Speech - Export Promotion Strategies - A New Agenda for SMEs

Inaugural Address: Conference on “Streamlining Export & Trade Finance for SMEs”

December 12, 2012

Good Morning Ladies and Gentlemen...

At the outset I congratulate SME Chamber of India for organising this conference. We all know that along with the 8% GDP growth story that we have had narrated for long time, the sub-tale was our booming exports which have grown to cross the $ 300 bn mark last year. Looking ahead, this number will be critical for the economy given the pressure on maintaining the current account deficit at a manageable level of less than 3% of GDP. Given the strong link between exports and the SME segment, it is only befitting that we keep discussing how to strengthen this bond relentlessly so that we move ahead in the right direction. It is a pleasure to be addressing this audience on Export Promotion Strategies and Trade Finance for this very important sector of Small and Medium Enterprises (SMEs).

Just to emphasize the importance of the SME sector, let’s quickly run through a few statistics – the sector accounts for about 45% of the country’s manufacturing output, contributes around 40% of the total export of the country and employs around 59.7 million persons across 26.1 million enterprises (second largest employer after agriculture in the country). SMEs have grown to become powerhouses for overall economic growth – be it in terms of industrial production, employment and income generation and/or in the capacity of earners of foreign exchange through exports; also lending resilience to the macroeconomic fundamentals of the Indian economy.

While SMEs might, in size, be small production units using labour-intensive techniques of output generation, they form an important integration link between large corporate entities and the bottom of the pyramid; providing for immense forward and backward linkages in close association with large mainstream production units. We are hence, looking at increased demand leading to increased productive activities, enhanced business prospects, new employment opportunities, financial inclusion, expansion of retail reach and increased export orientation.

Output & Exports: Trends in SME Performance

As this conference is all about enhancing the contribution of the SME/MSME sector in the external sector of the Indian economy through exports, I would like to highlight some trends here –

- The share of gross output from MSME sector in aggregate GDP for the country has encouragingly been in double digits in the past decade, around 14%-15% in the last 4 years, coupled with a sustained contribution to total exports.
- A segmentation of the MSME sector based on activities suggests that 67% of MSME units are engaged in manufacturing activities, 17% in services and 16% in repair and maintenance. Intuitively, we can see the role that can be played by this segment in enhancing growth.
- In terms of products - food and beverages is the largest contributor to gross output (accounting for 14.3% share), followed by wearing apparel (13.7%), fabricated metal products (9.0%), repair & maintenance of personal & household goods & retail trade (8.5%), textiles (6.8%), furniture (6.4%) and machinery and equipment (4.7%), to name just a few.
- Exports from this sector have traditionally been dominated by products such as sports goods, readymade garments, woollen garments and knitwear, plastic products, processed food and leather products and also gems and jewellery. These lucrative export products of the SME sector have largely been responsible for fuelling growth here.

I would like to applaud the progress in this sector here - in terms of product lines, the Indian SME sector has to a great extent achieved considerable diversification, ranging from traditional goods to technologically advanced products. One of the major challenges for emerging market economies is the transition in production from primary products to higher value-added goods in order to boost export competeiveness of SMEs and we have precisely tackled this first obstacle in India.

However, we cannot ignore the fact that there have been fluctuations and indeed a mild decline in the contribution of MSMEs to overall GDP and exports in the last four years indicating that this sector needs a strong boost. Also, it is pertinent to state here that, while the contribution of MSME units in total exports is quite significant at around 40%, just about half of all MSME units are engaged in export of products. Making a greater number of MSME units competitive to participate in the external market hence is the need of the hour.

In this context, it is important to set the discussion on issues and concerns that hamper export competitiveness of SMEs to find likely solutions for the same. I shall move to discuss the challenges in the SME sector now -

Issues and Concerns

Broadly speaking, structural challenges in this sector are the main hindrance and are needed to be addressed on an urgent basis with a motive of propelling growth in this space. Here, I am identifying four major roadblocks in the growth and export promotion trajectory of Indian SMEs –

1. **Access to finance**
2. **Openness to external sector –**
3. **Availability of infrastructure, technology and skilled manpower**
4. **Management issues and SME sickness**

I shall quickly expand on each of these.

1. **Access to finance –**

As we all know, credit to SMEs qualifies as priority sector credit and banks have been advised to achieve 20% y-o-y growth in credit to MSMEs. Yet 93% of units in this sector remain excluded from access to finance or depend on self-finance or the unorganized market, which is not sustainable in the long run. Particularly, demand for trade finance across countries, India being no exception, declined during the crisis period. As the current scenario has been constrained by limited liquidity, global financial instability, weak economic recovery and lower trade flows, trade finance has come to entail higher costs, thereby limiting scope for export promotion.

