves with the Department of Industry of a state government if they employ more than 50 people and use power or employ 100 workers and don't use power. Small industries below these levels of employment can choose to register but they don't have to. Other social legislation such as labour laws, social security and medical insurance apply for firms employing more than 10 workers with power and 20 without power. By implication, household enterprises are defined as ones with less than 10 workers with power and 20 without power and are not subjected to social legislation.

Finally, exemptions from indirect taxes, i.e. excise and sales tax, are allowed for firms below the threshold levels of sales turnover. The turnover ceiling is set at Rs 30 lakh per year for full exemption and on a sliding scale upto a turnover of Rs 300 lakh per year for small companies.

3.2. Policy Framework

The foundations of the policy for the small scale industry were laid in the Second Five Year Plan. In 1956, the government announced its second industrial policy which unambiguously chose equity as the guiding principle for small industry development. The operative statement says: "small scale industries provide immediate large scale employment, offer a method of ensuring a more equitable distribution of national income and facilitate an effective mobilisation of resources of capital and skill which might otherwise remain unutilised."

3.2.1. 1977 Policy Statement

A high watermark in the evolution of the policy for small industry was the Industrial Policy Statement of 1977. It was then that the protection of small industry touched its acme; the guarded initiatives of earlier years were cast aside by a heightened zeal for an expanded role for this sector. In particular, the reservation of products for exclusive manufacture by the small industry, begun in 1967, was greatly extended to many more products. The important planks of the 1977 industrial policy statement were

- Whatever can be produced by small, cottage industries must only be so produced.
- The number of products reserved for SSI was increased from 180 to 504 and further to 807 items.
- Special attention to be given to the 'Tiny Sector' defined as enterprises with investment in plant and machinery of upto 1 lakh and situated in towns and in villages with population less than 50,000.

- Special legislation will be introduced to give due recognition and adequate protection to the self-employed in cottage and household industries.
- The focal point of development for small sector and cottage industries will be taken away from big cities and state capitals to the district headquarters. In each district, there will be one agency to deal with all requirements of small and village industries. This will be called "District Industries Centre".
- Special arrangements for marketing of the products of Small Scale will be made by providing services such as product standardisation, quality control, marketing surveys, etc.

3.21. 1980 Policy Statement

The recognition of the importance of ancillary industry found expression in the policy statement of 1980 which laid emphasis on ancillaries. Moreover, the programme for the development of rural and backward areas was accelerated. The salient features of this policy were.

- Investment limits were raised to Rs. 20 lakh for small scale industry as a whole.
- Investment limits for tiny sector increased from Rs 1 lakh to Rs 2 lakh.
- Higher limit for capital investment in ancillary units to Rs. 35 lakh.

3.23. 1985 Industrial Policy Statement

The Industrial Policy Statement of 1985 made incremental changes and took into account the impact of inflation. The investment ceiling for SSI was raised to Rs. 35 lakh and for ancillaries to Rs. 45 lakh.

3.24. Economic Policy Reforms of 1991 and Small Industry

In the wave of economic reform of 1991, the government took cognizance of the institutional context and complementary infrastructure impinging on the fortunes of small scale industry. The Statement on Industrial Policy of 1991 was accompanied by a special Policy Statement for Small Scale Industries whose salient points are listed below:

- The policy stated that its primary objective was to impart greater vitality and growth to the sector. In furtherance of this objective, the sector would be deregulated and debureaucratized to remove all fetters on its growth potential.
- Modifications in all statements, regulations and procedures should be made to ensure that they do not militate against the interest of small and village enterprises.
- A separate package for the promotion of tiny enterprises and recognition of all industry related service and business enterprises as Small Industries.
- Emphasis to shift from subsidised / cheap credit expect for specified target groups to adequate flow of credit on normative basis to SSI sector.
- To provide access to capital markets to SSI Sector by allowing 24 percent equity participation by other industrial undertakings.
- Legislation to ensure prompt payment of small industries bills and legislation for Limited Partnership Act.
- Introduction of a new scheme of Integrated Infrastructural Development to promote industrialisation in rural backward areas.
- Significant stress on technology upgradation by setting up of Technology Development Cell and strengthening the existing facilities available with SIDO.
- Promotion of marketing of SSI products through institutions, other agencies and consortia approach.
- Promotion of ancillarisation.
- Strengthening of exports through setting up of Export Development Centre.
- Enforcement of quality control and support to modernisation and technology upgradation of SSI sector.
- Change in definition of women enterprises and support to women entrepreneurs.
- Significant expansion in programmes for entrepreneurship development.
- Simplification of rules and procedures to enable small sector entrepreneurs.

3.3 Incentives for Small Scale Enterprise Development

3.31. Product Reservations

At present, 386 product are reserved for exclusive manufacture by small scale industries. The Units which are not in the small scale sector can manufacture reserved items only if they undertake to export 75 percent of their production (50 percent in case of garments).

Elements of Reservation Policy

The reservation policy is kept under constant review. A Statutory Advisory Committee on Reservation constituted by the central government under the chairmanship of Secretary (SSI) reviews the base of items / products reserved for exclusive manufacture in the SSI sector. The Advisory Committee on Reservation constituted under IDR Act, makes its recommendations after taking into consideration the following criteria which are listed below:

- o The nature of any article or class of articles which may be produced economically by the ancillary or small scale industrial undertakings.
- o The level of employment likely to be generated by the production of such article or class of articles by the ancillary of SSI undertaking.
- o The possibility of encouraging and diffusing entrepreneurship in industry.
- o The prevention of concentration of economic power to the common detriment.
- o Such other matters as the Advisory Committee may think fit.

The situations in which medium or large units can manufacture reserved items are:

i. Existing medium or large unit already manufacturing an item when it is put on reserved list. In such a case, the unit has to obtain 'Carry on Business' (COB) license from the Ministry of Industry. The capacity of the unit is pegged at the highest production level achieved by the unit in the three years preceding the date of reservation of the product.

ii. Existing SSI units manufacturing reserved items graduate by their process of growth into the medium / large scale. Such units have to obtain COB license wherein the capacity is pegged with respect to the date when it became incumbent on the unit to apply for and obtain a COB license.

iii. Medium / large units undertake to export a minimum of 75 percent of their production. In case of ready-made garments, units are allowed investment upto Rs. 3 crore in plant and machinery provided they export at least 50 percent of their production from the third year (at least half of the exports to non-quota areas).

There is no restriction on the marketing of products reserved for manufacture in SSI by large units or big companies.

3.32. Tax Incentives

Indirect Taxes

Excise duty waivers have been available to the small scale industries since 1986. Registered as well as unregistered units can avail of these benefits; the eligibility criteria is the annual turnover of the unit. No duty is charged upto a sales turnover of 30 lakh, a concession of 10 percent of normal duty (subject to a minimum tax of 5 percent for sales value between Rs 30 and Rs 50 lakh) and 5 percent for turnover between Rs 50 and Rs 75 lakh (subject to a minimum of 5 percent) is also available. These exemptions / concessions are available upto an annual turnover ceiling of Rs. 3 crore. Recent budgets have introduced some modifications in the general scheme for indirect tax benefits.

- o Excise duty exemption for products manufactured, under a brand license, for another company have been withdrawn since 1993-94.
- o National credit of 10 percent, subsequently reduced to 5 percent, on purchases of SSI products by other units has been withdrawn since 1993-94.
- o Full excise duty exemption on 389 products was withdrawn in 1993-94.

Direct Taxes

At present, there is no direct tax exemption for SSI units. The exemptions that were available earlier Under Section 80 HH and 80 HHA have been withdrawn. At present, there is a general exemption available to the industrial sector under Section 80 IA but most SSI units do not qualify since they do not fulfill the condition of employment levels in excess of 10 persons.

3.33 Government Procurement and Marketing

The central government has reserved 409 products that are purchased exclusively from small scale units. Such buying allows price preference of upto 15 percent to small / tiny units. State governments have their own list of products for exclusive purchase from small scale units.

3.34 State Policies and Programs

The very size and dispersed nature of the small scale sector implies that the onus of promotion and development of small scale industries rests mainly on state governments and state institutions. State governments have come out with their own policies to promote small scale industries. These policies provide a variety of direct and indirect support to SSI. Thus, the policy framework developed by the central government acts as a guiding principle and the efforts of the various organs of central and state governments complement one another. The institutional arrangement for coordination between central and state government is attained by the scheme of registration of small scale units. It is a voluntary scheme wherein small scale units are encouraged to register with the District Industries Centres. The registered units can avail the various benefits accruing from the policies of incentives and facilities and other direct support programmes put in place by the central and state governments. The important aspects of state policies are as follows:

- Development and management of industrial areas by the industrial development and investment corporations.
- Capital investment subsidy ranging from 15 percent to 25 percent of fixed investment (subject to an outer ceiling) to new units.
- Exemption / deferment in Sales Tax to units for a fixed period (ranging from 5 to 10 years). Quantum of benefit is limited by fixed capital investment as well as tax liabilities.
- Incentives / subsidies for using power derived from alternative energy sources.
- Special assistance programmes for women and weaker sections.
- Seed capital / margin money assistance scheme on soft terms.
- Underwriting costs on feasibility studies / constancy for modernisation, technology upgradation.
- Allocation of land / sheds in industrial areas on hire purchase or lease basis.
- Empowered committees at the district / state level to accord clearances and settle disputes.
- Higher incentives to set up 'pioneer' units in backward / 'no industry' districts.
- Equity participation by state corporations in joint / assisted sector projects.

3.4. Institutional Credit to Small Scale Industry Sector

3.41 Existing Institutional Network

Reserve Bank of India (RBI) has played an important role in building the requisite institutional structure to meet the credit requirements of the SSI sector by embarking on a multi-agency approach. At the national level the commercial banks provide both working capital and term loan to SSI units. At the state level, the main purveyors of credit to the SSI sector are State Financial Corporations (SFCs) and state co-operative banks, and at the regional and rural level, credit is provided through Regional Rural Banks (RRBs), district central co-operative banks and primary co-operative banks. At the apex level, Small Industries Development Bank of India (SIDBI) provides refinance and co-ordinates the activities of all these institutions engaged in providing assistance to SSIs. SIDBI reaches a large number of small scale industry (SSI) beneficiaries in the country by making use of network of banking and state level institutions numbering about 887 with over 65000 branches (including 169 specialised SSI branches) by providing refinance, bills rediscounting and resource support to these primary lending institutions (PLIs). In addition to refinance, SIDBI also extends direct credit assistance to the sector. National Bank for Agriculture and Rural Development (NABARD) provides refinance assistance to commercial banks / co-operative banks, regional rural banks and state land development banks for extending assistance to farm a non-farm sector. NABARD operates a 'Rural Infrastructure Development Fund' with a corpus of Rs. 2000 crore for supporting select infrastructure projects. Recently, RBI has announced the policy for establishing local area banks (LAB) to meet the credit requirement of tiny and SSI units at the micro level. The assistance to micro enterprises is also extended by non-government organisations (NGOs) / Voluntary Organisations (Vos) for the benefit of certain target groups. Khadi and Village Industries Commission (KVIC) an Khadi & Village Industries Board (KVIB) are providing assistance on soft terms to Khadi & Village Industries located in semi-urban and rural areas

The other services, like supply of raw materials and equipment on lease and hire purchase, are provided by National Small Industries Corporation (NISC) at the national level and State Small Industries Development corporations (SSIDCs) / State Small Industries Corporation (SSICs) at the state level.

42. According to the Nayak Committee Report, the total long term credit demand during the Eighth Plan period was placed at Rs. 13,7000 crore. Of this, the demand for credit under non-farm sector covered under NABARD's refinance was estimated at Rs. 2,000 crore. The balance was to be provide under SIDBI's refinance scheme which was estimated at Rs 11,7000 crore reflecting the demand for SIDBI refinance at Rs. 9,950 crore and balance (Rs. 1,750 crore) being provided by SFCs / banks etc. Based on the disbursements made by SIDBI and NABARD during the four years of the 8th plan period [1992-93 to 1995-96] and the expected credit flow from these institutions during FY 97, the Expert Group I of the opinion that the term credit during the 8th plan period at 55 percent of the fixed capital formation in SSI sector as projected by the Nayak Committee would have been by and large met by the Institutions / banks. However, looking to the increasing need of the sector, it is desirable that the ratio goes up to about 75 percent of fixed capital formation until strong equity culture is developed in the sector to tap the capital market for part financing the long term requirement. LTC includes various instruments such as term credit, leasing / hire purchase, deferred credit bills etc. Trends in bank and institutional credit to SSI sector during 8th plan period is given in Table 3.4.

Table 3.4: Trends in Bank an institutional Credit In The Small Scale Sector During the Eighth Plan Period (Rs. Crore)

S. NO	1992-93	1993-94	1994-95	1995-96	1996-97
1. Total no of units (nos. lakh)	22	24	26	28	29
2. Production	209,300	241,648	299,990	356,060	460,000
3. Growth rate in production (%)	17	15	22	21	21
4. bank credit to SSI of total Bank credit (%)	15	15	15	16	16
5. Net Bank credit to SSI	19,338	21,561	25,483	29,482	33,000
6. Share of Working capital financial (WCF) (78% of 5)	15,123	16,818	20,158	22,996	25,740
7. Long term credit (LTC) from SFC to SSI	1,204	1,311	1,313	1,686	1,975
8. WCF from SIDBI (direct discounting of Bills)	289	561	1,074	1,3000	1,430
9. LTC from SIDBI direct	226	573	916	1,168	1,4000
10. Total WCF from formal sources (6+8)	15,412	17,379	21,232	24,296	27,170
11. Total WCF from formal / production (%)	7	7	7	7	6
12. Total LTC from formal sources (22% of 5+7+9)	5,695	6,627	7,914	9,430	10,635
13. Total credit to SSI (10+12)	21,107	24,006	29,146	33,430	37,635
14. Total credit to SSI / Production (%)	10	10	10	9	9

Sources:

- i. SIDBI Annual Report
- ii. Report of Sub-Group on finance, credit & sickness on SSIs for the 9th five year plan.

3.43 Small Industries Development Bank of India (SIDBI)

SIDBI is the apex bank set up for promotion, financing and development of industry in the small scale sector. The bank commenced operations on 2nd April, 1990. Its main functions consist of :

- Refinance of term loans extended to SSI by banks and State Financial Institutions.
- Special refinance to SSI units.
- Special refinance schemes for in-house quality control facilities. DG sets, pollution control equipment, energy saving systems.
- Financial assistance to marketing organisations marketing SSI products.
- Loans to organisations / institutions to set up industrial estates for SSI.
- Equity type assistance schemes, e.g. Seed capital scheme, National Equity Fund Scheme.
- Single Window Scheme (SWS) to provide both term loan and working capital to SSI through one agency.
- Special refinance schemes for women entrepreneurs.
- Bills Rediscounting scheme for sale / acquisition of machinery on deferred payment terms.
- Direct discounting scheme for equipment and components.
- Pre-shipment credit in foreign currency to EOUs.
- Venture Capital Fund with a corpus of Rs. 20 crore.
- Resource support to factoring companies and other institutions promoting SSI.
- Direct Project Financing.

Since its inception in April 1990 till March 1996, SIDBI has provided assistance of Rs. 22,272 crore to 4,91 lakh units in SSI sector, the year-wise data on assistance sanctioned and disbursed by SIDBI is given in Table 3.5

Table 3.5: SIDBI Operation 1991-1996 (Rs. Crore)

	FY 91	FY 92	FY 93	FY 94	FY 95	FY 95	Cumulative
Sanction	2,409	,2846	2,908	3,354	4,699	6,056	22,272
disbursement	1,839	2,027	2,146	2,671	3,385	4,796	16,864

Source: SIDBI Annual Reports

If the real growth of the sector is estimated at 12 percent the total long term credit requirement of the sector during the 9th plan period (1997-2002) is likely to be Rs. 36,5000 crore as can be see from Table 3.6 Refinance availment from SIDBI has been about 60 percent of the long term credit (LTC) of Public Lending Institutions. Thus the requirement of funds by SIDBI during the 9th plan on account of LTC refinance alone would be around Rs. 21,9000 crore, in addition to the requirement for its direct lending operations. The Expert Group notes that sizable credit out of its refinance portion flows to lower segments of the SSI sector at highly concessional rates of interest. In view of the proposed change of definition to SSE and coverage of all service sector activities, the requirement of LTC of SSEs is likely to go up substantially during the 9th plan period and appropriate arrangements would have to be mobiles larger resources for its refinance and direct operations.

Table 3.6A : Project for Working Capital Finance (WCF) from Institutional and Bank Sources to the SSI Sector During the 9th Plan Period (Rs. Crore)

	1996-97	1997-98	1998-99	1999-2000	2001-01	2001-02
Est, production (at 1997-98 Prices)	521,447	584,021	654,103	732,595	820,507	918,968
Est, WCF required at 20% of production value		116,804	130,821	146,519	164,101	183,794
Est, WCF likely at the start of the plan (est at 8% of production)	41,716	46,722				
Target WCF outstanding		67,746	86,946	111,586	143,209	183,794

Gap in WCF outstanding		49,058	43,875	34,933	20,893	0
Annul (additional WCF target		26,031	19,199	24,640	31,623	40,585
Shortfall in the annual WCF provision		49,058	43,875	34,933	20,893	0

Projecting at a 12% rate of growth and an assumed rate of inflation of 6% from the figure for 1994-95

Table 3.6B: Projections for Long Term Credit (LTC) from Institutional and Bank Sources to the SSI Sector During the 9th Plan Period (Rs. Crore)

	1997-98	1998-99	1999-2000	2000-01	2001-02
Projected requirement of LTC (1997-98 prices)@	38,660	43,299	48,495	54,315	60,833
Gap on LTC	7,732	5,789	3,866	1,933	0
Target for outstanding LTC	30,928	37,500	44,629	52,382	60,833
Annual disbursement target #	6,614	6,572	7,129	7,752	8,851
Commutative disbursement target	6,614	13,186	20,315	28,067	36,518

@

obtained by projecting the March end 1995 figures of total LTC outstanding to the sector, adjusting the same for adequacy (at 75% of the fixed capital stocks) and with an assumed (most likely) growth rate of 10% during the closing years of the 9th plan and at an inflation rate of 6%.

#

this figure is likely to go up substantially on account of recommended change in definition of SSI into SSE including coverage of all service activities.

Source : Report of Sub-group on finance, credit & sickness on SSIs for the 9th five year plan.

3.44. National Small Industries Corporation (NSIC)

NSIC was established by the central government in 1955. Over the years, it has emerged as a premier institution for SSI which provides technology and marketing support. Its main functions are

- Machinery hire purchase scheme for small scale units.
- Equipment leasing scheme.
- Marketing support programmes under consortia marketing.
- Single point registration scheme for marketing
- Technology assistance.
- Development and training activities
- **Raw Material Assistance.**

3.45. State Financial Corporations (SFCs)

During the last four decades, SFCs have been mainly responsible for term lending to the SSI sector. However, the need for evolving a new approach by SFCs has been underlined by the liberalised environment. While some SFCs have performed well in terms of growth in sanctions and disbursements, the average recovery rate of all the SFCs put together has been very low at around 37 percent. Four SFCs have almost become defunct and non-functional owing to their inherent weaknesses.

It has been recognised that the scope of activities of the SFCs need to be widened, their resource base enlarged and their organisation transformed to ensure operational autonomy. A committee constituted by the finance ministry under the chairmanship of Shri S H Khan, Chairman and Managing Director, IDBI addressed various issues which

would substantially effect the operations of SFCs. The suggested changes were in the areas relating to

- i. widening the definition of industrial concern and addition of certain business activities to be undertaken by the SFCs
- ii. increasing the share capital and changes in share holding pattern
- iii. borrowings from other sources and deployment of funds in other securities
- iv. restructuring of Board of Directors ensuring functional autonomy
- v. exposure limit in the borrowing companies, and
- vi. recovery of SFCs' dues.

3.46. Trend In Institutional Credit-Working Capital Finance (WFC)

Small Scale Industries are entitled to priority sector lending from the public sector banks. Over the years, it has been found that this sector has been getting about 15 percent to 16 percent of total bank's advances. Small loans are available at lower rates but these are not specifically meant for the small scale industry. Loans of amounts up to Rs. 25,000 are at present extended at a rate of interest of 12 percent, the interest rate rises to 13.5 percent for loans more than 25,000 but less than Rs. 2 lakh. For loans higher than 2 lakh, the interest rate is now deregulated.

The percentage of bank credit to SSI total bank credit remained more or less at 15 percent during the initial 3 years of the 8th plan period and is estimated to be around 16 percent during the last two years of the 8th plan. Total WCF from formal sources available to the sector was around Rs. 15,400 crore in 1992-93 which is estimated to have increased to around Rs. 27,000 crore at the end of the 8th plan period (Table 3.4). However, the percentage of working capital finance from formal sources (banks / FIs) to the total production was lower at about 7 percent than the expected level of requirement at 20 percent as suggested by the Nayak Committee. As per the estimates of Sub-Group on finance, credit and sickness on SSI for the 9th plan period, the likely requirement of WFC at 20 percent of the production is estimated at about Rs. 116,800 Crore in 1997-98 which is expected to go up to Rs. 184,000 crore by the end of the 9th plan period (Table 3.6). The estimated gap would be about Rs. 49,000 Crore in the initial year of the 9th plan (1997-98).

3.47 The Credit Policy of 1992

In recognition of the widespread dissatisfaction with the availability of credit to small scale enterprises, in September 1992, the Reserve Bank of India set up a Committee under Deputy Governor Shri P R Nayak to recommend measures to enhance credit to the small scale sector. Its key recommendations are given below:

- o SSI units are entitled to working capital of a minimum of 20 percent of their projected sales turnover but not exceeding Rs. 100 lakh of their fund based needs.
- o The entire SSI sector (upto Rs. 60 lakh investment in plant and machinery) is entitled to priority sector lending of the banks. At least 40 percent of the loans to the SSI have to be directed towards the cottage, KVIC units, artisans and tiny industries or other such units subject to credit ceilings of upto Rs. 5 lakh.
- o State Financial Corporations (SFCs) will act as the principal financing agency for SSIs in 23 out of the 85 districts with significantly high industry density (each having more than 2,000 registered SSI units). They will take care of the working capital as well as the demand for term loans. The commercial banks will be the principal financing agency under the Single Window Scheme (SWS) in the remaining districts. Commercial banks will also open specialised or dedicated branches in other areas of high small industry density.
- o An effective grievance redressal machinery will be established within each bank to take care of SSI problems.
- o Banks would adopt and implement the single window scheme in full earnest.
- o Rehabilitation packages for alleviating sickness for potentially viable small units made more attractive.
- o The government announced a seven point action plan in 1995-96 Budget for the effective implementation of the Nayak committee report. This was done when it was found that the SSI sector was getting working capital worth 7.8 percent of its turnover in 1995-96 down from 8.1 percent as reported by the Nayak committee. The important features of this action plan are as follows:

- Time bound action for setting up specialised SSI branches in 85 identified districts and at least 100 such dedicated branches to be opened before the end of 1995-96.
- Adequate delegation of powers at the branch and regional level.
- Banks to conduct sample surveys of their performing SSI account to find out whether they are getting adequate credit.
- Steps to be taken to see that as far as possible composite loans (covering both term loans and working capital) are sanctioned to SSI entrepreneurs
- Regular meeting by banks at zonal and regional levels with SSI entrepreneurs.
- Need to sensitize bank managers and reorient them regarding working of the SSI sector
- Simplification of procedural formalities by banks for SSI entrepreneurs.

3.5. Institutional Framework for SSI Support

The highest echelon of the administrative hierarchy for the promotion of the small industry in India is the Department of Small Scale Industries and Agro & Rural Industries (SSI & ARI) in the central government it is responsible for the policy framework for small scale industries in India.

3.5.1. Small Industries Development Organisation

A tier below the Department of Small Scale Industry is the Development Commissioner for the Small Scale Industries (DCSSI) and the associated Small Industry Development Organisation (MSME-DO). It formulates and monitors the policies and programmes for promotion of small scale industries. SILDO also provides a host of business services, ranging from quality control to consultancy, delivered by a network of institutions. A description of the nature of the services supplied by MSME-DO follows.

- **Entrepreneurship Development and Training**

A variety of Entrepreneurship Development Programmes (EDPs) familiarize new entrepreneurs with the dos and do nots of setting up a unit. These courses are conducted by the technical personnel available with the SISIs and Branch Institutions and the National Institute for Entrepreneurship and Small Business Development (NIESBUD), New Delhi, set up in 1983. This body provides training to EDP trainers and develops training aids and materials.

- **Extension and Training Services**

Another national institute called the National Institute for Small Industry Extension and Training (NISIET), Hyderabad, was established under the aegis of MSME-DO and its functions are self-explanatory. Another institute called the Integrated Training Centre at Nilokheri provides technical training to artisans / workers. It also organised training of extension officers engaged in various developmental organisations.

- **Skills Development**

Training in technical skills development is given to technicians and workers in various workshops attached to the SSIs and institutions such as Testing Centres and Tool Rooms. For example, Central Footwear Training Centre (CFTC) provides training to the workers in footwear trade.

- **Assistance to Entrepreneurship Development Institutes (EDIs)**

A new scheme assists state governments, by way of capital and revenue grants not exceeding Rs. 50 lakh for each state, to strengthen and establish Entrepreneurship was established at Guwahati in March, 1993.

- **Preparation of Project profiles**

Technical officers of MSME-DO at central / state level prepare and update project profiles on various product groups on a regular basis these are disseminated to entrepreneurs around the country. Nearly 1,000 project profiles are prepared / updated by the various officers every year. These efforts are supplemented by potentially / feasibility studies on trade-wise basis and preparation of state / district potentiality survey reports. Information on markets and technologies is also collected, assessed and disseminated.

- **Plant Modernisation Studies**

Detailed in-plant studies are undertaken in particular units located in industry clusters. The studies identify the present uses of processes / technology and prepare programmes for modernisation of the specified industry group based on the empirical

studies. This is supplemented by efforts to encourage units to take up projects for modernisation. On an average 10-20 studies are taken up each year in various groups.

- **Testing Services**

Testing facilities are available through Regional Testing Centres and 19 Field Testing Stations and the workshops attached to the SISIs. Besides testing, these institutions provide certification as well as third party assurance to purchasers who procure goods from SSI units. The centres also organise training programmes for suitable people to equip them to handle testing work. Nearly 50 percent of the expenses incurred on these centres are earned as revenue through job work.

- **Sub-contracting Exchanges**

As many as 16 exchanges have been established for dissemination of information relevant to ancillaries.

- To register idle capacities available in SSI units.
- To identify the requirements of large units so as to utilise the idle capacities.
- Organise vendor development programmes and exhibitions and promotional programmes.
- To promote interaction between small and large units.

Efforts are being made to strengthen the activities of the sub-contract exchanges and to promote private ventures to setup such exchanges throughout the country.

- **Tool Rooms and Product and Process Development Centres**

These provide the following services:

- Design / manufacture of tools, jigs, fixtures etc.
- Service facilities for manufacture of tools etc.
- Training to tool makers.

- **Short term / part time courses for entrepreneurs.**

- **Product-cum-process development work in specific industry groups.**

The Tool Rooms / PPDCs generate revenue from the job work they undertake on the behalf of the SSIs.

- **Marketing Support**

The schemes being operated by MSME-DO for promoting market including exports consists of:

- Training in packaging.
- Participation in Indian and International Trade Fairs.

- **Data Collection**

MSME-DO has a vast programme for collection of statistics through a central scheme by involving both District Industries Centres and Small Industries Service Institute. MSME-DO meets the salary of the state staff engaged in the task of data collection. At present, data are collected regularly under these programmes:

- Sample survey of 2 percent of the registered units. This is being raised to 5 percent of registered units by raising the number of units to 29,000 and for 500 items.
- The data is supplied to CSO for the preparation of Index of Industrial Production (every month).
- Collection of quarterly data for preparation of Index of SSI production.
- Analysis of registration data.

It also conducts ad hoc surveys and census. So far MSME-DO had held two Census of Registered SSI Units for base year 1972-73 and 1987-88 and two diagnostic survey on Sickness of SSIs in 1985 and 1994-95. It is also computerising 147 DISCs and 25 Director Industries in Eighth Plan.

- **Major schemes of MSME-DO**

The budget of MSME-DO under various functions is given in Table 3.7 below.

Table 3.7: Budgetary Provision for SSI Promotion**8th Plan 1996-97**

Prime Minister's Rozgar Yojana 305.50 120.00

Integrated Infrastructure 50.00 17.59

Development Scheme

Tool Rooms 105.05 22.11

PPDCs 58.00 3.83

Collection of Statistics 29.00 6.48

Modernisation and Technology 15.80 0.05

Upgradation

Other 64.15 48.59

Total : SIDO 627.50 218.65**3.52. Small Industries Service Institutes (SISIs)**

SISIs are associated with MSME-DO. There are 28 SISIs, 30 Branch institutes set up in state capitals and other places all over the country. Their main functions are

- Interface between the central and state governments.
- Technical support services and consultancy services.
- Entrepreneurial development programmes.
- Developmental efforts.
- Promotional programmes.
- Export promotion Liaison.

3.53. Tool Room / Tools Design Institutes

The Tool room is at the heart of engineering industry. Due to huge investments needed, small scale industrial units cannot afford to have their own tool rooms. Therefore, the central government established these centres to help SSI units to obtain quality toolings.

Functions

- Assistance in tool design.
- Manufacture of tools, jigs, fixtures, moulds etc.
- Training facilities to toolmakers.
- Common service facilities
- Consultancy.

• Facilities provided by Tool Rooms

- Tool production
 - Manufacture of dies, tools, moulds, jigs and fixtures, gauges and tool components.
 - Heat treatment of all types of steels.
 - Quality control and testing.
 - Regrinding, resharpening and maintenance of dies and tools.
 - CAM (Computer Aided Manufacturing).
- Tool Design
 - Design of dies, tools, moulds, jigs, fixtures, gauges for metal and plastic industry as per international standards.
 - Design to the customer requirements.
 - CAD (Computer Aided Design).

- Tool-related innovations for imported products design.
- Consultancy
- Introduction of modern production technology.
- Use and maintenance of precision tools.
- Quality control and testing of tools and products.
- Selection and use of CNC machines.
- Selection of proper materials for tools as well as the products manufactured.
- Training
- Industry based long term training for tool and die makers.
- Short term training for Managers / Supervisors to upgrade their knowledge and skills.
- Need-based technical training for skilled workers / tool makers / machinists.
- Training for inspection, quality control, testing and maintenance.
- CNC technology training
- Heat treatment training.
- Certified, long duration courses such as post-graduate diploma in tool, die and mould design.

Tool Rooms are located at several locations – Calcutta, Ludhiana, Jalandhar, Hyderabad, Negore, Ahmedabad, Aurangabad, Indore, Bhuvaneshwar, Jamshedpur, New Tool Rooms are likely to come up in future at Mysore and Bhopal. There are also proposals under consideration for new tool rooms at other places. These Tool Rooms are being established with the help of financial assistance from international agencies from Germany and Denmark.

3.54. Product-Cum-Process Development Centres (PPDC)

Certain industries have a tendency to grow in a concentrated way in a certain important centres. Such areas have emerged as important centres for specific type of industries like sports goods in Meerut, Glass items in Firozabad, Foundry in Agra etc. These units have normally engaged in production of items in traditional manner and do not have much exposure to changing technology, designs and manufacturing process. To help meet the above requirements, MSME-DO has a programme of establishing PPDCs at such centres.

- **Functions served by PPDCs**
- To serve as research and development institutions in areas of dense industry cluster.
- Product design and innovation.
- Product and process improvement and development of improved packaging techniques.
- Common facility centre.
- Manpower development / training.
- **Existing PPDCs are located at:**
- PPDC, Agra for foundries, PPDC, Meerut for sports goods; PPDC, Mumbai for household electrical appliances; ESTC, Ramnagar (UP) for electronic industries.
- **New PPDCs**
- CIGI, Firozabad (UP) for glass industry (under implementation).
- PPDC, Kannauj (UP) for essential oils and perfume industries (under implementation).
- PPDCs are designed to work basically as R & D institutes to carry out advanced developmental work and act as centres of excellence in the concerned field.
- Steps to establish more PPDCs for pumps and diesel engines, food and bakery products, polymer and polymer based products are also on the cards.
- Financial assistance is obtained for PPDCs from international agencies.

Till 1995-96, SIDBI has sanctioned an aggregate assistance of Rs. 13,795 crore and made disbursements of Rs. 10,960 crore. Among the new schemes started / assisted by SIDBI are 'Factoring Service' for Small Scale Industries and a Venture Capital Fund.

3.55. Other Autonomous Institutions Extending Support the SSI

There are various national level institutions which help support the SSI in various ways. Some of the important institutions among them are :

- Entrepreneurship Development Training Institute of India, Ahmedabad, a national resource institution promoting and developing entrepreneurship through education, training, research, and institution buildings.
- National Institute of Design, Ahmedabad is a premier design school in the country. It also provides specialised courses in product design in areas of furniture, ceramics, textile printing, leather, plastics and metal forming to SSI.
- National Productivity Council (NPC) and its local branches to provide help in improving productivity in SSI units.
- Seven product cum process development centres in areas of ceramics, foundry, sports goods, electrical appliances, electronics glass and essential oils.
- Ten tool rooms located in different part of the country.
- Four Central Footwear Training Centres for training manpower in leather and footwear products.

