MSMEs AND THE GROWING ROLE OF INDUSTRIAL CLUSTERS

January 2013
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1. **MSMEs ACT AS BEDROCK FOR INDIA’S INDUSTRIAL GROWTH**

Micro, Small and Medium Enterprises (MSMEs) in India have evolved considerably since independence. From being referred to merely as the Small Scale Industries (SSI) sector in the 60s and 70s, the MSME sector has progressed in scale and in the scope of business activities over the years. Today, MSMEs are present across sectors (manufacturing, trade and services) in India, thereby constituting a formidable component of the country’s outstanding economic growth. While a key achievement of MSMEs over time has been their talent in utilising available domestic resources to deliver quality products and services, these firms have made their presence felt across India’s key sectors as well as in prominent export markets. MSMEs have made an impact on a range of issues, from industrial progress to entrepreneurship and from job creation to economic empowerment. The inclusiveness of the MSME sector is highlighted by the fact that around 50.0 per cent of MSMEs in India are owned by underprivileged groups. Due to its low capital structure, coupled with high labour absorbing power, the sector has played a noteworthy role in achieving rural industrialisation as well. The MSME sector remains a key driving force for India’s complete transition from an agrarian economy to an industrialised one. Subsequently, MSMEs have been awarded a host of incentives by governments across India. A number of other organisations in the private and non-profit domain have also been aiding MSMEs to remain competitive in a more globalised economic order. This is set to continue in the coming decade as well, with MSMEs requiring access to credit, technological know-how and training centres for bridging the skill gap.

2. THE MSE SECTOR IN INDIA IS HETEROGENEOUS, DISPERSED AND MOSTLY UNORGANISED

A key feature of MSMEs in India is that a majority of them are unregistered. As per the Annual Report FY12 issued by the Ministry of Micro Small and Medium Enterprises, the number of registered units in the MSME sector is estimated at around 1.6 million. Micro enterprises dominate the sector with a 94.9 per cent share, followed by small enterprises (4.9 per cent) and medium enterprises (0.2 per cent). Geography wise, around 45.2 per cent of enterprises operate in rural regions. On activity basis, firms can be classified into three categories: manufacturing (67.1 per cent of total registered units), services (16.8 per cent), and repair and maintenance (16.1 per cent).

Exhibit 2
Number of MSME units in India versus employment generation (million)

Source: Annual Report FY12, Ministry of Micro Small and Medium Enterprises, Government of India, Aranca Research
Note: * data for FY11 is projected; data up to FY06 is for small scale industries. Subsequent to which data is for MSMEs

Exhibit 3
Distribution of 6000 products of MSMEs into their respective sectors (FY06-07)

MSMEs account for more than 90.0 per cent of total industrial units in India. The MSME sector has registered an impressive growth over the years; total number of units increased at a CAGR of 20.3 per cent to 31.2 million during FY06–11. MSMEs contribute 45.0 per cent to manufacturing output, 40.0 per cent to exports and 8.0 per cent to the country’s GDP.

Given strong growth and rising potential, the MSME sector experienced a significant increase in investment flows. For example, fixed investments rose at a CAGR of 19.6 per cent during FY02–11. Analysts believe a major portion of investments has been directed towards technological developments, resulting in an improvement in volume and quality. Production in the MSME sector outpaced overall growth in industrial production. For instance, the sector registered a growth rate of 11.5 per cent in FY11; this is 3.3 percentage points (ppt) higher than growth in the overall industrial sector. The MSME sector also plays an important role in India’s exports. MSME exports have expanded at a CAGR of 19.0 per cent during FY02–08. The MSME sector accounts for around 40.0 per cent of total exports in India.

Exhibit 4
Growth in MSME production and investment (INR billion)

Source: Annual Report FY12, Ministry of Micro Small and Medium Enterprises, Government of India, Aranca Research
Note: * data for FY11 is projected; data up to FY06 is for small scale industries. Subsequent to which data is for MSMEs

As per the MSME Annual Report FY12 published by the Ministry of Micro, Small and Medium Enterprises
4. INDIA'S MSME SECTOR PLAYS A CRUCIAL ROLE IN SUPPORTING EMPLOYMENT AND SKILL UPGRADING

The MSME sector is the second largest employment generator in India after agriculture. It generated employment for 73.2 million people in FY11; the figure is set to increase by another 12.0 million over FY12–14. While MSMEs are a key source of employment for low-skilled and semi-skilled workers, the sector has been working hard towards upgrading the skill base and attracting more talent. In line with this, the government and various private players are heavily investing in training centres. A good example for this is upgradation of nearly 1,390 Industrial Training Institutes (ITIs) across India through public private partnerships (PPPs).

