

FINAL REPORT

CSM Consultation on SMEs and Technology: Addressing the Barriers to Technical Assistance & Finance

on September 10, 2005 at The Park, Kolkata (India)

The Centre for Social Markets¹ Consultation on **SMEs & Technology: Addressing the Barriers to Technical Assistance and Finance** had a set of key learnings – finances were certainly the key barrier to technology upgradation, but business support services and a greater facilitating role by the government were also sorely needed in West Bengal. While finances do exist for the small-scale industries (SSI) sector, much more needs to be done to make their reach effective. For that, reality checks by both policy makers and financiers must accompany the imminent legislative changes being proposed for the SSI sector. The underlying paradigm shift in the definition change from SSI to SME was also a cause for worry, because by opening the field wider, the business environment was likely to be too harshly competitive for the tiny sector.

It emerged from the Consultation that cluster development was perceived as only a partial answer to the problems faced by the small and medium enterprises in West Bengal. The problem was that within clusters, achieving some common ground was quite a difficult task as the much-needed co-operation was not always available. The Consultation also inferred that in the context of the **SME Development Bill 2005** and the recent Government of India directive to **enhance capital flow to the Small and Medium Enterprises (SME)** sector, banks need to rethink their lending approach in order to be instrumental to promote growth of this sector. A lot of policy changes have been proposed to effectively reach finance to SMEs within a five-year time period. But considering that a lot of local level inputs are crucial for the success of the ambitious government programme to double credit flow to SMEs within five years, not just a cluster-based but a sectoral cum local approach may be advisable to promote growth in the SME sector through technology upgradation and market development.

The Consultation, which focused on five key sectors – **Leather & Footwear, Garments, Paints & Pigments, Foundry, Engineering & Allied, Food Processing** – had a wide spectrum of participants starting from Romit Mutsuddi, Special Secretary, Department of Cottage & SSI, Govt of West Bengal and Sunanda Lahiri, Executive Director, United Bank of India to important technical experts like Dr P.K.Chowdhuri of the Regional Testing Centre, D.K. Mohta, President, FOSMI (Federation of Small and Medium Industries) and Mukesh Gulati, Focal Point Manager, Cluster Development Programme of the United Nations Industrial Development Organisation (UNIDO). CSM's Consultation on SMEs was organized with the active support of FOSMI.

BACKGROUND

The West Bengal Forum on Business Partnerships for Sustainable Development – under the banner of which the SME Consultation has been hosted – was created in 2002 to foster tri-sector cooperation between the government, private sector and other stakeholders to promote development. In November 2003 we had our 3rd Annual Conference on Corporate Citizenship: Focus on Small, Medium and Micro Enterprises. CSM's learnings from the conference about how little understood the concept of Sustainable Finance was and subsequent networking with SMEs in the state led to the birth of the SME Initiative in October 2004, to serve as a common information exchange platform by popular demand. SMEs present there, who spoke on

¹ The Centre for Social Markets is a UK and India-based non-profit that promotes responsible business and advocates for markets to be attentive to sustainable development, in order to bring about positive social change. Founded in 2000 by social entrepreneur Ms Malini Mehra, CSM takes pride in being a predominantly women-run organisation and stresses the importance of addressing critical human issues while acknowledging the power of the markets.

the current most important concerns, said: they lack information on **demand**, on **finances available** and **technology support available** to make them competitive. The September 10 event was a response to this finding and sought to explore possible links between the SME agenda in this state and region and the broader CSR issues.

CURRENT SCENARIO

At the policy level, the small industries sector has attracted steady attention. The Small and Medium Enterprises Development (SMED) Bill 2005 is under debate in Parliament and once passed, will broaden the scope of the definition of SMEs. Complementing this course of action, access to credit is also being stepped up. In a crucial step in August 2005, the government announced a package for **doubling credit flow** to small and medium enterprises (SMEs) over the next five years and the process was to be monitored by the Reserve Bank of India. Simultaneously, Indian Banks' Association (IBA) Chief Executive H N Sinor has said existing SME portfolios would qualify for priority sector lending, and help many banks meet the stipulated targets. These measures surely promise to open the doors to financial accessibility. And yet, for this finance thrust to be truly effective, they first need to be examined against the backdrop of the current constraints and gaps faced between policy and practice. The SME Consultation examined just some of those gaps.