2. **Openness to external sector –**

Undeniably, it is difficult for the SME sector to stand stiff competition against global players. And here, I would call for some change in government stance - instead of encouraging protection of these units; there is a need to enhance collaboration of SME units with large domestic corporates, multi- and trans-national corporations (MNCs/TNCs); particularly because SMEs allow for localisation of global business with the use of appropriate technology. This would be ideal in the creation of niche products that can easily penetrate global markets. Again the pricing of such niche products would need to be given due consideration, as some SME products could tend to get caught in unprofitable low price bands in domestic and international markets alike. A prime key to export promotion and creation of international market space for indigenous SME products would be pricing of these products in the coming years.

3. **Availability of infrastructure, technology and skilled manpower**

The state of infrastructure, including power, water, roads, etc. is inadequate and unreliable. Technological upgradation, and commensurate technological literacy is the need of the hour to enhance capacity and increase supplies. Furthermore, lack of professionalism, training and labour laws renders limited skill base to this sector. In many ways, the SME sector even today function in a rather informal set-up that needs to be given a clear institutional framework.

4. Management issues and SME sickness

In the face of an industrial slowdown there has been considerable delay in settlement of dues by the large-scale buyers to the MSMEs units adversely affecting their recycling of funds and business operation. In the context of exports and receivables thereof, exchange rate volatility could further significantly impact earnings of SMEs.

Solutions

Having listed the main issues, it is important to look at how we may address them in order to expand the scope of SMEs with an aim to enhance their role in the external sector.

Firstly, in relation to finance – a lot needs to and can be done in this area. Being one of the most important, the list of reforms to augment SME access to finance is long and requires emphasis and elaboration -

1. ***Sources of funding -*** we have to develop new models and probably revive the Business Correspondent (BC) model, expand regional reach of banking and relax KYC norms for SMEs in order to increase their access to bank credit. The sector additionally, requires venture capital for financing start-ups and high-growth-potential for existing units, along with alternative sources of capital like angel funds/risk capital. Removal of regulatory impediments is vital in this regard. The India Opportunities Venture Fund with SIDBI (Rs 5000 cr) is a good step in this direction. The need for equity capital has also been partly addressed with the newly set up BSE and NSE platforms, although SMEs have to be attracted towards it. There is need to enhance the equity base of NSIC from time to time so as to provide a demand-side impetus to MSME units as outlined in the New National Manufacturing Policy (New NMP) released last year. Indeed policy implementation in this regard has been fast-paced and must be applauded.
2. ***Availability of export credit -*** access to not only short-term export credit but also to long-term loans for the expansion of SME export capacity is vital. A variety of credit collateral, export insurance and loan options need to be explored in this domain. The ECGC has been proactive in providing a variety of export insurance policies to the SME sector. Also as suggested by UNCTAD, there must be agreements in place between SMEs and select financial institutions to enable SMEs access to medium and long-term finance at preferential interest rates, along with the creation of some export development and investment funds (EDIF) designed to improve the export competitiveness of SMEs.
3. ***Availability of credit enhancements –*** SMEs within a cluster can form a mutual guarantee scheme such that the units mutually guarantee each other's bank borrowing against a fund

created by regular joint contributions. Also, foreign buyers, TNCs and other business linkage makers should be invited as facilitators or guarantors. Proposals in the 12^{th} Five Year Plan have also revolved around an Umbrella Scheme for SMEs, including recommendations on making Rs 180,000 crore of credit guarantees available to MSEs by the end of the 12^{th} FYP period.

4. ***Technology development funds –*** a common pool of funding technological upgradation is essential. This may be initiated by the government and supported by participating SMEs through yearly contributions to the corpus. Disbursements from the corpus may in some way be linked to SME performance in terms of production efficiency and improvement in output quality. Again here, the New NMP has recommended the establishment of a Technology Acquisition and Development Fund (TADF); an incentive for SMEs to improve the application and use of appropriate technology and engage in research and development (R&D) activities.
5. ***Scope for foreign funding*** - the SME segment by far attracts little foreign investment. It is essential to reverse this trend and boost foreign investments directed towards SMEs, preferably in the form of long-term funds through the FDI route. It may be nascent to introduce FII investments in SMEs, given the volatile nature of such funds and recent introduction of SME exchanges that are yet to take off. However, the government may most definitely promote FDI in SMEs.
6. ***SME finance programmes with multilateral financial institutions –*** the government may play a proactive role in facilitating interest of multi-lateral lenders to SMEs be it at the global, interregional, regional and sub-regional levels through trade agreements. Streamlining export-related documentation, stripping down complex procedures, improving accuracy and accessing finance from multi-lateral financial institutions in adherence to international norms would be crucial here.
7. ***Dissemination of information and creation of credit histories –*** this can help deal with the problem of unwillingness of banks to lend to SMEs. The success of SME ratings is noteworthy in this context. Indeed, this is top priority for us at CARE and with the help of NSIC we do hope to expand this canvas to a broader community year after year.