3.56. Industry Associations

The industry associations provide the SSI with a common platform to voice their needs and to initiate co-operative efforts in promoting SSI. Government policies in recent years have stressed the increasing role of the industry associations and the NGOs in setting up common facilities and other co-operative ventures in areas of technology, marketing and other support services. Some of the major national associations are

- Federation of Association of Small Industries of India (FASSI).
- Indian Council of Small Industries.
- Indian Federation of Tiny Enterprises.
- World Association of Small and Medium Enterprises.
- All India Manufacturers Organisation.
- Federation of India Chamber of Commerce and Industry.
- PHD Chamber of Commerce and Industry.
- Confederation of Indian Industry.

3.57. Small Scale Industries Board

The range of development work in small scale industries involves several departments / ministries and several organs of the central and state governments. To facilitate co-ordination and inter-institutional linkages, the Small Scale Industries Board was constituted in 1954. It is an apex advisory body constituted to render advice to the government on all issues pertaining to the Small Scale Sector. The Industries ministers, some members of parliament, secretaries of various departments of the central government, representatives of financial institutions, public sector undertakings, industry associations and experts.

3.6. State Level Institutions

The following are the state level institutions playing an important role in the development of small enterprises in India.

- The State Financial Corporations which provide term loans to small and medium enterprises
- The State Small Industries Export Corporations which procure and distribute scarce raw material, machinery on hire purchase, assist in marketing, equality support etc
- The State Industrial Development Corporations which acquire land and offer plots and sheds to entrepreneurs
- State Trading Corporation which assist in exports, provide market intelligence at national and international levels and operate show rooms
- A few states have regional development corporations for individual regions
- A few states have set up venture capital funds

- A few states have set up Institutes for Entrepreneurship development.

3.7. District Industries Centres (DICs)

DICs came into being as a result of recommendations of Industrial Policy Statement of 1977. Their objective is to provide an integrated administrative machinery at the district level to support cottage and small industries which are widely dispersed in rural areas and other small towns.

DICs were designed to provide all the service and support required by small entrepreneurs ranging from pre-investment, investment and post-investments stages under a single roof. The services include economic investigation of local resources, supply of machinery and equipment, provision of raw material, arrangement for credit facilities, marketing, quality input, consultancy and extension services.

About 430 District Industries Centres have been set up covering almost all districts of the country leaving out the metropolitan cities. This programme was started in May 1978, as a centrally sponsored scheme with the central government providing 50 percent assistance. The District Industries Centres are envisaged as a single window interacting agency with the entrepreneur at the district level. Service and support to small entrepreneurs are provided under a single roof through the DICs. They are the implementing arm of the central and state governments of the various schemes and programmes. Registration of small industries is done at the District Industries Centres.

Management of the District Industries Centres is done by the state governments. Beginning from 1993-94, the scheme has been transferred to states and they will also provide funds for running the DICs. The central scheme of Prime Minister's Rozgar Yojana will also be administered by them. The activities of DICs include:

- **Regulatory Functions**
- Registration of SSI units.
- Activities connected with policy implementation.
- Administrative work including settlement of disputes.
- Implementation and monitoring of programs of both central and state governments.
- **Recommendatory for assistance from government agencies for:**
- Machinery
- Finance
- Procurement of materials
- Registration and licenses
- **Promotional**
- Preparation of Project Reports
- District Action Plans
- Entrepreneurship Development
- Surveys
- Consultancy
- Escort Services

3.8. Summary

This review has shown the wide array of policies, programs, schemes and institutions that have been developed over the years to provide support to small scale industries. We have not itemised in detail some of the other schemes for support provided to traditional industries such as khadi and village industries, handicrafts, coir industries and the like each of which have specific institutional structures to cater to their needs.

The design of policies and schemes have two basic characteristics. First, many policies have been designed to protect small scale industries from competition from large industries, the premier instrument being the reservation policy. This protective aspect is buttressed by other measures of credit and fiscal policies to provide concessions to small scale industries. The second characteristic is to design programmes and institutions to provide support from the government to selected sectors and directly to small scale units.

The central government supported by the state governments has, therefore, clearly recognised the need for providing special support to small scale industries as argued in

Chapter I. The support structure has reflected well the needs of 1950's and 1960's in particular, the beginning of industrialization in India, and the controlled economic regime, in particular, characterised by licenses and quotas. Consequently, as in other sectors, the government has attempted to intervene directly in its support programmes.

In view of the vast growth of small scale industries that has taken place through the years, the existing network of government institutions cannot hope to serve well the needs of the all the vast number of small industrial units throughout the country. Second, as argued in Chapter II, it is better to provide overall support to small scale enterprises rather than selecting particular sectors or units. Third, with the general opening of the economy and the imperatives of industrial growth, the continuation of the reservation policy becomes increasingly questionable. Fourth, the support structure has focused exclusively on the small scale industries rather than small enterprises. There is immense potential in the growth of business and technical support services-both for entrepreneurship and employment growth. The policy framework for the small scale sector should therefore support all small scale enterprises equally.

The Export Group, therefore, feels that we no need to review the overall approach for policy support to the small scale sector. We would like to emphatically reconfirm the need for providing special support to small scale enterprises as argued in Chapters I and II. However, the policy support must be much more promotional rather than protective. It must consciously promote development of entrepreneurship for entry-into the small scale sector, and be much more growth oriented than in the past. Our recommendations are provided in Chapter VI.



IV. STRUCTURE, GROWTH AND PRODUCTIVITY OF THE SMALL SCALE SECTOR: AN OVERVIEW

This chapter pulls together the empirical material available on the SSI sector in India. We are first interested in the size of the sector and its importance in the total manufacturing activity in the country, both in terms of employment and output. A number of statistical sources have to be utilised for this purpose. Although not entirely consistent the use of the several sources enables us to provide a 'best estimate' of the SSI sector (more details of the sources used are to be found in the Annex to this chapter).

We build on the same sources to look successively at other dimensions of the SSI sector, its growth over the last two decades; changes in its composition; the distribution by size within SSI; an trends in investment and productivity in the sub sector. The issue of regional dispersion of small enterprises is also addressed in this discussion.

In part II of this chapter we turn to the empirical evidence of the key economic ratios in small and large units. We want to know if the balance of evidence suggests that enterprises are indeed more labour intensive-and if so at what level of overall economic efficiency.

4.1. Size of the SSI Sector: Employment

4.1.1. The population census and The Annual Survey Of Industry

An estimate of the total employment in the SSI manufacturing sector can be made for the years of the decennial population Censuses by using the Census figures together with the number given in the Annual Survey of Industries (ASI) for the corresponding years. The former records employment in manufacturing for the census years by the household and non-household enterprises. The ASI provides figures of employment in the 'registered' sector, i.e., the establishments covered by the Factories Act. By subtracting this estimate from the Census figure of employment in the non-household sector it is possible to estimate three sub-groups of workers in manufacturing: those in the household, the non-household unregistered, and the non-household registered sectors it is possible to estimate three sub-groups of workers in manufacturing: those in the household, the non-household unregistered, and the non-household registered sector. The results are reported in Table 4.1.

Table 4.1: Growth And Distribution Of Main Workers: 1981-91

	Census	Census	Absolute Change in 000s	Rate of Growth (%)	Share in Total Share in Non	
	1981 in 000s	1991 in 000s			(%) Household	(%) Non Household
All Manufacturing	25,145	28,671	3,526	1.4	100	100
Household	7,713	6,804	-909	-1.18	30.7	23.7
Non Household	17,432	21,867	4,435	2.54	69.3	76.3
ASI	7,715		448	0.58	100.0	100.0

Non Factory	9,717	8,163	3,987	4.1	30.7	28.5	44.3	37.3
Household non ASI		13,704			38.6	55.7	55.7	62.7

Note: Population figures exclude Assam and Jammu and Kashmir, manufacturing includes electricity, water and gas-Census-81 from Part-2 of 1983, key population statistics based on 5 percent sample data. Census-91 from Primary Abstract, 1991.

ASI summary results for the factory sector, 1980-81 & 1990-91.

In 1991, while the non-household sector provided employment for 76.3 percent of total manufacturing employment, the unregistered sector accounted for as much as 47.8 percent. The SSI sector is bigger than the 'unregistered' sector, because some of the units covered by the ASI are small scale according to conventional definitions, whether by employment size (less than 50 workers) or by capital size. In 1990-91, units under 50 workers add another 6.5 percentage points to the SSI- giving a total of 54.3 percent of employment in the sector, (17.5 percent of ASI employment was in units of 0.49 size class. It was 18.2 percent if we adopt the capital size definition prevailing at this date i.e. those having a value of plant and machinery of less than Rs. 5 lakhs). Adding the household sector, of course, increases the importance of small scale in total manufacturing enormously- to over three quarters of the total.

4.12. The Economic Census

The Central Statistical Organization (CSO) conducts a survey of non-agricultural establishments in the unorganized sector every five years. The first one was in 1978-79, the second in 1984-85, and the last in 1989-90. As explained in the annex to the chapter the survey was in two rounds – here we use only the first round pertaining to manufacturing and repairs services units. The establishments are classified into three groups.

- i. Directory Manufacturing Establishments (DME);
- ii. Non-Directory Manufacturing Establishments (NDME) and
- iii. Own Account Enterprises (OAE).

A DME is an establishment with six or more workers, at least one of whom is hired on a fairly regular basis. An NDME is one which employs five or less workers, at least one of whom is hired, and an establishment with no hired worker is classified as OAE.

It should be noted that the OAE sector does not coincide with the household sector as conceived of in the Population Census, although there is considerable overlap between the two. The Census of Population considers the household sector to be those establishments which carry out their operations from their own residence.

Furthermore, the absolute numbers employed in manufacturing are not comparable between the two sets of statistics. There are two conceptual reasons for this apart from errors in recording. First, considerable uncertainty and volatility exist in the Census of Population because of the problems in identifying "main" and "subsidiary" workers employed in manufacturing. This is why in the figures given in Table 4.1 only the Census figure of main or principal workers is used. It is not known if the Economic Census confronted the problem of distinguishing main and subsidiary workers, and if so how they solved it. But at least, on this point, it is reassuring to find that the Economic Census figure of the total employed in the non-factory sector is considerably higher than the figure given in Table 4.1 – 40.25 million in the 1989-90 CSO survey results as against 28.67 million in the Census of Population, suggesting that the former did include some secondary workers. A second reason why the absolute figures of employment in manufacturing might differ in the two Censuses is that the boundary between manufacturing and repair/services is very hazy in the SSI sector, and particularly in the household sector. In any event, more interest attaches to the proportions of employment in the different sectors as recorded in the two Censuses.

The statistics provided by this source add to our information because it is possible to classify small scale sector by further size categories, in particular, distinguish the small (> 6 workers) from the tiny sector (1-5 workers) consisting of the NDME and the own account establishments.

The statistics provided by the two more recent survey of DME and NDME & OAE are reproduced in Table 4.2. Full details (absolute numbers and percentages) are provided in Appendix Table A-1 and A-2.

Table 4.2: Manufacturing Employment in Different Sectors (Percent)

Sector		1984-85	1989-90
I	Factory sector	16.8	20.2
	of which SSI	(5.7)	(7.6)
II	DME	10	14.5

III	NME (1-5 Workers)	10	6.4
IV	OAE (Own Account)	63.2	58.9
	Total	100	100
	Total in Number (Lakh)	468.2	402.51

Sources:

- i. ASI, 1984-85 & 1985-90 Summary Results for Factory Sector (COS)
- ii. Directory Manufacturing Establishments Survey Results of 1994-85, 1989-90 (cso).
- iii. Non Directory Manufacturing Establishments Survey Results of 1984-85 & 1989-90 (NISSO)

It is clear that the not of the quality which can be used to trace detailed changes between the Censuses. It seems very unlikely that the total employment in manufacturing should have fallen between the two dates by more than 10 percent, (the first census of 1978-9 was not reliable enough to be used by the National Accounts Office). Nevertheless the orders of magnitude of proportion of workers in the different segments are fairly close together at the to dates ad could be used for giving reliable estimates of the distribution. It is seen that if the modern small-scale sector is assumed to be the sum of the DME and the SSI in the manufacturing sector (a procedure which makes it comparable with much international data giving information on manufacturing employment in enterprises of more than 5 and less then 50 workers), it accounts for around 20 percent of the total, but perhaps 50 percent of the modern manufacturing sector.

4.13. Small Industry Development Organisation (MSME-DO) Census

The Office of the Development Commissioner, Small Scale Industries has conducted two censuses of the small-scale units (CSSU) with reference period as 1972 in 1987-88. This is based on a scheme of voluntary registration with the State industry Departments (Dis and DICs). Because of the uncertainty of the criterion of registration and of its continuation over time, it is difficult to be sure where it fits into the other sources mentioned above. In 1987-88 the estimate of employment in the MSME-DO unit was 7.692 million, which compares with the Economic Census estimate of employment of 7.348 million in 1984-85 in the DEM plus the SSI factory sector. In 1989-90 estimate of employment in MSME-DO units was 8.699 million which falls short of economic census estimate of 8.919 million for 1989-90,(ee Appendix Table A-2).

It is apparent that it is impossible to obtain a consistent estimate of the total employment in the small-scale sector in the absence of coordination among the different agencies responsible for recording statistical counts. The comments made on the proportions in each of the segments distinguished above is as far as we can go.

4.2. Size of the SSI Sector: Value Added

The vast majority of enterprises in the small-scale sector are units of the cottage type, with low productivity or value added per worker. The structure of value added would thus differ significantly from the structure of employment.

Presumably the most reliable source of data on value added would be the National Accounts Statistics. For 1989-90 the unregistered sector in manufacturing accounted for 37.7 percent for Gross Value Added (GVA). The registered sector, of course, included the SSI part of the factory sector. The ASI estimate for this sector was 11.5 percent of GVA. Thus summing them, the total small scale sector contributed 49.2 percent of GVA to the manufacturing sector.

It might be of interest to supplement this estimate with the breakdown of different sub-section given in the Economic Census of this date. This is done in Table 4.3 based on the data in Appendix Table A-1.

Table 4.3: Gross Value Added in Manufacturing in Different Sectors (Percent)

Sector		1984-85	1989-90
I	Factory Sector	66.2	73.3
	(of which SSI	(10.4)	(11.5)
II	DME	9.2	8.2
III	NME	8.8	6.4
IV	OAE	15.9	11.7
	Total	100.0	100.0

Total	1984-85	1990-91
Total GVA (Rs. Crore)	37,697	70,966

Sources: Table A-2

Comparing the percentage distribution of employment in Table 4.2 with that of value added in Table 4.3, we see the enormous differences in labour productivity. The indices of value added per worker (relative to the average of all manufacturing), are obtained by dividing the percentages of Table 4.3 with those of Table 2. These are reproduced for 1984-85 only in Table 4.4.

Table 4.4: Indices of Relative Gross Value Added Per Worker

SECTOR		1984-85
I	Factory Sector (non SSI)	476.1
II	SSI Factory Sector	161.4
III	DME	92
IV	NME	88
V	OAE	18.5
Total		100

Source: Table 4.2 and 4.3

The data show the dominance of the high productivity large scale unit in the productivity ladder, and the remarkably low value of the own-account enterprises. Many of the latter must be providing supplementary income to workers engaged in multiple occupations. Another important point to notice in the Table is the difference in labour productivity between the SSI in the Factory sector and the DME units outside the purview of this sector.

4.3. Growth Rate

4.3.1. The Household Sector

As in all countries the household sector within manufacturing has shown a declining trend over several decades. Looking at the changes under the Population Census definition, employment in this sector, as shown in Table 4.1 above, declined from 30.7 to 23.7 percent in the decade of the eighties, if we confine our attention to main workers only. This continues the trend noticed in little, Mazumdar and Page (hereafter LMP) of a nearly 20 percent decline in household industry in the 1961-71 period, concentrating on male workers only (LMP, Table 5-2,p61). The Economic Census, adopting a different definition of own-account units, also shows a decline in the proportion of OAE employment in the last 1980s (Table 4.2 above). India is thus behaving no different from other countries in which the sector of low productivity shrinks with economic development. This is all to the good, as the process of transformation raises overall productivity and labour earnings by shifting workers from cottage shops to more productive units.

4.3.2. The Registered and the Unregistered Sectors

The National Accounts data presented in Appendix Table A-3 show the changing composition of manufacturing output in terms of the "registered" and the "unregistered" sectors- the criterion of registration being coverage under the Factories Act. It is seen that the proportion of value added accounted for by the unregistered sector has fallen slowly from a share of just over 41 percent in the early eighties to just over 37 percent in the early nineties. Evidently the decline in the household sector in manufacturing was not fully compensated for by the growth of the non-household production in the small-scale sector. Of course, the "registered" sector in the National Accounts includes SSI units coming under the Factories Act.

But as the figures 1, 2 and 3 show the growth rate of the SSI sector fell short of the growth rate of the non-SSI sector value added over the 1980s and early 1990s. Table 4.5 presents figures of annual growth rates of the small scale sector (adding together the unregistered sector of the National accounts and SSI sector obtained from the ASI) for the years since 1980-81.

Figure 1: TREND GROWTH IN GROSS VALUE ADDED REGISTERED

FACTORY SECTOR

$$\text{Log (GVA)} = 0.0.18T + 2.0899$$

2.6

$R^2 = 0.9766$

2.5

2.4

2.3

2.2

2.1

2

1980-81 81-82 82-83 83-84 84-85 85-86 86-87 87-88 88-89 89-90 90-91 91-92 92-93 93-94

Figure 2: TREND GROWTH IN GROSS VALUE ADDED UNREGISTERED FACTORY SECTOR

2.3

$\text{Log (GVA)} = 0.0232t + 1.9578$

2.25

$R^2 = 0.9743$

2.2

2.15

2.1

2.05

2

1.95

1980-81 81-82 82-83 83-84 84-85 85-86 86-87 87-88 88-89 89-90 90-91 91-92 92-93 93-94

Figure 1: TREND GROWTH IN GROSS VALUE ADDED SMALL SCALE INDUSTRY SECTOR

2.45

2.4

$\text{Log (GVA)} = 0.0.264t + 2.0399$

2.35

$R^2 = 0.9826$

2.3

2.25

2.2

2.15

2.1

2.05

1980-81 81-82 82-83 83-84 84-85 85-86 86-87 87-88 88-89 89-90 90-91 91-92 92-93 93-94

Table 4.5: Growth Rates of Small Scale Sector

(Unregistered Sector of The National Accounts and The SSI Sector From the Annual Survey of Industries)

Year	Gross value Added Rs.Crore)	Growth Rate (%)
1980-81	11,973	
1981-82	11,477	(-)4.14
1982-83	13,319	16.05
1983-84	14,271	7.15
1984-85	14,469	1.39
1985-86	15,999	10.57
1986-87	16,932	5.83
1987-88	18,157	7.23
1988-89	19,402	6.86
1989-90	20,898	7.71
1990-91	21,440	2.59
1991-92	22,525	5.06
1992-93	23,370	5015

Source:
i Annual Survey of Industry
ii National Accounts statistics

MSME-DO figures give an estimate of growth rates of the small-scale sectors under their purview, which is considerably in excess of the estimates presented in the national accounts. For example, the average annual growth rate of value added was estimated at 9.22 percent between the two Censuses of 1972 and 1987-88 at 1972-3 constant prices (NCAER, table 3.10, p. 68). Even allowing for the fact that the household sector has dragged the growth rate down in the National Accounts estimate of the small-scale sector, the difference between the MSME-DO and the National Accounts estimates is very large. However, the methodology of estimating the growth rate in the MSME-DO data is deficient. It appears that the MSME-DO arrives at its figures on a gross basis, without allowing for the mortality of previously counted units. An NCAER study, allowing for a mortality of around 4 percent per annum showed that over a period of time the over estimation of the number of units, and hence the inflation of employment and output based on the per unit data, would be considerable (see Appendix Table A-2). It should be noted that while the MSME-DO data cannot be used for calculating over-all growth rates of the SSI sector, the changes in the proportions and ratios of various variables over the period of the two Censuses are likely to be not subject to error, unless there are big differences in the relevant ratios between surviving and extinct units.

4.4. The industrial composition of SSI and its change over time

We now use various sources to trace the more significant changes in the composition of industry. Which are the sectors or industry groups which are most prominent in the growth of the SSEs?

4.4.1. Traditional vs Modern SSI

The Planning commission provides the basic composition of the entire decentralized (small-scale or VSI) sector by major types of industries, bringing together the different areas under the purview of different government entities. The data for different dates are set out in Table 4.6.

Table 4.6: Composition of Output of Very Small Industries

--	--	--	--	--	--

Industry	1973-74	1979-80	1984-85	1989-90	1991-92
A traditional Industries					
Khadi	0.44	0.27	0.26	0.18	0.14
Village Industries	0.90	1.04	1.17	0.96	1.10
Handlooms	6.20	5.19	4.45	2.95	2.08
Sericulture	0.46	0.39	0.49	0.43	0.51
Handicrafts	7.83	6.11	5.41	6.18	6.79
Coir	0.44	0.26	0.15	0.11	0.09
Sub Total of A	16.10	13.26	11.45	10.82	10.71
B Modern Small Industries					
Small Scale Industries	52.94	64.51	78.12	80.55	81.93
Power Looms	14.56	9.96	9.93	8.63	7.36
Sub Total of B	67.50	74.20	88.05	89.18	89.29
C Other	16.40	12.54	0.5	0	0
Grand Total (A+B+C)	100	100	100	100	100

Source: Planning Commission

The composition of output in the VSI sector mirrors the long-term change already noticed in the relative decline of the household sector in terms of employment. There has been a significant increase in the modern small-scale sector from a share of 67.5 percent in 1973-4 to as much as 89.3 percent in 1991-2. Furthermore within the modern sector the importance of basic textile production in powerloom units has also been reduced.

4.42. Composition of the Modern SSI Sector

We can use the data from the Economic Census and the ASI to put together the data for the DME sector and the SSI part of the ASI. The summing of these mutually exclusive types (distinguished by the fact that they are not or are covered by the Factories Act.) provide a fairly accurate picture of the composition of employment and output in the small scale modern sector. By relating these figures to the ASI data for the non-SSI sector one can also compute the share of the small-scale sector in total output or employment in the modern manufacturing sector. These data are reproduced in Table 4.7.

Table 4.7: Role of SSI In Different Product Categories (Percent Share)

For group of 2-digit industries have substantially higher presence of the SSEs in total production (in terms of value added) of total modern manufacturing. In 1984-5 the overall share of the SSEs was 28 percent. The following four group had considerably higher shares. Textile products(62.8), Wood, furniture etc. (78.0). Paper and printing (47.9) and Metal products (56.5)

A miscellaneous collection of "other manufacturing" also have a share of 46.9 percent. Only 7 of the other 13 two-digit groups have particularly small shares of SSEs. These are cotton textiles, jute textiles, rubber and petroleum, chemicals, basic metal industries, electrical machinery and transport equipment.

At this level of aggregation, India does not stand out as particularly peculiar in terms of the presence of the small-scale sector in modern manufacturing. A more formal analysis has found that the presence of small-scale was higher the less vertically integrated the industry, the lower the extent of economies of scale in management (as measured by the proportion of workers to total employees), and the higher the labour productivity of small firms relative to the total industry sub-sector. (Ira N. Gang, 1990).

4.43. Changes in the Composition of SSE Output in the Modern Small Scale Sector

Some interest attaches to the change in the composition of product groups which are under the purview of the MSME-DO, and this represent largely the modern small scale sector, not covered by the Factories Act. Table 4.8 reproduces the data, grouping the products into five broad groups.

Table 4.8: Growth And Structure of Employment By Major Product Groups

Major Product Group	Employment		Annual Average Group Rate (%)	Share of Total Employment (%)	
	1972			1972	1987-88
Food & Beverages	136,000	555,000	9.87	8.2	15.1
Textiles	75,000	238,000	8.00	4.5	6.5
Metals and Electrical	705,000	1,092,000	2.96	42.6	29.8
Other Manufacturing	698,000	1,524,000	5.34	42.2	41.6
Services	39,000	256,000	13.36	2.5	7
Total	1,653,000	3,665,000	5.45	100	100

Source: Census Reports 1972 and 1987-88

The table gives the surprising result that between the two Censuses there has been a big decline in the metals in the metals and electrical products group, and a marked shift to the more traditional food and beverages group.

4.44. The Role of "Reserved Items"

The number of reserved products manufactured by SSI have increased from 177 to 843 between the two MSME-DO censuses, but the total value of reserved products in the over-all total of The MSME-DO sector increased only marginally from 24 to 29 percent (Ramaswamy, Table A-10, reproduced in appendix Table A-4).

More than 75 percent of reserved items in 1972 were in three-industry groups viz., chemical products, metal products and transport equipment. But by 1987-8 the share of these groups had come down to only 50 percent, although the number of reserved items within these groups had been increased quite substantially (Ramaswamy, 1994, p.15).

The point suggests a substantial growth in the SSI sector outside the reserved category. According to the second MSME-DO Census, out of 7,500 products manufactured in the Small Sector, 1,075 products Rs 40 crores during 1987-88, but only 48 these were in the reserved category. This implies that production activity of small units is not dominated by reservation- excepting in hosiery and garments.

The fact that production increase in SSI has grown outside the reserved sector, in spite of the huge growth in reserved items, calls into question the rationale for this policy stance. On the one hand it might be suggested that since growth takes place outside the reserved sector, the policy of reservation is of limited importance. On the other hand, the policy might still be allowing the creation of a stagnant pool of inefficient producers who might be discouraging the entry of more dynamic units in these product lines. In the absence of full analysis of the micro data available in the Census, it is not possible to test for the relative efficiency of the units in the reserved sector. However, Sandesara has drawn attention to one relevant statistic available in the MSME-DO report, at the aggregate level and in a majority of the individual industries, capacity utilization of the SSI units producing the reserved items was lower than those producing the unreserved items. (Sandesara, 1993, pp.28-29).

4.5. Size Structure within the Small Scale Sector

One criterion of excessive development of inefficient units in a sector is a strikingly unequal development of the distribution of enterprises. In a dynamic sector, one would naturally expect a large number of very small units which are newly born and struggling to make their way upwards. But if the proportion of such units is excessive, then the natural conclusion is that artificial protection or other measures of subsidy are supporting a host of inefficient units, which show little ability to grow. The unequal distribution of units of small and large sizes in terms of contribution to production is quite striking in the MSME-DO Report in 1987-88, at the upper end of the distribution (Investment in plant & machinery upto Rs.2 lakh) 83 percent of the units employing 54 percent of the workers, managed to produce only 28 percent of the output (using figures from Table 14 CCSU-1987-88).

Sandesara also compared the change between the two Censuses. There is a clear increase in concentration of output in larger units and a more unequal distribution of enterprises in terms of production level within the sector. Between 1972 and 1987-8 the

group of enterprises with investment of more than Rs.3 lakh (at 1972-3 constant prices) increased its share of production from 21 to 52 percent, but the percentage of units went up from only 2 to 7. This represents an increase in the "concentration ratio" from 10.5 to 13 (using data given by Sandesara, 1993, Table 7, p.226). To look at it from the lower end of the distribution, the relative production per unit, in the group with less than Rs. 3 lakh investment (at 1972-3 prices). Fell from 0.81 to 0.52. (The percentage of units in this group fell only marginally from 97 to 93).

The NCAER Survey of 657 small-scale enterprises in 1992 also commented on the highly skewed distribution of the units in terms of their output, particularly in some of the industries. In garments, 14 units (17 percent) employing more than 50 persons accounted for no less than 82 percent of production in the units. In electrical components, the share of two units employing more than 50 workers was 36 percent, and in detergents four units in the same size group accounted for 37 percent of production (NCAER, Table 3.23).

Evidently, the market structure within the SSI sector has been showing clear indications of monopolistic competition, with an excessive number of tiny units crowding in to share in the rent created through policy of protection and subsidisation, while success is achieved by a mere handful.

4.6. Trends in Employment, Investment and Productivity in the SSI Sector

The CSSUs of 1972 and 1987-8 have been compared by Sandesara for assessing the nature of growth in the MSME-DO sector some of his Tables are reported in Appendix Tables A-5 and A-6. Substantial growth was recorded in production and fixed assets (at constant prices), but as explained above some of this growth is due to increase in the scope of the industries sampled at the two dates.

More interesting is the change in factor ratios over time. The average size of the units (enterprise) fell in terms of all factors – but most dramatically in terms of employment – from 12 to 6 while investment in plant and machinery (at 1972-3 prices) fell by 8 percent, and net value added by 8 percent. The smaller employment size of the average enterprise was thus accompanied by an increase in capital intensity (K/L) and also by an increase in productivity of both labour and capital. To summarize, net value added/employment (V/L) increased by 73 percent, investment in fixed assets/employment (K/L) by 66 percent, net value added/ Investment in fixed assets (V/K) by 66 percent, net value added/ Investment in fixed assets (V/K) by 38 percent.

The data show increase capitalization of the average unit, together with significant economies of scale (or total factor productivity growth). They are consistent with a more skewed distribution of enterprises, in which the more capitalized units achieve a high level of productivity, while a large number of units of low employment size crowd the lower part of the distribution.

4.7. Spatial Distribution of SSEs

One of the aims of India's SSI policy was the dispersed development of units in rural areas and in less developed "backward" areas. There has been only limited success in attaining this objective.

Analysing the data of registered SSEs the Sixth Plan reported that nearly 67 percent of units had been established in developed States until 1976 (NCAER, p.79). The second MSME-DO Census reported a big leap in the share of SSEs in backward areas-increasing from 35 percent in 1972 to 62 percent in 1987-88. It has, however, been pointed out that the degree of dispersion might have been exaggerated.

The NCAER Report points out that in the case of rural areas, nearly 25 percent of the units are in food products. No less than 83 percent of the rural units are in few industries each employing only 2-4 workers. The development of artisan type units cannot be considered to be a strong growth of modern SSEs even if they are registered by the DICs.

The MSME-DO figures suggest that 85 districts with more than 2,000 units in each accounts for 51 percent of the total. More than 81 percent of SSEs are concentrated in 204 districts, and more than 50 percent of the districts do not have any significant number of small enterprises (NCAER, 3.7.6,p.81).

The objective of dispersal might be in conflict with the dynamic growth of modern and efficient growth. There has been important spatial concentration of SSEs in "clusters" in particular product lines. The external economics which these clusters generate in terms of easy availability of raw materials, skilled labour, markets etc, have been known to have been instrumental in the growth of SSEs in many countries, including Italy and Germany. India is proving no exception to this basic economic impulse. (See NCAER, p.81 for a list of the more important "clusters" in India). It is appropriate that these trends might be more emphatically encouraged in official policies and objectives. A closer look needs to be taken at the methods for fostering development in "backward" areas" through such methods as tax concessions and special allotment of scarce materials.

4.8. Economic Ratios

Much space has been used up in the literature on the variations in key economic ratios by establishment size. The objective of these discussions is to search for, and perhaps establish, the productivity (Y/K) and increase in labour productivity (Y/L). In other words, arranging enterprises in ascending order of size groups one might be able to discover a fairly smooth production function in which larger use of capital per worker leads to diminishing return to capital. If then, as explained in the opening chapters, if the prevailing ratio of prices of capital to labour in the economy is lower than the socially optimal, the empirical case for selective support of the small-scale is established. In some ways, such exercises are of secondary interest, because even though the expected relationship is established it says nothing about the nature of through supply side interventions in the factor markets (e.g. providing subsidized credit).

Instead of going through a laborious process of reviewing the many studies in this area, we propose to summarize the most persistent findings which stand out from this area of research.

