BRIEFING NOTE

SMEs and Technology: Addressing the Barriers to Technical Assistance and Finance

INTRODUCTION

The small-scale sector occupies a position of importance in any developing economy. In India too, the sector receives considerable attention due to its contribution to the country's overall economic growth. Today, with the global economic scenario undergoing rapid and significant changes and India integrating closer to the global mainstream, opportunities as well as challenges have emerged for the small-scale industries. While on the one hand, there is scope for small units to step up productivity and look for new markets in other countries, on the other, there is also an obligation on them to improve in terms of technological competence, management ability and financial strength. Innovative technology and the access to technical assistance and finance are two of the pillars on which such improvement can materialise.

At the policy level, this sector has currently 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 last month (August 2005), the government announced a package for doubling credit flow to small and medium enterprises (SMEs) over the next five years. Simultaneously, Indian Banks' Association (IBA) Chief Executive H N Sinor 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 for greater expansion of this sector. And yet, for these policy measures 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 present Consultation is a step in that direction.

There are a slew of causes that plague the small-scale industry[1], some of which will be addressed by the present CSM[2] consultation. This short briefing note by CSM, by no means exhaustive, dwells on the present health of the small business sector and posits a few pertinent questions on how, in the light of the recent broadening of policy focus by the Government of India, practical steps can be taken for improvement of this sector. It highlights how such steps are vitally connected to the sustainability of a sector that is after all, the second largest employer in West Bengal next only to agriculture.

DEFINING SSIs AND SMEs

Earlier, the Government focused on small-scale enterprises and provided certain incentives to organisations that qualified as SSI (small scale industry) units. Subsequently, however, there was a

[1] Earlier, reference used to be made to the Small Scale Industry (SSI) sector and the meaning was roughly equivalent to small business. However, after the introduction of the Small and Medium Enterprises Development (SMED) Bill in Parliament, the usage can appropriately be modified to Small and Medium Enterprises (SME) sector. In this working paper, the terms SME and SSI have been used interchangeably, to mean the same category of business units.

[2] CSM, a Kolkata and UK-based non-profit working on domestic private sector participation in sustainable development in the country, has chosen to focus on SMEs at a state-wide level as a key contributor to employment generation and wealth creation. CSM's pioneering **SME Initiative**, under the aegis of the **West Bengal Forum on Business Partnerships for Sustainable Development**, aims to promote better awareness within the sector and address the sustainability challenges facing it.

change of definition and in the recently introduced Small and Medium Enterprises (SME) Development Bill 2005 the Government has put forward a new category called small and medium enterprises.

The new Bill divides enterprises into two categories: "**manufacturing**" and "**services**". The definitions of SMEs are:

(a) in the case of the enterprises engaged in the **manufacture** or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 as -
(i) a small enterprise, where the investment in plant and machinery does not exceed five crore rupees; or
(ii) a medium enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees;

(b) in the case of the enterprises engaged in providing or rendering of **services** in relation to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, as:
(i) a small enterprise, where the investment in equipment does not exceed two crore rupees; or
(ii) a medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

Investment in land and building or equipment will not be taken into account while determining the investment in plant and machinery.

This broadening of policy focus will certainly help new units in fast expanding sunrise sectors like pharma, biotechnology and information technology. However, whether it will ease the conditions of doing business for units in already functional sectors like leather, food processing etc and help strengthen the field for small business, needs further debate in the light of the current environment.

SSI SECTOR: A FEW GENERAL FACTS

In terms of production and employment, the SSI sector has grown in spite of stiff competition from the large sector. The number of SSI units went up from 9.72 million in 1999-2000 to 11.40 million in 2003-04. The SSI sector contributed about 34% of the country's export during 1999-2003. It created additional employment of more than a million persons every year during the same period. Side by side, of course, this sector is beset with sickness, as will soon be found out below.

In West Bengal, there are 3,36,253 units (up to March 31, 2004) employing 21,80,642 people. Undoubtedly, this sector has a crucial role to play in increasing the prosperity of the state and its employability scenario. Sector-wise, the highest number of permanently registered SSI units under any single sector is food products, beverage, tobacco etc. (10372 units), with the second highest being the textile, apparels and hosiery sector (5931 units).

TECHNOLOGY & TECHNICAL ASSISTANCE

The key to better growth, better health and greater employability of the SSI sector in West Bengal lies in its ability to survive competition and making inroads into newer markets. This is possible through a combination of factors – ability to innovate for an identified market, constant availability of up to date market information and execution of technology upgradation through appropriate technical assistance.