MSMEs have been coordinating with private sector players in upgrading skills and delivering quality. Large industrial firms (such as those in automotive sector) often tend to be the end-customer for MSMEs. To ensure product quality, these firms often coordinate with smaller suppliers to impart the requisite skills and ensure adherence to standardised processes. The government as well as NGOs have been actively involved in this endeavour. With improving skills, better coordination with bigger firms and greater technological access, MSMEs in India have moved into a higher trajectory of success. The sector currently produces more than 6,000 quality products, ranging from handloom saris, carpets and soaps to pickles and machine parts, for huge industries targeting domestic and international markets.

5. MSMEs IN INDIA OWE MUCH OF THEIR SUCCESS TO INDUSTRIAL CLUSTERS

The MSME landscape has matured over time and moved up the value chain. The MSME sector has evolved from the manufacturing of traditional products to much more hybrid products to the value-added services segment. This transition has been majorly fuelled by the consortium approach adopted by MSMEs. Firms in the MSME sector that were earlier facing difficulties in achieving economies of scale, specialisation and innovation due to their small size are now increasingly benefitting from the advent of industrial clusters. Clusters and associated networks enable small firms to combine the advantages of running a small unit with the benefits of scale and specialisation provided by large units. Currently, there are more than 600 industrial SMEs clusters and over 7,000 artisan/micro enterprise clusters operating in India. Moreover, there are about 2,500 untapped rural industry clusters in the country. Some of these clusters are so large that they account for nearly 80.0 per cent of production of a selected product within the country. The networking approach has helped MSMEs to overcome barriers such as technological obsolescence, supply chain incompetence, global competition and investment shortages. Furthermore, to capitalise on the benefits from specific target customer base, clusters are classified as export-oriented and specialised domestic ones. Tirupur textile and Vizag marine processing clusters focus mostly on exports. On the other hand, the requirements of large domestic
firms are supplied by MSMEs in specialised domestic clusters such as Jamshedpur’s engineering cluster and Pune’s auto cluster.

6. INDUSTRIAL CLUSTERS WOULD CONTINUE TO BENEFIT MSMEs

The inter-firm linkages stimulated by these clusters and networks have aided MSMEs to move up the value chain and gain competitiveness. At the same time, given greater access to technology and better production coordination techniques in the sector, MSMEs’ efficiency has significantly improved. This would provide them with greater business viability.

Given this greater sense of sustainability, entrepreneurs have been emboldened to introduce innovation in products and processes and enter new geographies. Moreover, diffusion of information, resources and technical proficiencies within industrial clusters has reduced total costs and facilitated technical reforms. Most technological improvements in the sector were influenced by demand from large domestic or international buyers or supply-chain partners. In addition to the above benefits, firms within a specific cluster have been able to better utilise the available infrastructure by sharing the same transport mechanism. These clusters even helped the journey of rural artisans with innate skills to self-sufficiency by overcoming their funding and technology-based constraints.

7. CLUSTER DEVELOPMENT STRATEGIES HELPED IN EXPLORING UNMAPPED POTENTIAL CLUSTERS

Numerous success stories showcasing the potential of MSMEs have been recorded in India. Many industrial zones across sectors adopted the participatory approach by coming together to reap the enormous benefits of clustering. The event of cluster formation may be classified as natural and artificial. The former is driven by huge demand conditions or a private sector unit, while the latter is supported by favourable infrastructure ecosystem and policies or a large buying undertaken by a public sector initiative. The textile industry, largely operated within industrial clusters, in India is home to more than 70 clusters, accounting for around 80.0 per cent of the total country’s production. There are several successful natural clusters across the country. Panipat is home to 75.0 per cent of total blankets produced in the country, the Tirupur contributes 80.0 per cent to total cotton hosiery export, and Agra exports shoes worth USD60.0 million annually. Similarly, Ludhiana has become the hub for production of woollen knitwear, sewing machines and, bicycles and bicycle parts in India. On the other hand, the auto component industry at Gurgaon is an induced cluster. Setting up of Maruti Udyog Ltd.’s public sector car manufacturing unit laid the foundation for the cluster formation. Moreover, petrochemical-based cluster at Vadodara was driven by the establishment of Indian Petrochemical Industries Ltd. (another public sector initiative). Additionally, majority of the gems and jewellery exports come from Surat (Gujarat) and Mumbai (Maharashtra). Likewise, Chennai, Agra
and Kolkata are hubs for leather and leather-based products.