- i. At the aggregate level, looking at all manufacturing industrial groups together, the expected behaviour of the economic ratios is observed with much greater regularity and smoothness when enterprises are grouped by capital or fixed investment size than by employment size. This is as true of industrial census data in India, as in other countries like Japan (LMP, Chapter 7). This is also as true of the ASI sector as of the units surveyed under the MSME-DO survey of SSI units (Suresh Narayan). Even smaller surveys confined to a few selected industries and a limited number of units produce these results (NCAER, Tables 3.17 and 3.18, pp. 96-97). A little reflection will show that this is as it should be. Techniques of production are distinguished by the degree of mechanization which is reflected in the amount of fixed capital employed, not so generally require a small amount of investment in plant and machinery, but because of low labour productivity (and low wages) could use a lot of labour. The systematic rise in capital used by larger enterprises. Furthermore, at the aggregate level there is not much evidence of increasing returns to capital, so that economic ratios change in the expected way.
- ii. For guides to policy, however, examination of the aggregate data for all industrial groups put together, serve little purpose. The relevant question is: does this relationship hold at the level of individual industries – and more disaggregated the industrial grouping the more realistic is the result for policy purposes. Unfortunately, when we consider individual industries even at the 2-digit level, the systematic relationship breaks down. This is because of the very large variations in the capital-labour ratio prevalent in different industries. The more disaggregated the data from industrial Censuses the more pronounced the difference between inter-industry variations in capital-labour ratios and the variations by size groups within industries. In an early study of Korean data, which were available at the five-digit level of classification. Ho (1980) found that the variation in capital intensity by size groups within individual industries seldom exceeded 1.3 while the inter-industry range was more like one hundred.
- iii. A second important point to remember is that partial factor productivities like the amount of capital per unit of output or the amount of labour per unit of output are not sufficient to measure the true resource use for any size class of firms. The small-scale units might use less of capital and more of labour, but this does not make it automatically more efficient from a welfare point of view. We need to calculate the value to the economy of the capital saved and weigh it against the value of the extra labour used. Thus we need to calculate the "total factor productivity" of different classes of firms, weighting the inputs, capital and labour, by their appropriate economic or "shadow" prices.
- iv. Industry studies in a systematic way have not been possible in India because we need firm level data to perform any meaningful analysis of economic ratios by size within individual industries. The major surveys like the ASI and the SSI have been reluctant to make such material available for detailed analysis. We have to depend on the result of small-scale individual studies of specific industries for this purpose.

LMP studies several industries in Northern India shoemaking, printing, soap manufacturing, machine tool manufacturing and metal casting. There was a distinct increase in capital intensity, accompanied by the expected increase in labour productivity and fall in capital productivity in only one of these industries – shoe making. This was so partly because it was possible in this industry to mix mechanized and non-mechanized techniques in different ways, and also the units differed in the degree of vertical integration. In soap making, where only non-mechanized units were surveyed, capital first fell and then rose with firm size, while labour productivity remained virtually constant. A sharp increase in capital intensity above Rs. 10 lakh (at 1980 prices) in machine tool manufacturing was reflected in a rise in labour productivity but without a corresponding marked decrease in capital productivity – suggesting that in this industry larger units in terms of capital size were probably more productive.

In general, the variations in the economic ratios within each capital size class were large so that differences in the mean values of economic ratios between size groups were often not statistically significant. Furthermore, there was surprisingly less regularity in the pattern of labour and capital productivities than in capital intensity, which suggested that there were substantial variations in efficiency in production, as measured by total factor productivity.

The wide variation in total factor productivity was confirmed by our analysis of technical efficiency. Within each of the five industries technical inefficiency (measured by the difference between actual and predicted output) was substantial and variations in total factor productivity (indicated by comparison of the Farrell indexes across firms) were also marked. We were able to find relatively little evidence of a systematic bivariate relationship between employment size and technical efficiency. The only industry in which technical efficiency was correlated with firm employment size was machine tool manufacturing. We have already mentioned our conjecture that this relationship revealed the effect of superior organization in production and mastery of technology by large firms.

A heroic attempt has been made in the unpublished literature to use the ASI data at the 3-digit level of industries. A state-wise breakdown of data from seventeen industries for the year 1984-5 was utilized to increase the number of observations. These are reproduced in Appendix Table A-7. The results are summarized as follows:

- In the first instance, relative efficiency was measured by calculating partial productives. Of the seventeen product groups, only four showed that the small-scale enterprises (defined as less than 2 million rupees of capital investment) were comparable, or superior to, the larger units. These product groups were spinning, Weaving and Textile Finishing, Garments manufacturing, footwear manufacturing, and Structural Metal Products. Of these garments and leatherwear are leading export sectors with a large SSE representation, and one would assume that relative efficiency and competitiveness would be high in these sectors. In the Structural Metal Product category, Ramaswamy (1990) also found similar results, using more disaggregated data. These results give us some confidence about the exercise undertaken. But the most noteworthy result is that in about 75 percent of the product categories SSEs were found to be less efficient, sometimes by a wide margin.
- A second step of the analysis with the above data set was the comparison across firm size groups of efficiency relative to the 'best practice' observed within the data set. For this purpose a deterministic production frontier econometric approach was adopted, constrained by the assumption of constant returns to scale.

Of the sixteen product groups analyzed as per Table A-8 only three showed SSEs to be technically more efficient – Grain Mill Products, Spinning, Weaving, Finishing of other textiles, and Knitting Mills. In all other product groups SSEs were shown to be less efficient – the difference with larger firms bring larger the higher measured returns to scale (e.g., in metal utensils)

All this, of course, is the result based on the performance of the firms actually in operation. It does not say anything about the relative merits of SSEs in a particular lines of production if more competitive conditions prevailed in Indian manufacturing. To sum up: our tentative conclusion is that, with all the difficulties of drawing firm conclusions from less than ideal data sets, nothing in the several studies cited give one any confidence in the relative efficiency of SSEs in specific lines of production. With this in view, a better course of action for encouraging labour intensive production would seem to be to institute general policies aimed at providing positive help to SSEs in all lines of production. We recall the result cited earlier for Korea, in which SSEs were found to be distributed over a wide range of product groups, and the number found in groups in which SSEs dominated accounted for only a minority of total employment in SSEs.

4.9. Conclusions

This chapter has surveyed a large number of sources to throw light on different aspects of the structure, growth and economic characteristics of the SSI sector in India. It might be useful to highlight the more important of the findings.

- i. On the size of SSI, in spite of the different measures obtained from the different sources, the orders of magnitude of the share of SSI in total manufacturing and of its various components are reasonably clear. We may distinguish the 'small scale modern' sector – consisting of units employing 6 or more workers and the 'tiny' sector including household enterprises. In terms of employment around 1991, the former accounted for roughly 20 percent of all manufacturing employment, but nearly a half of employment in the modern manufacturing sector. The tiny and household sector is 2.5 to 3 times as large, depending on whether or not we include secondary workers in the labour force. The contribution of SSI in terms of value added is, of course, much smaller – only a third as for as the modern manufacturing sub-sector is concerned and no more than 40 percent of all manufacturing value added. The last point emphasises the

enormous difference in labour productivity between the different sub-sectors of manufacturing (as the dramatic figures brought together in Table 4.4 show).

- ii. As in other countries, the household sub-sector has declined slowly over the last two or three decades. A more surprising finding is that in spite of the vigorous policy of protecting the small scale, this decline has not been fully compensated for by the growth of non-household production in the small scale sector. The MSME-DO figures of high growth rates of SSI's under their purview seem to be grossly exaggerated.
- iii. In spite of the vast increase in the number of reserved items, much of the growth in the SSI sector to have been in product lines outside the reserved list. It is possible that the policy of reservation might be merely protecting inefficient units in stagnant industries.
- iv. A finding of some concern is the unequal distribution of units of small and large sizes within the SSI sector. There seems to be an increase in the concentration of output in larger units over the last two decades. A comparison of the data from the two MSME-DO censuses of 1972 and 1987-88 show a sharp fall in the mean employment size but an increase in capital-intensity of the MSME-DO units- which is consistent with a more skewed distribution of enterprises, and increased contribution of the more productive units.
- v. The claim that there has substantial dispersal of units to backward and rural areas under the SSI policy might be exaggerated. As far as the modern SSI's are concerned there is considerable evidence of spatial concentration of SSE's in 'clusters' in specific product groups. We have already emphasised in earlier chapters that there is a need for policies of decentralization to come to terms with the economic logic of external economies which 'clusters' provide.
- vi. In section 4.8 the empirical work on relative economic efficiency of small versus large units in India was reviewed. Nothing in the several studies examined give one any confidence in the relative efficiency of SSE's as they exist in specific lines of production. Rather, some economically efficient small enterprises exist in many product groups. The cause of SSI development is then best served by encouraging the potentially dynamic units to grow and prosper in any product group they operate in - rather than by the prejudice the product group which will favour the small units.

ANNEX TO CHAPTER IV: STATISTICS ON SMALL SCALE INDUSTRY IN INDIA

INTRODUCTION

1. There are two major sources of information on small-scale industries (SSI) in India, namely, the Small Scale Industry Organisation (MSME-DO) and Central Statistical Organization (CSO). Each has its own strengths and weaknesses. Although representing a substantial share of the total SSI population, MSME-DO does not cover all industries. More importantly, its data suffer from sampling problems and are highly aggregated. On the other hand, CSO provides better coverage and is less aggregated, but its information is scattered among different surveys and is not readily available.
2. Administratively, India's SSI is divided into seven industry groups : (1) handicrafts, (2) handlooms, (3) khadi, village and cottage industries, (4) coir, (5) sericulture, (6) powerlooms, and (7) small-scale industries which are residual. Many on account of simple tools and production process, the first five subsectors are collectively called the "traditional" sector whereas the last two-powerlooms and residual small-scale industries – are known as the "modern" sector. For coordination of development programs at the central level, each of the subsectors has its own supervisory body or board, such as Khadi and Village Industries Commission, Development Commissioner for Handlooms, Development Commissioner for Handlooms, Development Commissioner for Handicrafts Board, Central Silk Board, Coir Board, and MSME-DO. The residual "small-scale industries" subsector is overseen by MSME-DO. Because it accounts for the important share of SSI, MSME-DO is often seen as representing the whole sector. In the present report, unless otherwise stated we include in our analysis both the traditional and modern sectors in line with CSO's statistical coverage.
3. For the purposes of administering tax and promotional benefits, there is a unified official definition of SSI which cuts across the different supervisory lines. Since 1954, when the Small Industries Development Program was introduced, the definition has undergone continual change. In 1955, SSI was defined as establishments with fixed investment of less than Rs. 5 lakh, which employed less than 50 workers when working with power or less than 100 workers when not working with power. But the employment criterion was dropped in 1960, and SSI has since been officially defined solely in terms of investment in plant and

machinery at original value. From time to time, the investment ceiling is revised upwards. In 1966, it was raised from Rs. 5 lakh to Rs. 7.5 lakh (or Rs. 10 lakh for ancillary units). These went up further to Rs. 10 lakh and Rs. 15 lakh in 1975; Rs. 20 lakh and Rs.25 lakh in 1980; and the current levels of Rs. 35 lakh and Rs. 45 lakh in 1985. New ceilings of Rs. 60 lakh and Rs. 75 lakh were introduced in August 1991.

MSME-DO DATA

4. **First Census:** The first attempt by MSME-DO to establish a database was made in 1973/74 when it undertook an All-India census of the registered small-scale industrial units. Detailed information was collected from around 140,000 units (out of 258,000 expected) on number of units, employment, fixed investment, borrowings, inputs, output, and export at the four-digit level of the National Industrial Classification. Some of the results were presented in the Handbook of Statistics 1985.
5. For the purpose of updating the census data on a year-to-year basis, a revised registration procedure was introduced in 1975. As before, registration with MSME-DO remained voluntary, but new provision was made in the application itself to collect all basic information including product manufactured, employment, capacity, investment etc. Also, all registrants were requested to supply annual production returns to the Directorates of Industries in each state.
6. To keep track production trends at the industry-group level, production data have been collected on a quarterly basis since 1976 from establishments registered with MSME-DO, covering 356 products based on a 2 percent sample (2400 units) from the 1973/74 Census. From this, a weighted production index for the registered small-scale sector is routinely computed using 1970 as the base year. Given the small sample size, the results are neither precise nor representative, while the corresponding index for unregistered units is nothing but a very rough approximation.
7. **Second Census:** Although the data collected during the first census continued to be periodically updated, it was found that the system was inadequate because it did not cover all the 2.400 products and that almost half the units sampled were either untraceable or had been closed down. It was therefore decided that a second All-India census of registered SSI units be conducted so as to obtain a more reliable frame of SSI units registered with the State/UT Industries Directorates up to March 31, 1988. The main objectives of the census were to :
 - i. Obtain a dependable frame of functioning SSI units registered up to March 31, 1988 and falling under the purview of MSME-DO so as to enable state governments to identify SSI units to whom concession/facilities are to be continued;
 - ii. provide data by product group on capacity, production, employment, and other important characteristics of registered SSI units at All-India as well as State/UT level;
 - iii. facilities selection of sample units out of live units frame for estimating monthly production of selected items/products manufactured in the small-scale sector for use in construction of the Index of Industrial Production by the Central Statistical Organization; and for building up further estimates for products, industry groups, employment, investment, etc; and
 - iv. estimate the mortality rate of SSI units in various industry groups.
1. The census was to cover around one million registered SSI units, but in the event only around 8000,000 were enumerated.

ANNUAL SURVEY OF INDUSTRIES (ASI)

2. Since 1959 various data collecting agencies such as the Census Organization and the COS/National Sample Survey Organization (NSSO) have made conscious efforts to accommodate some of its data needs of SSI in their data collection programs. The ASI is the principal source of industrial statistics in India. It is conducted annually under the statutory provisions of the Collection of Statistics Act, 1953, except in the state of Jammu & Kashmir where it is conducted under the State Collection of Statistics Act, 1961. The field works of the survey is carried out by the Field Operations Division (FOD) of the National Sample Survey Organization (NSSO) through its network of regional and sub-regional offices located in different parts of the country. The processing of data and publication of reports are the responsibility of the Central Statistical Organization (CSO). However, the overall responsibility for the choice and collection, processing and tabulation lies with the steering Committee on Industrial Statistics constituted by the Government Council of the NSSO.
3. The ASI covers the entire country except the states of Nagaland and Sikkim and union territories of Arunachal Pradesh, Dadra & Nagar Haveli and Lakshadweep

Islands and Mizoram. All the electricity undertakings engaged in the generation, transmission, and distribution of electricity registered with the Central Electricity Authority are covered under ASI irrespective of employment size. ASI covers all factories registered under the Factories Act of 1948, which employed 10 or more workers and using power or 20 or more workers and not using power on any day of the preceding 12 months. Certain durables like watches etc. are covered under the survey. (In the present reports, we are concerned mainly with manufacturing activities and have thus omitted all services except repairs.

4. The primary units of enumeration is a factory in the case of manufacturing, a workshop in the case of repair services, an undertaking or a licence in the case of electricity, gas and water supply undertakings, and an establishment in the case of bidi and cigar industries. The owner of two or more establishments located in the same state and belonging to the same industry group is, however, permitted to furnish a single consolidated return, a common practice among bidi and cigar establishments, electricity and certain public sector undertakings.
5. The ASI frame is revised ever four years by the Regional Office of the FOD who liaise with the chief Inspector of Factories in the states. While names of the de-registered factories are removed from the ASI frame only once every four years, newly registered units are added every year. In enumeration, the units (often small-sized) that have been selected for the survey but are found to be non-existent are excluded from calculation.
6. For the purpose of the ASI, the factories in the frame are classified into two sectors, viz., the census and the non-census (or sample) sectors. Until 1987-88, the census sector was operationally defined as factories employing 50 or more workers and using power, or those employing 100 or more workers but not using power, while the remaining factories constitute the non-census sector. As from 1987/88, the census sector is redefined as units with 100 or more workers regardless of power use. Once a factory is classified into census/non-census sector, its status is not altered for a period of four years, i.e., until the frame is revised, even though a change in employment might warrant it.
7. All the census units are enumerated, while only half (on third since 1987/88) of the sample sector are enumerated each year, with the exceptions of : (1) industries, which, at the three/four digit level of NIC, do not total more than 50 factories in the whole country; and (2) factories located in relatively less industrialized states and union territories. Otherwise, individual units in the sample sector were enumerated every other year, based on a stratified unistage sample design. 1 the reference period for ASI 1984/85 was the accounting year of the factory ending on any day during the fiscal year 1984/85.
8. ASI provides results by employment size and investment value at the aggregate level, whereby SSI units may be readily distinguished. However, at detailed levels of two-or three-digit NIC no such breakdowns are available which by virtue of their relatively large employment size are registered with MSME-DO.) But these represent only the larger units of SSI. For information on smaller units, i.e., those with less than ten employees and using power or less than twenty without power 2 , one has to consult two other complementary surveys also by CSO, namely Directory Manufacturing Establishment (DME) and Non-Directory manufacturing Establishment (NDME) surveys, the latter including Own-Account Establishments (OAE).

DIRECTORY AND NON-DIRECTORY MANUFACTURING ESTABLISHMENT SURVEYS

9. To obtain information on the "unorganised" non-agricultural sectors of the economy, the first economic census of non-agricultural establishments was carried out in 1977 by the Central Statistical Organisation in collaboration with the Department of Economics and Statistics (DES) in the States/Union territories. In the census, establishments were divided into three groups, namely (i) Directory Establishments (DE) which had six employees, at least one of whom was hired, and (iii) Own-Account Enterprises (OAE) if there are no hired workers at all.
10. Based on the frame produced from the census, two rounds of sample surveys were subsequently conducted involving establishments that were not covered by ASI, i.e., DE, NDE. The first round which took place in 1978/79 covered units in manufacturing and repair services, while the second round which followed six months later was concerned with trade, restaurants and hotels, transport and services. In the first round (manufacturing and repair services), two separate surveys were undertaken, Non-Directory Manufacturing Establishment (NDME) survey which included OAE3 and Directory manufacturing Establishment survey (DME). The joint NDME/OAE survey took place during July 1978-June 1979 as part of the 33rd round of the National Sample Survey (NSS), while the DME was undertaken as a separate survey three months later by the Central Statistical Organization in October 1978-September 1979.

11. Conducted at the three-digit level of National Industrial Classification (NIC),⁴ the survey covered the entire country excluding the rural areas of Nagaland and Chandigarh, Sikkim, Lakshadweep, Manipur and Andaman & Nicobar Islands. In NDME and OAE, a combined total of 178,664 were enumerated or about 2.2 percent of the estimated total of 8.13 million. In the DME, a total of 34,878 establishments were enumerated, or 10.4 percent of the estimated total of 334,896.
12. Similar surveys were conducted five years later in 1984/85, based on the frame obtained from the Second Economic Census (1980). The second NDME survey along with OAE was undertaken during July 1984 to June 1985 as part of the fortieth round of the NSS and was followed three months later by the second DME during October 1984 – September 1985. In these surveys, the output/turnover/receipts criterion that was used in the first round was dropped, and distinction between Directory and Non-Directory is now based on the number of employees only. That is, units with six or more employees, at least one of whom was hired on a fairly regular basis were classified as DE, including establishments manufacturing bidi and cigar other than those covered in the ASI establishments manufacturing bidi and cigar other than those covered in the ASI irrespective of whether they were registered or not under the Bidi and Cigar Act. Likewise NDME is defined as those with five or less employees, at least one of whom is an hired worker, establishments with no hired worker at all are classified as OAE.
13. In the 1984/85 (along with OAE) survey, a total of 135,998 enterprises were canvassed, or 0.7 percent of the estimated total of 19.2 million. Of this, 75 percent were in rural areas and 25 percent in urban areas. Own-account enterprises accounted for 89 percent of the total. In the corresponding DME, a total of 31,739 units were interviewed, or 6.7 percent of the estimated total of 474,882. Of this, 37.7 percent were in rural areas and 62.3 percent in urban areas. The geographic coverage of the second surveys was essentially the same as in the first.

DATA LIMITATIONS AND ALTERNATIVES

14. None of the above data sets separately provide complete coverage of India's SSI. To recapitulate, MSME-DO's data and censuses only cover units under its purview, i.e., the "residual" SSI in the modern sector, and are thus incomplete in their coverage. Of those units under its purview, only about two thirds are reportedly registered; information on the rest is just a rough estimate.
15. ASI is also partial in its coverage as if only covers the larger spectrum of the SSI units that are registered factories. A further complication is that in the publicity available results these units cannot be distinguished from the rest of the sample except in the aggregates where the results are broken down by employment and investment size. No such distinction is made in industry-wise data. To get around this problem, some researchers have resorted to the "sample" portion in 1982/83. Apart from their obvious datedness, the data from the "sample" roster have another serious limitation in that the SSI is necessarily defined in terms of employment size (49 or less not using power), rather than in terms of investment value as it officially adopted, thus making it less useful from the policy point of view.
16. Another commonly used proxy for SSI'S output is the value added of "unregistered/unorganised sector" at the two-digit level of NIC as reported in the National Accounts Statistics. Based on DE, NDE, and OAE5, these represent net output of the unregistered units that are not covered by ASI. However, as these establishments cover mainly those with ten or less employees, they represent the smaller units of the SSI sector. It should also be noted that as these surveys are conducted at five-year intervals the national accounts figures for the unorganised sector for years other than 1978/79 and 1984/85 are essentially extrapolations based in some cases (e.g., chemicals) on growth rates of medium and large scale enterprises.

TABLE

Table A-1: [Number of Manufacturing Establishments, their Employment, Output and Gross Value Added](#)

Table A-2: Estimates of Number of Units, Employment and Production and Current Prices

Year Before Adjustment			After Adjustment			
No of Units (Million)	Production (Rs. Crore)	Employment (Million)	No of Units (Million)	Production (Rs. Crore)	Employment (Million)	
1987-88	1.58	87,300	10.7	1.14	62,760	7.69

1988-89	1.71	106,400	11.3	1.24	77,070	8.2
1989-90	1.82	132,320	11.96	1.35	97,700	8.7
1990-91	1.95	155,340	12.53	1.45	115,790	9.12
1991-92	2.08	178,700	12.98	1.59	136,860	9.47

Source:
MSME-DO and Second SSI Census (1987-88)
Adjusted figures by NCAER (1993) Table 3.2, P 56

Table A-3a: [Gross Value Added in Indian Manufacturing \(Rs. Crore at 1980-81 prices\)](#)

Table A-3b: [Gross Domestic Investment \(Rs. Crore at 1980-81 prices\)](#)

Table A-4: Share of Reserved Products in Total Output

2Digit NIC Code	Industry Group	No. of Reserved Products	Percentage Share in Output of Group	No. of Reserved Products	Percentage Share in Output of Group
		1987-88	1987-88	1972	1972
	20 & 21 Food Products	17	35.85	0	0
	22 Beverages, Tobacco and Tobacco products	1	0.20	0	0
	23 Cotton Textile	0	0	0	0
	24 Wool, Silk and Synthetic Fiber Textile	0	0	0	0
	25 Jute, Hemp and Mesta Textiles	0	0	0	0
	26 Hosiery & Garments	31	80.11	0	0
	27 Wood Products	14	56.85	2	20.58
	28 paper products and Printing	30	24.79	0	0
	29 Leather Products	17	46.86	2	12.06
	30 Rubber and Plastic Products	99	30.92	7	32.43
	31 Chemicals and Chemical Products	166	29.74	19	26.55
	32 Non metallic mineral products	39	14.47	8	28.75
	33 Basic Metal Products	14	4.18	0	0
	34 Metal Products	131	42.62	62	49.06
	35 Machinery and Part except Electrical	55	8.83	2	32.76
	36 Electrical machinery and Parts	59	8.57	22	37.55
	37 Transport Equipment and Parts	102	23.80	48	8.58
	38 Miscellaneous Manufacturing	68	35.22	5	64.31
	97 Repair Services	0	0	0	0
	99 Services Not Elsewhere Classified	0	0	0	0
	OT Other Services and Products	0	0	0	0
	All Industries	843	29.36	177	23.71

Source:
Reports on Census of SSI Units 1972 and 1987-88 respectively
Reproduced from Ramaswamy (1994) Table A-10

Table A-5: Average Size of Small Industry 88in 1972 and 1987-88

Item	1972	1987-88	% Charge in 1987-88 over 1972
Investment in Fixed Assets (Rs. Thousand, Book Value 1972-73 prices)	57	50	-12
Investment in Plant and Machinery (Rs. Thousand, Original Value, 1972-73 prices)	38	30	-21
Gross Production (Rs. Thousand, 1972-73 Prices)	186	232	25
Net Value Added (Rs. Thousand, 1972-73 prices)	60	55	-8
Employment (Number, Lakh)	12	6	-50

Source:
Reports on Census of SSI Units 1972 and 1987-88 respectively

Table A-6: Selected Ratios in Small Industry in 1972 an 1987-88

Item	1972	1987-88	% Charge in 1987-88 over 1972
Production / Investment in Fixed Assets	3.27	4.62	41
Net Value Added / Investment in Fixed Assets	1.06	1.1	38
Output per worker (Rs. Thousand)	1.57	3.69	135
Net Value Added / Investment in Fixed Assets / Worker	5.09	8.81	73
Employment/ Rs. 1 Lakh investment in fixed assets	2.08	1.25	-40
Investment in Fixed Assets / Worker (Rs. Thousand)	48.09	79.83	66

Source:
Reports on Census of SSI Units 1972 and 1987-88 respectively

Table A-7: Productivity and Relative Efficiency

Product Category & NIC Number	Gross Value Added/ Employee (Rs. 000)			Gross Value Added/Productive Capital		
	Small	Large	Total	Small	Large	Total
Manufacture of Dairy Products (201)	13.52	30.39	27.68	0.42	0.38	0.38
Grain Mill Products	7.94	29.39	9.36	0.36	0.33	0.35
Mfg. of Other Edible Oils (211)	15.50	40.99	20.93	0.35	0.40	0.37
Printing, dyeing /Bleaching						
Cotton Textiles (232)	14.14	20.89	17.10	0.65	0.76	0.71
Spinning, Weaving & Textile Finishing (247)	21.47	38.48	35.76	0.77	0.45	0.47

Manufacture of Knitwear (260)	22.63	49.91	27.13	0.58	0.72	0.62
Mfg. of all types of Garments (264)	20.27	17.14	19.57	1.11	1.12	1.11
Printing & Publishing (285)	15.22	22.80	20.41	0.84	0.69	0.72
Mfg. of Footwear (291)	14.07	13.27	13.66	0.85	0.49	0.62
Mfg. Drugs & Medicines (313)	30.77	60.87	50.31	0.80	0.58	0.62
Mfg. Structural Clay prod (320)	6.02	27.55	10.04	0.70	0.39	0.50
Foundries for Casting Iron & Steel (331)	14.16	29.97	24.22	0.57	0.38	0.41
Mfg. of Fabricated Metal Products (340)	21.07	47.56	32.41	0.72	0.78	0.75
Mfg. of Structural Metal Products (341)	18.66	36.85	24.46	0.83	0.48	0.62
Mfg. of Handtools & Gen. Hardware(343)	15.18	33.70	25.08	0.55	0.53	0.54
Mfg. of Metal Utensils (345)	16.28	48.60	18.96	0.48	0.92	0.53
Mfg. of Electrical/Industrial						
Apparatus & Parts (360)	20.63	60.65	53.14	0.52	0.65	0.63

Product Category & NIC Number	Productive Capital/Employee (Rs. 000)			Relative Efficiency Index		
	Small	Large	Total	Small	Large	Total
Manufacture of Dairy Products (201)	31.87	79.64	71.98	0.77	1.04	1.00
Grain Mill Products	22.02	87.76	26.38	0.94	1.53	1.00
Mfg. of other Edible Oils (211)	44.91	102.72	57.24	0.89	1.26	1.00
Printing, dyeing /Bleaching						
Cotton Textiles (232)	21.60	27.46	24.17	0.87	1.15	1.00
Spinning, Weaving & Textile Finishing (247)	27.68	85.28	76.09	1.10	1.00	1.00
Manufacture of Knitwear (260)	38.83	69.38	43.86	0.91	1.32	1.00
Mfg. of all types of Garments (264)	18.29	15.24	17.61	1.01	0.96	1.00
Printing & Publishing (285)	18.03	32.89	28.21	0.87	1.06	1.00
Mfg. of Footwear (291)	16.50	27.07	21.88	1.17	0.88	1.00
Mfg. Drugs & Medicines (313)	38.37	104.51	81.31	0.92	1.06	1.00
Mfg. Structural Clay prod (320)	8.58	71.07	20.23	0.89	1.53	1.00
Foundries for Casting Iron & Steel (331)	24.95	78.09	58.76	0.86	1.09	1.00
Mfg. of Fabricated Metal Products (340)	29.36	61.26	43.02	0.80	1.21	1.00
Mfg. of Structural Metal Products (341)	22.51	76.40	39.69	1.03	1.07	1.00
Mfg. of Handtools & Gen. Hardware(343)	27.59	63.57	46.84	0.76	1.18	1.00
Mfg. of Metal Utensils (345)	33.96	52.76	35.52	0.88	2.00	1.00

Mfg. of Electrical/Industrial						
Apparatus & Parts (360)	39.50	93.97	83.75	0.60	1.07	1.00

Source: The data is drawn from the 1984-85 ASI broken down by state. Small is classified as units with investment in plant and machinery upto Rs. 20 lakh and large for those units with plant and machinery exceeding Rs. 20 lakh.

Table A-8: Estimates of Technical Efficiency

Remarks:

- i. Figures in parenthesis are statistics
- (ii) Efficiency index is ratio of technical efficiency of one class of firms over sample average

Table: Total Number of Manufacturing Establishments, Their Employment, Emoluments, Output and Gross Value Added



V. THE IMPACT OF NEW ECONOMIC POLICY ON SMALL ENTERPRISES IN INDIA

Successive rounds of liberalisation have transformed the macro economic fabric of the regime for small enterprises development. The approach of the previous regime, of low cost capital and cheap services supplied by the government, are out of place in context where financial repression is unlivable and expenditures on sprawling government departments have to be unavoidably pruned. Far-reaching reforms in India's financial system, trade and investment policy and structure of taxation have overtaken the lagging systems for promoting small industry. Therefore, small enterprises will be caught in a cleft unless their support system keeps pace with developments in the rest of the economy and the government devises meaningful support systems are devised.

Although it is premature to state definitive conclusions, a preliminary analysis suggests that the unfolding system continues to be skewed in favour of the large Indian corporate and multinationals. The, industrial regulatory system was hitherto characterised by a host of regulatory constraints which kept the cost of doing business high for large companies, it probably discriminated against small companies even more. Since permission for undertaking industrial activities had to be obtained in many different ways from the central government, the systems was based against less well endowed smaller companies because of the resources required for obtaining these permissions at the central level. Economic reforms have substantially disbanded the barriers to entry in almost all industrial sectors and hence in this respect the position is now better for the entry of small scale enterprises into the industrial sector. Further, in some other respects, particularly in the case of capital markets and availability of credit the situation may have become worse for small-scale enterprises. Small-scale industry policy continues to be hobbled by archaic system of social legislation.

In this section, we will review the ramifications of a gamut of economic policy reforms as they impinge on the relative competitiveness of small and medium scale enterprises on the one hand and large Indian corporations and multinationals on the other. In particular, we will focus on the impact of financial sector reforms, trade reform, foreign investment and technology reforms on the transaction costs and flow of credit to large and small companies.

5.1 Capital Markets

The deregulation in capital markets has most certainly worked to the advantage of large companies. Greater access to both the domestic and international capital markets has opened a whole new avenue for large companies to raise equity capital. The slow emergence of the bond market will open yet another avenue for which companies to raise debt capital in addition to the existing source of debt finance from the domestic financial institutions and that of fixed deposits. Small companies are, therefore, placed at a disadvantage since they do not have equal access to either domestic or international capital markets. Moreover, the volumes of capital that are being mobilised are so enormous that the relative importance of corresponding business in Indian stock markets is declining. The bias has been partly counterbalanced by the budget of 1996-97 which allowed Foreign Institutional Investors to invest in unlisted companies.

The figures for peak level investments in 1993-94 illustrate both the relative importance of inflows of overseas capital and their disproportionate distribution to large firms. GDR and Eurobond issues upto the end of October 1994 (i.e. 1991 till 1994) amounted to a closed to US \$ 4.5 billion compared to US \$ 6.2 billion issued by private sector companies in the domestic stock markets and US \$ 8.4 billion disbursed by the Indian financial institutions. Nearly half of the GDR and Eurobond issues were accounted for by the top 20 companies of the Indian corporate sector although fast growing small companies are also beginning to take advantage of the opportunity.

Furthermore, the costs of equity capital have fallen after the Controller of Capital Issues (CCI) was disbanded. Equity capital does not any longer have to be issued at formulae

fixed by the CCI and can be priced at levels reflecting the future earnings of the company or what the market is willing to bear. Consequently, large companies have been able to increase the price of their offers and to lower their cost of capital. Large companies have taken advantage of this opportunity to replace their higher cost debt capital with cheaper equity. Indeed, large companies had an opportunity to profit from parking their surplus cash in the inter-corporate markets when the interest rates rose following a credit squeeze.

Alternative sources of financing for small and medium scale companies like venture capital are yet to develop and traditional options for financing exhibit limited potential for expansion. Due to an overly long delay in the announcement of a new set of guidelines for venture capital which are expected to pave the way for domestic and foreign investors to invest in venture capital funds, their fund base has not been enlarged to make any significant impact on small and medium scale enterprises.

Moreover, the Malegam committee recommendations have limited the access that small and medium scale enterprises will have to the traditional stock markets. Henceforth, only companies with investments in excess of Rs. 5 crore will be eligible for listing on the BSE, NSE and other exchanges. Small and medium scale companies can be quoted on the over the counter market but this exchange has been unable to overcome its initial teething problems. A highly sophisticated trading system and advanced technology, notwithstanding, the OTCEI has witnessed a decline in the traded volumes.