In West Bengal, banking sources have observed two extant technology-related problems as (a) dearth of proposals under Credit Linked Capital Subsidy Scheme (CLCS) for technological upgradation, and (b) lack of proper entrepreneurship development for adopting state of the art technology. Also, the use of technology is largely dictated by whether the unit is in the manufacturing or the services sector.

Balancing this point of view is the contention by some sectors that technology support is not available for the asking. For example, veteran owners of foundry units, rolling mills and forging units say that they keenly feel the need for a foundry and forging college or training centre in West Bengal, on the lines of the one existing in Ranchi. But such a plea has so far fallen on deaf ears.

Likewise, in the area of technical assistance the entrepreneurs from the food processing sector are faced with the issue of obtaining packaging clearances from the Legal Metrology Department. Unit owners say they have no official knowledge of the new packaging requirements their products have to fulfil, but their products are being lifted from the market and they are being penalised for a situation that they are helpless about.

The CSM Consultation wishes to bring to the fore all issues related to the technological upgradation and adaptation with reference to the five focus sectors: **leather, footwear and allied sectors; garments; foundry, engineering and allied sectors; paints and pigments; food processing and allied sectors**. The focus is to facilitate free exchange of information regarding specific experiences of small unit owners with technology issues and examine how relevant it is for SMEs in West Bengal to adopt improved technology as a means for survival. It seeks to find out the practical possibilities of balancing the contrasting views of the units, the financiers and the government, so that clearer sector specific approaches to technology and technical assistance can be developed.

Of late, there has been a fresh initiative to finance technical assistance. The **Small and Medium Enterprise Financing and Development Project**, supported by a $120 million World Bank loan to Small Industries Development Bank of India (SIDBI) has one component in which the technical assistance required for policy and institutional development to speed up the efficiency of the SME credit market that will be financed through proposed grants from the Department for International Development (DFID), and cost sharing by local counter-parties. This consultation will explore the broad question of how such technical assistance can practically benefit small and medium enterprises.

MARKET DEVELOPMENT

Market development is the decisive factor for the very existence of the small business sector. As opposed to the protection afforded earlier, now, on a regular basis, items are de-reserved from the SSI list (this year, the Union Finance Minister in his 2005-06 Budget speech announced a list of 108 items for de-reservation). Whether it is in the upcoming sunrise sectors or the traditional sectors of doing business (both kinds are covered in this Consultation), small and medium units have to face a variety of challenges: from larger enterprises/ MNCs, dying out of bigger units which jeopardises the smaller ancillary units, continued downturn in mother industries like the steel industry, poor government support in market assistance and so on. These factors complement the overarching difficulty of obtaining relevant market information from the right places.

As a result, the SME sector often functions with inadequate knowledge of both the domestic and international market. A poor demand position can affect the ability to generate finance and quickly lead to sickness. A close look at the Third SSI Census (2001-02) figures (total number of units in the

SSI sector - 1,05,21,190, registered units 13,74,974 and unregistered units 91,46,216) will bear out that a lack of demand is one of the chief reasons for incipient sickness in the sector:

Various Reasons for Sickness/ Incipient Sickness

Reasons for sickness/ incipient sickness		Proportion of sick/ incipient sick units		
		Total SSI Sector	Regd SSI Sector	Unregd SSI sector
1	Lack of demand	66%	58%	69%
2	Shortage of working capital	46%	57%	43%
3	Non-availability of raw material	12%	12%	12%
4	Power shortage	13%	17%	12%
5	Labour problems	5%	6%	4%
6	Marketing problems	36%	37%	36%
7	Equipment problems	11%	9%	12%
8	Management problems	4%	5%	3%

Source: Ministry of SSI Annual Report 2004-05

Banks have tried to address this problem by providing subsidies for marketing initiatives – SIDBI, for example subsidises participation of SSI units in select trade fairs/ exhibitions at national and international levels. Two of the fairs in which SIDBI subsidised SSI participation are Pune Expo 2004 and INDSUM Fair and Technology Summit-cum-Symposium, Kolkata. Such opportunities do address the lack of market development support to some extent but there is evidently a long way to go.

In extensive pre-Consultation meetings, SME unit owners have expressed helplessness in obtaining adequate up-to-date information on international and to a certain extent also the domestic market, and have clearly indicated that assistance is necessary in this field. This is a sustainability issue in that the young entrepreneurs with small or even tiny scales of operations who represent the growing informal sector, and need to be groomed and take over from the veterans, are finding themselves increasingly marginalised in a very tough competitive environment.

Government support is a dire necessity in this area, especially for fledgling enterprises. Policy decisions taken in this regard need to be followed up with practical steps. For example, the Union Budget 2005-06 has emphasised on the creation of food parks, which will happen in three districts in Bengal viz Malda, Hooghly and Murshidabad. The Government of India will exclusively invest in this venture. Prior experience of unit owners in the Kolkata zone suggests that food parks erected by the government have limited accessibility for those who need it most i.e the units with the least access to organised market information.

