Article

Challenges and Future Prospects for the Indian MSME Sector: A Literature Review

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Abstract

There are more than 6.33 crore Micro, Small and Medium enterprises spread across the length and breadth of India. More than half of these are based in rural areas and thus help develop the rural economy and generate local employment for workers in the region. These firms also contribute a third to the national gross value added (GVA) and close to a third to India's gross domestic product (GDP) and employ over 11.1 crore workers. MSMEs are also a catalyst in the social welfare of Indian society. A greater share of MSME is led by women (20%) and backward classes (66%) as compared to a fewer woman (17%) and backward groups in senior corporate positions. And a greater share of MSME jobs is held by women (24%) in contrast to the lower national women labour participation rate (20%). Policymakers also understand the importance of MSMEs and have supported these firms in their rapid growth over the last two decades with access to funds, and, technology and managerial expertise. Despite this, Indian MSMEs face a number of challenges related to access to bank credits, lack of strategic management, financial literacy, attracting and retaining talent, etc. This article reviews literature on challenges faced by MSMEs and the future prospects of the sector.

Keywords: *Financial performance evaluation, MSMEs, Nanded, Small-scale industries, Data envelopment analysis (DEA)*

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Introduction

The 73rd National Sample Survey (NSS) [1] estimated that there were more than 6.33 crore non-agriculture micro, small and medium enterprises (MSMEs) engaged in various services and manufacturing industries. Over 99% of these are micro-enterprises [2]. Between 2006-07 and 2015-16, the number of MSMEs grew from 3.62 to 6.33 crores [1] [3]. The last major policy revision set a new set of qualification criteria for registration as a micro, small or medium enterprise [4]. With effect from July 1, 2020, the capital investment cap has been increased. So, more enterprises qualify under the new definitions. It also introduced annual turnover as a second criterion and ruled out the distinction between enterprises.

Table 1 Classification of MSMEs

	Old definition (Inv.)		New definition	
	Mfg.	Services	Inv.	Turnover
Micro	₹25 lakhs	₹10 lakhs	₹1 crore	₹5 crore
Small	₹5 crore	₹2 crore	₹10 crore	₹50 crore
Medium	₹10 crore	₹5 crore	₹50 crore	₹250 crore

*The indicated numbers are the upper limits.

Nagaraj and Vaibhav [5] suggested two major reasons behind the recent change. Since the last update, the increase in caps has been meant to account for inflation. It could also support growing startups to achieve economy of scale before they disqualify for benefits under the MSME schemes. The authors also estimated that an additional 2597 enterprises qualified under the new definition with an average capital of ₹22.6 crores and ₹87 crores of annual turnover.

The MSME sector account for about a third of the national gross value added (GVA) and contributed nearly an equal ratio to the national gross domestic production (GDP). A detailed breakup of their contribution to the national GVA and GDP is illustrated in Table 1. Close to 60% of these enterprises engage in labour-intensive manufacturing activities and employ over 3.60 crore workers in the manufacturing sector alone [2]. Those engaged in electricity, trade and other services employed an additional 7.49 crore workers.

Table 2 Contribution of MSMEs in Indian GVA and GDP at current prices (in ₹ Crore)

Year	Total MSME GVA	Total GVA	Share of MSME in Total GVA (%)	All India GDP	Share of MSME in All India GDP (%)
2014-15	36.58 L	1.15 Cr.	31.80	12467959	29.34
2015-16	40.59 L	1.25 Cr.	32.28	13771874	29.48
2016-17	45.02 L	1.39 Cr.	32.24	15391669	29.25
2017-18	50.86 L	1.55 Cr.	23.79	17098304	29.75
2018-19	57.41 L	1.71 Cr.	33.50	18971237	30.27

Source: CSO, M/o Statistics and Programme Implementation

Women accounted for 24% of these 11+ crore workers: 27% in rural enterprises and 20% in urban enterprises. The average 24% is still greater than the national labour participation of women at only 20.8%. In fact, between 2005 and 2019, the labour participation of women in India has declined from 31.8% to 20.8% [6]. Only 17% of senior corporate roles are held by women in India, whereas women own 20.37% of all MSMEs in the country [7] [2]. Backward classes, including scheduled communities, own more than 66% of all MSMEs [2]. In comparison with large urban-based corporates, MSMEs offer a greater role for women and backward classes, many of whom are also poor and less educated. A majority of these enterprises are based in rural areas and help generate local employment opportunities.

The Ministry of Micro, Small and Medium Enterprises (M/o MSME) overlooks the MSME sector. The ministry is responsible for the regulation of the sector, intelligence, and for the implementation of policies related to MSMEs. The Micro, Small and Medium Enterprises Development Act, 2006 is the principal legislation governing the sector. Prior to the Act, the sector was known as Small-Sector Industries (SSI). The Act created the M/o MSME by combining the ministries of small-scale industries and agro & rural industries. M/o MSME performs its responsibilities with the help of six divisions and several statutory bodies such as the Khadi and Village Industries Commission (KVIC) and the Coir Board.