In response to the new developments in capital markets, some private equity funds have entered the Indian capital market, Draper, Ind-Ocean, First National etc, have opened up shop to invest in unlisted companies. The stringent listing requirements on the stock exchanges will drive small and medium scale enterprises to private equity funds. Such funds specialise in assessment of projects promoted by relatively less well known entrepreneurs before their companies are listed on the stock exchanges. They effectively screen and prepare unlisted companies for floatation in the public stock markets. But there are few such funds as yet, an most of them are foreign funds.

Even though the quality of paper issued in the capital markets will improve substantially, the recourse to private equity is reportedly limited to the largest among the small companies. In an environment where information flows are incomplete and slow, the identification and assessment of new projects is costly and it is not possible for private equity to finance very small projects. Venture capital can potentially play a more important role for start-ups if it has the opportunity to diversity its risks. It is, therefore, an essential supplement for private equity funds to succeed in the Indian capital markets.

Here the state of development of the venture capital industry in India is a cause for considerable worry. India has the dubious distinction of having one the smallest venture capital industries in the world and is small even in comparison to its counterparts in Asian countries. The graph illustrates that the number of venture capital companies per 10 million capitals is about 1 compared to more than 100 in Singapore.

Furthermore, the information systems to identify good projects, so necessary for investment in unlisted companies, are in a primitive state of development. The experience with bought-out deals, which were an important source of financing for medium-scale companies in 1994, suggests that the markets can collapse unless investors can systematically detect poor quality projects and ignore them.

Competitive small companies have no systematic way to communicate their worth to the capital markets and raise finance at costs that reflect their individual risks. It is possible for modern small companies to raise capital at relatively low costs since their growth rates are known to be higher than the average industrial growth rate. However, systematic methods for assessing the worth of their projects does not exist in the country.

In the emerging economic climate in India, small companies need support to facilitate their access to capital markets. Financial intermediaries are required for the assessment of their projects and to communicate their worth to the capital markets.

5.2. Financial Markets

Term Loans

The fulcrum of the financial system supporting concessional finance for the small and medium scale industry has been the Long Term Operations Fund. This fund contributed by the Reserve Bank of India helped to refinance term loans extended by the State Finance Corporations and the State Industrial Development Corporations to the small and medium scale enterprises.

Over the last five years, the importance of the Long Term Operations Fund has declined as a result of the fiscal crisis. Increasingly, the Small Industry Development Bank of India has had to borrow from the markets at higher costs. Table 5.1 below shows that bonds, debentures and deposits account for nearly thirty percent of the resources raised by the SIDBI (excepting the amounts transferred from the IDBI, equity and market assistance funds) after reaching a peak of 35 percent. A part of the pressure of the

resource crunch has been relieved by generous funding support from overseas donor organisations. The share of concessional finance raised from the government has declined to 30 percent. In the future, it is likely that SIDBI will be required to borrow even higher amounts from the market.

Moreover, the financial vulnerability of the State Financial Corporations and the State Industrial Development Corporations and their low rates of recovery has decreased the levels of refinancing. As the rules for income recognition become more stringent, SIDBI is constrained to limit the refinancing of loans extended by SFCs and SIDCs in a poor state of health. The table below shows that the level of lending to SFCs/SIDCs declined from its peak in 1991-92 till 1994-95. In the latest year of reporting, however, refinancing levels have again increased as SIDBI's trust in commercial banks was enhanced by their improved financial state.

The financial system traditionally dedicated to meet the needs of the small and medium scale industry has decayed while new opportunities are opening to the large sector. This is a major weakness of the emerging economic system in the country that is loaded against the small scale sector. This is happening at a time when the demand for capital has risen as market opportunities grow and new capacities have to be created by all sectors of industry including the small scale industry. With the kind of rapid industrial growth that is expected and necessary to achieve an overall higher rate of economic growth there is a great need to encourage entry of new entrepreneurs and to help small scale enterprises grow in the coming years. Hence there is a need to review the existing system for the provision of capital to small scale enterprises in the new economic environment.

Working Capital

Historically, small scale industries have had a privileged access to bank lending. Priority sector lending was available to them at concessional rates of interest. Since interest rates were controlled at less than the market rates, the higher risks and costs of investing in small borrowers were not reflected in the lending rates. Moreover, small borrowers benefited from the implicit subsidies inherent in the lax standards for provisioning for bad and doubtful debts.

The deregulation of interest rates began in October 1995 and was taken further in July 1996. To begin with, scheduled banks were granted the freedom to fix interest rates on term deposits with maturities of over two years. This was later relaxed further when they were allowed to fix interest rates for term deposits with maturities of over one year. The benchmark rate of interest for the banks is the prime lending rates and the excess over it reflects the risks of lending to individual borrowers. Consequently, interest rates have risen sharply for small companies. The concessional lending under priority sector lending hardly softens the burden since no more than Rs.2 lakh can be borrowed under this scheme.

Moreover, the obligation to provide for bad and doubtful debts has now been extended to small loans. Provisioning for non-performing assets of less than Rs.25,000 has been enhanced to 10 percent for the year ending March 1996 from 7.5 the year before. From 1996-97 onwards, the rules will be the same as for amounts more than Rs25,000.

The impact of stricter regulation of the banking sector is already reflected in the supply of credit to the small scale sector. A study of clusters of small enterprises done by the NCAER³ shows that most of them have experienced a fall in the supply of credit. The only clusters unaffected are the glass manufacturing and woollen hosiery and knitted products sector which have vastly improved their export performance. Overall, the relative share of credit to the small sector has fallen from 13.0 percent of the incremental non-food gross bank credit in 1994-95 to 11.4 in 1995-96⁴.

This clearly constitutes a series of great alarm for the small-scale sector which is heavily dependent on the availability of bank credit for its health. In recommendation of this problem the government and Reserve Bank of India had appointed a Committee under Shri P R Nayak, Dy. Governor, RBI to look into the credit problems of small scale enterprises. We have summarised their main recommendations elsewhere and then suggested further measures in the Chapter on recommendations.

Undoubtedly, large companies are also affected by the stringent supervision of the banking system. However, they have more options to cope with short supply of credit. Creditworthy large companies have the choice to raise capital by commercial paper and certificates of deposits. Many of them have also established in-house finance companies as an additional means to raise resources. Finally, they can take recourse to international capital markets especially as India enjoys the confidence of overseas investors.

In the emerging economic climate in India, small companies will have to inevitably rely more on trade credit which has been their traditional source of finance as bank credit has become more difficult as seen above and other sources of finance such as the securities markets are out of reach or sources such as venture capital funds are yet to materialise. Their costs of debt will rise, as interest costs remain high. In periods of

economic downturns, small companies will be extremely vulnerable as the costs of servicing debt rise.

5.3 Trade Policy

Imports

The Import Policy has undergone drastic changes since 1991. Whereas earlier there were very few products that were freely importable into the country and licenses have to be obtained for most imports, now, almost all items are freely importable except for consumer goods. Consequently, in the earlier control regime, all most all items reserved for small-scale industries were not allowed to be imported. Thus small-scale enterprises producing reserved items were protected against both large domestic companies as well as foreign companies make such products. With the large scale trade liberalisation that has taken place a large number of items reserved for small scale industries are now freely importable. (see Appendix 1 for details). Furthermore, the government has recently announced that it is now considering a phased removal of quantity restrictions on consumer goods imports over a period of 5 years. Once this happens almost all items currently reserved for small-scale industries would become freely importable. With reservations inhibiting small companies from expanding and achieving economies of scale such companies may find it increasingly difficult to compete against the imported items if they are not allowed to invest further and to upgrade technology in the coming years.

Since 1991, three fourths of the products that were previously subject to import licensing procedures are now freely importable. Till 1991, a positive list of products was allowed to be imported which has been replaced by a negative list of items that cannot be imported. Out of 5,021 Harmonised System tariff lines at the six-digit level, 4,000 products were subject to quantitative restrictions. By December 1995, more than 3000 tariff lines covering raw materials, intermediates and capital goods were freely importable. The remaining items consist of consumer goods and agricultural commodities. Even here, no less than 1,487 tariff lines in the restricted list can be imported under the freely traded special import licenses granted to export houses / trading houses / star trading houses. Finally, as already mentioned the imports of consumer goods will have to be eventually permitted in accordance with India's commitment to the WTO.

Exports

The successful completion of the Uruguay Round of negotiations has prepared the ground for a substantial decline in non-tariff barriers to imports into the developed markets. The countries that have entered into free trade agreements have already removed non-tariff barriers ahead of the transition period permitted by multilateral rules. The NTB coverage ratio of India's exports is estimated to be 29 percent which is expected to drop to 5 percent⁶.

India stands to gain a great deal from the new rules since a very high share of its exports have Europe as their destination. India as an early entrant in the European markets especially for textiles has accumulated quotas over a period of time. It could, therefore, maintain its market shares even after many other Asian countries made a bid for the European markets. As non-tariff barriers are withdrawn, India will benefit from the expanded volume of imports but will also be subjected to increased competition from the Asian countries.

Research studies indicate that South Asia will be a major beneficiary from the removal of the Multi Fibre Agreement (MFA). South Asia's output and exports of textiles will increase by 17 percent and 26 percent. As for clothing, output and exports are expected to increase by 91 percent and 254 percent⁷. The judgment of scholars is that the gain from expanded trade will be far greater than the loss of rents from the end of quotas.

However, the potential benefits will be realized only if India can keep its costs down. In nominal terms, India is one of the cheapest offshore locations for production for textiles and clothing. After making adjustments for productivity and absenteeism, however, India's competitiveness falls and its costs are higher than in Korea and China by about two thirds⁸. Low productivity and high levels of absenteeism are inherent in the small scale of production.

5.4 Transaction Costs

In the era of protection, large companies incurred higher transaction costs as they had to comply with a variety of regulations under the Industrial Development and Regulation Act. On the other hand, small companies were exempt from the IDR Act if they employed less than 50 people with the use of power and 100 without its use. Consequently, small companies had an edge over large companies.

Moreover, large companies had to conform to the rules laid down by the MRTP Act on expansion, diversification and merger of companies. The costs of doing business for

large companies was also high because case-to-case approvals were required if the equity investment was more than 40 percent or if a sector was otherwise reserved for the public sector. Small enterprises were generally exempt from such rules that applied to the large Indian corporate sector.

In the emerging economic climate in India, the large Indian corporate sector has been relieved of the many transaction costs inflicted by the earlier policy regime. They do not any longer have to invest an enormous effort to deal with licensing procedures before they begin production. Moreover, the costs incurred on case-to-case approvals have declined, as many sectors formerly reserved for the public sector are now open to the private sector. Similarly, special permissions are not required for expansion, diversification and mergers of associate companies.

Furthermore, other transaction costs for large companies have declined as related systems have been streamlined. The procedures for purchase of technology, for making foreign exchange payments and for hiring overseas manpower are subject to much less discretionary oversight than they did before. Similarly, the costs of raising capital in the capital markets has been reduced after the Office of the Controller of Capital was disbanded.

The transaction costs specific to small business, on the other hand, have virtually remained constant. Above all, the insidious "Insidious "Inspector Raj" continues to throttle the very vitals of small enterprise. An intricate system of social legislation including social security, medical insurance and labor laws traps enterprise into a vicious circle of paper work and bureaucracy. Similarly, the systems for registration and other business laws have not been differentiated for large and small companies. They are, moreover, administered by a variety of ministries which have conflicting objectives and obtuse procedures. Thus, considerable thought needs to be given on how to help small-scale enterprises in coping with the prevailing system of "Inspector Raj" which makes it extremely difficult for them to function efficiently. Our recommendations attempt to address these issues as well.

As the burden on infrastructure services worsens, moreover, the transaction costs will only increase for the small-scale sector. Larger industry has access to capital to find private solutions to poor public services but the same is not possible for the small scale sector. A classic instance of the phenomena is telecom services. Whereas large companies have installed V-Sat networks to cope with the variable quality of telecom services provided by the public networks, the small-scale sector is unlikely to be able to invest large amounts to deal with such constraints. On the contrary, the opportunity costs of abysmal civic and urban services, and of environmental corrosion have risen steeply especially in clusters which have witnessed exponential growth rates. Access to infrastructure services at low costs will be essential for both the encouragement of new entrepreneurship as well as growth of existing small companies. Such attention therefore needs to be given to the provision of such services on a commercial and economic manner for small-scale enterprises. Our recommendations in this regard have therefore focused on the provision of infrastructure services to small-scale enterprises which are groups in clusters.

5.5. Business Services

The convenience of doing business is influenced considerably by the cost and quality of services available to enterprises. In the era of protection, small business in India was entitled to free or low cost services provided by the government. On the other hand, the large sector had to pay for services if they were at all available.

Large companies had to mostly do without services as this sector in India was underdeveloped and dominated by the state. Financial services, for example, were almost non-existent as the somnolent nationalised sector was not motivated to supply them. Management and technology consulting services were scarce as overseas companies could not operate in the country. Similarly, the choice for training services was limited since policy restricted payments to overseas experts. Consequently, large companies had few options even when they had an interest in purchasing superior services.

Currently, however, the large sector has many more options to source services to improve their competitiveness than the small-scale sector. The quality of financial services is vastly improved as a result of the entry of numerous merchant banks and private banks who tend to specialise in corporate services. Large companies now have the option of hiring overseas technical expert to assist them. Superior management consultancy is available to them as a result of entry of a large number of overseas and domestic consulting firms. Similarly, quality control services have improved as a result of linkages with overseas institutions in this field.

The advantage of vastly superior external sources of services is reinforced by greater freedom to hire better-trained manpower. Ceilings on salaries have been substantially relaxed so that large companies now have opportunities for learning in the plants of their overseas collaborators. Large companies are also able to draw on an increasing pool of professionally trained managers.

On the other hand, the traditional sources of support services for the small scale sector have fallen into disrepair as a result of the fiscal crisis. The most useful source of information, knowledge and skills remain the buyers. State sponsored institutions have been unable to keep pace with modern technological developments, to increase their geographical reach or to respond quickly enough to meet the demands of the day.

Small companies, moreover, have to make do with workers with a bare modicum of literacy and barely adequate skills. The demand for skills, however, has risen as keener competition is experienced with the entry of multinationals. Small companies cannot any longer expect to survive on the strength of their lower costs. The era of stagnant technologies has come to end so that non-price factors are the determining factors for survival.

5.6. Technology

Large companies have a free hand to enter into strategic alliances and joint ventures with overseas companies. Since multinationals can acquire equal or majority control, they are more willing to share technology. The increasing collaboration between large Indian companies and the multinationals will also enable the transfer of tacit knowledge of firms that will form the basis of product innovation.

The choices of small and medium scale companies, on the other hand, are far more limited. Their potential partners are overseas small and medium scale companies who, in fact, have a better reputation for innovation. However, the investment climate in India is not yet perceived to be hospitable enough to attract firms of a smaller size. Furthermore, special steps have not yet been taken to address the issues of collaboration between Indian and overseas small and medium scale companies.

Meanwhile, the remaining option for small and medium scale enterprises in India is to strengthen linkages with large Indian and multinational companies for transfer of technology. However, the reality is the subcontract exchanges especially established to facilitate relationships between large and small companies have floundered. Large and small companies, typically, enter into long-term stable relationships but this has not been possible in India.

Large companies cannot invest any more than 24 percent in small companies and they cannot establish long-term relationships on this basis. Stable and long term alliances with large companies for sharing of technology will enable small companies to take advantage of the potential for higher volumes of subcontracting business. However, such mutually beneficial relationships will only be possible when small companies have greater latitude to enter into joint ventures with large foreign and Indian companies.

5.7. Excise Concessions

The most important incentive for small companies, excise duty concessions, has been watered down by MODVAT and the reduction in excise duty rates. Under the era of protection, large companies had to pay very high levels of duty. Consequently, excise duty waivers upto a threshold levels at concessional rates, thereafter, implied that small firms could afford to sell at much lower prices or realised higher levels of profit.

As a result of the fall in excise duty rates and MODVAT, the relative difference in the tax burden for large and small companies has declined. Large companies can claim MODVAT benefits on inputs and capital goods so that the cascading effect of excise duty taxation is factored out. For many commodities, especially consumer goods, the rates of excise duty have also fallen.

5.8. Conclusions

Our brief review of the relative impact of the new economic policy on the small and large companies suggests that the former cannot grow by default anymore. The large Indian companies and multinationals now have the advantage of greater access to capital markets, superior business services and technology. Small enterprises can continue to grow in such an environment if they are fortified with positive strengths.

Indian policy has to be redesigned to afford a fair chance for small enterprises to survive and prosper in the emerging economic climate in India. Their transaction costs have to be lowered by the reform of the legal and institutional structure. The financial system will have to be refurbished to direct larger flows of capital to the small-scale sector. Finally, small-scale industry needs a wider choice of superior business services to cope with change. It is only then that they can expect to compete with large companies on an equal footing.



VI. NEW POLICY DIRECTIONS

6.1. Introduction: The premises

Indian industrial policy has had a pronounced penchant for the promotion of small and medium scale of enterprises; a sentiment that remains in tune with the realities of the

day. From the very early stages of industrial development, the government in India assiduously fostered an elaborate structure of institutions that met a wide array of needs of the small scale industry. In an economic environment that was characterized by a pervasive system of commands and controls, entry into industry and success subsequent to entry was heavily dependent on the entrepreneur's ability to obtain licenses, quotas and permissions from the central government. The system was heavily biased against small and medium entrepreneurs who could not participate successfully in this competition for licenses and quotas. Consequently much of the policy regime for providing support for small scale industries was protectionist in nature and itself provide for special access for small enterprises to raw materials allocation, imports, credit, etc. similarly, the policy of reservations specifically addressed the difficulty of small enterprises in competing with the large in obtaining industrial licenses and the like, and set aside specific areas for their exclusive operations. These institutions were, however, moulded by a protectionist and scarcity ridden economy. In the unfolding liberalising economic environment, the extant institutions are patently incongruous and have to be recast to address the needs of the day.

In retrospect, the premises of the earlier regime for small industry development have to be reconsidered to take into account the experience of the last two decades and to prepare for the future evolution of this sector. Hitherto, government policy sought to nurse new enterprise but overlooked the needs of growing companies. In a context where an unprecedented expansion in market size is taking place, the guiding principle of support institutions for small industry should arguably be to reinforce the impulse for accelerated expansion. The social benefits of the enormous public expenditure in nurturing new enterprise can be realised if small scale companies grow rapidly.

In the past, state policy for small scale industry stressed protection of fledgling enterprises against predatory competition from large companies. There was excessive emphasis on small enterprises being in competition with the large. The experience, however, in other countries suggests that small and medium enterprises are as often complementary to the operation of large enterprises, as they are in competition. There is a wide range of relationships that exist between the small, medium and large segments of industry small firms can act as ancillaries, suppliers, sub-contractors and the like. Each of these relationships imply interdependence rather than dependence of one on another. Consequently, new policies being designed to support small scale enterprises must encourage such interdependence.

In a context where market failure was pervasive, state owned institutions were the surrogate for equivalent private sector services. As detailed earlier, both central and state government have, over the years, set up a host of institutions which directly provide support services to small scale over the years, set up, a host of institutions which directly provide support services to small scale industry. This took place in an environment where such support was not forthcoming from within the private sector. However, government institutions can only be one source of information and expertise for small-scale companies. Internationally, small-scale companies are nourished by myriad sources of skill and knowledge.

Growing enterprises, however, have altogether different needs that existing state owned support institutions are unprepared to meet. The demand for capital is swelling but skills for project development have not kept pace and the finances of the term lending institutions for small companies are in a perilous state. Business services have to be delivered promptly which is not possible for bureaucratically run state organisations. Technology of a more recent vintage is required and workers have to be retrained to assimilate them. The antiquated infrastructure is a fetter on enterprises who have access to markets to grow at an accelerated rate. State institutions have to be located close to centres of enterprise to sense emerging needs and to address them speedily.

The accent on nurturing new enterprises has also resulted in inadequate attention on improving the competitiveness of small and medium scale enterprises. An overriding influence on the collective fortunes of small and medium scale enterprises is their overall business environment. Southern Italy's (popularly termed as "Third Italy") extraordinary success in fostering competitive small and medium scale firms, confirmed by similar experiments in several developing countries, has established that such companies need linkages with numerous organisations and individuals for their sustenance¹.

Individually, small enterprises are powerless to structure the institutions affecting their performance. Collective action by business associations, local governments and support organisations is indispensable for acquisition of knowledge and skills to renew production and marketing methods of individual enterprises. The predominance of government in all aspects of small industry development in India emasculates other agencies who can contribute to strengthening small and medium scale enterprises.

Internationally, regional beehives of small and medium scale enterprises are a hallmark of their development, their multiplication and growth aided by investment in complimentary services and infrastructure. Individual enterprises are interlocked into a network of relationships that sustain their growth. The Expert Group visualizes clusters as the centerpiece of a future strategy of promotion of small and medium scale

enterprises. Such cluster can lower transaction costs, help realize informational economies and lower the costs of credit surveillance.

Fortunately, the ground has been prepared to fashion a new regime for the growth of small scale enterprises. Above all, clusters of small scale companies have emerged spontaneously around the country. Private companies now supply a host of business services to small scale companies hitherto delivered by state owned institutions. A few business associations are prepared to shoulder the responsibility of improving the business environment and others will follow if the right signals are sent out by the government finally, the state governments have an adequate administrative infrastructure to address the demands of industrial districts in their regions.

In India, agglomeration of small and medium scale enterprises has often taken place spontaneously unaided by government policy, close to target markets, sources of raw materials and human skills. The prodigious growth in such clusters in the 1980s, driven by cheap labor and access to markets, is slowing down dragged down by their primitive state of infrastructure and services. The stark reality of decrepit infrastructure, environmental erosion, endemic technological obsolescence and the poignant abuse of child labor in such clusters is an eloquent indictment of the extant policy for small industry development².

Clearly, the prevailing emphasis on protection of small companies and the attendant mechanisms are inappropriate in the current context. Instead, the growth of small industry has to be assisted by promotional means and this will require several changes.

The tiny and small scale industry in India is indiscriminately treated as an infant and protection by reservation of products remains in place despite liberalization in other domains of economic activity. This is entirely unnecessary since small scale enterprises are predisposed to invest in product groups where small size is a competitive advantage and a variety of technology and market related factors preclude the entry or expansion of large firms.

Similarly, fiscal benefits lavished on small enterprises have discouraged the beneficiaries from graduating into large and medium scale companies. Consequently, the social benefit from the investment in nurturing new enterprises is not fully realized by their subsequent growth. Infant industry protection should therefore mainly benefit tiny enterprises.

On equity considerations, the government sought geographical dispersion of growth by investing in the infrastructure of backward areas. In reality, enterprise has not been forthcoming in backward areas developed by the government. Instead, dispersion of growth as unexpectedly taken place in regions where markets have grown and some communities has the resources and the grit to invest in industrial growth. The social benefits of infrastructure investment will be higher if it dovetails enterprise.

A variety of central and state governments small industry development agencies providing a gamut of professional services, ranging from consulting to quality control, have been rendered ineffective by their entropy. These institutions can be revitalised if business related services are divested from administrative ministries and are delivered by independent corporations.

Government can meet its obligations more effectively if it incurs the cost of nurturing new enterprises. Its expenditures can yield the greatest social benefit, of facilitating entry, if they are confined to new entrepreneurs mostly in micro-enterprises. Moreover, government aid should be largely restricted to activities at the time of formation.

Small and medium scale companies prefer and can afford services offered by the private sector. However, government can play a useful function by sharing the costs of common facilities such as training, technological upgradation, infrastructure development, effluent treatment and market promotion.

The energies of government agencies are exhausted by the minutiae of promotion and regulation while evolution of policy has languished. A law for small business has been recommended by several government committees but has not been enacted as yet. New demands on legal and institutional development such as provisions for Limited Partnerships and for recovery of receivables have still to be satisfactorily addressed.

The supply of credit and investment capital to small enterprises from state level institutions has shrunk due to poor recovery of loans. So far, monitoring mechanisms to increase the rate of recovery have not been instituted. Similarly, the venture capital industry plays a marginal role due to its small fund base in the absence of private pension funds and insurance companies.

As detailed at the beginning of this report, a strong rationale exists for exceptional state support for fostering small scale enterprises. This has always been recognized in India. Now in order to keep in step with the changing domestic and international environment, it is imperative that a new approach for promoting the small-scale sector be developed. The state must increasingly use its scarce resources to act as a facilitator rather than as a direct provider of services. This requires a new approach. The past policies have also concentrated excessively on small-scale industry to the exclusion of other activities. It

must be recognized that enterprise exists in a whole host of activities, and in many areas such as software development and other industrial support services, the distinction between industry and services is increasingly getting blurred. Consequently, the new approach must for the support of small-scale enterprises (SSEs) as a whole.

As documented in chapter IV the small scale industry sector in the country is characterised by a striking dichotomy of the co-existence of tiny and non-tiny sectors with differing organisational profile, needs and constraints. The predominance of the tiny sector in the industrial scene is established beyond doubt by a few recent enquiries. According to All India Census of Small Scale Industries (AICSSI) 96 percent of the small enterprises are in the tiny sector. A sample study conducted by the NCAER-FNST team reveals that nearly 87% of their respondent firms belonged to this category. The statistics provided by AICSSI on the MSME-DO units in the country reveal that nearly 82 per cent of the employment in the MSME-DO sector is generated in units with less than 15 lakh of investment in plant and machinery and upto Rs. 30 lakh production. They also possess characteristics distinct from those of the non-tiny sector.

As related aspect of this dichotomy in the small industry sector is the declining share of output in traditional industries (comprising khadi an village industries, handlooms, handicrafts, coir and sericulture) from 16.10 percent in 1973-74 to 10.71 percent in 1991-92 and a corresponding increase in the proportion of modern small scale industry (excluding powerlooms) from 53 percent to 82 percent. The traditional sector units largely belong to the tiny sector, the co-existence of a vibrant modern enterprise sector accounting for only 13% in number, 55% production and 41% in employment and a subsistence traditional sector forming 87% of total units, 45% of production and 59% of employment indicates the relevance of evolving policy directives differently for these two sectors addressing their specific nature.

The core competence of most of the tiny units is their flexibility and capacity to customise. Unfortunately the policies so far have not addressed these strengths adequately. Rather, they have been allowed to assume the dimension of an endemic problem of technological obsolescence coupled with primitive business practices. The Expert Group proposes that the government should pay special attention to the modernisation needs of the tiny sector, given its competitive advantages. The country's industrialization process still have long way to go and there will be a continuing need to foster new industrial and business entrepreneurship for the foreseeable future. It is the new entrepreneurs starting tiny units today who could be the industrial titans of tomorrow. Thus the Expert Group places particular emphasis on encouraging the entry of new entrepreneurs and on promoting the growth of tiny units as they prosper.

The approach of the Expert Group is based on these basic premises and our recommendations are made accordingly.

6.2. Role of Government

6.21. The Role of Central and State Governments

In the 1950s, the central government had a legitimate rationale to foster small and medium scale enterprises since it took the lead in initiating this new idea. Since then, however, most states have created adequate administrative infrastructure to address the needs of the small and medium scale enterprises. Most states have a minister and secretary designated to supervise the small scale sector. They also have a Director of Industries, supported by a large number of functionaries, to assist him or her in promoting industries³. The central government, therefore, should increasingly withdraw from the implementation of most promotional programs and regulatory functions governing the small and medium-scale industry.

Central government agencies will serve a more useful purpose if their duties are largely confined to policy formulation and institutional development. The central government should take the lead in promoting the kind of new approach that is being suggested here for the support of small scale enterprises. This would require consultations with state governments, the result of which could be a model support package for small enterprises which the state governments could then implement. Such a support package should have enough flexibility to take care of the many differences that exist between states. **The centre-piece of the new approach is an increasing public private partnership in setting up support systems for small scale enterprises. Such public private partnership would thrive particularly in clusters of small-scale enterprises.** The central government will always continue to have the responsibility for farming fiscal policies, trade policies and the like. In addition, since a major requirement for helping small scale enterprises to become competitive is their technology upgradation, the central government should also assume such a role in promoting technology development programmes in the support of the small scale industries. In this context the central government can take on special projects such as building linkages with universities and other training institutions in India and abroad as well as with clusters overseas. It is also better positioned for residual functions such as monitoring international trade developments affecting the small scale industry as well as liaison with international development agencies.

As documented in chapter IV the data on small scale industries bristles with inconsistencies that can only be sorted out by national agencies. The statistical information published by the DCSSI is not consistent with that provided by the National Accounts Statistics. **The Expert Group therefore recommends that the Centrals Statistical Organisation and the Ministry of Industry from a group to improve the quality of statistical information on small scale industry as well as to identify additional needs of the industry and other users of this information.**

In the area of extension activity, the functions of the central and state government agencies overlap and create confusion among entrepreneurs. The Small Industry Development Organization (MSME-DO), the principal promotional agency at the Center, through its Small Industries Service Institutes (SISIs) and extension centers for specific products, provides technical and management consultancy for new and established entrepreneurs, training in technology and management, conducts entrepreneurship development programs, techno-economic surveys, etc. similarly, the District Industry Centres (DICs), the focal point of promotion at the state level, have a General Manager who supervises extension services for technology, raw materials, credit, economic investigation, training, marketing and village industries. The services at the DICs are rudimentary and more complex problems are referred to the SISIs.

Evaluation of the impact of such services predictably find that government services are plagued by insufficient resources and poor quality of services. According to one state level study, 60 percent of entrepreneurs are not even aware of the services provided by the Direct Industry Centres⁴. This is not surprising since most users are not happy with the services about 61 percent in a sample investigated by the NCAER reported that they were not satisfied.

The promotion of small an medium scale enterprises is an aspect of regional development that is best pursued by state governments. On the other hand, the present structure of institutions governing small enterprises has been created in the image of central planning and is unable to respond to local aspirations. The growth of small an medium scale enterprises is usually rooted in peculiar characteristics of a region e.g. small scale software enterprises have multiplied in Bangalore sustained by a tradition of technical education dating back to colonial times. State governments need greater latitude to fashion the mechanisms appropriate to their endowments, skills and historical peculiarities.

District Industry Centres were established as the main link between the state and central governments and small scale industries whereas they were originally setup as promotional agencies. The DICs currently function mainly as regulators, they are used extensively as registration centres for small scale industries whereas much industry has been delicensed, they are continued to be various requirements for the registration of small scale industries. Such registration is usually necessary to avail of the various incentives that are available to small scale industries. The DICs administer the various incentives programmes of state governments such as capital subsidies, fiscal incentives, raw material allocations, power subsidies and the like. They are also supposed to provide clearances in a single window. However, evaluation of District Industry Centres suggests that they have not succeeded in achieving their limited objective of single window clearance⁵. Entrepreneurs still have to shuttle between a variety of departments for clearance of projects. The extension work of DICs has languished as 46 percent of them were found to have not updated their technical and information⁶. A fair assessment would be that the DICs are unable to cope with administrative overload.

The Expert Group therefore recommends that a completely new look be taken on the functioning of the District Industry Centres in order to make them more promotional rather than regulatory. DICs would acquire additional significance if they can weave a web of linkages with other institutions. They should function as key conduits for information flowing from a variety of channels for dissemination to local business firms. The District Industry Centres can function with greater efficiency if they can draw on other resources from business, they can work in association with local councils constituted of members from industry, banks, training institutions, etc. The function of councils should be to solve problems encountered day-today.

Presently, a large number of sector specific institutions are involved in the promotion and administration of small enterprises. Most of these institutions have been set up by the central government at various times, they include institutions like the Khadi and Village Industries Commission (KVIC) the Khadi and Village Industries Board (KVIBs) Development Commissioner (Handlooms), Coir Board, Silk Board, Tea Board, etc. most of these central promotional agencies do not have distinct presence at the field level. Further, regulatory agencies like the Labour Department and the Pollution Control Boards function in entirely separate settings with little coordination with promotion agencies. The result is regulation by multiple agencies and insufficient presence of the promotional bodies at the decentralised level. It has been said earlier that a good system of decentralised administration should have minimum regulatory channels and a single source of information. Together with this, there should have minimum regulatory channels and a single source of information. Together with this, there should be multiple channels of support and services with integrative features. **To achieve this purpose, would be advisable to set up a flexible broad based District Enterprise Promotion**

Agency (DEPA) to replace the present DICs. It should be constituted as a broad based district level society with representation from the Departments of Industry, Revenue, Labour Environment & Sales Tax, banking institutions, state financial institutions, state industry corporations, small industry associations and the local governments. The representatives of the specialised promotion agencies of the central and state governments could be standing invitees to this body. Conceptually, this agency can be developed an autonomous agency functioning as a single stop service for information, grievance redressal, clearances, coordination an project planning. Similarly, the Department of Small Scale Industries is conceived to be structured as an umbrella body for the promotion of small enterprises. Since this department is now envisaged to promote small scale enterprises in general, the **Expert Group recommends that its nomenclature be now changed to Department of Small Scale Industries and Business Enterprises.** With this structure in place, we expect that coordination at policy and conceptual levels will be achieved at the central level in the Development of SSI. Similarly coordination and integration at the field / execution level will be achieved in the District Enterprise Promotion Agency.