KEY ISSUES

Scale: The key to the success of the small industries sector is an encouraging policy environment. But in West Bengal, the trend seems to be to encourage the large enterprise rather than a simultaneous encouragement of both the large and the small enterprise. A case in point is that of the Bantala Leather Complex, which was ambitiously conceived by the state government to be developed as a cluster of small and medium sized leather units way back in 1995. The context was an environmental lawsuit and the Supreme Court had ordered re-location of close to 400 polluting leather units situated in Tiljala, an urban peripheral location in Kolkata. The state government had then drawn up a plan that could accommodate both large and small units in the Bantala Leather Complex, which would have a complete integrated raw material supply, processing, waste treatment and marketing facilities. The blueprint of the complex took into consideration the needs of entrepreneurs of various unit sizes. However, with the passage of time, the accommodative attitude of the Government changed, posing stiff problems for small units at the very basic level of land acquisition, according to a memorandum by the Tiljala Leather Manufacturers Association.

The Consultation threw up an interesting dichotomy: on the one hand, the small business sector is being looked upon as a vehicle for growth and development and therefore policy thrust is being provided through formally opening up channels to access finance. On the other hand, attrition characterizes this sector globally, trends in West Bengal and India are just aligning with the global trend as India seeks a paradigm shift in how this sector is looked at – by widening the definition of SSI to SME, a certain preference is implied to entities with a stronger financial muscle.

Competitiveness vs social responsibility: Some of the dilemmas facing this sector were apparent from the introductory session itself. **Mr Romit Mutsuddi, Special Secretary, Department of Cottage & SSI, Government of West Bengal** said in his presentation that technology upgradation is essential for SMEs. But in response to an observation by Mr Anil Ghosh of Fairfields Pvt Ltd about increased automation leading to retrenchment, he pointed out that since SMEs serve a social purpose the need of the hour was to balance adoption of cost-effective technology with minimum workforce displacement. Mr Mutsuddi also mentioned the employability scenario in West Bengal where the SME sector is the second largest employer only after agriculture. This implies that the small business sector will always face an uphill task in balancing its need to survive with social responsibility objectives.

Systems approach: The modern diagnosis emphasizes on a systemic examination of the problems that plague small business, to look for solutions to problems. So when finding out about technology use patterns, the approach would be to examine the working of the economic system of which the firm is a part and go to the root causes of why firms do not upgrade on their own. Thereafter, the effort would be to find the drivers to energise the economic system. Speaking on the systems approach **UNIDO Cluster Development**

Programme Manager Mr Mukesh Gulati emphasized that every cluster is unique in its status, aspirations and scope and needs an external agent to bring about change. He also pointed out that a systems approach is best applied when accompanying cluster policy support is provided through public institutional restructuring and training, business development support, keeping the knowledge base growing and so forth.

Speaking of Small Industries Development Bank of India's Cluster Development Programme, **SIDBI Chief General Manager N K Maini** said the bank's main learning from the Cluster Development Programme, carried out along with UNIDO in seven places, was that a broad-based, rather than technology-centric approach is ultimately beneficial for the growth and prosperity of a cluster. Some of the targeted interventions of SIDBI have been in the Bicycle industry cluster – Ludhiana, Foundry cluster in Howrah, Utensil cluster – Jagadhri, and Scientific Instruments cluster – Ambala.

Feedback from the Consultation suggested that in West Bengal, SMEs have been only partially responsive to the potential of cluster development. In Kolkata and its suburbs, for example, clusters may be sector-based, like the foundry clusters in Howrah or the leather cluster in Tiljala. But clusters may also be region-based without necessarily being composed of units from one particular sector, as has happened in Kasba Industrial Estate. Whether the cluster has only one type of industrial unit or various types, the effort has been to concentrate on infrastructure issues that are key to clusters, rather than adopt more sophisticated approaches to access finance for technological upgradation. For example, the system of Group Guarantees that clusters have successfully negotiated with bankers in Italy, has not been widely adapted in West Bengal. A systems approach can be advocated more strongly only when SMEs perceive the strategic and practical connections between group coordination and individual profit.

Compliance: All sectors present at the Consultation were unanimous that the current compliance load was very heavy and taking a long list of 25/26 clearances from various authorities only added to the cost burden. This was also emphasized by **Mr D K Mohta, President of FOSMI** in his address to the Consultation, where he implied that taking care of the compliance load would go a long way in betterment of the SME sector. A single licence that unified as many clearances as possible, even if that meant a steep, one-time cost, would be very welcome indeed, according to representatives across various sectors. However, this issue has so far met with steep institutional challenges, even skepticism at the Government level².

There are other perspectives on compliance too. At pre-Consultation sessions, exporter-manufacturers of small leather units expressed their helplessness in overcoming practical barriers in implementing the SA 8000 standard that they had to comply with. While the leather sector points to existing state government rules that act as barriers to full compliance, experts believe that innovative ways can still be devised to overcome the compliance challenges that the SA 8000 standards pose for the sector.

