# SMEs IN INDIA: WILL THEY BE ABLE TO JOIN "GLOBAL CHAINS"?

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Globalisation has generated new opportunities in the global market. But, will Indian SMEs be able to exploit these opportunities? This article attempts to deal with this issue in the backdrop of the change in the relative importance of SMEs in Indian industry in the 1990s and the meaning and opportunities of globalisation.

Small & Medium Enterprises (SMEs) play a major role in global economic growth in terms of their contribution to industrial employment, output and exports. SMEs occupy a place of strategic importance in the Indian economy as well. However, since the early 1990s, Indian SMEs have been exposed to intense competition due to the accelerated process of globalisation. . Therefore, the survival as well as growth of SMEs is under strain. However, globalisation has also brought, in its wake, newer opportunities for SMEs.

## Importance of SMEs to Indian economy

SMEs are officially defined and exclusively identified for promotion in the manufacturing sector of most national economies. The most important justification for the exclusive promotion of SMEs is their potential for employment intensity. In general, a SME generates more jobs per unit of capital investment than a large enterprise. A SME has many other benefits: it can be started with relatively less capital; it facilitates nurturing of entrepreneurship, which could emerge from within; it can be used as an instrument for alleviating regional disparities in development etc. Further, a SME is flexible in production, has the potential to be a trainingground for managerial skills, promotes individual initiatives, and encourages rich personal relations. Therefore, it is often promoted as a source of technological innovations in industrialised economies.

However, there is no uniform definition of a SME in the global economy. Different countries have defined SMEs in different ways. In Japan, a SME in the manufacturing sector is defined in terms of upper limit of paid-up capital of 300 million Yen or 300 employees (Small & Medium Enterprise Agency, 2004). In South Korea, SMEs are defined as firms, which are independently owned and employ less than 300 persons in the manufacturing, mining, transportation and construction sectors (Baek, 2002). In the European Union, SMEs are defined in terms of employment and turnover/balance sheet total (Table 1). To be classified as a SME, an enterprise must satisfy the criteria for the number of employees and one of the two financial criteria, that is, either the turnover total or the balance sheet total. In addition, it must be independent.

There is no official definition of a SME in India. The Gov-

**Table 1: EU Definition of SMEs**

| Criteria | Micro Enterprises | Small Enterprises | Medium Enterprises |
|---|---|---|---|
| No of Employees | <10 | <50 | <250 |
| Turnover (Million Euros) | 2 | 10 | 50 |
| Balance sheet total (million Euros) | 2 | 10 | 43 |

*Source: United Nations-Economic Commission for Europe (2005)*

ernment of India has officially defined a small-scale enterprise under the Industries Development and Regulation (IDR) Act, 1951, in terms of upper limit of original investment in plant and machinery at Rs.10 million. But the recently introduced Small and Medium Enterprises Bill, 2005 (SIDO, 2005) has proposed a definition of a medium enterprise in terms of investment in plant and machinery in the range of Rs.50 million to Rs.100 million and proposed to revise the upper investment limit for a small-scale enterprise to Rs.50 million. If this definition is accepted, then SMEs would cover all enterprises having investment in plant and machinery up to Rs.100 million. But there is no single source of data, which provides statistics on the size and composition of SMEs in India. The Annual Survey of Industries (ASI) is the most comprehensive and reliable source of data on Indian industry covering registered factories. But, this source excludes unregistered or unorganised manufacturing enterprises, which is critical to any compilation of statistics on SMEs.

According to ASI, SMEs account for a major share of registered factories, employment, production and gross value added in Indian industry. In 1989/90, SMEs accounted for more than 93 per cent of registered factories, 66 per cent of employment, almost 52 per cent of the value of production and about 44 per cent of the gross value added. But by 1996/97, the share of SMEs declined marginally in terms of the number of factories and employment, and considerably in terms of value of output and value added (Table 2). (Figures for later years are not readily available). The question, therefore, is whether Indian can afford to allow the gradual dilution of SMEs when their growth and performance plays a vital role in the growth and performance of the Indian economy?