It would be useful to explore how such an agency could be made more autonomous and services oriented. Effective support of small scale industries now requires greater technical expertise than is presently available in the DICs. An autonomous structure would help making it possible to recruit people with appropriate expertise which would otherwise not be feasible within the current governmental structure. The effort must be made to form public private partnerships so that government could continue to provide substantial funding support-say sliding from 90% now to 50% in 10 years time. The rest should be raised from industry association partners and from fees for services. The funding pattern would have to vary between districts. Those districts which have industry clusters would be able to contribute larger proportions of funds whereas in less developed districts the government would have to shoulder greater responsibility. Such restructured DEPAs should function as centres for bringing together different local institutions on an organised basis to solve local day to day problems. Local councils should be formed involving representatives of government, banks, industries, training institutions, government regulators and the like. Such a forum would provide the basis for initiating promotional activities which are necessary for the support of small scale enterprises in the district. In order to encourage specific support activities for technology upgradation, pollution control, quality upgradation etc. the government should set up a fund at the state level from which matching funds could be sort for the promotion of these activities.

All this does not mean that the State should wash its hands off its role as a promoter of small scale enterprises. As outlined in the beginning there is enough evidence of market failures and externalities that there is a clear promotional role for the states. But, this must be made much more performance oriented. Furthermore, the state should not try to perform functions that are now quite ably perform by private sector itself.

In general, state intervention will continue to be relevant in the further primarily to reap external economies from collective action. However, government budgets will have to be proportionate to performance. Part funding will be means to extract results from expenditure incurred.

The Coordination of Support to Tiny Units

The performance of the existing public sector units like the DICs and DISO service institutions have been found tobe particularly lacking in providing services to tiny units. Lack of interaction, networking and proper coordination among various agencies are the other weaknesses that have resulted in special difficulties in the sphere of extension services for tiny units.

There is an urgent need to evolve an institutional mechanism to facilitate co-ordination at all levels of activities relating to entrepreneurship / small business promotion. Though the district and state level institutions are currently given the responsibility of extending support to the tiny enterprise sector, as suggested above, the government should look forward to the formation self-regulating resource networks at the district and state levels, where the support institutions like financial institutions, entrepreneurship organisations and public support organisations work in collaboration with entrepreneurs and industry associations as partners in the process of removing barriers to entry into business and industry of tiny units, and fostering their growth.

The area of operation of the state and district level support network should be focused sharply on information gathering, dissemination and advisory functions to the tiny sector. The new entrepreneurs are in need of such services at the per-investment / state-up phases at low cost.

We have already suggested above the restructuring of DICs as DEPAs with joint "ownership" between government and other non-government institution like industry associations. We have also suggested the formation of local councils to assist in identifying the promotional needs of small scale enterprises. Tiny units need a special focus sonce their assistance needs are greater. **The Expert Group therefore recommends that these restructured DICs or the newly proposed DEPAs have a special focus for the assistance of tiny units.** Each of these agencies must have a

special unit which is primarily oriented towards catering to the specific requirements of the new entrepreneurs in the tiny sector.

6.22. The Private Sector and the State

Government agencies can also be fortified if they restrict their mandate to a few functions while the remaining needs are met by the private sector. The tasks chosen by government agencies should alleviate recognized market failures. Arguably, new entrepreneurs encounter formidable barriers at the point of the entry. Government efforts will realize the greatest social benefits if they are focused on "start-up" incentives for tiny enterprises and new entrepreneurs⁷. Moreover, the participation of government agencies in the actual delivery of services should be minimized to the extent possible and phased out over a period of time.

Recent surveys have confirmed that private sector consulting companies have emerged as the prime source of services for small enterprises. Thus an NCAER study found that 136 units had utilized technical consulting services in three consecutive years out of a sample of 657. Out of these, the source of services for 29 companies was the SISIs while an overwhelming 82 units got it from respondents expressing satisfaction. Curiously, the relatively larger companies expressed greater satisfaction with government extension services than the smaller units. In general, public sector extension services are considered to be cheap but slow and inefficient. On the other hand, the private sector is preferred for its faster delivery and greater efficiency but is more expensive.

The Expert Group is proposing that policy support must be broadened from the current support of only small scale industries to all small scale enterprises. The past approach has been to provide technical support and other services by the government agencies themselves. Now that such support is available from private sector business services companies of different kinds such as consulting companies, software companies, technical consultants etc, these business support services themselves should become eligible for receiving bank credit on the same basis as small scale industries at present. Technical Consultancy Organisation (TCOs) have been promoted by financial institutions and concerned state governments, as public sector organisations. In their present form it is not possible for SIDBI to support them. In order to encourage such services to come up in the private sector, **it is recommended that SIDBI open a special window for the funding of technical consultancy organisation and other business support services aimed mainly at small scale enterprises.** To begin with, for a period of five years, consideration could be given to provide equity support in the setting up of such enterprises. This could be done through a mechanism similar to the national equity fund, but the funds should be made available to the specialised SSI branches of commercial banks located in industrial clusters for assisting such business support enterprises. Such support measures would go a long way in providing both adequate financial and technical support services to small scale industries while increasing new small scale enterprises themselves.

Similarly, the private sector should be encouraged to invest in infrastructure and common professional services such as training and quality control in clusters. Government should only share part of the capital costs.

Private Sector Technical Support for Tiny Units

Tiny enterprises are increasingly sourcing services from the private sector, though they do get some assistance from the existing government agencies. Given the nature of tiny enterprises and their owner entrepreneurs they generally find it easier to take the assistance of private small services enterprises or of individuals. Among the functions of the special tiny enterprise unit in the proposed DEPAs would be the promotion of tiny and small business support enterprises for which help other tiny enterprises. State governments could provide some subsidy element for promoting such activities. In this manner collection of data relating to markets, technology, business opportunities etc could be done on a commercial basis with the help of young professionals. The data thus collected should be computerised and made available to the entrepreneurs, business counselors and entrepreneurs trainer-motivators on payment.

A cadre of young business counselors equipped with the knowledge and skills of opportunity identification, business planning and knowledge about procedures and formalities could be created. They would be attached to the proposed DEPAs and existing service institutions. Retraining of the existing extension officers to develop counseling skills is also recommended.

The business / industry associations may be encouraged to start counseling services. The state through the existing National Entrepreneurship Development Board (NEDB) of the Ministry of Industry should help those who are willing to start such services build a corpus with one time financial support on a matching basis.

6.24. Corporatisation of Government Extension Agencies

Most government extension agencies ought to be reorganized as corporations so that their ability to compete with the private sector is not impaired due to organizational reasons. Thus the Regional Testing Centers and the Field Testing Centers are potentially capable of generating their own revenue and need only support from the government for a few years. Similarly, the Process and Product Development Centers, the workshops, the Central Tool Rooms the National Institute of Entrepreneurship and Small Business Development in Delhi and the National Small Industries Extension Institute can also function as companies with part funding from the government.

The earlier system of technical assistance by Small Industry Service Institutes is outmoded since they are not able to keep pace with the rapid changes in technology. Evaluation studies suggest that SISIs are able to cater to the needs of low tech industries but not that of new industries such as electronics or even auto-components⁸. Evidently, SISIs have a low motivation to upgrade their skills to meet customer requirements. Their energies are dispersed over technical assistance as well as management consultancy and related services. **The Expert Group recommends that SISIs should be corporatised and functions such as technical assistance and management should be divested to separate companies.**

In the transitional period, the corporatised SISIs should be supported by matching contributions from the government, to begin with they should be entitled to government contribution twice the value of their market revenues. This should be lowered to half their market revenue over a ten-year period. At the end of the ten year period when they are able to independently earn their revenue by their services, the full equity of such corporations should be disinvested in favour of the private sector.

The recommendation for corporatising the various existing government technical extension agencies is supported by the experience of the National Small Industry Corporation (NSIC). Because of its corporate character it has been able to provide leasing, hire purchase facilities and other services to small scale industry quite successfully. The entry of new private finance companies which offer similar services is now providing it with significant competition⁹. NSIC should also now be looking for new roles such as being a guarantor for tiny business.

Finally, specialized functions such as information ought to be assigned to institutions which pursue these tasks as part of their core activity. NISIET in Hyderabad has an information and documentation center known as SENDOC which stores and retrieves information of interest to small companies but its reach is limited. The International Trade Promotion Organization (ITPO) stores international trade data that is not widely disseminated. With the spread of information technology and Internet, as already mentioned, there is now a mushrooming of small private business enterprises which are attempting to provide technical information services both nationally and internationally. The government runs information systems and attempt to use these new small enterprises for dissemination of the data base on that the government itself compiles and runs. Once again such a project would not only provide information more readily to small scale enterprises spread throughout the country but also would provide new employment and business opportunities in such enterprises themselves. If such enterprises disseminate information compiled by a credited government agencies the authenticity of the information would be insured.

6.3. Reservation Of Products And Investment Limits

6.3.1 Abolition of Small Scale Industry Reservations¹⁰

A keystone of the policy governing the small enterprises has been their exclusive right to manufacture specified products reserved for them. The rationale for this policy is that this is the surest way to protect small companies against competition from large companies. In reality reservations may have played only a limited role in promoting small scale industries while restricting the entry of large companies into these industries. **The existence of reservation policy has also provided an illusion to the government and the country at large that adequate protection/promotion was being provided to small scale industries.** This may have militated against more realistic policies for providing support to small scale industries for entry and growth. The issue of investment limit is also of greater relevance for the items that are reserved for small scale industries. In the case of items that are not reserved small scale industries are free to grow the only incentive not to grow is the loss of the various facilities and incentives that the units may have availed of as small scale units. In the case of industrial units manufacturing reserved items they are not permitted to cross the small scale investment limits and are therefore not able to grow. Instead it is often found that such units merely clone themselves and set up parallel separate units rather than expanding the original units as would have happened if the items were not reserved. Thus the reservation policy acts as a powerful barrier to growth.

The tenacious opposition to the withdrawal of this policy is rooted in the historical memory of the decline of crafts following the import of factory made products from England in the nineteenth century. The resurgence of exports of carpets, fine silk and home textiles, valued in international markets for their aesthetic qualities, gives lie to the impression that protection is indispensable for crafts. The Expert Group held wide consultations with representatives of industry associations and of state governments. It

also sought the views of the central government departments and of state governments regarding this issues as well as others. As might be expected, a wide range of views was received. It was found that many associations did represent that they felt that reservation should be continued. Other felt that the reservation could be removed but on a phased basis.

After considering the issues very carefully and looking to the future of the Indian industry and its place in the world economy, and the imperatives for growth among small scale industries themselves, **the Expert Group has concluded that the changed economic circumstances suggest that the obsolete policies of small scale reservations should now be abolished.** At the same time we feel that transitional support should be provided to those units which might encounter some difficulty as a result of this abolition. Our judgment is that such units will not be many.

The policy of reservation prevents the successful units from growing. It therefore acts a dampener on entrepreneurship. The biggest psychological incentives for new entrepreneurs is the example of small enterprises which have grown to become large. The policy for promoting small scale enterprises should be such as to induce new entry by small entrepreneurs, and then to aid them to prosper and grow. The SSI reservations policy prevents this.

We will show that the case for reservations is fundamentally flawed and self-contradictory. Not only is it indefensible on logical grounds, the empirical realities lay bare its patent obsolescence. The policy of reservations has crippled the growth of several industrial sectors, restricted exports and has done little for the promotion of small scale industries.

The case for reservations would be sustainable only if the minimum economic size was the same for all the products reserved for the small scale industries. Since the technology and market must still be maintained, the investment limits for individual products should vary reflecting the minimum economic scale of production it has been found that in the case of many items currently reserved for small scale industries the manufacture of these items at appropriate quality and efficiency levels requires investments in plant and machinery at a level much higher than the existing investment limits, some of these have been selectively given as illustrations. (See Appendix on small scale industry products. The existing investment limit on these items therefore precludes the quality production of such items in India.

Since the changes in the trade policy instituted since 1991 almost all items except for consumer goods are now freely importable. A careful examination of the import policy has shown that more than 550 items on the list of reserved products are now freely importable (See Appendix for details). This means that, whereas foreign companies which produce these products could sell them freely in India, large domestic companies are not free to manufacture such items. Some protection however, is provided by the applicable customs tariff. The stage is now also set for a phased removal of quantitative restriction on the remaining imports and hence more and more items that are currently reserved for small scale industries would become freely importable within a period of five years. When quantitative restrictions on the imports of consumer goods are removed, very few of the reserved items will not be imported. These facts give credence to the view that the government has allowed free competition between the Indian small scale sector and the multinationals but not with the large Indian companies.

These changes in import policy and the ongoing tariff reforms which is progressively reducing customs tariffs on all goods would mean that within the next 5-10 years, all the currently reserved items would face competition from imported products at relatively low tariffs. **The Expert Group believes that this is the most powerful argument for the abolition of small scale industry reservations forthwith. The existing small scale units as well as new entrants in these industries must be provided an opportunity to investment in appropriate size and technologies to be able to compete with imports in the coming years.**

Several labor-intensive industries such as garments, shoes, leather goods, sports goods, hand tools, and the like that have flourished in East Asian economies but have not done so in India due to the exclusion of large companies. The toy industry has prospered in other Asian countries but its growth in India has been unremarkable. Similarly, the light engineering industry, e.g. hand tools, is among the larger industries in East Asia but have not achieved significant progress in India. The food processing industry in India is a potential giant but its growth has been arrested by the reservation policy.

The reservation of products for the small scale sector has provide to be a barrier to growth of exports in a number of these industries. It is true that despite severe odds, some of these industries such as garments and shoes have contributed tremendously to the country's export effort as is documented elsewhere. These are the sectors where the country exhibits significant comparative advantage. But various studies conducted by the Export Import Bank of India and others who that our export of items such as garments and shoes are limited to a narrow range of goods and exhibit low unit values. They are also not able to supply branded goods in large quantities with consistent quality to large buyers like trading houses and department stores. In the case of

garments, for example, our record of exporting to non-quota countries is poor since we are not able to complete. The dismantling of the Multiple Fiber Agreement (MFA) will mean the existing quota markets will also become increasingly competitive over the next 8 year. **It is therefore, imperative for future export growth to remove such small scale industry reservations so that adequate new investment and technology upgradation take place in these industries and that existing units are allowed to upgrade.** It should be understood that existing units are unlikely to be hurt as they could continue exporting their current composition of products, instead they would be enabled to grow. The experience in South East and East Asian countries suggests that these industries would grow quite spectacularly if they are free in such a manner. Whereas many large units could come up in sectors such as garments, toys, and shoes, a great amount of outsourcing and subcontracting would take place so that, in fact, even greater growth would take place in the small scale sector with the attendant employment growth.

An additional consideration that has a bearing on exports is speedy delivery. The clearest example of this can be found in the garments industry where the exporters need to use computer aided cutting machines to be able to match the delivery schedules of their competitors, Consequently, large scale investments are required.

Similarly, the poor quality of inputs manufactured in the small scale sector has its deleterious influence on the end products. This is, for example, evident in the automobile sectors markets and bicycles. The final product suffers because low quality components over the final quality of the assembled product. The result is that for export of items such as bicycles many components have to be imported.

We have also been made aware of some of the impacts of reserved items on the large industries which are the suppliers of intermediate goods to the final manufactures of the finished goods which are reserved for small scale industries. For example, in the case of the textile industry, where fiber or fabric producers supply to garment producers in the small scale sectors, domestic industry is handicapped because they do not have large scale buyers. Large industries would become more competitive if they had more demanding buyers. They would then upgrade in quality as well.

The experience with reservation tells a story of love's labour lost. Good intentions of the government have manifestly not registered in the business calculations of small enterprises. The second census of small scale industries provides persuasive evidence of the misplace importance given the policy of reservation. Out of a total of 200 products leading in value of output produced by the small scale sector, it was found that reserved products accounted for only 21 percent. Only 210,000 small scale units, less than half out of a total of 5,82,000 units, manufactured the reserved products at all. No less than 233 reserved items out of a total of 1,076 (when expanded at a lower level of aggregation in the NIC code) were found not be manufactured at all according to the census. Although further inquiries have revealed that many of these products are found to be manufactured by some units, the fact remains that their production is in negligible quantities.

Conversely, very few of the reserved products attracted significant levels of participation from small scale unit. As many as 90 products were found to be manufactured by just one company each. The sum total of the value of production of all small scale companies in as many as 692 items was a low of Rs. 10 crore or less. Just 68 reserved items accounted for 81 percent of the total value of production of reserved products and 83 percent of the units¹¹.

In general, small scale units do not need protection by reservation and can survive in free markets. Analysis of Korean data showed that small scale companies (defined as employing between 1 to 100 employees) accounted for between 17 to 39 percent of the employment in as many as 373 industries¹². They survive due to product differentiation. This can take the form of small companies specialising for consumption in different markets. Or small companies survive in niche markets requiring custom designed products. They also do well in new markets where large companies have not made their presence felt. Thus existence of product differentiation means that many SSI firms co-exists with large firms and cater to different consumption needs. In some cases small firms supply low priced products for mass consumption in local markets where larger firms cannot compete. In other cases they supply high priced products for the elite market. As the markets grow, small companies also grow in size and retain their dominant position.

The removal of reservation will also pave the way for greater equity participation from large Indian companies and foreign investors along with greater sub-contracting. Large companies will then have an incentive to establish long-term relationships and transfer proprietary technology for improving the quality of products supplied by small scale companies. It would then be much easier to establish interdependent relationship between large, medium and small industries as subcontractors, ancillaries, and suppliers of parts and components. The establishment of mother units would then spawn large numbers of small units in clusters.

Currently, equity participation by both large domestic companies and foreign direct investment is limited to 24 percent. Once the reservations are abolished there would be

no reason to retain this limit. The ability of large companies and foreign investors to take equity stakes in SSI units would pave the way for a more synergistic relationships.

It is, on all these considerations that the Expert Group is suggesting that the policy of reservation be entirely abolished. We have considered the option of a phased abolition in order to give time to industry to adjust. However, in view of the overwhelming evidence that the reservation policy is now serving no purpose in the promotion of the small scale sector, we are recommending a complete abolition. The interests of the small and medium scale industry are better served by technical assistance and other programs to enhance their competitiveness. Cluster associations should be involved in the administration of funds. Part funded by the government, to improve the technology and manufacturing processes of small and medium scale enterprises. The Expert Group is of the strong view that the abolition of small scale reservations must be accompanied by a credible support package which assists units that are affected by this dereservation. The strategy and programme for such assistance is outlined in the section below.

6.32. Transitional Arrangements for Small Scale Industries Affected by Derservation

Whereas the Expert Group feels that dereservation of the items reserved for small scale industries will not substantially affect existing units, it is still necessary to provide some source of support for existing small scale units which might encounter some difficulty as a result of dereservation. As has been noted, the vast majority of small scale units are tiny units with investment of less than Rs. 5 lakh. These units currently co-exist with large units which can have investment upto the Rs. 60 lakh limit at present. Thus, it is unlikely that the existing tiny units would be affected by the introduction of new units of a larger size as a result of dereservation. Similarly it has also been noted that due to product differentiation in the demand for products at different levels, small scale units co-exist with large units in unreserved areas of industries without any difficulty. Similar would be the case for the areas currently reserved for SSI. None-the-less it is recognised that, at the margin, there would be some units which would indeed get affected by the entry of large industries into the areas currently reserved for small scale industries.

Two kinds of assistance may be required. First, existing small scale units which have not been able to expand by inducting new technologies and new equipment because of the existing investment limit should be given special assistance for expansion as a consequence of dereservation. Such support could include equity support, interest rate concessions, and technology assistance. Equity support can be given both directly and indirectly in order to assist greater internal generation of resources by existing entrepreneurs and additional fiscal concessions would help in providing such additional resources which can than be reinvested. Second, external equity support can be provided by financial institutions and banks through support by an equity fund. There could also be existing small scale units which are considerably below the current investment limit and which could be adversely effected by dereservation. Such units also get similar assistance as described above for expansion and induction of new technology.

The Expert Group recommends that the ministry of Industry should immediately set up a joint mechanism between the government and industry representatives to identify specific industries/items in which small scale units are likely to be affected by the proposed dereservation. These are perhaps among the 68 reserved items which account for more than 80% of the total value of production of reserved products. Subsequent to this identification the geographical areas where such affected units are concentrated could also be identified. The proposed assistance would then be easier to administer.

In order to provide both equity support and interest concessions the **Expert Group recommends that the government should provide annual resources of the order of Rs. 500 crore over next five years, thereby totaling Rs. 2500 crore, to the Ministry of Industry for providing the proposed support.** The fund should be used to leverage larger resources from banks and financial institutions in order to provide support to existing small scale units exclusively in the areas currently reserved for small scale industries. This fund should be used for the purposes of providing equity support, and interest rate concessions for funding the expansion of existing units in the reserved areas, for technology upgradation and modernization, technology absorption and for new marketing initiatives. The fund could be administered by SIDBI and other financial institutions and commercial banks on the basis of parameters laid out by Ministry of Industry for the purposes and industries which would receive priority for this support. Such provision of funds would essentially be used to provide interest subsidies for funding expansion of small scale industrial units currently manufacturing reserved items, and for funding the upgradation of technology and modernisation. Realising that such small scale units were also need support in the process of technology absorption (through training and re-training their workers, supervisors, managers, and even some owners), it is suggested that these funds may also be used to provide for capacity building requirements of these units. It must be understood that this would be in the from of a one time support to such a small sale units and the maximum limit of about Rs. 50,000 could be put for this purpose. Further, in view of the competition that SSIs may face in th market from the large sector after dereservation this fund should also be

used to assist SSIs in developing marketing alternatives. This funding would be made available to groups of entrepreneurs and industry associations if they get together to permit marketing consortia to market their products and apply credible brand names. In order to serve these different purposes it is recommended that the Ministry of Industry should provide guidelines on the specific industries and areas which would receive priorities for support from this fund. Access to it from different financial institutions and commercial banks should be made on the basis of their expertise in lending to small scale enterprises for these designated purposes and geographical locations. Such funds could be disbursed particularly through the commercial bank branches which have now been designated as special branches for small scale industries. Priority in the use of these funds must be given to tiny units.

Similarly, a specific scheme for fiscal concessions should be devised for small scale units which manufacture items in the reserved list. Full excise exemption is currently available to small scale units which have turn over up to Rs. 30 lakh; partial exemptions is available upto a turn over of Rs. 75 lakh; and these slab-wise exemptions are available upto a total turn over of Rs. 3 crore. **It is suggested that, as a transitional measure for a period of 5 years, these fiscal concessions may be extended for existing units which manufacture reserved items. For such units complete exemption may be granted upto a turn over of Rs. 50 lakh, partial exemption for these units at Rs. 3 crore.** This measure would have the effect of increasing internal generation of funds for small scale units in the reserved sector. It would then make it easier for them to make additional investments for expansion and technology modernisation to be able to compete with large units; and also give them some price cushion in competing against any larger units that come in.

633. Investment Limits And Definition Of Small Scale Sector

The investment limits set by the Industrial Policy announced in 1991 need to be revised in accordance with the new perspectives proposed so far. Hitherto, separate investment limits have been set for small units and for the tiny units Rs. 60 lakh for the former and Rs. 5 lakh for the latter. The investment limit for SSI is most relevant for the industries producing items reserved for small scale industries. Once reservations are abolished that relevance will automatically go, and the limit will no longer be a hindrance to growth. However, limits would still be required for definitional purposes in order to determine the eligibility of units to avail of the different incentives and promotional facilities available for small scale enterprises.

Definition of Small Scale Sector

First, the definition of the small scale sector must be broadened from just that of small scale industries to small scale enterprises (SSEs). Incentives, credit facilities, and promotional facilities should then be available to all small scale enterprises. To begin with, the concept of the SSE sector, should include all business enterprises in the service sector which provide services to industrial enterprises.

Investment Limit

A revision in the ceiling for tiny enterprises is now overdue since several dimensions have to be taken into account. For one, the inflation in the last five years and devaluation of the rupee has substantially lowered the real value of the investment limits. Second, the cost of pollution prevention equipment was not included in the investment limits set in 1991. The value of other equipment such as generator sets, tools, jigs, fixtures, R&D equipment, etc, was also not included. **Taking into account all these factors, an investment limit of Rs. 25 lakh for tiny units is adjudged to be most appropriate. For small and medium scale enterprises, the threshold level should be immediately raised to Rs. 3 crore for the same reasons.** By doing this a large number of smaller units at the lower end of the small industry sector which are otherwise clubbed with their larger counterparts and hence having unequal bargaining power in the market place, could be helped in the direction of stability and growth.

We are recommending a somewhat higher limit for both tiny enterprises and for small and medium enterprises so that the threshold level does not provide any disincentive to growth of small scale enterprise for the next 5 years. The thrust of policy should be on the one hand to promote the easy entry of new entrepreneurs into the tiny sectors and then to provide all help necessary for the successful enterprises to grow and prosper. It would be expected that once enterprises reach an investment level at the threshold level of Rs. 3 crore they would no longer need special assistance from incentives or promotional facilities available for these sectors.

Excise Incentives for Graduating Tiny and Small Scale Units

At present, complete exemption is available for turnover up to Rs. 30 lakh, somewhat lower concession for turnover between Rs. 30 lakh and 50 lakh and still lower for turnover between Rs. 50 lakh and 75 lakh and the threshold turnover limit for eligibility or getting such excise concession is limited to Rs. 3 crore. **Some, modification is required, as already suggested for units that currently manufacture reserved items. Second, some modification may also be made to remove the disincentive for tiny units to grow beyond their investment limits. It is therefore proposed that**

tiny units which graduate beyond the investment limit of Rs. 25 lakh be permitted a higher total exemption limit of turnover to Rs. 50 lakh, for a period of 5 years after crossing the tiny sector investment limit. Similarly the total turnover limit of Rs. 3 crore may be expanded to Rs. 5 crore after the SSI crosses the proposed new investment limit of Rs. 3 crore, but only for a period of 3 years from such graduation. Although this would cause some complication in administration it would remove the fiscal incentive hindrances to growth. In the medium and long term tax revenues should also gain from such growth.

Restoration of Excise Exemption for Branded Goods

There is one more modification that is necessary Since 1993-94 the excise exemption available to SSI units which manufacture branded products was withdrawn in 1993-94. This reduces the incentive for large enterprises to sub-contract and outsource their branded products since we envisage a future of much closer relationships between small and large enterprise this disincentive must be removed. Indeed, this practice must be positively encouraged in the interest of promoting technology upgradation, quality enhancement, entrepreneurship and employment in small scale units. The Expert Group therefore recommends that the applicable excise exemption should be restored to units manufacturing branded products.

The tiny sector units can be gainful partners to the small and large units as vendors and subcontractors. In order to nurture and sustain such relationships between tiny, small and large enterprises, the Export Group thinks it important to bring these tiny units that manufacture branded products under the excise exemption system as proposed above.

The social benefits of nurturing new enterprises cannot be realized unless small scale enterprises are driven to grow in size and increase productivity. Investment limits and the associated benefits of excise duty concessions have deterred new enterprises from advancing into larger companies. Instead, smaller companies are tempted to expand by establishing new units of a size below the investment limits. Moreover, inefficient small companies are able to survive simply by taking advantage of fiscal concessions available to small companies.

The comparative experience of Asian countries shows that India is one among a few countries where labor productivity differential between large and small companies has not been bridged¹³. The labor productivity in large enterprises in Hongkong and Singapore is, on an average, only fifty percent higher than in small companies and compares well with the corresponding figure of 15 percent in developed countries. On the other hand, India, Philippines and Indonesia report labor productivity differentials that are three times higher for large companies than for small companies. Clearly, a huge productivity gain of nearly one hundred percent is in store if investment limits are raised for the small scale enterprises with concomitant reforms in fiscal incentives.

6.4. clusters

Small and medium scale enterprises learn to develop a forte in a narrow segment of business to extract the most from their slender financial and human resources. Their survival is, therefore, contingent on the aggregation of complementary businesses and infrastructure in the same vicinity. The proximity of a web of businesses lowers the units cost of infrastructure, leads to accretion of skills and is a source of informational economies. From an institutional point of view, the costs of monitoring and promotion are lowered since news spreads faster in a regional context. The consequent low transaction costs stimulate a virtuous circle of growth.

Worldwide, a common characteristic of growth of small and medium scale enterprises is their agglomeration in clusters. India is not an exception to this pattern of growth and a recent survey of the UNIDO has identified 138 such clusters (see Appendix 2). A fact of far-reaching significance is that the formation of only 13 of the 138 clusters has been induced by policy. The rest of the 125 clusters have grown spontaneously on the initiative of entrepreneurs. No less than 99 of the clusters have grown in response to market opportunities in the region, only 6 have been attracted by the availability of infrastructure and the rest 33 were drawn by raw materials or skilled labor.

The industrial estates developed by the **government** have been plagued by under utilization due to wrong location. A striking evidence of this can be found in NCAER's survey of rural estates the share of functioning units was 46 percent of sheds and plots in Maharashtra, 60 percent in Karnataka, 47 percent percent in Andhra Pradesh, 50 percent in Tripura and a dismal 22 percent in Bihar. By contrast, the rate of utilization of urban estates was much better but not entirely satisfactory, 81 percent in Karnataka, 74 percent in Haryana. 71 percent in Andhra Pradesh and 62 percent in Maharashtra and a depressing 35 percent in Bihar. Industrial estates developed by the **government** suffer the consequences of ignoring the overriding importance of agglomeration economies in inducing investment by small and medium scale enterprises.

An analysis of available evidence in India does not validate the assumption that **government** policy alone can significantly influence the dispersion of industry¹⁴. It can, at best, reinforce any trend of voluntary movement of industry out of the traditional centres. The main results from the Indian data show some evidence of regional spread

of industrial growth in the figures of industrial employment. On the other hand, statistics on valued added show mixed results suggesting that low productivity industrial activities spread to new centres. Furthermore, the figures of bot employment and value added in the unorganised sector confirm that it has not at all responded to government policies for even geographical distribution of industrial growth.

Similarly, experience elsewhere in the world confirms that regional development policies have not succeeded except where government has intervened with a comprehensive program such as in Southern Italy and has been complementary to entrepreneurial effort¹⁵. An important lesson from Italy is that a single unified regional authority governed a complete package of inter-related programs for industrial dispersion before private industry found it profitable to move to regions with low level of industrialization. A noteworthy aspect of the Italian experience is that government interventions were based on a great deal of research and analysis.

A fundamental flaw in the policy for small industry development in India has been that it has ignored the clusters that have taken root as a result of entrepreneurial effort. Worldwide experience suggests that such clusters can stagnate in their later stages of development unless they are supported by institutions. These clusters are appropriate units for focused development of a large number of enterprises in a way that lowers the cost of administration of development programs. Since these clusters usually specialise in a single area of activity, it is possible to design composite programs meeting interrelated needs. It will also possible to forge government-private sector partnerships for effective implementation of regional development programs.

The touchstone of cluster formation, the nutrient of their growth, is the cross flow of information. This is doubly true for science parks where knowledge is translated into innovative products. An uninhibited flow of information can take place in an environment of mutual trust.

The free flow of information is important not just to knowledge workers but also for the assessment of the viability of projects where tangibles like plant and equipment have not been installed. Venture capital financiers cannot evaluate the value of intangible innovative concepts unless their details are disclosed to them. However, entrepreneurs would be unwilling to share information about their inventions if they fear their appropriation by their competitors.

We have laid emphasis on the promotional facilitation role of the government in intervening to support small scale enterprises. Such support would essentially be in the nature of providing credit and technological support to enable small scale enterprises to enter new activities and to grow successfully after entering. We have also suggested that with the considerable growth that has already been seen in entrepreneurship and the appearance of the private sector in business support activities, the future of small scale enterprises promotion would lie in public private partnerships. We have also observed that the promotion of small scale enterprises now requires much greater level of knowledge and technical expertise in order to be useful. All such activities would be practical to provide if there is some degree of information of small enterprises in certain locations, since there are also economies of scale in the provision of support services. It would be most practical if the package of promotional measures is provided to small scale enterprises in clusters.

Agglomeration economies that accrue from clustering of firms can be enhanced through planned intervention. Realising that most of the clustered industrial complexes, both spontaneous and policy induced, are dominated by entrepreneurial tiny units, the Expert Group feels that the time has come to carry out a need assessment study for each of such clusters at the district level.

Subsequently a comprehensive and intensified policy and action programme for promoting clusters should be initiated. This should give special importance to the specific needs of tiny units, the basic elements of such a programme would be technology upgradation, skill enhancement, information dissemination and entrepreneurial competency development.

The Expert Group therefore recommends that state governments identify the existing SSE clusters and then promote new types of organisations which are joint ventures between the state governments or local authorities and business associations in these clusters. It would be found that in most clusters there already exists business association which can readily come forward to form such partnerships. In some cases they would need to be fostered anew. A mechanism that should be used by state governments is to offer funds on some level of matching basis to fund and run these promotional organisations. **The Expert Group recommends that the 9th Five Year Plan should include such funds to be provided for funding and running these organisations on this basis.** It should be understood that the promotional organisations being suggested : **the Clusters Small Enterprise Associations (CSEA) should be autonomous and the government should only support them if the local business associations are willing to provide some level of matching funding. The level of matching funding would have to differ between different locations depending on the size and strength of clusters.**

The believe that this is a very practical approach to SSE promotion in India since there already exists a large range of small scale industry clusters across the country. Many existing clusters of industries in India suffer from extremely inadequate infrastructure support since most of them have come up naturally and without the benefit of government support. The government policy should therefore be much more geared to recognise natural existing clusters and to promote infrastructure support wherever possible.