The CSM Consultation seeks to address the issues related to domestic and overseas market development in West Bengal, the possible fresh policy level and practical support available from the government, whether and enhanced role by banks is necessary for market development support and should that be mandated by law, what do the small scale entrepreneurs themselves need to do in order to contribute to market development and how this is connected to the overall sustainability of SMEs in this state.

FINANCE: THE KEY

From a banker's point of view, the SSI sector presents both an opportunity and a difficulty. Lending to SMEs means distributing risks. But at the same time, distributing risks over many units does not mean that a good recovery level will be guaranteed from small units. According to the Union Ministry of SSI, the lending profile of public sector banks to the SSIs (since 2000) has been:

Lending Profile of Public Sector banks (all-India)

(Amount Rs crore)

	As at the end of March				
	2000	2001	2002	2003	2004 (P)
Net bank credit	2,92,943	3,40,888	3,96,954	4,77,899	5,58,608
Credit to SSI	45,788	48,445	49,743	52,988	58,277
No of SSI Accounts (in lakh)	22.72	22.80	22.23	16.95	16.33
SSI Credit as % of Net Bank Credit	15.6	14.2	12.5	11.1	10.1

(P): *Provisional*

Source: Ministry of SSI Annual Report 2004-05

While credit to SSIs has increased over the years, the number of SSI accounts have gone down from 22.72 lakh in 2000 to 16.33 lakh in 2004. There is also a clear declining trend in SSI credit as a percentage of net bank credit, having gone down from 15.6% in 2000 to 10.1% in 2004, an average of slightly over 1% a year. Clearly, while the intention of better-targeted finance remains, the figures suggest that banks do not lend keeping in pace with their deposit flow.

On its part, the Government has facilitated up to Rs 25 lakh of collateral free lending, increase in loan limit to SSIs and a number of other pro-SSI decisions, but there is evidently a gap between policy support and implementation. For example, recently, at an interactive session with West Bengal Governor Hon'ble Gopalkrishna Gandhi on the SMED Bill a Council member of the Federation of Small and Medium Industry (FOSMI) pointed out that though on-paper access to collateral-free loans by SMEs was facilitated through the CGTSI by SIDBI, actual lending lay with the banks, who were reluctant to assist the fledgling tiny/ small entrepreneur. The repercussion was that while on the one hand the Government was encouraging self-employment, the actual field for small/ tiny entrepreneurs was constricted by lack of opportunity.

Non-availability of institutional finance can force even veterans in business to take personal loans from the informal sector i.e through moneylenders at high rates of interest. This in turn acts as a barrier to obtain assistance from the institutional avenues of finance. Unless the barriers to smooth flow of credit are addressed, the conflict between formal and informal lending channels will not just stay, but get aggravated.

This swathe of issues raises important questions about not just the practical barriers faced by SME entrepreneurs in accessing finance, but also by the banks in the actual lending process. The Consultation aims to find out the finance constraints both of the SME sector and the banks, the overall scenario of recovery of SME loans in the five participating sectors (leather, footwear and allied sectors; garments; foundry, engineering and allied sectors; paints and pigments; food processing and allied sectors), the health of these five sectors in general and also explore the practical financial flexibilities possible within the current framework to promote SME growth in West Bengal.

SSI LENDING BY PUBLIC SECTOR BANKS IN WEST BENGAL

The overall lending profile by banks in West Bengal under the Annual Credit Plan for the last five years (in Rs crore) is as follows:

Year	Plan (SSI)	Disbursement (SSI)	% of achievement of SSI out of Plan
2000-01	394	255	65
2001-02	422	323	77
2002-03	505	365	72
2003-04	1011	538	54
2004-05	1097	683	62
2005-06	2008		

Source: United Bank of India

A district-wise break-up of lending in four key districts for the past five years is as follows:

District-wise disbursement of Credit vis-a-vis targets under the Annual Credit Plan

(Amount in Rs lakh)