**Table 2: SMEs in Indian Industry**

| Year | % share in No. of Factories | % share in Employment | % share in Value of Production | % share in Gross Value Added |
|---|---|---|---|---|
| 1989/90 | 93.00 | 66.00 | 52.00 | 44.00 |
| 1996/97 | 92.31 | 61.29 | 43.57 | 34.19 |

*Source: EPW Research Foundation (2002)*

## Globalisation and SMEs

Globalisation is usually seen as the conversion of the world into a single economic space, one macro-economy, or perhaps mega-economy, and as a result, into a single seamless society and culture (Sutcliffe, 1998). Globalisation – the process of continuing integration of the countries in the world – is strongly underway in all parts of the globe. While the movement of goods, services, ideas, capital and technology across national borders is not a new phenomenon, its process since the past decade marks a qualitative break with the past. Globalisation has exposed national economies to much more intense competition than ever before (Mrak, 2000). This process is characterised by national governments across the world moving towards more open and market-oriented regimes, with greater reliance on private business and less direction of resource allocation. Protective barriers are being lowered, restrictions to Foreign Direct Investment (FDI) removed and the private sector allowed into areas previously reserved for public enterprises (Lall, 1995).

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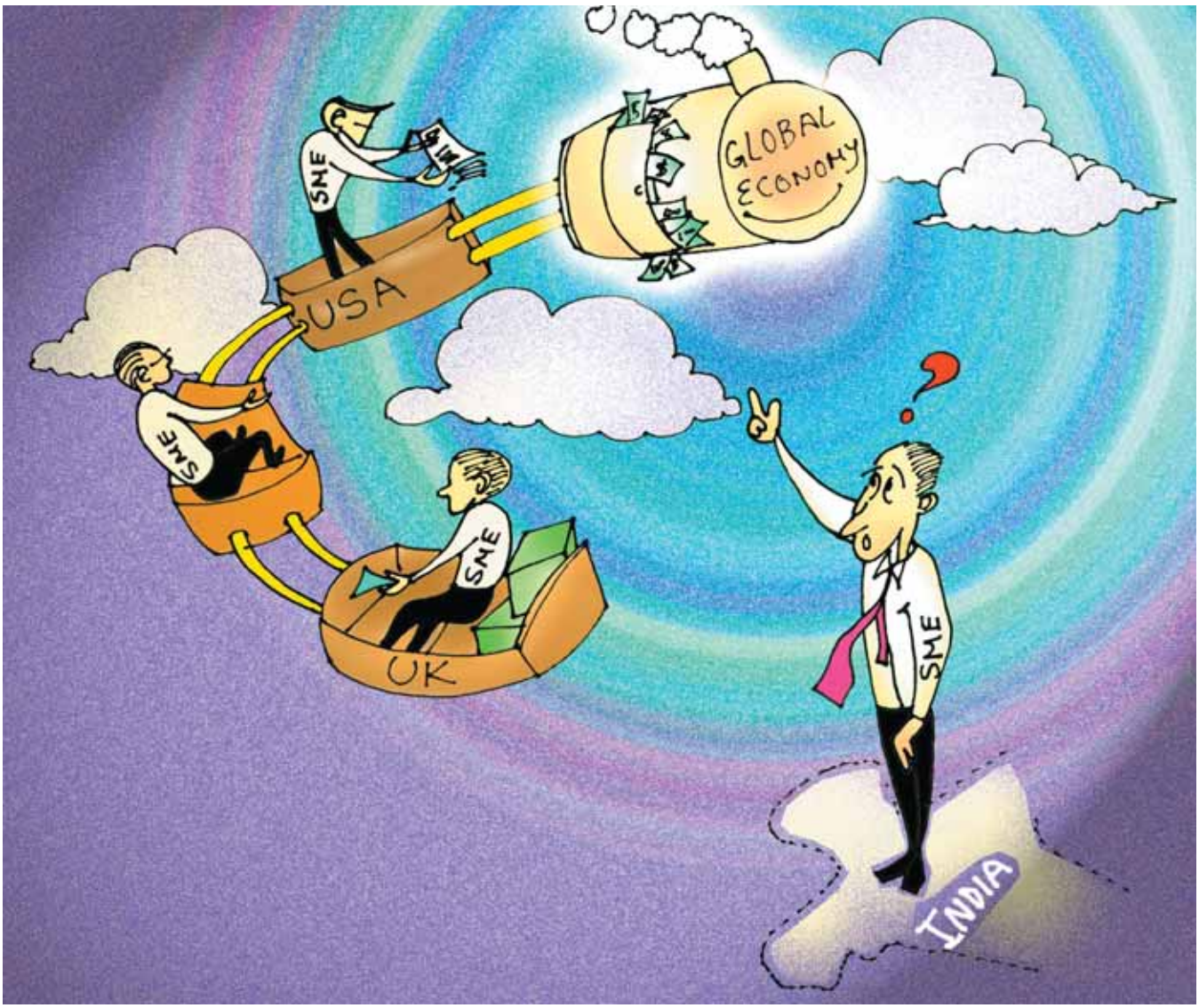
During 1991-2003, the number of countries that have introduced changes in their investment regimes has more or less steadily increased from 35 in 1991 to 82 in 2003 and the number of regulatory changes introduced favouring FDI increased from 80 in 1991 to 220 in 2003 (UNCTAD, 2001; 2004). As a result, there was a remarkable increase in FDI inflows: it increased from US $209 billion in 1990 to US $ 560 billion in 2003 (UNCTAD, 2001; 2004). Of course, in the last three years, there has been a consistent decline in global FDI inflows, which was more caused by economic decline in developed countries, particularly the US, Latin American and Caribbean countries (UNCTAD, 2004). The setting up of the World Trade Organisation in 1995 and the subsequent dilution of tariff and non-tariff barriers have given a fillip to the growth of international