6.5. financial Support

6.51. Credit Related Problems Faced by SSEs

The discussions held by the Expert Group have shown that small scale industries experience the supply of credit as their key problem. It is claimed that not only is the availability of credit to SSI of high cost, it is not timely and is also inadequate in volume. Moreover, the past system of the financing of SSIs provides for little interaction between term loans and working capital. Term loans were available directly from State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs), whereas working capital was then sought from commercial banks. Many SSEs therefore complain that even when they able to achieve access to term loans they were not able to obtain adequate working capital. The need therefore is for a single window approach. The past financial system has engendered a vicious cycle. On average it has been found that the recovery rate of SFCs has been around 37%. Consequently most SFCs are in a very poor financial situation, and IDBI/SIDBI now face difficulty in providing them adequate support. Given such a record it is also then not surprising that commercial banks regard small scale enterprises as risky propositions.

As regards interest rates the small scale sector had the benefit of lower interest rates during the administered interest rate regime. After deregulation of interest rates only loans of upto Rs 2 lakh are now getting these low interest rates. Loans above this amount carry deregulated interest rates. Since SSIs are usually seen by commercial banks as more risky they naturally, levy interest rates much higher than the Prime Lending Rate (PLR) on them. Consequently small scale enterprises have gone up from subsidized interest rates before economic reforms to interest rates that are higher than what large companies receive. This problem is even more acute for tiny enterprises. Thus the financing system for small scale enterprises needs considerable attention an a new approach is called for.

Discussions with various SSI Associations and other agencies, have drawn attention to a host of other credit related problems which affect SSEs.

- Need for credit rating agencies exclusively for SSE units.
- Financing for technology upgradation and modernization
- Delay in realisation of sales proceeds
- Non availability of state-up equity assistance to small SSEs and venture funds to innovative projects.
- Inadequate marketing infrastructure and credit for intangible marketing expenditure
- Need for functional autonomy for existing support service agencies such as TCOs, SISIs and the need for encouraging setting up of private sector business service enterprises in the clusters.
- Inadequate credit to micro enterprises.
- Need for resource support for shifting polluting units.

We have made an attempt to address each of these concerns in our recommendations.

6.52. restructuring of SFCs and SIDCs

Under the multi-agency approach for financing SSEs, term finance is provided by SFCs and working capital by banks. Lack of co-ordination between the two has been the major cause for the difficulties faced by SSE entrepreneurs. Several measures initiated in the past to secure better co-ordination have had only limited impact. For the tiny enterprise the distinction between term finance and working capital is not meaningful. For other larger SSEs, the process of appraisal by SFCs and banks separately is onerous and time consuming not only because they all chose to carry out appraisal sequentially rather than in parallel but also because of the tremendous bureaucratic hassles that the entrepreneur has to go through. Banks typically address the needs of the entrepreneur after SIDBI / SFC have committed their funds. **It is therefore necessary that the distinction between term lending and working capital institutions be done away with and banks and SFCs increasingly get into making composite loans.** It is essential for a single agency to provide all the credit

requirements of an SSE under one roof though there could be some impediments in implementing the idea in the initial years. The Nayak Committee has also recommended that SFCs and banks should cover financial requirements of SSE under the Single Window Scheme (SWS) to the maximum extent. This calls for a major restructuring of SFCs and SIDCs and in the operation of commercial banks.

SFCs and SIDCs have so far been structured as state government institutions. They usually have politicians as chairmen and bureaucrats as managing directors. Over the years it has been found that the heads of these institutions have not only been generalists but have also suffered from short tenures. With the lack of expertise at the top these institutions have not been run professionally and have not developed expertise in evaluation of projects and companies and have consequently suffered from low recovery ratios arising from poor lending practices. Given the political and bureaucratic leadership of these institutions they have also suffered from the ills of behest lending. If these institutions are to be re-vitalised they would have to be restructured anew and made independent from state government. **The Expert Group recommends that the IDBI in association with SIDBI devise a new scheme to revitalise these institutions. The approach should be to make these institutions autonomous by reducing government equity to less than 50%. The rest of equity could be held by other financial institutions, other private investors which have particular interest in the specific states.** Naturally, for this to take place Non-performing Assets (NPAs) would have to be separated out so that the new investors would then be willing to invest in these revitalised institutions. Once the restructuring is done these institutions would be able to upgrade their professional capacity for evaluating projects and monitoring them and hence be better able to provide credit to small scale enterprises.

Specialised Commercial Bank Branches and Local Area Banks

In recognition of the many credit problems faced by the small scale sector the Reserve Bank of India had appointed a committee under Dy. Governor Sri P.R. Naya to suggest measures for increasing the flow of credit to the small scale sector. **The Expert Group endorses the recommendations of the Nayak Committee and urges the RBI to implement them. In particular, all effort must be made to achieve the prescribed target of providing working capital of a minimum of 20 percent of the projected turnover of small scale enterprises.** Among the many recommendations made by that committee a recommendation was made to commercial banks to designate special branches in areas which have a high concentration of the small scale sector. There was to be time bound action for setting up specialised SSI branches in 85 identified districts and at least 100 such dedicated branches were to be opened before the end of 1995-96. This approach is consistent with our approach of centering policy support to small scale enterprise in clusters of industries and other enterprises. **A special emphasis should be given to this scheme so that special training for appraisal, evaluation and monitoring can be given to the staff in these branches.** There should be at least one of these special branches in each of the clusters that are identified by state government as proposed earlier. **Now that commercial banks are also allowed to do term lending, these special branches must provide term loans and working capital to the small enterprises within their jurisdiction.** With this kind of a cluster approach and the professionalisation of the staff, it should be possible to increase the availability of credit to small scale enterprises and on lower costs.

The Finance Minister in his budget speech of June 1996 announced a new scheme for founding new private sector local area banks. The guidelines proposed by the Reserve Bank of India suggest that these banks will be subject to all the normal commercial bank requirements in terms of capital adequacy ratios and other potential requirements. Since these banks would be small to begin with, the prudential requirements would automatically force them to concentrate more on small scale enterprises. They could then be expected to specialise in lending to SSEs. **The Expert Group recommends that the Reserve Bank of India should promote the speedy establishment of these local area banks in the districts where SSI clusters have been identified.** The introduction of these banks would provide appropriate competition to the existing commercial banks. To the extent

that the specialised SSE commercial bank branches would also be located in these clusters, it may be expected that the specialised SSE commercial bank branches would also be located in these clusters, it may be expected that their own operation would also be improved in the light of competition from these new local area banks. **The Expert Group also recommends that the Reserve Bank of India should initiate action to provide support for special training schemes for the staff of these new local area banks so that appropriate expertise is built up quickly in these new financial institutions.**

The concentration of lending to SSEs in the specialised branches and local area banks should help considerably in providing better financial support to the SSEs. Further it must be understood that there are other generic problems that would still exist in the financial support for SSEs. The key issue is inadequacy in the availability of credit information on borrowers. The cost of collecting such information is high for commercial banks. The cost of loan processing for a large loan is not too different from that of processing of a small loan. Consequently, banks naturally prefer to lend to large

companies and would like to charge higher interest rate from smaller companies to cover such higher lending costs. This problem will affect the new local area banks as much as it affects the existing commercial banks. The one advantage that the new local area banks may be expected to possess is that they would probably have access to better informal information on borrowers than bureaucratized commercial bank branches. This would be so if the promoters of these new LABs would be local entrepreneurs. The **Expert Group recommends that the Board composition of these LABs would benefit from the participation of the representatives from local business associations.** Such participation at the Board level would help in providing better information on local small business borrowers.

None-the-less the basic problem of credit information would persist. We therefore feel that special attention has to be given to provide a mechanism to lower the credit assessment costs for banks. Our suggestions to this end are provided below.

6.54. Reducing Credit Costs for SSEs: Extending Credit Ratings Services to SSEs

The term lending institutions and banks have legitimate concerns about the low recovery of loans and these have to be faced squarely. It would be imprudent to admonish financial institutions to raise the credit earmarked for the small and medium enterprises without due consideration about their stability. Moreover, the cost of credit rises if lending to small companies is perceived to be synonymous with low recovery. There is need for a new approach and attitudinal change on the part of the banks in such a way that banks view lending to the SSE sector as an opportunity rather than a threat. In the post liberalisation era, there are discernable changes with regard to availability of credit to the small scale sector. among other things, in the absence of proper financial statements, risk assessment by lenders becomes quite difficult. The Expert Group concluded that the recovery rates have to rise to increase the stock of financial resources that can be allocated to small and medium scale enterprises.

The recovery rates can rise only if banks and financial institutions have access to reliable information as well as by more stringent monitoring. Several options were explored to achieve this objective, i.e., credit rating, community, data banks on credit information and the measures required to make them more effective.

The business of credit rating has already taken root in the country and can be extended to smaller enterprises. However, the existing credit rating agencies find it more profitable to serve well endowed clients. Moreover, only a fraction of the small scale enterprises are incorporated as limited liability companies. The costs of credit rating, will be lower in clusters since a large client base will be available within their precincts if the **government** shares a part of the costs of credit rating agencies located in clusters, it can urge them to move there. SIDBI has already launched a scheme in coordination with national credit rating agencies to grant assistance to SSE units going in for credit rating. It is felt that SSE units need encouragement to go for credit rating either on cluster basis or individually to strengthen their resource raising capability. The costs of national level credit rating agencies would always be too high for the rating of SSEs. Thus, in order to bring down such costs what is required are local level credit rating mechanisms.

The Expert Group recommends that SIDBI in cooperation with the national credit rating agencies should promote the establishment of local credit rating agencies in the identified SSE clusters. This would require some level of equity participation by existing financial institutions including commercial banks and the national credit rating agencies. The government could provide a small seed fund to help in kick starting this process.

Community guarantee is appropriate where the clients are not fortunate to possess adequate collateral. The celebrated story of Grameen Bank an similar experiments with rural credit in Gujarat have confirmed that recovery rates rise where micro-credit is supported by community guarantee. **We, therefore, recommend that cluster associations be allowed to stand as guarantors and their co-operation should be enlisted for this purpose.** A few of the public-spirited associations such as the Tirppur Exporters Association are possible candidates as community guarantors. The refinancing agencies can keep an eye on the track record of these guarantors to build confidence.

We suggest that efforts be made to build data bases of credit information. The fledgling information services industry has already shown keen interest in creating data bases out of scattered information available with public institutions. However, concerns about secrecy as well the absence of known means to price information have been a barrier to the growth of the information services industry.

Potentially, information about the credit record of individuals will be the most effective means to check defaults. The information that banks and financial institutions share with data banks does not have to be divulged to the general public but can be utilised by a closed group of members bound by suitable rules. The regional banks should be encouraged to share information with data banks.

Once such a credit rating system gets established the costs of credit assessment for each LAB or commercial bank branch would get reduced. Moreover, the credit rating system would make more transparent credit quality of small borrowers so that banks are able to distinguish adequately between good risks and bad risks within the small scale sector. In principal, within the small scale sector good borrowers should be able to receive interest rates closed to the PLR, whereas borrowers of lower credit quality would then naturally be subject of higher interest rates. Such a system should help in improving the overall quality of lending to SSEs and to reduce the incidence of bad loans over a period of time. It may be expected that there would be a private sector response to such a system that provides consultancy services and would start becoming available to small enterprises to improve their credit quality. The measure proposed above would essentially improve the access of SSEs to debt funds, both for term loans and working capital purposes.

The cost of lending can also be decreased if the Small Industries Development Bank of India (SIDBI) is allowed to borrow low cost funds in international capital markets. A supporting guarantee from the **government** including sharing the exchange rate risk, can enable SIDBI to borrow at very low rates of interest.

6.55. Other Funding Sources for SSEs

National Equity Fund

Encouragement of SSEs start ups also requires improved access for entrepreneurs to additional equity funds. Unlike large enterprises SSEs are not able to access equity funds from capital markets until they grow to a certain level. In recognition of this problem the government has established the National Equity Fund. SIDBI has been operating the National Equity Fund which receives resources jointly from GOI and IDBI (now SIDBI). Even though the scheme is in operation for the past 10 years, the off-take under the scheme has not been adequate. Some of the commercial banks have also set up specific funds for providing equity support to new entrepreneurs. **In this case also the Expert Group recommends that the National Equity Fund would operate much better if disbursement of its resources is decentralised to the cluster level.** In order to mitigate the shortage of risk capital required by the small SSEs there is need for encouraging setting up of equity funds by majority of the specialised branches of commercial banks and LABs. SIDBI could contribute upto 50% of the equity funds floated by these commercial banks / LABs out of the National Equity Fund operated by it. The Expert Group is of the opinion that such a measure would encourage accelerated flow of equity funds to large number of needy small SSEs. It would be much more likely for these clusters to have new credible entrepreneurs who could be assessed commercially for the provision of additional equity from the national equity fund. These branches and LABs should be encouraged to form their own local equity fund with assistance from the national equity fund. This scheme would provide special assistance to technocratic entrepreneurs who have adequate technical expertise but inadequate resources. The assumptions of such entrepreneurship would require greater technical expertise on the part of these bank branches and LABs which have already been suggested above. Resources from these local equity funds should also be available to assist existing SSEs for further expansion.

The other source of equity as well as debt that SSEs could tap are other companies, both small and large, and foreign investors. With the removal of SSI reservations there would no longer be any need to impose 24% limit on equity that currently exists on investment in SSEs by large companies and by foreign investors. As already recommended this limit be removed forthwith so that SSEs could benefit from closer relationships with large companies and foreign investors. In addition to getting better access to funds this move will also promote outsourcing of end component by large companies and promote closer technological relationship.

Encouragement of Bills Culture and Factoring Services

As a result of the 1991 policy statement, the Delayed Payments Act has been enacted. So far, it has not had the desired effect and SSEs continue to be plagued by non-payment of their dues, particularly by large enterprises. Effectively then, SSEs are providing working capital credit to large enterprises, rather than vice versa. The Act could be made more effective by inclusion of stringent provisions for non-payment of dues to SSIs. Besides commercial banks, SIDBI and SFCs have also attempted to solve the problems relating to timely realisation of sale proceeds by discounting the bills arising out of sale of components / intermediates by SSE units. The bills culture should be encouraged in greater measure to mitigate the problems of delayed payment of receivables of SSEs. RBI has been restricting cash credit component which is presently 25% and 40% of the maximum permissible bank finance (MPBF) in case of large and medium borrowers and the balance being provided by way of term loans. In order to increasingly encourage the bill culture, the Group suggests that RBI may consider measures which would promote the covering of purchases from SSE suppliers through the bills route. Further measures must therefore be taken to reduce delayed payments by large enterprises. One suggestion that we have received and we recommend is **that in the annual accounts of large companies. Information be provided on a**

statutory basis on the extent of accounts payable to small enterprises. It is felt that this would reduce considerably the incidence of delayed payments. **The Expert Group recommends that the Department of Company Affairs explore this possibility.**

Further, a beginning has been made by State Bank of India, Canara Bank and SIDBI in setting up factoring organisations, one each in southern and western parts of the country. This activity must be replicated by allowing factoring agencies in the private sector in different regions of the country, especially in SSE clusters by removing the legal constraints and other impediments relating to stamp duty, registration changes and the like.

6.56. venture Capital

An infant venture capital industry has existed in the country since the mid 1980s and can grow into an adult if appropriate regulatory changes are made. Its early development was nurtured by low cost capital sourced from multilateral agencies, the Indian development finance institutions, some commercial banks and overseas donor organizations. In its first stage of development, the impact of venture capital industry on small and medium scale industry has been unremarkable although some successes point to a promising future.

Two important developments have undermined the foundations on which the venture capital industry was able to grow so far. One, the era of low cost capital has come to an end as the Indian development finance organisations, the chief financiers of venture capital companies, have had to raise capital from the stock markets. Secondly, the venture capital companies now face competition from private equity funds and non-bank finance companies who have entered into larger stage financing in the form of "bought-out" deals. The profits from bought-out deals, during the boom of 1994, were high enough for financiers to forego tax benefits granted by the venture capital guidelines of 1988.

So far the venture capital funds set up by private enterprises do not seem to have made significant impact in the field in supporting start-up ventures on account of paucity of funds and their inability to tap the capital market. Pursuant to the announcement made in the budget for 1996-97 SIDBI has a scheme to contribute 50 percent of the corpus of venture funds of private and public sector companies provided they are fully dedicated to SSEs. This is carried out of a Venture Capital Fund created by SIDBI out of its own resources. The fund is also used for assisting SSI units directly. Effective steps need to be taken for setting up of regional and sector-specific venture funds. This coupled with the liberalised tax incentives extended by the **government** to venture capital companies will go a long way in flow of credit to innovative ventures of SSE.

Against this background, venture capital companies have to find alternative means to survive in a competitive market. They will have to access capital from other large funds who can share the extraordinary risk of investments in start-up ventures. The returns from investments can also be raised by better management with experience in this specialised business. Finally, the transaction costs are so high that venture capital companies are unable to afford investments of a value less than Rs. 4 million while most small scale investments are below this threshold level¹⁶.

Venture capital companies can share risks with large funds only if private pension funds and insurance companies are permitted to invest in venture capital funds. Typically, pension funds, insurance companies and other institutional investors, with their large pools of capital, can afford to invest a small share of capital in risky venture capital companies. In the USA, pension funds and insurance companies accounts for 71 percent of venture capital investments¹⁷. In the UK, 65 percent of venture capital comes from pension funds and foreign financial institution.

The successful management of venture capital projects is ensured by partners, who have long experience in this business in 1990, for example, 89 percent of venture capital investments in the USA were supervised by management partners who had at least 5 years of experience¹⁸. Typically, the investors enter into a management partnership agreement and have no control over day-to-day operation of the project.

The third aspect of successful management of venture capital projects is their location in science parks or some other form of cluster. Venture capital companies establish offices in such parks and network within a small community to identify start-ups for financing. Transaction costs, under the circumstance, can be kept low. Moreover, the probability of a successful venture in a science park is higher and is reported to be three times higher¹⁹.

Several changes are required in the Indian regulatory system before venture capital companies can make a perceptible difference to small companies. The entry of private pension funds would have to be permitted and freer entry of private insurance companies would have to be possible. Moreover, the rules under the Insurance Act 27 A and 27 B stipulating investment of more than 70 percent of the capital in government securities and similar rules under pension schemes requiring 50 percent of the capital in government securities and similar rules under pension schemes requiring 50 percent of the investment in public sector bonds will have to be abolished.

The 1991 policy for small scale industries had proposed an enactment of a Limited Partnership Act so that it would be easier for SSE entrepreneurs to source additional funding from other partners who could invest in partnership as sleeping partners. This is another source of funding for SSEs. **The Expert Group recommends that the Limited Partnership Act should be enacted as soon as possible.**

The proposed Limited Partnership Act should also incorporate the law governing limited management partnerships. These rules should lay down the rights and obligations of the managers and the investors. Since expertise would have to be sought from management companies overseas, the rules for the repatriation of their profits should also be spelt out.

6.57 Addressing the Credit Needs of Tiny Enterprises

As may be expected, among small scale enterprises the credit problems of tiny enterprises are even more acute and therefore require special attention. They particularly require exceptional assistance at the time of entry when the budding new entrepreneur may not have any credit history nor collateral. The various suggestions given above regarding the use of the National Equity Fund apply in particular providing support to tiny enterprises. The financial intermediaries in the formal sector (SIDBI) commercial banks, SFCs, Regional Rural Banks, Cooperative Banks) attempt to cater to the needs of small scale enterprises in an undifferentiated manner. The smaller among the small units have lost out to the relatively larger ones over the years in this process of transfer of credit from the formal system. This has resulted in this segment facing acute problems that arise mainly out of inadequate and delayed credit, procedural bottlenecks and institutional limitations as manifested in the insistence on collateral and a general lack of empathy with the needs and constraints of the tiny enterprises owners.

This in turn has contributed to high mortality rate, high incidence of default, shortage of funds and stunted growth in the tiny sector. These in fact are just symptoms of a systemic problem viz, the inability, both structural and attitudinal, of the formal system to reach out to the smaller clients on a sustained basis.

For ensuring that the tiny sector is not bypassed by the commercial banking system, the Committee proposes that it should earmark a minimum of 70 per cent of its priority lending allocated to the small scale sector to the tiny sector.

Considering these facts the Expert Group recommends that an alternative system of financial intermediation should be evolved for dealing exclusively with the needs of tiny sector. This may be done primarily through augmenting the existing system with active involvement of District Co-operative Banks, private sector Local Area Banks, and NGOs including business / industry associations. These institutions will be working at the district level confining their activities to not more than three districts. This would ensure better appreciation of local requirements and minimization of transactions (and costs) both for the intermediary as well as the borrower. These institutions need to be self-sustaining in the long run. They should also have access to the existing avenues of refinancing by NABARD and SIDBI.

Under the financial sector reforms the **government** is committed to revision of SLR and CRR in due course. A specified portion of the liquidity thus released into the system may be allocated for on lending either to tiny units directly or to the district level intermediaries as suggested above. However, whenever these ratios are increased as part of monetary regulations, the funds allocated to this sector should be insulated.

To help those entrepreneurs without sufficient collateral towards procuring bank loans, it is suggested that a **Revolving Collateral Reserve** be created at the intermediary level. In order to compensate the financial intermediary for the loss arising out of default for the first five years of their operation, the state governments should subsidise default upto 20 per cent of the total which would be brought to naught in the sixth year in a phased manner. The subsidy should be available on a matching basis to the intermediaries against their contribution for creating aforementioned **Collateral Reserve** by setting aside a share in profits. Income tax exemption to the extent of this provision may be made available as an additional incentive. This would be applicable only to district level intermediaries. The National Equity Fund may also be made generally accessible to the intermediaries to build this collateral reserve. Alternatively at the cluster level, the CSEA may be allowed to stand as community guarantor for securing loans from banks.

Composite loans (term loan plus working capital) would be made available to tiny units from a single source with an enhanced limit of Rs. 10 lakh from the present limit of Rs. 50,000. However, while scheduling the repayment only the term loan component would be considered. The working capital component would be governed by the level of activity. For financial assistance under this scheme, banks and financial institutions should not take any collateral from entrepreneurs.

While deliberating on other issues in finance encountered by tiny enterprises, the Expert group felt that a perpetual problem is the delayed or non-payment of dues by large buyers to the small suppliers. The tiny units, especially are affected by this as it will cost them dearly if they estrange big customers. At the same time they are deprived of the

benefits of inter-industry and inter-firm linkages due to their weak bargaining power as suppliers. As already noted the Delayed Payment Act, introduced as part of the 1991, policy statement has not been able to help the smaller entrepreneurs overcome this hurdle because it suffers from certain inherent lacuna. The proposed DEPA should be entrusted with the task of assisting tiny units in getting timely payment of their dues. Where legal action is required under the Delayed Payment Act the DEPA should be authorised to act on behalf of tiny units. Similarly, special efforts must be made by factoring service organisations to address the needs of tiny units.

Summary

To sum up, there is need in so far as credit dispensation is concerned, for a paradigm shift in favour of tiny enterprises. Adequate and timely credit under a single window arrangement would enhance the productivity of assets already created in SSE sector and in the process increase the competitive strength of the small units. A time bound programme for investment in research and development, technology upgradation and technology transfer has assumed critical urgency in view of economic liberalisation. This issue is addressed below. Besides increasing the flow of term loans and working capital, there is also a strong case for easing legal constraints so as to encourage factoring services. It is equally important that institutional arrangement be made for meeting the shortfall in equity assistance both for new and existing ones. In so far as small credit needs of rural poor and more so women, are concerned, all encouragement should be provided to micro finance institutions with the help of specially created fund in NABARD / SIDBI.

6.6. Support Services For SSIs

Two major lessons can be drawn from successful experiences, worldwide, with small industry development of recent times. Firstly, access to a diverse range of sources of support services, whether it is government, private companies, consultancies, educational institutions, business associations, is necessary for individual small companies to identify the one most suitable for them. Therefore, the government's role gets restricted to part financing of services without any bias for any particular source. Secondly, support services such as technical assistance, training, market development and information should be available as a single package for them to be effective. In India, however, government is the primary source of support services and a co-ordinated program for joint delivery does not exist.

6.6.1. Technology Development

Lately, the survival of enterprises in the large majority of natural clusters has been threatened by endemic technological obsolescence. When the exports of low quality products fell, the first alarm bells rang. In some product segments such as electronic components, Indian companies have braced themselves for competition from multinational corporations and have pressed their vendors to upgrade quality. In other cases such as diesel engines in Ludhiana, new opportunities for diversification into related products like electric generators and automotive components have been foregone due to technological limitations²⁰.

The slow pace of technological progress is not necessarily inherent in the very nature of small scale enterprise in India. Admittedly, these companies catered to a price sensitive home market disinterested in quality. Correspondingly, most household enterprises have been promoted by poorly educated entrepreneurs unable to absorb new information. Many of them also manufacture products like furniture or crude tobacco based products where technology is stagnant.

The critical barriers to technological development, however, are decidedly policies and regulatory practices governing factors markets in India. For one, labour laws have driven proprietors to contract work to numerous household enterprises equipped with primitive techniques. In some cases, biased allocation of **government** subsidy has favoured obsolete products such as diesel engines and has driven modern lightweight and fuel-efficient engine using aluminum alloys out of the market. In an industry like food processing, the Prevention of Food Adulteration Act has vested the monopoly of food testing with the government. Not only are these antiquated government owned laboratories unable to undertake tests required by a modern food processing industry they also deny access to information about the required standards particularly to small scale enterprise. **The Expert Group, therefore, recommends that urgent action to amend or repeal laws that are a barrier to technological progress.**

The atrophy in complementary infrastructure and institutions has proved to be a fetter on technological progress. Thus the Bureau of Industrial Standards played a catalytic role in stimulating technological improvements in the past but is not reportedly doing so now²¹. In the electronics industry, an acute need for common infrastructure for development of instrumentation, calibration and precision tools has been felt but has not been forthcoming. The crafts and textile enterprises have expressed an urgent need for design facilities that is not being met. Similarly, training and quality control facilities need to be refurbished in consonance with emerging demands. **The Expert Group recommends that government share the costs or providing these services in collaboration with the private sector and voluntary organisations.**

The enforcement of industrial standards has been used in many countries as a means of raising the technology used by SSEs and the quality of their products. The Bureau of Industrial Standards therefore must transform itself into an activist organisation and initiate an outreach programme for SSEs, once again, this could best be done in the basis of SSE clusters which have some degree of industrial sector specialisation. **The Expert Group recommends that the government should provide funds to the BIS in the Ninth Plan to fund such an exercise.** The seed funding With BIS would have to be complemented by funds from SIDBI, commercial banks and the proposal BABs for this purpose. Moreover, the transitional fund proposed in the context of the removal of SSI reservations should devote a portion of its resources for this purpose in the case of currently reservations should devote a portion of its resources for this purpose in the case of currently reserved products. **This assistance would be particularly relevant to tiny units.**

20 The information for this section has been drawn from "Restructuring and Modernization of SME clusters in India ", UNIDO, November 1996.

Technological assistance as well as the institutional mechanisms for its delivery will have to be tailored to the distinctive needs of the household enterprises and small and medium scale enterprises. Tiny craft enterprises have achieved huge productivity gains from incremental improvements in their tools²². Voluntary organisations are predisposed towards the welfare of household enterprises and more likely to take a keen interest in the delivery of technical assistance to them

Small and medium scale enterprises located in few metropolitan areas like Bangalore, Pune, Bombay and Hyderabad have shown promise in some high-tech industries. Specifically, they have demonstrated innovation potential in specialty chemicals, pharmaceuticals, information technology, bio-technology and machine design²³. However, the yield of commercially successful technology has been small due the absence of intermediaries, i.e., counselors, research associations and technology centres engineering consultancies, between research institutions and the development centers in enterprises. Governments in developed countries have focused their efforts at assisting the growth of such intermediaries and India should also learn from these experiences and emulate them²⁴.

As has been detailed in Chapter III the Small Industries Development Organisation (MSME-DO) has over the years set up a wide range of technology support institutions to help small scale industries in improving their access to technologies in different ways. As noted earlier, although these institutions have performed a very useful role in the past they need to be restructured as proposed earlier to become much more commercially oriented in order to provide higher level of services that are now required by small scale industries.

Financing for Technology Upgradation

The upgradation of technology which is the key to any programme of modernisation of small scale units, requires an integrated approach encompassing identification, adaptation, absorption, transfer of technology including energy conservation, waste management, quality certification. Such technology upgradation has to be taken up on sector-specific requirements by providing some measure of concessional financial assistance. Presently SIDBI operates a Rs. 200 crore Technology Development and Modernisation Fund (TDMF). State Bank of India and some of the nationalised banks also operate schemes for sector-specific technology upgradation.

Keeping in view the interdependence of the SSE sector vis-à-vis the large undertakings and need for the SSE sector to improve its capabilities to produce quality products, components/intermediates technology upgradation of the SSE sector must be strongly promoted in the coming years. **To achieve this, the Expert Group proposes that the scope of the existing TDMF Scheme of SIDBI which is presently linked to 25% export obligation be enlarged to cover all modernisation proposals including those which involve the improvements of capabilities and competitiveness in the domestic market. Further assistance should be provided out of this fund to support service institutions / enterprises engaged in technology transfer, technology-oriented research and development and the like. To encourage increased availment by SSEs under the scheme, the assistance under TDMF could be provided at a concessional rate of interest. SIDBI and other financial / banking institutions which opt to take up this scheme may be compensated for such soft lending under a Special Revamped Scheme for Technology Development and Modernisation of SSEs.** Such a scheme could operate much better if specific sectors and clusters are identified and then targeted for technology upgradation. The specialised commercial bank branches (and Local Area Banks as they come into operation) would have to devise and administer such schemes, with refinancing being obtained from SIDBI. It is likely that soft resources for such a scheme could be sought from soft funds available from foreign aid agencies.

Support for Research and Development

The technology support required by small scale industries includes research and development support, testing and calibration, assistance in environmental technology,

assistance in pollution control mechanisms, and assistance in improving quality, particularly through the achievement of designated industrial standards. In each of these areas of assistance it is necessary to provide new technology support institutions which could provide these services effectively. **Once again, the Expert Group is of the view that such services could be provided most effectively through institutions based around clusters of similar industries so that they are able to specialise as well as reap economies of scale.** These new technology support institutions should basically be run by the cluster industry associations (CSEAs) in response to the felt needs of the industries based in these clusters. Further since there are clear externalities in the provision of such support, there is full justification for participation of the government in the establishment and funding of such institutions. **The Expert Group recommends that the government should establish fund(s) at both central and state level in order to design schemes which provide matching funds as incentives to clusters industry associations to establish the required technology support institutions.** Such institutions could be formed as registered societies with appropriate participation from both government and cluster institutions.

Research and development needs are more specialised than the other technology supports that have been mentioned. Although a great amount of innovation is observed in small scale industry, they are clearly not equipped to perform R&D functions. What is needed is cooperation between small scale units in the same industry to identify common technical problems which require R&D assistance. Different countries have experimented with different ideas to provide such R&D associations and through project funds. Such R&D associations however, are seldom seen to succeed without matching support from government funding sources. **The Expert Group recommends that the Department of Science and Technology initiates a new scheme in the 9th five-year plan to form R&D associations based around identified clusters of industries which may be identified as those which are in urgent need of technology upgradation. At least 10 such clusters should be identified within the first year and the aim should be to establish at least 50 such industrial R&D associations for assisting SSEs, within 5 years.**

There is at present very little interaction between regional engineering college and other industrial training institutions and small scale industries within their areas of operation. The above scheme for technology support and R&D would be much more practical if the proposed technology support institutions and R&D associations are formed with close links with existing engineering and other institutions at the local level. There must be much greater provision for sandwich courses, fellowships etc, for students to get industry level experience and for teachers in these institutions to get industry experience. However, these institutions should be encouraged to specialise in those industries which are concentrated in clusters in the areas where regional engineering college are located. **The Expert Group recommends that these links between these existing technical institutions and existing industries on the one hand, and with the new proposed technology support institutions could best be forged by the national level industry associations through their regional members.** The Ministry of Industry should approach these organisations to launch special programmes to forge these linkages.

In recognition of the great requirement of technology upgradation of SSEs for competing in the increasingly open economic environment. SIDBI and some commercial banks such as the State Bank of India have already organised special technology upgradation programmes in industry clusters such as Coimbatore. This experience should be used to form similar programmes in other industry clusters through the proposed specialised branches suggested above and the new local area banks. The existing technology development scheme of SIDBI could be expanded for promoting this scheme.