8. FUNDING GAP NEEDS TO BE BRIDGED TO CAPTURE SECTORS PROMISING GROWTH

Availability of funds at competitive rates is considered to be an important factor to fund long-term growth plans and short-term working capital needs of MSMEs. Small Industries Development Bank of India (SIDBI)'s contribution to the sector so far has been remarkable. Furthermore, with an aim to streamline the funding process, SIDBI, in collaboration with various major public and private sector banks in India, launched a dedicated rating agency called SME Rating Agency of India in 2005. The rating agency provides a third-party rating for the overall condition of a specific SME before granting loans. The need for such committed financing institutions is consistently being felt mainly due to the sector's increasing appetite for credit. This offers immense scope for other private and public sector banks in India to formulate innovative financing models.

Total advances from various public sector banks to micro and small sized firms have been growing at a fast pace; it expanded at a CAGR of 23.8 per cent to USD106.2 billion over FY00–11. Policymakers are keen to ease credit flows to the MSME sector mainly due to the sector's underlying growth potential. In that context, the RBI has become more proactive. As part of an RBI initiative, all banks have been instructed to boost credit to micro and small units to 55.0 per cent of total SME lending by 2012 and 60.0 per cent by 2013. Furthermore, the number of MSME accounts need to register 10.0 per cent growth annually. Some of the major forms of SME financing are leasing, trade credit, and fiscal incentives in the form of tax breaks. Perhaps one of the best incentives for aiding SME financing and growth is the Government of India's directive to include SMEs in the priority sector.

9. THE GOVERNMENT HAS BEEN PROACTIVE IN AIDING CLUSTER DEVELOPMENT STRATEGIES

The numerous advantages of operating in a cluster have prompted several regional and local organisations to take up cluster-based projects and promote smaller firms. The various central government initiatives involve provision of technical aid, grant for technology advancement and marketing assistance to provide a competitive edge to MSME units in the global ecosystem. State governments of Andhra Pradesh, Gujarat, Kerala, Madhya Pradesh and Tamil Nadu have also undertaken cluster development strategies. The early advancements in the field are formation of National Small Industrial Corporation Ltd., Small Industries Development Bank of India, Khadi and Village Industries Commission, The Baba Saheb Ambedkar Hastshilp Vikas Yojana Scheme, United Nations Industrial Development Organisation Cluster Development Programme, State Bank of India’s UPTECH Programme, and Rajasthan Chamber of Commerce and Industry, among others. The soft and hard intervention provided
due to MSE-Cluster Development Programme, Lean Manufacturing Programme, ISO Certification Programme and other information and communication tools programmes launched by the Government of India would also help industrial clusters in India to improve their productivity. To avail benefits from the above mentioned funding schemes, the government is actively disseminating information amongst rural entrepreneurs. Moreover, schemes and programmes supporting infrastructure, skill set, and entrepreneurship and technology development, coupled with cluster-building activities, would help in optimising the returns and maximising the country’s growth in the long term.

10. BEGINNING OF A SUCCESSFUL JOURNEY FOR MSME SECTOR IN INDIA

MSMEs are likely to experience a more conducive landscape going forward, with the government committed to provide momentum to the sector by including it as an integral part of industrial policy. Experts opine the share of MSMEs in the country’s GDP would touch double-digits by the end of this decade from the current 8.0 per cent. SMEs’ contribution to the country’s GDP is expected to increase to 22.0 per cent by 2020. The anticipated rise can be attributed to policymakers’ focus on boosting the country’s manufacturing sector and promoting greater role of entrepreneurial activity across sectors. This could lead to a wide range of lucrative opportunities for domestic and international investors.
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