trade. The Information and Communication Technology (ICT) revolution has made the spread of information and communication easy, fast and virtually costless. These have contributed immensely to the accelerating process of globalisation.

Globalisation has facilitated two major developments, both of which have significant implications for SMEs in developing countries: (1) Globally spread complex integration strategy of Transnational Corporation (TNC) production network, and (2) Global expansion and procurement of TNC Super Market Chains. Both are necessitated by the need for sustaining competitiveness. Today, competitiveness matters much more than in the past. Competitiveness has two dimensions – cost and quality. A firm should have both. Transnational Corporations (TNCs) are looking for firms, which could supply intermediate as well as consumer products of superior quality but at a reasonable price because they are under constant pressure to cut down costs to sustain their competitiveness globally.

Since 1990s, more and more TNCs adopt complex integration strategies as a means of enhancing competitiveness. A complex integration strategy is based on a firm's ability to shift any part of its value-chain to wherever it is most profitable. Complex integration reflects a willingness to locate various functional activities – not just production but also R&D, finance, accounting, procurement, etc. – to wherever they can be done best to fulfil the firm's overall strategy (UNCTAD, 1993). It is the increasing adoption of this complex integration strategy by TNCs, among others, which has giv-

en a boost to the growth of international subcontracting relationship between SMEs of developing countries and TNCs of developed countries (UNCTAD, 2000).

As a result, globalisation affects almost every economy, favourably or adversely. Even, the Japanese economy is perhaps no exception. The Japanese manufacturing industry comprised about 649,000 manufacturing SMEs with an employment of 7.9 million in 1970, which increased to about 731,000 with an employment of 8.03 million in 1980. By 1990, the number of SMEs declined to about 725,000 but employment increased to 8.7 million. However, since then both the number of SMEs and their employment figures are on the decline. The number of SMEs came down to about 501,000 with an employment of 6.4 million in 2003 (MITI, 1972; 1982; 1992; METI, 2005). Why have SMEs in Japan, which are known for their industrial efficiency, declined?

Industrial subcontracting is an important distinguishing feature of the Japanese manufacturing industry. In the Japanese economy, subcontracting has been regarded as a crucial source of efficiency and competitiveness for industries such as textiles, general machinery, electric machinery and automobiles (Nishiguchi, 1994; Kimura, 2001). A significant proportion of Japanese SMEs are linked to large enterprises through subcontracting relationships for the manufacturing of not only consumer products such as food products, wood products, textiles and clothing, but also intermediate products like plastic and rubber products, metal products and more importantly, general and electrical machinery, precision machinery and transport equipment (Kimura, 2001). This relationship has been a means of technology transfer and support, among others, from large enterprises to SMEs, thereby resulting in increased competitiveness of the latter.