In summary, the existence of small scale industry clusters can be profitably used to found a new approach to technology support for small scale enterprises. Whereas, as has been recommended, such technology support should come on commercialised basis from autonomous institutions, the government has a very important role in initiating action to encourage these institutions and to provide matching funds for their establishment and operation. **This should be the new promotional approach of the government towards small scale enterprises.**

In order to provide a focus and to promote the various schemes suggested above for assisting In technology upgradation and R&D for SSEs, **the Expert Group recommends that a National Research Institute for Small Scale Enterprises be established.** This institute would be expected to operate as a networking institution and a clearing house for policy studies and technology issues that get raised by small scale industries. It would promote the establishment of R&D networks on a clusters wise or sector wise basis, depending on where demand for technology appears to be most urgent; it would find funding mechanism for promoting R&D networks on a clusters wise or sector wise basis, depending on where demand for technology appears to be most urgent; it would find funding mechanisms for promoting R&D relevant for SSEs; it would promote the establishment of institutional mechanisms to achieve these purposes. **It is proposed that this institutes should be promoted jointly by the central government and apex industry associations.**

6.62. Training

Human capability is observed to be a prerequisite for absorption of technological developments²⁵. Besides traditional sources of learning such as training institutes and universities, informal sources of knowledge acquired from the tacit knowledge of firms, machine suppliers, consultants, feedback from markets and quality control organisations are known to be more valuable. Indian enterprises, however, are not able to conveniently tap a diversity of sources of information and learning. Indian industry in general needs to upgrade its technical capability in order to be able to compete internationally. With increasing foreign investment and free new entry of domestic firms, existing firms also have to upgrade their technological levels. The onset of information technology in almost all sectors of industry and services is another contributor to technological change. For all these reasons it is becoming increasingly necessary to improve the training of new workers and to organise continuous retraining of workers already in service. Whereas many large firms have their own in-house training mechanisms small firms do not have such facilities. Thus there is a great need to initiate a vigorous new programme for industrial training of workers both for the industrial sector and service sector. Some hints can be taken from the experience of other countries.

Some East Asian countries have forged new institutions to act as conduits for channeling information from large firms and other institutions to small and medium scale enterprises. In particular, Malaysia and Singapore report remarkable success with institutions which draw on the expertise of large MNEs and other organizations. The Standards and Industrial Research Institute of Malaysia (SIRIM), for example, has entered into an agreement with Hewlett Packard to train local industries in computer aided manufacturing²⁶. Its Quality Improvement Practice Program involves large companies to help small firms in meeting quality standards. Similarly, the Penang Skills Development Centre is a joint venture of the private and public sector for meeting training needs of Malaysian industry. The state government provided the premises and grant for eight years and the corporate members contributed the seed money and other donations. A double deduction tax incentive is available to the private sector against the expenditure incurred for human development. Similarly, Singapore's Local Industry Upgrading program is a joint effort of resident MNEs, its Economic Development Board and the local industry²⁷.

Among the best known vocational training programmes is the long standing system prevalent in Germany. This system is a unique example of widespread public private partnerships, as well as cooperation between their federal and state governments. Most German school leavers who do not go on for higher studies go through such a apprenticeship programmes. The government has identified a large number of distinct technical vocations for both the industrial and service sectors. A base curriculum is prescribed for each of these vocations by the federal government. The state governments finance and run training schools which each apprentice attends for one or two days a week. Firms, both large and small, employ these apprentices who work and receive on the job training for the remaining three or four days a week. Finally, the qualifying examinations are conducted by local commercial and industry associations. Thus there is effective participation by federal and state governments, industry associations and firms. Apprentices are funded by their firm employers, though these wages are lower than those for fully qualified technicians.

The Expert Group recommends that the central government initiate a special exercise to start a training programme for technicians in both the industry and services sectors. A mechanism should be evolved to obtain participation in this activity by companies, industry associations, state governments and the central government. **The Ministries Industry, Labour and Education should set up a special Task Force to work out the modalities for such a scheme and provision should be made in the Ninth Five Year Plan for the provision of seed capital.** The Task Force should have adequate representation from state governments and industry associations. Once again, this idea should be initiated in selected clusters to begin with where the felt needs for such training are obvious, and where firms are willing to contribute. The Malaysian example quoted above could also be used to found skills development centres in clusters for ongoing training for mid-career workers. **The Expert Group recommends that state governments should make provision for matching funds to be provided for establishing such skills development centres.**

India needs to emulate such programs as this would be the quickest way to acquire expertise especially in manufacturing processes, quality control and standardisation. Suitable tax incentives should also be devised to make this possible.

In the area of entrepreneurship development, in spite of having a number of national and state level entrepreneurship training institutions, only around 10% of the potential target could be accessed through new entrepreneurship training facilities, the Committee feels that efforts to create and develop entrepreneurship training institutions are highly imperative in every state. Simultaneously, the performance of the existing state level institutions must be reviewed and strengthened. The NEDB can shoulder this responsibility with the help of national resource institutions in the field of entrepreneurship.

Through the provision of appropriate training, a cadre of 'Professional Management Assistants' (thus replacing the currently used inappropriate term 'Barefoot Managers') needs to be created for effectively facilitating the functioning of the tiny sector. the

managerial deficiencies now rampant in units in the lower size categories of investment could be removed to a significant extent by making the services of this cadre available to them.

6.63. Marketing Assistance

Marketing is the core strength of a successful enterprise. SSE enterprise by sheer size of the organisation has not been able to have resilience or wherewithal to incur expenditure on marketing activities, many of which being intangibles were not financed by formal sources. Identifying 'marketing' one of its trust areas, SIDBI has initiated action in providing assistance for tangible marketing activities like setting up of a show rooms, warehouse, organising trade fairs / exhibitions both in India and abroad and permanent exhibition centres. The finance for meeting intangible expenses of SSE such as cataloguing, advertising, branding and participation in trade fare and exhibition in also provided by SIDBI. Similar facilities should be made available by commercial banks which can resort to guarantee from local community / industry associations. In the post-liberalised environment, patenting and branding are to be increasingly encouraged for which there is need to set up separate fund. **The Expert Group suggests that, on the lines of Marketing Development Assistance Fund set up earlier in EXIM Bank with World Bank assistance, a fund be created and operated through SIDBI for assisting a targeted SSE exporting units numbering around 5000 in the 9th plan period.** The India Brand Equity Fund (IBEF) of the central government may also be suitably enlarged in order to enable the SSEs to have a share in the assistance from the IBEF.

Market Development for the Tiny Sector

Marketing is another area that poses challenges to the tiny sector. Strengthening the links of the tiny sector with the rest of industry is one aspect of ensuring markets for the former, especially in the capital and intermediate goods sector. **The Expert Group recommends that a suitable mechanism be evolved to promote marketing outlets specialising in marketing the products manufactured by the tiny sector. Efforts may also be made to develop common brand names for such products. We do, in fact, have a few such successful initiatives in India by NGOs LIKE Sarya Shanti Ayog (SASA), Calcutta and Orissa Rural and Urban Producers' Association (ORUPA).**

Franchising

The marketing of SSI products and services can also be promoted by a more widespread adoption of the system of franchising. We have already recommended the removal of the 24 percent limit on equity holding in SSEs by large companies and foreign investors. This removal would make it easier for franchising companies to take equity positions in SSEs which become their franchisees. This would be applicable for both manufacturing and service SSEs. The restoration of the excise duty exemption for branded goods as also recommended would also help in the promotion of franchising as a concept in India.

6.64 Government Procurement And Market Promotion

Government currently procures 409 products from the small scale sector on a preferential basis and pays a premium of 15 percent on them. Data from the Directorate General of Supplies and Disposal, however, showed that in 1982-83 purchases from small companies accounted for only a small fraction of less than 12 percent of its total buying for such products. Moreover, the buying was mainly from the larger units among the small companies²⁸. The reasons for procuring from the larger companies seems to be the relatively lower transaction costs of dealing with the larger companies.

The old system of preferential procurement by the government is in obvious need of change. Involuntary purchase by the government is against the basic principles of free markets. Such a system also perpetuates technological obsolescence in small companies since it does not demand improvements in quality. In any case, government procurement will not be a significant factor unless means are found to lower the transaction costs of purchases from the small scale sector. Moreover, small companies lose interest due to long delays in payments to small companies.

The effectiveness of government procurement can be enhanced by co-operation with cluster associations. Transaction costs can be lowered if orders are placed with cluster associations and they distribute the work to individual companies. These cluster associations can also mediate with the government for prompt payment of bills. Collaboration with cluster associations can also enable the government to procure goods of superior quality without a proportionate increase in price. This will be possible if technical assistance is dovetailed with procurement.

Experience in other countries confirm that procurement coupled with technical assistance is an all win approach²⁹. A striking example is that of the Brazilian state of Ceara where the Industry and Commerce Department organized such a program in collaboration with the Brazilian SME assistance agency and associations of small producers. The Education Department of the state agreed to voluntarily purchase wood

products from associations of small companies if the price and quality was competitive. The Association agreed to guarantee the quality and product warranties and would take back the fault products returned by the Education department. The only subsidy in the entire program was a down payment of half the amount which the association had to repay in case of a default. In turn, the association lobbied with the government for technical training of the workers. The results are reported to be starting.

Marketing development is another activity where the government can play a catalytic role to elicit interest from private buyers. The government cannot play a useful direct role since a diverse range of marketing channels exists and not all of them are useful for all companies. Current research indicates that government intervention has been most useful in organising trade fairs where private distributors are invited to gain an exposure to the products of unknown companies³⁰. Also research has concluded that government can play a useful role in financing specific needs, such as marketing consultants, for market development.

Research done in India uncovers an unsatisfactory situation in marketing of small industry products. In general, small companies do not have a good reputation for quality and delivery³¹. In turn, small companies are harassed by problems of prompt payment and uncertainty about their outlets. The most important channel is the wholesaler who offers relatively low prices but a stable outlet. On the other hand, prices are higher closer to the final consumer where the prospects of a brand presence improves.

Clearly, linkages with markets have to be strengthened if small enterprises are to grow. The emergence of department stores in the country opens a new and a promising opportunity for small firms which can be realized with adequate attention on quality improvement. It is well known that department stores are keen on direct links with manufacturers but are unable to achieve this because large companies have established relationships with traditional distribution channels. Small firms do not have such loyalties and would be willing to sell to department stores. However, consistency in quality and prompt delivery would be absolutely important before department stores agree to buy from small companies.

The Expert Group recommends that an effort be made in collaboration with clusters associations to build links with department stores. A program be undertaken for greater exposure to high quality products available with small companies. Technical assistance should be made available through BIS for small companies to meet the desired standards of quality. The cluster associations should stand guarantee to the quality of the product. A market development fund should finance a diverse range of activities to improve access to markets.

6.65. Information Services

The Expert Group is dismayed by the reported paucity of information available to entrepreneurs and that it is not disseminated in an organised form by reputed data base companies. It is also disturbed by the fact that the pioneering effort of NISIET in Hyderabad to develop a specialised data base, SENDOC, for small companies has tottered due to budgetary cuts. This is an extremely regrettable situation particularly because the Internet has created a new environment for an explosion of information services greatly adding to the convenience of doing business in the small scale sector.

The recent survey of the Friedrich-Naumann Stiftung and NCAER found that information services are either neglected or there is no systematic way to collate and disseminate them. Thus forty nine percent of the DICs, which are potentially the links with information sources, report that there is no accepted way to regularly source information from the SISs NSICs, etc. Another 21 percent report that information is exchanged only on request³². Similarly, thirty nine percent of DICs did not carry out any area development survey and 45 percent had not undertaken any industry potential surveys³³.

A great deal of stress is laid on information services in clusters that have succeeded overseas. This is well illustrated by an example from Italy. CIRER³⁴, located in Modena in Third Italy, specialises in knitwear and keeps artisans informed about prices and nature of yarns, technological developments, fashion and market trends. CITER was initially financed with public funds when it was created in 1980 but government's share declined to 30 percent of the budget a decade later. The remaining budget is financed by subscriptions from members or from earnings. The regional development agency of Emilia-Romagna, ERVET in Bologna has inspired other such sector specific centers for shoes, farm machinery etc.

The upshot of this very revealing background is that considerable effort is required to create a data base industry in India. This would mean that data base vendors should have access to sources of information in the various government departments. Conversely, the government should have a policy to price information. In the absence of legislation on freedom of access to information, a policy for preservation and sharing of information does not exist in the country.

The Expert Group has already recommended cluster based organisation for providing technical support to small scale enterprises. One of their specific functions should be to

provide Internet based information services to their constituents. It would be easier to do this on the basis of clusters since there would be specialisation in the kinds of industries located there. With technical and trade opening of the economy, SSEs can benefit greatly from the ready availability of information on sources of raw materials, intermediate goods, capital goods and technology. Similarly, SSEs can build up on line relationships with customers as well as suppliers. The availability of such information will enable SSEs to source their need from the best suppliers and sell to the best customers, thereby making them more competitive.

A great amount of technical marketing and other information is now available on Internet. Most of the enterprises that are entering this information service segment around the world are small scale enterprises. In India also we are witnessing many small technocratic entrepreneurs entering this business. The Expert Group recommends that the provision of such information services be recognised as eligible SSE activity and be made eligible for commercial bank and SIDBI funding.

The Expert Group recommends that the Ministry of Industry should set up a Task Force with the participation of the apex industry associations to set up such information systems at the cluster level. Issues of secretary, sale and dissemination should be examined as well as a beneficial law governing the information industry. The proposed committee should also examine the implications of VSNL's monopoly in the Internet and NIC over information services.

6.7. Infrastructure Development

Historically, the State Industrial Development Corporations (SIDCs) were conferred the authority to acquire land, develop it as industrial estates and sell sheds and plots to entrepreneurs. Their mandate did not include the development of related infrastructure such as effluent treatment, power, etc. The central government scheme of Integrated Infrastructure Development and the SIDBI scheme of "development of Industrial Areas" have not really taken off so far³⁵. In the future, industrial parks should develop all the distinct components of infrastructure and not just land.

The clusters of small industry, spontaneously formed, have expanded to a level where their further growth will not be possible without rapid development of their infrastructure. The private sector will find it attractive to invest in such regions because their residents have a high willingness to pay for public services. In some cases, such as in Tiruppur, the local associations have already taken the initiative to persuade financial institutions to invest in infrastructure development and a scheme for the integrated development of infrastructure is already under way.

As has been documented elsewhere, most of the existing SSE clusters have developed spontaneously with minimal organised governmental support, though there are some which have been developed by government agencies. A great deal of productivity improvement can take place in these clusters if the infrastructure environment is enhanced in these places. The provision of basic services such as water supply sanitation, roads, reliable power supply and labour welfare. **The Expert Group therefore recommends that both central and state governments redirect their existing growth centre and other infrastructure development schemes to the infrastructural development of existing SSE clusters.**

The available information suggests that the progress in the construction of large infrastructure projects is impeded by the low level of participation by the government. The state needs to share some of the risks and subsidise some components of projects especially where social benefits are higher than the private gain. Furthermore, the government can play an important role as a guarantor. In the interest of speedy development of infrastructure, the government may have to also share some commercial risks, in the initial stages, to attract greater interest from the private sector.

Several considerations have a bearing on the success of industrial estates and the interest they elicit from entrepreneurs. Above all, intangibles such as services contribute to the convenience of doing business in an industrial estate. A coherent design of the estate and its appropriate location is essential to attract investment from a single industry. Considerable expertise and ingenuity goes into developing a property that satisfies the users and this is best done by specialists.

India, moreover, needs expertise to cater the emerging demand for science and incubation parks as seedbeds of technological innovation. These parks have burgeoned in developed and some newly industrialising countries to commercialise technology transferred from universities. Indian educational institutions have evinced interest in science parks as a means to commercialise their intellectual property³⁶. One of the projects for technology incubation at Pune has succeeded and the experience can be reproduced in other cities such as Bangalore³⁷.

The Expert Group, therefore, recommends that private sector investment be encouraged for the development of industrial parks. State governments have invested significantly in existing industrial estates and growth centres. Some have functioned very well and others have not. The existing estates provide a good opportunity for state governments to invite private sector participation in their

upgradation and management. This could raise resources for state governments to invest elsewhere, while improving the functioning of existing estates. But a clear framework for these activities would be required, and rules of the game regarding rights, responsibilities and duties of industrial park companies would have to be made transparent. In countries such as Thailand and Indonesia, the private sector plays a key role in the development of industrial estates.³⁸ As also proposed by the Expert Group on Commercialisation of Infrastructure Projects, **we also recommend that state governments set up State Industrial Parks Promotion Authorities (SIPAs) which will regulate the setting up of industrial parks and assist and negotiate with the private sector for their participation.** SIPAs will prepare a database of enterprise, regional dispersion of industry, etc, to identify locations for industrial estates and the timing for their construction. They will also review policy periodically based on the experience gained.

Many of the older industrial cities suffer from the existence of old decayed industrial areas, usually located in what is now the central city. A coordinated approach to these areas could help in regenerating these decaying areas while providing a new thrust to SSE development: these areas, being in the central city, are ideal for the development of SSEs, both industrial as well as service enterprises. The re-use of the land would provide enough resources to help in liquidation of the existing sick enterprises, usually large enterprises, which are currently located on this land. These sites are ideal locations for science and incubation parks referred to above. Information intensive, non polluting, labour using SSEs could profitably be encouraged to come up in these areas. The Expert Group recommends that state governments identify such areas and initiate action to initiate these industrial (science and incubation) parks in such cities.

As mentioned, a policy framework will have to be created to attract investment in industrial parks. For one, industrial parks should be defined as infrastructure to distinguish them from real estate business. The state governments or the proposed SIPAs should prepare guidelines that will form the basis of investment in industrial parks. In particular, they should enunciate the terms for land use conversion and transfer land. Presently, the rules should spell out whether foreign direct investment is possible in companies formed to develop and operate industrial parks. Finally, a decision has to be taken on whether profits from land sale can be repatriated. We recommend that only the dividends of the special purpose vehicle be allowed to be taken back.

Similarly, the participation of the private sector will entail writing rules governing the relationships between the estate developer and the residents. Most companies hosted in the parks will prefer lease contracts as a means to reduce their risks. It is unlikely that the developers will be at ease with the existing rent control acts skewed in favour of the tenants. Private developers offering maintenance services, including the interface with civic bodies would expect adequate authority to penalise defaulters. Field studies have indicated that tiny enterprises show a marked reluctance to relocate in industrial estates. Household enterprises economise their overhead costs by undertaking work at their dwellings. It is, therefore, recommended that the craft enterprises be allowed to exchange their present houses for properties in industrial estates where they can work and live.

In recent times, land acquisition by the government has bogged down in innumerable legal disputes as landlords have learnt to defend their rights in the courts. The conflicts arise when the landlords have to involuntarily part with their titles to conform to public purpose clause, under the Land Acquisitions Act, 1895, that the government typically invokes. Landlords make their own assessments of the future value of the land and contest the acquisition when their compensation is less than their estimated present value of the property. In the courts, landlords take recourse to one of a variety of injuries and damages clauses since the law protects the original owners from them. Appropriate action has to be taken to resolve the current impasse in acquisition of land.

One way to overcome the problem is to offer landlords tradable rights in exchange for their land. At the outset, a modest down payment is paid by the landlords in order that the viability of the project is not jeopardised by high fixed costs. However, landlords will benefit from the upside potential of the project. Such tradable rights, called development rights, have been successfully implemented in New Bombay³⁹. However, widespread use of this method will also require the development of a secondary market for land rights.

Secondly, the government often possesses land which it is unable to sell to the private sector due to restrictions on transfer decreed by the Land Acquisition Act. Under the circumstances, the option of contributing government owned land in lieu of equity in a private sector should be explored. The law should not prove to be a barrier especially if a project is structured as a BOT vehicle.

The emerging situation allows recourse to alternative means of development of infrastructure, viable at the regional level, such as co-generation and sale of captive power. The supply of electricity can be increased by trading electricity generated by co-generation and captive power. Since companies specialising in small power stations such as Bechtel Energy Works, GEC Alstom and ABB have set base in India and free import of small size turbines is now possible, the potential of co-generation can be

realized. However, rules for the sale of power to the grid have to be laid down before full capacity utilisation of cogeneration and captive power will be possible.

Telecommunications infrastructure is another crucial ingredient of the quality of services that private industrial parks would want to offer. In services export industries, teleports from the bedrock of the transport infrastructure and have been utilised with telling success in Jamaica⁴⁰. Moreover, the internet offers an indispensable and cheap means to communicate with the world for small and medium scale enterprises. In India, the software technology parks have had a privileged access to advanced telecommunications facilities courtesy the Department of Electronics. Other parks should also have access to comparable telecom facilities on the same terms as those available to the software industry.

Speed of delivery has become the decisive instrument of competition in world markets offsetting the labor cost advantage of exports by small and medium scale enterprises in India. The transportation infrastructure is not able to cope due to a variety of administrative barriers. The first step towards accelerating delivery time has been taken by the installation of inland container facilities, including custom clearance, at some of the clusters and have been unanimously well received⁴¹. This can be extended to all other centres. The linchpin of speedy delivery, however, is a system of electronic commerce grounded in a national information infrastructure. A host of regulatory barriers, however, stand in the way of creating such an infrastructure that is becoming the standard in other countries.

Shifting of Polluting SSE Units to Conforming Area.

Some of the SSE clusters have happened to come up in certain urban and metropolitan areas and are now causing unacceptable levels of pollution. Courts are acting on citizen, NGO and government complaints to force such SSEs to relocate their units from non-conforming areas to conforming areas. Besides providing infrastructure in the conforming areas, a strategy has to be devised by the concerned state governments in co-ordination with institutions and banks for providing need-based facilities / finance to these polluting units for shifting their enterprises in the conforming areas. Installation of in-house effluent treatment plant and common effluent treatment plants in the clusters may also have to be supported by these agencies.

State governments should also have the latitude to decide on the terms for entering into partnerships with the private sector. A variety of mechanisms such as leasing of the estate, contracting of services, management contracts or special purpose vehicles can be designed in accordance with the objectives to be achieved and the peculiar characteristics of the regions. Moreover, feedback from cluster associations should be sought to avoid errors made in the past.

6.71 Role of Business Associations

Private business associations need to be brought centre stage to benefit from their counsel, sources of information and potential for supervision. The Expert Group has recommended the participation of business association in a whole host of activities. Subsequent of the economic reforms the national level business associations have got rejuvenated and are now undertaking many more promotional activities for their constituents than before. However, at the local level, business associations still function largely as lobbying groups. Historically, business associations have only clamoured for the indulgence of the government even if it was at the expense of the larger interests of the community. Lately, however, setbacks in some of the export markets, stringent implementation of environmental laws and congestion of the infrastructure has jolted a few of the associations into collective action for the improvement of the business environment. **The government, particularly at the state level, must initiate action to activate the city / cluster level business associations so that they can participate actively in the many activities recommended in this report.** Support to SSEs can not be delivered by the government alone but it should actively participate in designing all the support mechanism indicated, particularly by way of providing matching funds. The central government should open a purposive with the national level business associations to help in this endeavour at the local level.

Some of the notable initiatives have come from clusters where the business community is not divided. The Mahratha Chamber of Commerce and Industry in Pune, for example, has promoted 6 institutions including an Institute for Business Research, the Pune Stock Exchange and is currently constructing an International exhibition complex⁴². The Tiruppur Exporters Association has been boldest and has developed an industrial complex, it has a scheme for effluent treatment and has invested in a school. On the other hand, the cluster at Jaipur has a pressing need for an effluent treatment plant but is unable to raise resources. Government collaboration in such projects, by way of part funding or selective subsidisation, will send out clear signals to other associations to take similar initiatives.

Greater co-operation of business associations is essential, at this juncture, given the nature of the objectives to be accomplished. Private participation in infrastructure development raises several contentious issues of risk sharing and pricing of goods

previously available free to consumers. Business associations can also be instrumental in dissemination of information and resolution of disputes.

Moreover, the design and location of industrial parks and other infrastructure projects will require feedback from the industry associations to ensure that the felt needs of their members are met.

A great deal of thinking and work is required to devise mechanisms for industry and business associations to act as promotional and extension agencies for SSEs. This may require the scanning of practices in different countries. The activist role of industry associations is perhaps most developed in European countries, and particularly in Germany. **The Expert Group recommends that the Ministry of Industry should initiate a programme of technical assistance from the European Union or other bilateral sources to bring this about.**

Naturally, participation in this programme must be sought from the industry associations themselves. A programme of partnering local level industry associations with their counterparts abroad should also be pursued.

6.8. Institutional And Legal Innovation

The Expert Group analysed the reasons for the tardy progress in the reform of the byzantine social legislation governing the small and medium scale industry. It came to the conclusion that alternatives to the antediluvian systems for insurance and social security, currently in practice, have not been found to substitute existing systems. Earlier attempts at reform have been mired in the conflicting perceptions of individual ministries supervising the diverse laws. The nuisance of corrupt inspectors goes unchecked due to low liability for negligent and arbitrary implementation of the law. Finally, the implementation of environmental laws could be simpler and more effective if recourse to deterrence mechanisms is taken instead of administrative methods.

Presently, the idea and definition of small enterprise stems from the Industries (Development and Regulation) Act, 1951. It is quite clear that this legislation does not adequately reflect the concerns of the small enterprise sector. The I (D&R) Act is basically structured to regulate large industries through mechanisms such as licensing, and the like. For that reason, it applies only to scheduled industries. Rightly, the administration of small industries is a state subject. Typically the state governments could have their own laws to support small enterprise development. However, a uniform promotional framework is desirable to service the overall interests of promoting the small enterprises with a view to equitable growth and development. The uniform framework will also enable compatible structure vis-à-vis banking institutions, corporate bodies and issues of national concern such as employment, rural development and social welfare.

The Expert Group, therefore, recommends a separate law for small enterprises. The objective of the law would be to define the small enterprise sector and outline the broad framework for the promotion of the sector. A single law for small enterprises will be a superior instrument for governing these enterprises. Among other things, the law could provide for:

- Definition of small enterprises
- Constituting the All India Small Enterprises Board under the law.
- Aspects of small scale enterprise promotion.
- Involvement of the industry associations in regulation and promotion activities. Constitution of appropriate "Industry facilitation councils" to resolve disputes and various concerns using techniques of mediation and arbitration.
- Voluntary registration of small scale enterprises.
- Provision for labour welfare measures for all small enterprises. Provisioning also for all clearances and approvals through a single agency.

Such a **single business law called the "Basic Law for Small Enterprises"** will be a superior instrument for governing small enterprises. This will obviate the need for a host of ministries administering diverse laws such as the minimum Wages Act, the Shops and Establishments Act, Workmen's Compensation Act, as applicable to SSEs etc. Such a law can be implemented by the normal judicial process.

The Employee State Insurance Act, as it is administered, inflicts immense costs to the employer as well as to the workers. The utility of ESI to workers is low since government doctors attend to them after a considerable lapse of time and usually medicines are often not available in stock. As a result, the poorer households have shown a marked preference for private hospitals and nursing homes. Employers suffer productivity losses due to the time spent in dealing with officials. It is, therefore, suggested that employers should be allowed to meet their obligations by paying for medical insurance under the Workmen Insurance Scheme.

Similarly, the Provident Fund Act is implemented at high costs to the employers as well as the employees. Ideally, the alternative of paid systems of social security will be more beneficial since higher returns can be realised in the capital markets. However, it will be a while before private pension funds are allowed to enter Indian capital markets. In the interim, the employers should be allowed to mark contributions to the Public Provident Fund. This will relieve them of intrusive government inspectors.

For the protection of the rights of workers, suitable provisions can be made in the Basic Law for Small Enterprises. The state can meet its obligations towards workmen by creating a fund for legal aid. A part of the finance of the fund should be sought from the employers.

The working of labor laws has been a thorny issue for the small and medium scale enterprises. Labor laws have little utility since they are evaded by the simple expedient of keeping employment below the threshold level, specified by the IDR Act, for the enforcement of labor legislation. It is recommended that the threshold level for the application of the labor laws is raised to 50 for units using power and 100 without power. The interests of workmen can be taken care of by instituting a system of unemployment insurance paid for jointly by employers and employees.

Finally, the survival of small and medium scale enterprises has been threatened by environmental laws. In some regions in Tirrupur, Madras and Jaipur, business associations have risen to the occasion and have organised common effluent plants. However, the Jaipur cluster has been unable to raise the capital required for such a plant. The initiatives of private business associations should be supported by capital subsidies.

Moreover, aggregate pollution levels for each cluster can be set and the precise means to achieve them should be left to the local association. The units unable to lower pollution cost-effectively should have the option to pay others to do so. These aggregate pollution levels are implemented equally effectively by deterrence mechanisms such as imposition of fines when clear evidence of violation of laws is found.

The issue of inspector raj is a thorny one. As long as there are laws which govern different aspects of regulation – labour welfare, labour safety, labour social security, equipment safety, statistical reporting, environmental laws and the lime-systems have to be devised for their compliance, the main system being used currently is that of inspection by inspectors, and the result is "inspector raj" the ills of the system are acknowledged by all industry and government representatives alike, but solutions offered so far have been few. The Expert Group offers the following suggestions:

- **Review and Modernisation of Laws:** There is now adequate identification of all the laws affecting the functioning of SSEs (e.g. the Mahapatra Committee Report. The Report of the Committee to Suggest Simplification of Procedures of Various Approvals of Industrial Projects at the State Level" (1994) constituted by the Ministry of Industry, and many reports compiled by business association). We can scarcely improve on their suggestions. We can only recommend that governments at both the state and central levels review these reports and act on them. Our generic suggestion is that modernisation of outdated laws, repeal of obsolete ones and greater transparency will do much to mitigate the tyranny of the arbitrary inspector raj.
- **"Clustering" Inspectors:** While the government acts to simplify and modernise laws, it is necessary to act immediately to reduce or eliminate the harassment of SSEs. Governments at both central and state levels must "cluster" inspectors to eliminate repeated inspections by inspectors from different departments. Different departments must be made to cooperate so that inspection where necessary is done on a consolidated basis. Further, the recommended cluster associations should participate in this activity in order to eliminate harassment and corruption.
- **Random Selection:** A move must be made towards self certification in the compliance with the different laws that govern SSE operation. SSEs could be asked to specifically certify that they are complying with the regulations that affect them. Beyond that inspection could be done periodically on a random basis. This can be made transparent by an open drawing of lots on a monthly basis through a random number generator in defined special jurisdictions. Once again business associations can assist in this activity to promote transparency.

Institutional Innovation

In the vision for the structure of promotional institutions recommended, government funding bodies will play a key role. It is suggested that autonomous Enterprises Business Services Funds be created at the state level to finance a variety of projects in collaboration with the private sector. They would be able to garner funds from multilateral funding bodies as well international and national donor would be able to garner funds from multilateral funding bodies as well international and national donor organisations if they are governed by an independent board outside the government. A guiding principle of such funds would be that disbursements will be made only against specific projects suggested by state governments or by business associations. The funds should be

staffed by experienced professionals with proven ability to judge the value of schemes proposed for financing.

The central government should take the initiative and provide the seed money for creating such funds in a few states. States should be made to compete for the seed money and those contributing the highest matching funds, including contributions from their private sector, should be selected. This will ensure that adequate commitment is forthcoming for such projects.

Finally, the need for a restructuring of MSME-DO has been indicated in order to make it much more functional. The Expert Group recommends that the Industry Ministry appoints professional management consultants to assist in this restructuring.

In order to act on the many suggestions made in this report the **Expert Group recommends that the ministry of Industry set up a Steering Committee under the chairmanship of the Industry Minister to oversee the evolution of the new policy approach suggested.** This Steering Committee should consist of representatives of the key government departments concerned, of business associations, of the banking system and of state governments. The Industry Ministry should recommend to state governments to set up similar Steering Committees at the state level. This Steering Committee should compile regular progress reports on the actions taken in support of small scale enterprise development on a quarterly basis and issue them for public information.

APPENDICES

APPENDIX I: POLICY FOR RESERVATION OF ITEMS FOR EXCLUSIVE MANUFACTURE IN THE SMALL SCALE SECTOR

Background

The policy of reservation was primarily initiated in 1967 as a promotional and protective measure for the small scale sector vis-à-vis the large scale sector. Under this policy selected products are identified for exclusive production in the small-scale sector. The overwhelming consideration for reservation is whether the items are economically viable and technically feasible for manufacture in the small scale sector, the manufacturing process is of a simple nature i.e. is essentially labour intensive and whether the small scale units can meet the requirements of the consumers both in terms of quantity and quality.

Rationale

The rationale for reservation was based on the advantages of the small sector's like labour intensity and adaptability to semi-urban and rural environment as also to make their products competitive with those of the large scale to offset disadvantage of mass scale production, economies of scale, wider marketing network, better credit availability and publicity through mass media and advertisements. The Industrial Policy Resolution, 1956 has stressed the role of small scale sector in development of the national economy. The small scale sector was thought to provide large scale employment opportunities at lower capital cost, establish a wider entrepreneurial base and to generate an equitable distribution of national income and wealth.