Bringing about a positive attitude towards compliance and standards is easily the priority CSR agenda for any worker or institution. In West Bengal, the trend matches the national trend of standards being seen as an obstacle to growth. Experience suggests that sectors with export potential tend to have this perception, but even for sectors that cater to big domestic markets also, like the foundry sector, environmental compliances tend to be a source of both cost and worry.

Context for technology upgradation: **Mr Dharm Prakash, CEO of Technology Bureau for Small Enterprises (TBSE)**, an institution created by Small Industries Development Bank of India (SIDBI) to facilitate technology transfer to SMEs, set the context for upgradation when he pointed out the level of wastage that needed to be curbed by introducing efficient technology. For example, in the food processing industry value addition is a mere 7% of the need and capacity utilization is appalling at 35-40%. A good 30-40% of production is wasted in processing the food. The only answer to efficiency in this sector, and in the other SME sectors, is technology upgradation with technical assistance. But Mr Prakash spoke of second grade technologies being dumped in developing countries and urged caution while adopting new technology. He also candidly admitted that while there were various institutions in place from where technology or

² This was narrated to CSM in a pre-Consultation meeting by Mr Mani Shankar Almal, President of the Indian Footwear Components Manufacturers Association (IFCOMA).

technical assistance was available, government agencies rarely provided complete one-stop technology solutions. CSM's learning was that while technology was essential, it may often be costly – if cost effectiveness was not possible, entrepreneurs, no matter how convinced about the efficacy of technology, would continue to face obsolescence and poor markets. Also, practically accessible finance was often the greatest stumbling block.

Finance: Speaking on the perspective of the banking community regarding financing the SME sector, **United Bank of India Executive Director Ms Sunanda Lahiri** said there is growing realization among banks that the SME sector represents an important lending base where the banks can both earn profits as well as distribute their risks better, but there are practical barriers to lending. The health of SME units is affected by the practice of delayed payment by larger corporates which is still rampant in this sector and this in turn dents their borrowing prospects. Ms Lahiri suggested more lobbying by SSI organizations to have in place laws that can penalize larger corporates for delayed payments of dues to SMEs.

United Bank of India's views made it clear that while keeping pace with regulatory requirements, banks would continue to ensure the security and recoverability of their lending and lend depending on transaction cost, efficiency of recovery and available security. Ms Lahiri spoke of SMERA, a rating agency set up by SIDBI in association with CIBIL, D&B and a number of banks so that they were able to decide on the cost of credit. The cost of credit would be linked to the credit rating of the loanee enterprise. SIDBI has also evolved a Credit Appraisal and Rating Tool (CART) and Risk Assessment Model (RAM) for SMEs, which banks may utilize to reduce transaction cost. Speaking from a rating agency point of view, **Mr Devashis Sengupta, Manager, Information and Rating Services, ICRA** said his organization faced a stiff challenge in being able to access credible and reliable information about SME units. Judging from such experience, it appears that availability of useful information would likely be a challenge for any rating agency, including SMERA, and assessing the true cost of lending would continue to be a problem. This in turn would have an effect on the availability of credit.

On their part, SMEs repeatedly emphasized that no technological upgradation or innovation was possible if the bankers continued to insist on high collateral for any loans to be extended to them. One of their chief grievances was that while under the Credit Guarantee Fund Trust for Small Industries (CGTSI) they were entitled to avail of loans of up to Rs 25 lakh without having to provide collateral security, in practice, the consortium of banks who are members of the CGTSI are never willing to lend free of collateral.

SECTORAL FEEDBACK

SME voices were heard most elaborately at the break-out sessions. Their comments elucidated the state of the sector, the finance bottlenecks they faced, the hindrances to innovation and the problems in market development. By sector, here are the comments, as reported by the session chairs:

Leather sector: The leather unit owners observed that out of the total exports last year, eastern India's share stood at 60%. But to improve this performance further, they unanimously felt that infrastructure had to be improved and service level support stepped up from the Small Industries Services Institute (SISI) in the eastern region and institutional intervention was very poor. The target for this sector was to achieve \$6 billion worth of exports by 2009 and for this a more enabling environment was needed to facilitate domestic expansion and market development. Also, more competitive packages were needed from banks and financial institutions to serve as growth drivers. This session was chaired by **Mr Anup Chatterjee, Chairman (Eastern Region), Council for Leather Exports**.