However, since the 1980s, the TNCs of Japan have been availing of a better option: procurement of parts and components from the South East Asian nations and China, whose SMEs manufacture a wide range of quality, but less expensive parts and components. According to experts, this trend has increased gradually since then. As a result, the proportion of subcontractors among SMEs, which increased steadily from about 53 per cent in 1966 to 66 per cent in 1981, declined to about 56 per cent in 1987 and further to 48 per cent in 1998 (Okamuro, 2002). Perhaps, the high cost of labour is a major deterrent for Japanese SMEs to manufacture products, which are competitive both in terms of quality and price. The loss of Japanese SMEs has been the gain of SMEs in South East Asia and China, thanks to globalisation.

Another major development in this globalisation era is related to the retailing industry. The retailing industry has seen aggressive global procurement of goods and international expansion by many leading players in recent times: Wal-Mart of the US has been expanding into Latin America, Europe, China and South Korea and currently knocking on the doors of India for entry; Carrefour of France has been rapidly expanding across Asia and Latin America; Royal Ahold of the Netherlands has been strengthening its presence in Europe, the US and Argentina. The entry of TNC Super Markets into India is only a matter of time. These global "Super Market Chains" (which are located primarily in industrialised and rapidly industrialising countries) acquire consumer goods globally, particularly from developing countries. According to a news report, Wal-Mart procures goods from India to some extent and China to a considerable extent (International Herald Tribune, 2005). However, it is not clear as to what is the share of SME products in these procurements.

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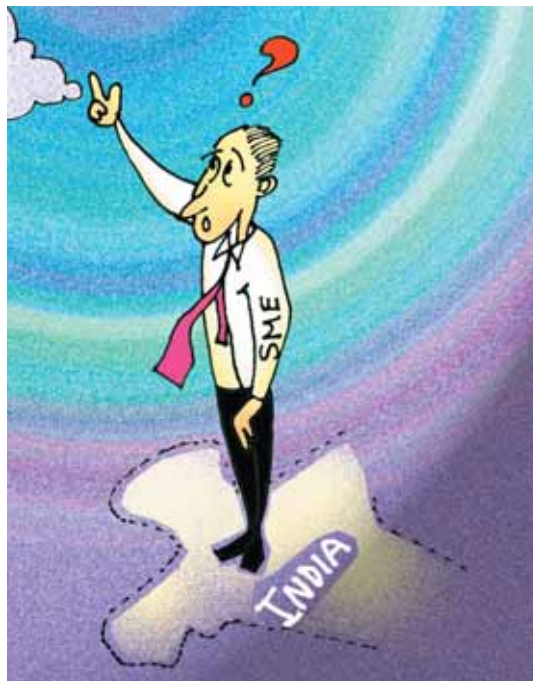

