Export promotion strategies - a new agenda for SMEs

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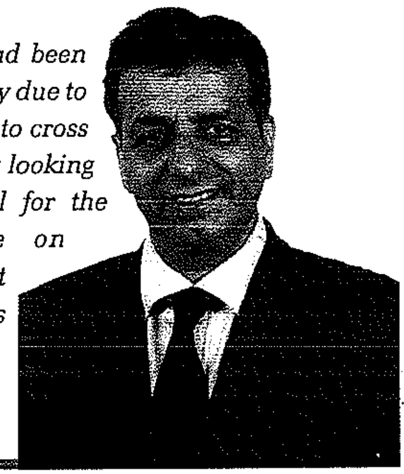
Mr. D R Dogra
MD & CEO, CARE Ratings



Pramod Shinde

The small and medium enterprises today constitute a very important segment of the Indian economy. It accounts for 45% of the country's manufacturing output contributing 40% of the total exports of the country. It also 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 of 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; it is also lending resilience to the macroeconomic fundamentals of the Indian economy.

SMEs sector has performed exceedingly well and enabled India to achieve a wide measure of industrial growth and diversification. By its less capital intensive and high labour absorption nature, SMEs sector has made significant contributions towards employment generation and rural industrialisation. SMEs sector in India creates largest employment opportunities for the Indian populace, next only to agriculture. It has been estimated that 100,000 rupees of investment in fixed assets in the SMEs sector generates employment for four persons.

According Mr.D RDogra, MD & CEO, CARE Ratings speech delivered at Export Promotion Strategies and Trade Finance Conference organised by SME Chamber of India emphasised that India's 8% GDP growth story that had been talked about for long time was largely due to booming exports which have grown to cross the $ 300 billion mark last year. By 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, he said. 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 this very important sector of Small and Medium Enterprises (SMEs).

According to CARE Rating, the share of gross output from MSME sector in aggregate to 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, the role that can be played by this segment is enhancing rapidly.

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 competitiveness of SMEs which is precisely tackled in India. 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.

According to Mr Dogra, the structural challenges in SME sector are the main hindrance and are needed to be addressed on an urgent basis with a motive of propelling growth in this space. CARE rating have enumerated four major roadblocks in the growth and export promotion trajectory of Indian SMEs - :

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.

2. Openness to external sector

Undeniably, it is difficult for the SME sector to stand stiff competition against global players. And here, it is important to 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 transnational 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..

3. Availability of infra, technology

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 to tackle SMEs' challenges

It is important to look at how we may address the above hindrance 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. For sources of funding - we need 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.5,000 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.

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.

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 12th 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 12th FYP period.

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.

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.

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.

What are the solutions here?

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. +bs, 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 here would, play a critical role in terms of providing for technical expertise and effective execution.

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.

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.

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