Special features

The special features of reservation policy are described as under:

1. The policy is applicable only to the manufacturing sector. It does not take into account the service sector including repairs of products.
2. No new unit in medium or large scale sector is allowed to be set up after the date of reservation nor any further capacity expansion in the existing medium or large scale units is permitted. All further expansion or capacity creations reserved for the small scale sector.
3. The medium or large scale industrial units can continue to manufacture reserved items in cases as mentioned below:
 - a. The existing medium or large unit which had already been manufacturing an item when it is put on the reserved list. In such a case the unit has to obtain a Carry on Business (COB) Licence from the Ministry of Industry. The capacity of the unit is pegged at the highest production level achieved by the unit in the last three years preceding the date of reservation of the product.
 - b. If the existing SSI units manufacturing reserved items graduate by their process of growth into medium / large scale, such have to obtain a COB Licence wherein the capacity is pegged with respect to the date when it became incumbent on the unit to apply for and obtain on the unit to apply for and obtain a COB Licence.
4. Creation of new capacity in the reserved areas is permitted among Medium / large scale units if they undertake to export a minimum of 75 percent of their production (50 percent in case of ready-made garments).
5. There is no restriction on the marketing of products reserved for manufacture in the SSI sector by large units or big companies.
6. Policy does not prohibit other types of linkages between large / medium and small industrial units in the field of technology, tie-ups etc.

7. The Industries Development and Regulation Act, 1951 has been amended in 1984 to give statutory backing to the policy of reservation empowering the government to reserve selected items for production by the ancillary or small scale industrial undertaking. The amendment also provided that the central government would constitute an Advisory Committee with a view to determining the nature of any article or classes of articles that may be reserved for production by the ancillary or small scale industrial undertaking.
8. An Advisory Committee on reservation with Secretary (Industrial Development) as Chairman was constituted under notification dated the 30th March 1984 under the IDR Act to review the reservation policy from time to time. Items are also de-reserved wherever justified. This committee is now headed by secretary (SSI & ARI).
9. The Statutory Advisory Committee on Reservation can undertake the review of items from time to time for:
 - De-reservation of items which are already reserved,
 - Reservation of new additional items, and
 - Change of the nomenclature of the items
10. Violation of reservation policy is punishable under section 24 of the IDR Act, 1951.
11. Government has constituted a committee in the Ministry of Industry to check entry / expansion of large and medium scale enterprises into areas of reservation of small scale sector.
12. The items are considered for de-reservation mostly for the reasons given here under:-
 - In case adequate additional capacity is not generated in the existing small scale units.
 - No new units have been set up for creation of new capacity,
 - Production in the small scale items has not shown substantial increase in relation to the demand.
 - The technology debar small industries to procure machinery, which crosses prescribed investment limits for small-scale sector.
 - It is not economical to manufacture the product having a low demand as compared to the minimum capacity for single units.

Coverage

In April 1967, the reservation policy was made effective for 47 items only. The number of new additional items reserved, number of reserved items de-reserved and net number of items in the reserved list at different points of time are shown in Table 1.

Table 1: Progressive Reservation of Items for Exclusive Manufacture in the Small Scale Sector

ate of Notification	No of items reserved	No of items deserved	Cumulative Net No of items reserved
Phase 1	47		47
1 April 1967	8		55
19 Feb 1970	73		128
24 Feb 1971		4	124
11 Nov 1971			177
26 Feb 1974	53		180
5 June 1976	3		504
26 April 1978	324		
Phase II			807
26 April 1978	807		806
30 Dec 1978		1	833
12 May 1980	27		833
19 Feb 1981	1	1	842
3 Aug 1981	9		831

23 Dec 1981	2	13	282
14 Oct 1982		3	837
19 Oct 1982	9		872
3 Sept 1983	35		873
18 Oct 1981	1	1	869
30 May 1984	7	14	863
13 Feb 1987	1	7	850
20 July 1987		13	847
18 Mar 1988		3	846
3 Mar 1989	3	1	835
31 July 1989	1	14	836

In 1978 it was decided to recast the reserved list by following codes adopted following codes adopted in the NIC and in this process, the list of reserved items expanded from 504 to 807 items

Since it included three sub-items, the effective number comes to 11 only

Neither any addition nor any deletion was made in the reserved list after Notification dated 25th July 1991 which indicated the total no. of reserved items as 836 in schedule III statement of industrial policy 1991 and as such net total no. of reserved items as on date (Dec, 1996) stands at 836. At 9 digit product code level, it is seen that total no. of reserved products covered under 836 reserved items is 1,045 (list appended).

It could be observed from the above statement that nets no. of reserved items reached the highest at 873, in act Oct. 1984 and thereafter it started declining. After July 1989 to Dec. 1996 i.e. for over seven years reservation policy has remained stagnant even though the no. of products manufactured in the small scale sector has gone up from 2400 to 8,000 from 1972 to 1996.

Concentration in Industry Groups

Reservation policy appears to have been encouraging lobbying by the vested interests as reservation has been concentrated mostly in four-industry group as shown in Table 2.

Table 2: Concentration of Reservation for the Small Scale Sector

Industry Group	No of Products	Percentage
Chemicals and Chemical Products	325	31.1
Metal Products	138	13.2
Transport Equipment and Parts	107	10.3
Rubber and Plastic Products	112	10.7
All Other Groups	363	37.7
Total	1,045	100.00

Progress in Reserved Industries

Office of the Development Commissioner (SSI) had been reviewing the progress made in the reserved industries by assessing the increase in the new units setup as well as production achieved in individual reserved items since the dates of reservation through various review studies. This exercise was undertaken till 1972-73 only and that too for a few selected items.

Industrial Census Data

No. detailed statistics on reserved products are available year after year to analyse actual growth an impact of reservation on small scale industries. However, data available from first and second all India Census of SSI units registered with the State / Uts Directorates of industries could be considered to review progress made in the reserved sector as given in Table 3.

Table 3: Performance Indicators for Small Scale Industries

Performance Indicator	First Census	Second Census
-----------------------	--------------	---------------

Performance Indicator	First Census (1972)	Second Census (1987-88)
Total number of products manufactured by SSI	2,400	7,449
Reserved Products	177	1,075
No of Reserved Products Manufactured	166	843
Share of Reserved items in Output	25	28
Capacity Utilization in reserved sector	47	48

Second All India Census revealed that capacity utilisation for unreserved items was 50.49 percent as against 47.73 percent among reserved items. Percentage variation in production of 1987-88 over 1985-86 was 40.14 percent in unreserved items as compared to 34.07 percent in the reserved items. These statistics show superiority of unreserved sector both in capacity utilisation as well as growth in production.

FNS-NCAER Study (Conclusions on reserved items)

657 units were covered in the study undertaken during 1993 by The National Council of Applied Economic Research, New Delhi in collaboration with Friedrich-Naumann-Stiftung. Analysis of information showed that among the responding units 8 percent reported to be producing reserved items, the remaining units were not aware of reservation list. Reservation has been continued since 1977 for years together while the need of the hour is to encourage small scale enterprises only to become competitive and efficient and as such policy needed review. An opinion survey showed that 32 percent of the Associations favoured reservation policy and 57 percent were in favour of phasing out the de-reservation of items, inference was drawn that outright abolition reservation of items. The programme would not cause any problems. In most of the reserved items large scale undertakings whose capacity has been pegged continue to enjoy the fruits as they do not have competition from other large scale sector. Reservation policy as such becomes questionable.

NIPFP Study (Findings on reserved items)

12 Districts covered on sample basis and actually 648 SSIs units surveyed by National Institute of Public Finance and Policy, New Delhi during 1994-95 to assess the impact of reservation showed that 40 percent of the sample units were manufacturing reserved items. The pattern of distribution of units producing reserved and unreserved items was almost similar.

Performance indicators in terms of size of employment, capital and output as also in terms of productivity of labour and capital showed that units producing unreserved items were better, particularly those having investment in plant and machinery of Rs. 10 lakh and above. Even in terms of profitability those having investment in plant and machinery of Rs. 10 lakh and above. Even in terms of profitability, inventory burden and capacity utilisation, units producing unreserved items and with output levels greater than Rs.30 lakh were found to be superior to those producing reserved items. With increasing output levels, a decreasing proportion of units in reserved category was higher in district centres as compared to have an impact only in the smallest of units which probably cater to the local needs. NIPFP Study has suggested that the items which can be manufactured economically with investment in plant and machinery upto Rs. 10 lakh may be retained in the reserved list for manufacture by the SSI units.

VIJAYRAGHAVAN COMMITTEE (Recommendations on Reserved items)

The Advisory Committee on Reservation has appointed in August '95, a Committee of officials under the chairmanship of Shri T.S. Vijayaghava, Additional Secretary, Ministry of Commerce to review the reservation list and submit recommendations. The committee, while examining the reserved list, kept in view the following aspects:

- i. Interest of small industries.
- ii. The minimum economic scale of production.
- iii. The need for technological upgradation.
- iv. National and international competitiveness.
- v. Productivity.
- vi. Serving consumer interest.
- vii. Labour intensity.
- viii. Other related considerations.

In Nov. '96 the Committee has given its report to the Advisory Committee with the recommendations that 95 products may be considered for de-reservation and 63 products for change in nomenclature / modifications. De-reservation of items has been recommended on the following grounds:

- o That it is not technically feasible to manufacture quality products within the specified investment ceiling of Rs. 60 lakh.
- o There has been product innovation as a result of which the scope of producing new items have emerged and these require higher investment.
- o On the ground of safety, hygiene and production of quality goods and to meet the changed demand of consumers for quality goods.

- On the ground of export potential and export promotion.
- Better utilisation of available resources.
- Monopoly like situation have been created in some products by large scale units under the cover of COB Licence. The modifications / change in nomenclature have been recommended in order to bring:
- Harmony and clarity in description and to avoid confusion.
- To reflect the existing situations more accurately',
- Change in technology of production
- To provide for integrated production wherever possible

Import Policy Liberalisation and Reserved Items

The Office of the Director General Foreign Trade has followed ITC (HS) codes for classification of individual items under import policy. Imports have been allowed under the categories as free, special import Licence, canalised and restricted. In particular cases HS code has been further sub-classified at 10 digit level and different policy indicators given against different sub-classifications. This process has resulted into more than one-policy options for some of the reserved items. Therefore import has products under different options or under different combinations of options.

When the reserved items list containing 1045 products is compared with the Import policy for items given under ITC (HS) classification, it is found that 563 products enjoy free imports. This could be seen from the categorisation of reserved items under various norms of import policy followed by the Ministry of Commerce. In table 4 given below, distribution of extreme focus products for export in accordance with import policy is also shown.

Table 4: Distribution of Reserved Products by Import Policy and Extreme Focused Export Strategy

Policy on Import of items	Reserved products in the category		Extreme Focus Products for export		
	No.	% of Total	No.	% of Total	% of Total 3
Free	563	53.9	218	82.6	38.7
Free and under SIL & Canalised	4	0.4	0	0.0	0.0
Free & restricted	69	6.6	8	3.0	11.6
Free and under SIL & restricted	12	1.1	1	0.4	8.3
SIL & restricted	48	4.6	7	2.6	14.6
Restricted	349	33.4	30	11.4	8.6
Total	1,045	100.0	264	100.0	25.3

Export Policy and Reserved Products

In order to increase the production capacity for various items of exports which fall under the SSI reservation list, Ministry of Commerce has been supporting the proposal that larger units may be allowed to be set up in such reserved areas provided such units accept an export obligation of 50 percent. This would enable India to cater more efficiently to the large volume orders which are placed for reserved items such as garments, footwear, plastic items in the chemical sector etc, which cannot be met from many separate units in the SSI sector with the same standard of uniformity and quality assurance. Many items currently reserved for SSI sector have also been identified and earmarked as items which have sound export potential calling them as 'Extreme Focus Products' 34 such items / Products groups have been identified and targeted for achieving a 30 percent growth in value / volume as a part of export strategy. When compared with the list of reserved products, it is seen that maximum concentration of extreme focus products is centered around the Dyes Group covering Basic, Direct, Acid, Reactive Dyes, Napthols and Fast Colour Basis accounting for about 150 products. Distribution of extreme focus products under different categories of import policy is shown in Table 4. It is seen that 38.7 percent of the reserved products falling under free import category are considered as extreme focus for export strategy.

Issues

Inspite of reservation of items for exclusive production in the small scale sector for the last about thirty years, the policy did not prove to be so effective as is revealed by the statistics of industrial censuses and other studies discussed above. The various issues that arise are as follows:

- **Production in Large / medium scale enterprises:** The existing large and medium scale units at the time of reservation of the items continued their production at the level of the pegged capacity. After reservation, those enterprises have benefited by not being subject to competition from other large enterprises. Besides in certain cases, large scale unite also encroached in the reserved areas by producing more than the pegged production capacity. The policy for encouraging the exports led to

the creation of additional capacities in the reserved areas by large scale industries on the undertaking that 75 percent of their production (50 percent in the case of ready-made garments) would be exported, but export obligations could not be adhered to. The excess production thus created competition for the small scale units. Even quantities imported under free imports, special import licence and through canalised sources under the import policy have also taken share of demand from the small scale sector.

- **Non-enforcement of reservation policy:**
- Nominal penalties prescribed for violation.
- Absence of powers given to the Encroachment Committee.
- Lack of effective monitoring or cases of violation by concerned Agencies / Departments
- Non observance of export obligations
- Orders / press notes issued on the reservation policy lacked legal validity.
- Status of Reserved Products :

In the light of import policy liberalisation, export promotion strategy and recommendations of Vijaya Raghavan Committee on de-reservation, it may be useful to review the entire list of SSI reserved areas and make the list more appropriate to reflect to changing industrial and exports scenario in India. The status of reserved products as mentioned above is shown in table 5.

Table 5: Status of Reserved Products in Import Category, Export Focus and Recommendations of Vijaya Raghavan Committee

Import Category	Total products	Export focus products	Non Focus products	Vijaya Raghavan Committee Recommendations					
				Dereserve		Change in Nomenclature		Status Quo	
				Extreme Focus	Non Focus	Extreme Focus	Non Focus	Extreme Focus	Non Focus
Free	563	218	345	8	27	2	13	208	305
Other	482	46	436	19	41	0	48	27	347
Total	1,45	264	781	27	68	2	61	235	652

Include restricted / canalised items as well as various combinations for such items which have different options under import policy.

From the above table it may be seen that 563 products fall under the category of free imports: while among other categories viz. Restricted / canalised / other combinations, 46 products are of extreme focus, 41 products are among non-free and non-focus and 48 products have been recommended for change of nomenclature by Vijaya Raghavan Committee. Thus 698 products are exposed to dereservation.

Current View of Associations and various Departments on Reservation Policy

In the context of liberalization, some fiscal incentives and reservation of items in favour of SSI sector are thought to be out of place. SSI units would be more exposed to competition from national and international enterprises if protection is totally withdrawn. There is still need to make SSI competitive by updating technologies. Economic reforms have permitted foreign direct investment, automatic approvals of technology transfer agreements as well as 51 percent foreign equity proposals. In this changed scenario, views / suggestions of various associations and departments have been sought on reservation policy. These views can be categorised under different aspect of reservation and are described as follows:

No De-reservation

United Cycle & Parts Mfrs. Assn. Ludhiana., PHD Chamber of Commerce and Industry, New Delhi, Tamil Nadu Assn. of Cottage, Tiny & SSI Madras, Maharatha Chamber of Commerce & Industry, Pune have suggested that 836 items reserved for exclusive manufacture in the small sector should not be reviewed for de-reservation. Tiny / SSI sector would be at stake and forced to close down their units when investment is raised for SSI and imported automotive plants are installed. Reservation is beneficial to SSI sector.

The Development Commissioner (SSI) New Delhi is of the view that reservation can help to enact special plants to develop SSIs in there as of high tech such as electronics and software. Reserved items list may not be changed till report of the Sub Committee is available and considered by the Advisory Committee. Out of 8000 products only 1045 products (836 items), 13% are reserved. SSI sector is able to manufacture internationally competitive products. SSI exports in several areas are substantial. Medium / large /MNC sector is already permitted to enter the reserved areas on condition of minimum of 75 percent exports obligations. DC (SSI) is of the view that dereservation should be done in phases, as recommended by the Vijayaraghavan Committee.

Partial De Reservation

Karnataka Small Scale Industries Assn. Bangalore, Confederation of Indian Industry, New Delhi, Department of Science and Technology, New Delhi, Associated Chamber of Commerce and Industry, New Delhi, Department of Economic Affairs New Delhi have suggested partial de-reservation. It is proposed that list be scrutinised item and only when reservation is warranted, it may be retained. De-reserve initially (i) those reserved items which are not being manufactured by SSIs, (ii) items whose output, accounts for insignificant part, (iii) items having export potential. Products which can be manufactured economically in the small scale sector may continue in the reserved list.

Product specific De-reservation

1. Calcium Gluconate

M/s The Anil Starch Products Ltd. Requests for de-reservation of Calcium Gluconate on the following grounds: The item is the only salt of gluconic acid which has a significant market. International price is such that it is highly cost effective to manufacture and export from India. State-of-the-art plant producing 5 MT / day costs Rs. 10 crore which exceed SSI limits. The company has desired to expand the capacity of the existing facility to manufacture calcium gluconate by the fermentation route. It is suggested to conditionally de-reserve calcium gluconate under the following condition :

- o When calcium gluconate is manufactured by the fermentation route
- o When the manufacture of calcium gluconate is a manufacture of starch and starch hydrolysis products.

2. Garment Industry

M/s Arvind Mills Ltd., Ahmedabad has requested for entry of non-small scale sector in garment industry on the following basis: (i) under new economic strategy Indian Garment producers will face competition from foreign producers, (ii) the conditions laid down in the present policy restrict investment upto Rs.3 crore in plant and machinery for producing garment and undertaking to export at least fifty percent of the garment production, (iii) import of garments is allowed under special import Licence, (iv) reservation has prohibited the entry of industry that can upgrade the product portfolio of Garment Industry. To infuse newer technology in the industry to compete in the foreign market with their counter parts in China and Vietnam the following two option for suggested to allow entry of large-scale firms in garments industry:

- o Allow the entry of large firms in the garment industry with no restrictions.
- o Raise the upper limit of investment, which divides the small scale sector from the medium and large sector, to Rupees 10 crore.

3. Knitting Industry-Cotton Cloth Knitted and Synthetic Knitted Fabrics

M/s Arvind Mills Ltd., Ahmedabad is planning to set up a state-of-the-art fully integrated composite Knit fabric unit near Ahmedabad. The project envisages manufacture of only 100 percent processed knit fabrics produced in a fully integrated composite unit incorporating spinning, yarn dyeing / processing, knitting, fabric dyeing / processing and finishing plants with contemporary world class technology with foreign collaboration. There is no restriction on large units for spinning, weaving, processing in the current policy in the textile sector. Only knitting is reserved. The Small Scale Sector would be constrained by the capital intensive and high technology demands of modern integrated knit fabrics plants. Considering the need for technology up-gradation, quality and consistency of fabrics and considerable value addition to boost the country's garment export trade realisation, it is requested that processed knitted fabrics made by integrated composite knitting and processing units be made an exception to the reservation of knitted fabrics (cotton and synthetic) in the small scale sector.

4. Plastic Closures For Carbonated Soft Drinks

M/s Alcola Closure Systems Internationals, Indianan has requested to de-regulate plastic closure for soft drinks from the SSI sector to large scale sector on the plea that this business is technologically capital intensive. It substitute imports and contribute earning of foreign exchange. The company intends to set up operations in India to manufacture engineered polymeric closures for high pressure and vacuum pack applications. Plastic Bottle Caps is reserved. Alcolas product needs to be considered whether it may fit in the descriptions due to its basic form and functions. However, company had requested to de-reserved the product as the investment in plant and machinery for the manufacture of the item has been estimated at US \$ 3.9 million.

5. Paper Cups (laminated)

M/s Modi Corp, New Delhi has requested to exclude paper cups (laminated) from the reserved list so that **paper containers (laminated)** also get out of the reserved list. The reason given by the company are : (i) Composite containers (laminated) are not reserved. Paper cups & plates both laminated & unlaminated are reserved in small scale. (ii) Demand in the domestic market is increasing for paper containers (laminated). The paper cups are preferable to plastic cups, being biodegradable. (iii) it involves considerable investment in technology & facility. For a minimum possible size of plant investment in plant & machinery alone will be Rs. 7 crores.

6. Crushing of Major Oil seeds (Groundnut, Rapeseed, Mustard and Sesame)

M/s ITC Agro Tech Ltd. Secunderabad has requested for de-reservation of major oil seeds mentioned above, as there is shift in government policy from one of self-sufficiency to global competitiveness. The reasons offered are: (i) Reservation has resulted into poor technology and some unviable units have been set up. (ii) De-reservation will facilitate induction of state-of-art technology and help attain global competitiveness in terms of price and quality. (iii) In March 1995, Govt. has changed its policy and permitted import of edible oils under OGL an imports are increasing.

7. All Sections of Food processing Industry

M/s Hindustan Levers Ltd. Have suggested that all sections of food processing industry may be removed from the ambit of reservation for the small scale sector. the reasons offered are: (i) Reservation Policy inhibits creation of modern hygienic facilities as the investment required is larger than permitted for Small Scale. (ii) Economies of Scale obtained through setting up of large size plants would result in making Indian Processed Food industry globally competitive. (iii) Hi-tech units would also be in the Food Processing Industry when they graduate to world class standards.

8. Change of Nomenclature of Sanitary Towels to Sanitary Towels Excluding those using Polyethylene netting

M/s Proctor and Gamble India Ltd, New Delhi has suggested that nomenclature of the product sanitary towels in the reserved list may be changed to sanitary towels excluding those using polyethylene netting. The reasons for change in the nomenclature are based on coverage of items which the company desires to manufacture. The other reasons are: (i) One large Nos-SSI company only has been dominating the market by offering traditional products for the last three decades. (ii) Towels using micro texturised Polyethylene netting are far superior to traditional Sanitary Towels and are hygienic,. (iii) Item is a premium product as the netting is imported. (iv) Technology used is sophisticated and expensive, minimum investment required in Plant & Machinery varies from Rs. 3 crore to Rs. 12 crore.

9. Centrifugal Pumps Upto 10CM 10CM Size

M/s Kirloskar Brothers Limited, Pune has desired to expand its manufacturing activity for centrifugal pumps and as such requested for deletion of centrifugal pumps up to 10 CM 10 CM size from the reserved list. The reasons offered are : (i) SSI units are unable to invest in updated technology and modern manufacturing process as by such process they become Non-SSI, (ii) pumps manufactured by SSI at present with existing obsolete technology are not fuel efficient, (iii) marketing costs in the international markets are heavy which SSI units can not afford and therefore restrict marketing of products locally, (iv) Govt. has permitted free import and the products from Italy, South Korea and Taiwan have made entry into Indian markets, (v) free market situation will make choices available to Indian customers and (vi) if allowed free manufacture, large units can cater to global markets for high quality pumps and also encourage ancillaries and subcontracting.

KEY TO PRODUCT RESERVATION CLASSIFICATIONS	
ITC (HS) Code	International Trade Classification (Harmonised System)
IMPORT CATEGORY	CODE
1. FREE	1
2. SPECIAL IMPOR LICENCE	2
3. CANALISED	3
4. RESTRICTED	4
EXTREME FOCUS PRODUCTS	CODE
1. EXTREME FOCUS PRODUCT	1
2. OTHER	0
V RAGHAVAN COMMITTEE's RECOMMENDATIONS	CODE
1. DERESERVE	1
2. CHANGE NOMENCLATURE	2
3. STATUS QUO	3

Table: [PRODUCTS RESERVED FOR EXCLUSIVE MANUFACTURE OF SMALL SCALE SECTOR \(December 1996\)](#)

[Appendix II: List of Clusters of Small Scale Industries in India](#)



BIBLIOGRAPHY

Anderson, Dennis and Farida Khambata (1981), 'Small Enterprises and Development Policy in the Philippines : A case study', World Bank Staff Working Paper, 468, Washington D.C.

- Ashok V Desai and Nisha Taneja **"Small Firms in Indian Industry-Economic Characteristics and Functioning"**, Journal of Indian School of Political Economy, Volume V, April-June 1993.
- Baek, Nak Ki (1992). **The exploitation of niche markets by small and medium Korean enterprises'** Small Enterprise Development, 3.3 September.
- Beng, Chew Soon (1988). **Small firms in Singapore**, Oxford University Press, Singapore.
- Berry, Albert and Levy, Brian **"Indonesia's Small and Medium-size Exporters and their Support Systems"** Policy Research Working Paper, 1402, World Bank
- Berry, Albert (1996). **'Best Practice' in the co-operation of SME's among themselves and with large firms'**, Momeo, University of Toronto, Toronto.
- Bruch, Mathias and Hiemenz, Ulrich, (1984). **Small and Medium Scale Industries in the ASEAN Countries: Agents or Victims of Economic Development?**, Westview Replica Edition, Colorado.
- Cawthome, Pamela M. (1995). **'Of Networks and Markets : The rise of a South Indian towns and the example of Tirippur's Cotton Knitwear-Industry'**, World Development, Vol.23, No. 1, pp 43-56, January.
- Collyns, Charles, **"Recent Experience with a surge in Capital Flows" in "India: Economic Reform and Growth"**, Occasional Paper 134, International Monetary Fund, December 1995
- Desai, Ashok V, **"Indian after the Reforms"**, Rajiv Gandhi Institute for Contemporary Studies, 1996
- Export Group on Commercialisation of Infrastructure Projects, **"Report on Industrial Parks"**, June 1996.
- Gang, Ira N. (1990). **'Small firm entry in Indian manufacturing' 'Small firms presence in Indian manufacturing'** Mimeo, December.
- Garg, Charu C, Sanyal, S K, Nagarathinam and Pandit, K R **"Central Fiscal Incentives and Concessions to Small Scale Industries"**, National Institute of Public Finance and Policy", March 1996.
- Gulati, Mukesh, **"Restructuring and Modernization of SME Clusters In India"** United Nations Industrial Development Organization, November 1996.
- Ho, Samuel (1979). **'De-centralized Industrialization and Rural Development : Evidence from Taiwan'**, Economic Development and Cultural Change, 28(1), October.....1980.
- Humphrey, John and Schmitz, Hubert, **"Principles for Promoting Clusters and Networks of SMEs"**, United National Industrial Development Organization, October 1995
- ILO-STAT (1996) **India : Economic Reforms and Labour Policies**, New Delhi.
- International Finance Corporation, **"Venture Capital " Venture Capital: Lessons from the Developed World for the Developing Markets"**, Discussion Paper 13.
- International Finance Corporation, **"Privatizing Telecommunications Systems"**, Discussion Paper 10.
- Ion Rabenau, Kurt (1976). 'Trade Policies and Industrialization in a Developing Country : The case of West Malaysia' The Malaysian Economic Review, 21.
- Jethanandani, Kishore, "Intellectual Property Generation and Protection: Public Policy Issues" in Private Sector Development in India: A Governance Perspective, Canadian International Development Agency, February 1996.
- Levy, Brian (1991). Transaction Costs, the size of firms and industrial Policy' Journal of Development Economics, 34.
- Levy, Brian with Berry, Albert Motohige Itoh, Shujiro Urata, Linsu Kim and Jeffrey B Nugent "technical and Marketing Support Systems for Successful Small and Medium-Size Enterprises in Four Countries", Policy Research Working Paper, 1400, World Bank
- Lieberman, S (1990) : India : Poverty and the Social Sector, A World Bank Country Study, Washington D.C.
- Linsu Kim and Jeffrey B Nugent "The Republic of Korea's Small and Medium-size Enterprises and Their Support Systems" Policy Research Working Paper, 1404, World Bank.
- Little, I.M.D. D. Mazumdar and J. Page : (1987) Small Manufacturing Enterprises : A Comparative Study of India and other Economies, Oxford University Press New York.

Majid, Nader, "the Uruguay Round and South Asia: An Overview of the Impact and Opportunities" Policy Research Working Paper 1448, World Bank

Marsden, Keith (1984), 'Services for Small Firms: The Rates of Government Programmes and Market Networks in Thailand' International Labour Review, 123(2), March-April.

Mohan, Rakesh, "Industrial Location Policies and Their implications for India", Ministry of Industry, Government of India, May 1993.

Motoshige Itoh and Shujiro Urata "Small and Medium-Size Enterprises Support Policies in Japan", Policy Research Working Paper, 1403, World Bank.

Nadvi, Khalid and Schmitz, Hubert, "Industrial Clusters in Less Developed Countries: Review of Experiences and Research Agenda", Discussion Paper 339, Institute of Development Studies, January 1994.

National Council of Applied Economic Research, "Impact of Economic Reforms on the Large, Small and Medium Enterprises in the Organized and Unorganised Sectors", June 1996.

National Council of Applied Economic Research, "structure and Promotion of Small Scale Industries in India" December 1993

National Institute of Urban Affairs, "Privatisation of Land Development and Urban Services: A Case Study of CIDCO", February 1994.

National Productivity Council, "Growth Profile of Small Scale Industries in Madhya Pradesh", 1996

Park, Joon-kyung, "Creating Extra-Firm Infrastructure of Institutions for Small and Medium-sized Businesses"

Piore, M and C. Sabel (1984). **The Second Industrial Divide : Possibilities for Prosperity**. Basic Books, New York.

Pitt, Mark M.(1981), '**Alternative Trade Strategies and Employment in Indonesia** in Anne O.Krenger, et al., Trade and Employment in Developing Countries, Chicago University Press, Chicago.

Ramaswamy, K.V. (1984). '**Small-Scale Manufacturing Industries in India : Some aspects of size, growth and structure**', Working paper, Indira Gandhi Institute of Development Research, Bombay.

Reserve Bank of India, "**Annual Report, 1995-96**", July 1996

Reserve Bank of India, "**Report of the Committee to examine the adequacy of Institutional Credit to the SSI Sector and Related Aspects**", 1992.

Saha Dhevan Meyanathan and Ismail Muha. Salleh "Malaysia" in "**Industrial Structures and the Development of Small and Medium Enterprise Linkages**", edited by Saha Dhevan Meyanathan, EDI Seminar Series.

Sandesara, J.C. (1993) '**Modern Small-Scale Industry, 1972 and 1987-88, Aspects of growth and structural change**', Economic and Potential Weekly, February, Bombay.

Schmitz, Hubert (1982). '**Growth constraints in small-scale manufacturing in developing countries : A critical review**'. World Development, 10(6) June.

Scitovsky, Tibor (1982). '**Economic Development in Taiwan and South Korea'1965-81**', Food Research Institute Studies. 19(3)

Sherwood, Robert M, "**Intellectual property and Economic Development**" Westview Press, 1990.

Small Industry Development Bank of India, **Annual Reports**

Soon Teck Wong, "Singapore" in Saha Dhevan Meyanathan, "**Industrial Structures and the Development of Small and Medium Enterprise Linkages**", edited by Saha Dhevan Meyanathan, EDI Seminar Series.

United Nations Industrial Development Organization, "**SMEs in the evolution of the Italian and Indian Industrial System**", Undated.

Vepa, Dr Ram K "**Restructuring the Institutional Framework for Promoting Small Scale Industries in India**", National Council of Applied Economic Research and Friedrich-Naumann-Stiftung, New Delhi, may 1995.

World Bank **Small-Scale Enterprises in Korea and Taiwan**', Staff Working Paper, 384, Washington D.C.

World Bank (1978). **Employment and Development of Small Enterprises**, Washington D.C.

World Bank, "India Country Economic Memorandum: Five years of Stabilization and Reforms: The Challenges Ahead", August 8, 1996.



- [MSME](#)
- [Home](#)
- [About Us](#)
- [Advt. Job & Tender](#)
- [Annual Reports](#)
- [Archive](#)
- [Budget & Allocations](#)
- [Contact Us](#)
- [Data & Statistics](#)
- [Disclaimer](#)
- [Draft New Website](#)
- [Dist. Ind. Profiles & Skill Mapping](#)
- [Entrepreneur's Corner](#)
- [Employee Corner](#)
- [eBook](#)
- [Election Commission](#)
- [Grievance](#)
- [eOffice](#)
- [eSamiksha](#)
- [FAQ](#)
- [Internet Grievance Monitoring System](#)
- [Knowledge](#)
- [Laghu Udyog Samachar](#)
- [List of Beneficiaries](#)
- [List of Stnd. Courses](#)
- [MPR-AB](#)
- [MSME in India](#)
- [MSME Publications](#)
- [National Board Meeting](#)
- [MyMSME](#)
- [MyMSME Mobile App](#)
- [Old dcmsme website](#)
- [Online Application](#)
- [Portal History](#)
- [PP Policy MSE-2012](#)
- [MSEFC](#)
- [RTI](#)
- [Samachar](#)
- NaN
- [Schemes](#)
- [Screen Reader Access](#)
- [Sitemap](#)
- [StandUpIndia](#)
- [Useful Links](#)
- [Vikas ka budget](#)
- [Website at a glance](#)
- [Hindi Website](#)

Website hosted & managed by [The office of Development Commissioner \(MSME\), Ministry of Micro, Small & Medium Enterprises, Government of India](#) Site is Hosted by [National Informatics Centre, Department of Electronics and Information Technology, Ministry of C&IT, Government of India.](#)