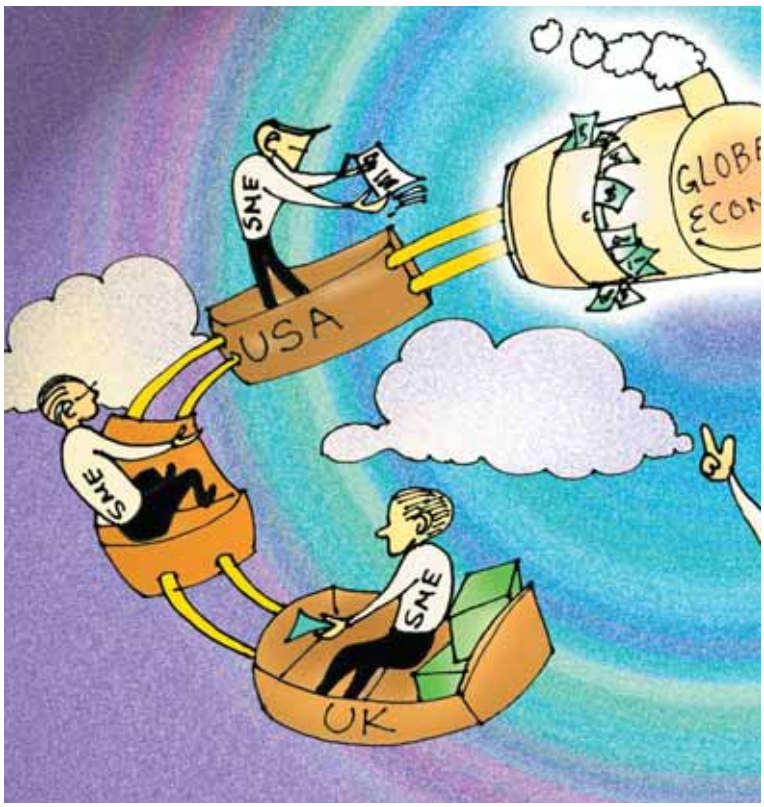


ucts of China have a significant presence, apart from that of South Korea, Taiwan and Thailand. The 99 Yen shops & 100 Yen shops in Japan and One-Pound shops in the UK are virtually flooded with Chinese goods, a significant proportion of which obviously comes from SMEs. The global procurement and expansion of super market retail chains have been driven by the need to locate the best merchandize wherever available across the world and to generate new growth opportunities. This has again opened up vast global market opportunities for local SMEs.

Thus globalisation has led to the opening up of opportunities for SMEs from manufacturing TNCs as well as TNC Super Market Chains for both intermediate and consumer products. Do Indian SMEs have any significant presence in the currently flourishing field of international subcontracting? If not, will Indian SMEs be able to exploit these opportunities?

## Prospects of Indian SMEs in the Era of Globalisation

There is no evidence available yet to indicate that Indian SMEs have a noticeable presence in the growing arena of global value-chains of TNCs (with the exception of textile products & garments, software and auto-components). What factors inhibit the entry of Indian SMEs on a considerable scale into the global value-chain circles?

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In fact, Indian SMEs comprise not just factory enterprises but a considerable number of predominantly rural based, un-organised manufacturing enterprises. Thus, Indian SMEs comprise three sub-sectors: (1) predominantly rural based, traditional household industries; (2) small and medium industries, functioning with relatively obsolete technologies; and (3) modern small and medium enterprises, which are owned and operated by techno-entrepreneurs, operating in new industries such as software and bio-technology, among others.

A substantial proportion of the traditional household enterprises will be catering to the demand of the rural population as well as that of low-income groups in urban India. As and when the level of income goes up, particularly in rural India, this sub-sector is bound to diminish gradually due to lack of demand on the one hand and transformation through modernisation, on the other. Therefore, this sub-sector is unlikely to benefit from the globalisation process. Rather, it may get affected adversely.

Modern SMEs, which are run by innovative techno-entrepreneurs and which are operating in new industries, will be able to perceive and pursue the opportunities offered by globalisation appropriately and, therefore, prosper rapidly. They would require little as-

sistance from the Policy Makers. But these modern SMEs account for a minority in the vast and diversified SME sector of India. Therefore, they alone cannot make a difference to the SME sector, at least in the near future.

A major proportion of the manufacturing enterprises in the Indian SME sector operate with obsolete technology. This lack of technology sophistication will act as a constraint in exploiting the opportunities presented by globalisation. Further, a considerable number of these entrepreneurs would be either less qualified or lack both the resources and sources of information to access global opportunities. If appropriate steps are not taken, they will find it difficult to hold on to the market, which they currently have within the country. This is because both consumers and large firm producers (who currently obtain intermediate products directly or indirectly from these SMEs) might, sooner than later, become more quality conscious and look for better alternatives available globally. Therefore, the future survival of these SMEs will be increasingly under strain.

## What should be done?

There is no automatic and easy route for Indian SMEs to enter the global chains. Concerted efforts are needed on the part of the stakeholders – SMEs as well as the Government – to strengthen and promote the competitiveness of the sector. The recently introduced Small and Medium Enterprises Development Bill, 2005 is a welcome development. The proposed definitions of Small Scale Enterprises and Medium Scale Enterprises are right steps in the current context.