Financial Year	District	Lead Bank	Target	Achievement	% of achievement of SSI out of Plan
1999-2000	Hooghly	UCO Bank	2460.95	699.20	28.41
	Howrah	UCO Bank	4787.15	4100.90	85.66
	24 Prgs (N)	Allahabad Bank	3247.62	2909.92	89.60
	24 Prgs (S)	United Bank of India	2173.31	1493.18	68.71
2000-01	Hooghly	UCO Bank	2559.47	733.08	29
	Howrah	UCO Bank	5625.54	4623.52	82
	24 Prgs (N)	Allahabad Bank	3029.32	1895.74	62
	24 Prgs (S)	United Bank of India	2427.47	1517.29	62
2001-02	Hooghly	UCO Bank	2306.33	1061.83	46
	Howrah	UCO Bank	6066.66	7326.90	121
	24 Prgs (N)	Allahabad Bank	3227.00	2579.00	80
	24 Prgs (S)	United Bank of India	2604.92	1904.12	73
2002-03	Hooghly	UCO Bank	2743.20	2010.50	73
	Howrah	UCO Bank	6689.58	4924.92	74
	24 Prgs (N)	Allahabad Bank	3960.17	1965.00	50
	24 Prgs (S)	United Bank of India	3027.04	2685.00	89

2003-04	Hooghly	UCO Bank	5486.00	2923.87	53
	Howrah	UCO Bank	14049.00	9178.59	65
	24 Prgs (N)	Allahabad Bank	8098.00	7565.00	93
	24 Prgs (S)	United Bank of India	6054.00	3376.00	56
2004-05	Hooghly	UCO Bank	5839.25	4708.33	81
	Howrah	UCO Bank	18200.00	12437.15	68
	24 Prgs (N)	Allahabad Bank	9119.00	7511.00	82
	24 Prgs (S)	United Bank of India	6755.00	4562.00	68
2005-06*	Hooghly	UCO Bank	10650.00	970.12	9
	Howrah	UCO Bank	33180.00	2673.14	8
	24 Prgs (N)	Allahabad Bank	16600.00	1566.00	9
	24 Prgs (S)	United Bank of India	12300.00	1155.00	9

**provisional estimates for April to June 2005*

Source: State Level Bankers Committee

Bank-wise targets & achievements in SSI in 2005-06 in West Bengal up to June 30, 2005 (provisional)

(Amount in Rs crore)

Sl No	Name of Bank	SSI	
		Target	Achievement
1	Allahabad Bank	152.15	9.66
2	Andhra Bank	7.27	0.76
3	Bank of Baroda	38.60	0.62
4	Bank of India	64.87	6.21
5	Bank of Madura	0	
6	Canara Bank	23.48	2.87
7	Central Bank of India	56.74	2.91
8	Corporation Bank	2.65	
9	Dena Bank	9.60	0.34
10	Indian Bank	16.44	0.18
11	Indian Overseas Bank	26.66	0.40
12	Oriental Bank of Commerce	34.25	3.41
13	Punjab National bank	98.25	11.18
14	Punjab & Sindh Bank	7.18	
15	Syndicate Bank	23.49	2.71
16	State Bank of India	322.94 (highest yearly target)	26.87
17	UB	20.27	0.81
18	United Bank of India	284.21	36.14
19	UCO Bank	100.40	21.08

20	Vysya Bank	6.09	0.01
21	SBI Associates	4.08	
22	Other banks	23.94**	3.93

*** Target for SSI*

Source: State Level Bankers Committee

A look at the overall lending profile shows that after a dip in financial year 2003-04, lending by the state's banks is on the rise again. However, as we examine the priority issues and the statistics that need to inform the lending decisions, the picture becomes really complex. Clearly, promoting of finance as an enabler for development of entrepreneurship, technological prowess and product superiority of the SME sector will be predicated on certain conducive conditions as well as more flexibility on part of both financiers and SMEs. This consultation seeks to find out some of those conditions, and how they can be brought about.

Needless to say, there is no one overarching panacea to the problems that overwhelm this sector. Neither does this consultation aim to find all the answers, but it at least wants to let the ball rolling on a how to address the barriers.

With an initiating process in mind, the consultation would like to promote debate by asking three key questions:

1) Are innovative products the key to being successful in a highly competitive market, and is technology important for that?

2) What can bankers and government do to practically improve SME access to finance?

3) Is there a need to rectify at least two or three priority areas for better market development?

These questions have to be debated at the break-out sessions where SME representatives from the five target sectors (leather, footwear and allied sectors; garments; foundry, engineering and allied sectors; paints and pigments; food processing and allied sectors) and all other segments – banks, technical experts, government representatives and industry body representatives – have a chance to clearly air their views. These will then be made out into a practical report, to be further taken up for advocacy and dissemination. Such dissemination will reach national and international partners, senior government functionaries at the national and state level, policymakers, bankers and financial institutions, donors and multilateral institutions as well as civil society organisations.

ABOUT THE WEST BENGAL FORUM

The **West Bengal Forum on Business Partnerships for Sustainable Development** was formed in 2002 by the Centre for Social Markets, a U.K and Kolkata-based non-profit organization committed to promoting responsible entrepreneurship 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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