Secondly, in a bid to increase openness, SMEs can link up with MNCs, TNCs or large domestic exporting firms and thereby integrate into global chains of production and supply through -

1. ***Foreign affiliations*** – there is direct gain in the form of increased output and employment opportunities and indirectly through B2B strategies of exchange of information, technology and expertise, plus we would have positive spill-over effects within SME clusters.

2. ***Contractual agreements and licence concessions*** - inter-firm collaboration, with efficient division of labour and greater specialization can result in economies of scope and scale which may be designed to mitigate financial risks, particularly, currency-related exposures. In this context, an additional step that would be essential is to have a strong legal framework.
3. ***Business development services*** – an external specialised unit may help provide business development services to SMEs after appropriate and in-depth market research to tap existing markets better and identify potential target markets. It must be recognised that market access is highly intelligence driven. This would also help improve the bargaining position of SMEs vis-à-vis large conglomerates in the supply chain and help diminish transaction costs and borrowing costs as well as credit risk,
4. ***Marketing and branding initiatives –*** these may include export advisory programmes, upgradation of trade support services, creation of trade platforms for online export operations and organizing trade exhibitions and conclaves, such as this one for showcasing SME products, allowing for exchange of ideas for product innovations and technological developments and discussion of new business avenue and tie-ups.

Third, the operational set-up for SMEs needs to be strengthened – be it infrastructure, technology or manpower. Labour-intensity in this sector being high, there has been only a commensurate growth in production with increase in fixed investments. We however, are looking at a faster expansion in the sector's output. A major deterrent in this regard is the weak operational set-up of SMEs that limits efficiency. What are the solutions here? -

1. ***Clustering and networking*** – clusters supported by IT and ITES systems have the potential to strengthen productive activities (in quantity and quality) whilst being one of the most cost-effective modes of increasing SME access to external markets and reinforcing their external competitiveness. Networking on the other hand, must be both vertical and horizontal across the spectrum of stakeholders (suppliers to customers) and across geographies. Membership of clusters and networks can enhance the productivity, rate of innovation and competitive performance of units, through collaborations on specialization and subcontracting. A very beneficial result of clustering is the diversification in product lines that can be achieved in lesser time and cost. A variety of complementary products can easily be produced and contracted as inputs to other units within a cluster. Synergies can help develop the right product mix to cater to varied consumer and/or industrial demands.
2. ***Promotion of public-private partnership*** - governments may approach domestic and foreign large corporations to design specialized institutions engaged in the provision of training centres,

technology upgrading hubs, research labs and quality check centres. The private sector needs to be attracted to the SME sector, the development of which may not necessarily be profitable for private players. Viability-gap funding in this context would also be important. The government has planned for an aggregate allocation of more than Rs 49,000 crore towards overall SME sector development in the 12th FYP. Along with the much required financial backing, the government needs to efficiently develop and implement strategies in a time-bound fashion to ensure optimal results. The private sector would here, play a critical role in terms of providing for technical expertise and effective execution.

3. ***SME associations and forums*** - there are few representative SME associations particularly in the area of SME import-export business. SMEs should become more active participants in business associations, chambers of commerce and employers' and labour unions in a bid to attract greater investments and better business opportunities while having a platform to discuss relevant challenges from time to time.
4. ***Awards and recognitions –*** incentivising SMEs to perform better is crucial, not just to serve as a self-check mechanism, but also to initiate a competitive spirit and promote recognition of SMEs in mainstream manufacturing. The National Awards for Quality Products, awarded to outstanding small scale units that have made significant contribution for improving quality of their products, is indeed the right step in this direction. Quality certifications are undoubtedly important for SMEs.

And lastly, management issues may be eliminated though appropriate training to enhance organisational and productive capacities, awareness of intellectual property rights and recourse to corporate governance strategies. The SME sector provides nearly 10 lakh additional jobs each year and going forward is expected to be the main contributor to the targeted job creation of another 100 million jobs by 2022. Given the sheer size of this talent pool, tackling management issues in the SMEs sector becomes a priority in itself.

Conclusion

While all the above suggestions may be called "strategies", they may indeed be termed as 'essentials' to enhance export competitiveness of SMEs.

Just to wrap up, I would say, ***there is need to develop a complete package for capacity building of SMEs – a package encompassing credit, marketing facilities, labour laws, infrastructure, technology, skill development, tax laws, exit policy, and above all, SMEs working as a group through clusters and associations to build a symbiotic relationship with one another to leverage***

opportunities in the external sector. Indian SMEs having achieved considerable diversification in product offerings, a major challenge that remains to be tackled is the access to trade finance and this must be addressed at the earliest.

What we must be looking at is enhancing the SME space across the entirety of its value chain and making it one of the most vibrant contributors to exports and overall growth of the country. With these thoughts, I wish the conference all success, with great prospects and future for the Indian SME sector...