Garments sector: This sector has huge employability potential, with 10 lakh units existing in South Bengal alone and employing people mainly from the economical poorer strata of society. This sector is also one of the most financially exploited, with middlemen forcing owners from micro units to sell off their readymade garments at abysmally low profit (sometimes even Re 1 per garment) at the *haats* (once or twice a week fairs) that serve as huge commercial points. One key trouble that plagues these people is their lack of education and training, which act as barriers to both negotiation with banks for loans as well as their ability to judge and employ the right kind of skilled labour (e.g casing assistant, pattern master etc). This sector is

characterized by fragmentation and lack of organization. The unit owners in this sector feel that to spur innovation and high quality standards, a training institute is the most important need of the day. While there has been an ongoing government effort in this direction, no practical achievement has been seen so far, the unit owners said. This session was chaired by **Mr Gopal Chandra Dey, Deputy Manager SME I, State Bank of India.**

Foundry, engineering and allied sectors: In this segment, there was a definite note of optimism that after a long spell of recession, there were now chances of a boom. But good quality human resource was a daunting factor, as engineering graduates, who would normally form the bulk of the recruits in this sector, show little interest in being employed in SME units, as they get better salaries elsewhere. There was a strong demand for government intervention in regulating raw material prices in the foundry sector, which was characterized by price manipulations in the open market. As in other sectors finance was a key problem and institutional and procedural bottlenecks often stood in the way of facilitating smooth finance flow. Entrepreneurs also felt that while innovation is extremely important, the right kind of technical assistance was needed simultaneously. One company, Nanda Miller narrated how it wasted money on buying unsuitable machines for its purpose and then had to buy again. Predictably, this segment felt the need for cluster development, having already had the experience of working in clusters in some pockets.

In terms of e-enablement, it was not always true that IT-enabled SMEs sold their products better. On the other hand, unit owners felt that if there were consortiums for marketing and exporting, the results would be better. This session was chaired by **Dr Dipankar Ghosh, Consultant, Metal Engineering & Testing & Research Centre, Howrah (METARCH).**

Paints and pigments sector: While SMEs in this sector were acutely aware about the value of branded paints and therefore the need for SSIs to be more organized and to innovate more, demand had to be created especially targeting the white goods industry, automobile and cycle paints, marine paints and road-marking paints, where the SSI sector has no presence so far. There was a suggestion to develop ancillarisation to large consumer houses through government agencies. The problem with technologies in these areas is their availability – those technologies that are available may not be that reliable. Better advertisements which would be a marketing advantage, was usually not possible by SSIs because of the steep costs involved. This session was chaired by **Dr P K Chowdhuri of the Regional Testing Centre, Kolkata.**

Food processing sector: Financial problems seemed to be rather peculiar in this sector because the government has accorded priority support for this sector but that has not ensured smooth financial going for the units. There is a Government stipulation that for units with plant and machinery of up to Rs 2 crores, up to Rs 50 lakh would be made available as government grant before disbursement and after sanction of a loan. The unit owners say that banks can easily draw collateral security from this amount, but in practice this is not happening. Once the entrepreneur has to fall back upon his/ her own resources, informal channels of finance are perforce resorted to. While units are aware of the necessity of innovation, the right kind of technology or even the right kind of guidance to adopt it, are unavailable. Besides, testing facilities are also inadequate, hampering productivity on this sector. To keep pace with demand, continuous training should be given to entrepreneurs. Apparently, such training programmes for SMEs are either subsidized or made available free of cost in western India. But in eastern India, no such practice exists. This session was chaired by **Mr A K Pattanaik, Assistant General Manager, SME I, State Bank of India, Kolkata main branch.**

WAY FORWARD

This consultation made it clear that in any future advocacy efforts, language would be a primary barrier. To prevail upon SMEs to adopt CSR practices, they have to be spoken to in a language that they understand – both literally and figuratively. To factor this in and customize key CSR messages to SME needs, would require time as well as persistent effort.

CSM intends to use its report to serve as an advocacy tool in upholding policy direction needed for betterment of SMEs both on a regional and national scale. Taking off from this point, the learnings from the

Consultation will feed into inquiries about the practical space available to encourage CSR practices, by sector. A policy brief on CSR dimensions to be introduced into the SMED Bill will be attempted in the near future.

ABOUT THE WEST BENGAL FORUM

The **West Bengal Forum on Business Partnerships for Sustainable Development** was initiated by the Centre for Social Markets in 2002. The Forum emerged from a Roundtable organized by CSM in April 2002 to promote networking and co-ordination among business, government agencies, civil society groups in West Bengal on issues related to corporate social responsibility and sustainable development.

The West Bengal Forum's three-fold goals are to:

- Raise awareness of current initiatives regarding business and sustainable development;
- Promote information exchange, networking and mutual learning for greater impact;
- Provide a lasting forum for co-ordination, partnership development and promotion of best practice in West Bengal.

The Forum's members comprise a select group of West Bengal-based businesses, civil society organizations, government and multilateral agencies active on all three dimensions of sustainable development: economic development, environmental stewardship and social justice.

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