The technological development of SMEs should be the top-most priority of the proposed National Small and Medium Enterprises Board. The technology development strategies of the Government of India adopted in the 1990s do not seem to have made a significant impact on the technological upgrading of SMEs. Of course, the major responsibility for this lies with the SMEs to understand the imperativeness of achieving technology up-gradation for their own survival and growth. Considering the global opportunities, Policy Makers should prioritise industrial sub-sectors of SMEs and product specific-clusters for targeting technological upgrading. If necessary the existing programmes must be revised to make it more target-oriented, based on feedback collected from organisations such as SIDBI, State Level Directorates of Industries, Apex Chambers such as ASSOCHAM, FICCI and CII and regional Small-Scale Industry Associations. In addition, Regional SME Associations should be involved in the future planning of technology upgradation of SMEs.

The ability of SMEs to compete in the global market place depends on their access to certain critical resources, the most important of which are finance, technology and managerial skills. TNCs have been an important means for SMEs to gain access to new technologies and management know-how (UNCTAD, 2000). Therefore, Indian policy- makers, on a priority basis, should adopt policies to deepen the developmental effects of Foreign Direct Investment by attracting TNCs will-

ing to forge such linkages and then to undertake measures to promote such linkages between TNCs and SMEs. The SMEs should be encouraged and guided to get involved in "intra-national exports", that is, sales to foreign firms, which operate within the home country of the supplier. A suitable strategy needs to be developed at the state level, to encourage the already established TNCs to forge links with the local SMEs who have "certain minimum technological capabilities". This is important because the type and strength of linkages established depends to a large extent on the technological and other resource capabilities of local firms (UNCTAD, 2000).

The Small Industry Development Organisation (SIDO) in the Ministry of SSI should conduct a study to assess the "ways and means" of facilitating SMEs to enter the growing global value chain circles of TNCs and publicise its findings among SMEs. It would be worthwhile to identify and develop a database, through District Industries Centres (DICs), of the existing SMEs who have successfully entered into such global relationships. The expertise of leaders of such "successful enterprises" should be thereafter utilised in formulating an appropriate strategy for the promotion of Indian SMEs in the global market. In the long run, international subcontracting relationships should act as a means of sustaining the competitiveness of such SMEs. Schmitz (2005) concludes from recent studies that in chains characterized by captive (subcontracting) relationships, developing country producers experienced rapid product and process upgrading. Of course, promotion of such relationships will have its own consequences. For, it would be difficult to prevent local SMEs from suffering from any fallout in the wake of global recession. .

Technology and innovation are the watchwords for strengthening competitiveness. Technological innovation is regarded as a tool for strengthening the competitiveness of a nation (Sikka, 1999). In recent years, technological innovation has been increasingly recognised as the engine for economic growth (Yeh and Chang, 2003). Among firms of different sizes, small firms are more suited for undertaking technological innovations due to their specific advantages of flexibility, concentration and internal communication. In India, a considerable proportion of small firms in Karnataka are predominantly engaged in incremental innovations to satisfy their customer needs and innovative firms are found to be successful (Bala Subrahmanya, 2005a; 2005b). It is essential to facilitate and promote technological innovations of SMEs through national policies and programmes for their long-term competitiveness.

SMEs should have access to strategic business information on potential foreign business partners, regulations and business environment issues in foreign markets, sources of technology, international technology and market development trends on a continuous basis, at the sub-regional level. Therefore, DICs should be promoted as the local SME information hubs to provide information on technology and global market trends, apart from government policy. All these steps would give a new dimension to the future growth and performance of SMEs in India.

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## Conclusion

Globalisation has been affecting every economic activity in almost every country across the world. Indian SMEs are no exception. The performance of SMEs has a determining significance for Indian economic growth due to their substantial share of enterprises, employment, production and gross value added in the industrial sector. However, in general, Indian SMEs lack technological strength to access and exploit the benefits emerging from the intensifying process of globalisation. Therefore, technological transformation of SMEs should attract the focus of attention of policymakers.

In addition, FDI and TNC entry should be used to promote inter-firm linkages for the benefit of SMEs. They need to be "consciously guided" to enter the ever expanding global value chains of TNCs, both in the manufacturing and retail sectors. Further, technological innovation and orientation of SMEs should be promoted and information access be made easy. On the whole, SMEs should be enabled to achieve self-sustainable competitiveness and reap the fruits of globalisation for their own growth and the growth of the Indian economy. ❐