The sector has changed over the last decade: from a two-fold growth in registered enterprises to the rise of service enterprises. Policymakers have also attempted to keep up to date with these changes and supported the growth of the sector in major ways, yet the sector continues to face challenges from lack of access to bank credits to lengthy paperwork needed to start a business in the country. Lack of expertise and archaic technology also hold these enterprises back from competing with corporates that are increasingly eating into their business. The current article is a review of the latest research into the challenges faced by MSMEs, possible solutions and growth prospects of the Indian MSME sector in the coming years.

Challenges faced by MSMEs

Access to bank credits

Capital is important for the growth and development of MSMEs. Despite various govt. initiatives and clear instructions from the Reserve Bank of India encouraging the flow of credits to smaller enterprises, access to bank credits remains the number 1 challenge to most MSMEs [8]. Despite the fact that India has one of the largest banking networks for a country, the provision of finance to grass root level businesses remains an enormous challenge. A national level research observed that "there are strong structural underpinnings to the inadequate flow of finance: the organisational structure of banks, and processes within them, have taken far from task orientation, and have created a specific partiality against small loan portfolios" [9].

The Indian MSME sector's expansion is being stifled by a lack of access to suitable financing. Banks' information irregularity and efficiency in dealing with MSMEs in the Indian context, whether transaction lending or lending based on a relationship with small businesses is appropriate to deal with the information issues or should lending be based on the relationship with the small businesses. Banks are the primary source of financing for businesses. As a result, they play an important role in financing smaller businesses, which are unable to access financial markets for finance. Low-risk borrowers, such as major corporations with lucrative investments and good collateral, are preferred by banks. Small businesses are high-risk borrowers, which makes it not only difficult for them to get their loan requests approved but even when they are approved, these businesses are offered loans at a higher interest rate. On the contrary, according to a report, MSMEs have had the lowest default rate in business loans [10]. Where the non-performing asset (NPA) for corporates stood at 19.7%, as of January 2020, that for MSMEs was only 12.5%. Despite this, loan requests of MSMEs are looked down upon, and they struggle to get loans at reasonable interest rates.

Since a healthy and thriving MSME sector provides a robust foundation for entrepreneurship and economic growth [11], policymakers and governments have been paying close attention to how to help the sector grow. Because of their smaller size and lack of access to formal forms of external funding like loans, MSME's are less likely to contribute to economic growth. MSME's growth restrictions can be alleviated, and its access to external financing improved through institutional and financial development [12].

For small companies, financing obstacles are more growth-constraining and hinder them from achieving their optimal size. This is especially true for small businesses. In terms of operating capital and investment, small enterprises rely on formal financial sources for a smaller share of their total funding than large firms. MSME's access to funding is limited by the structure of the financial sector, and specific financing instruments and strategies are necessary for small businesses to overcome these limits. Relationship banking has always been regarded as a trait of a financial system that supports small and medium-sized enterprises (SMEs). Financial instruments like factoring and credit scoring have highlighted the advantages of major banks in giving loans to tiny, unknown businesses [13] [14].

The lender's costs, connected with the prospective insolvency of the borrower, increase, thereby resulting in a decrease in lending to small businesses. The financial difficulties of small businesses are exacerbated by this. Purchasing raw materials, training programmes, promotion of current or new products, import and export of items, and other normal tasks might be hampered when a company's finances are precarious. In order to remain competitive, businesses must have the resources to maintain and expand their operations. MSMEs face challenges in acquiring funding for these activities. According to research, government involvement in these activities, such as setting up special funds to assist MSMEs in starting their first firm, is warranted

[15]. A fundamental difficulty in India's financial system is that there is a lack of information about the finances of MSMEs. Consequently, traditional lending institutes like banks are reluctant to lend to small businesses [16].

Strategic financial management

Competitiveness is directly linked to the allocation of funds or resources to specific departments in a systematic budget system or simply earmarking [17]. Organisational strategic planning is a continuous and open process that includes the development and evaluation of strategies, as well as the formulation of goals. According to research, MSMEs' financial performance is linked to strategic planning [18]. Literature indicates that most MSMEs do not engage in strategic financial planning. On the contrary, most literature also supports the view that small businesses should actively plan their finance to effectively compete and survive in the market in the long run [19]. Mazzarol found that most small-scale entrepreneurs were myopic with the survival and competitiveness of their business [20].

Setting long-term organisational goals, developing and implementing methods to attain these goals, and allocating financial resources required to achieve these goals are part of systematic budget planning. The primary goal of a strategic budget system is to help a company acquire a long-term competitive advantage over its rivals. More recently, patented items that use new processes and management technologies that are more innovative and achieve international expansion are found in companies who plan their budgets [21].

As a result, MSMEs are typically hindered by capacity issues that prevent them from effectively utilising the funds they have at their disposal. Remote control, telephone management, or even weekend management are common methods for running many businesses. Financial resources must be used more efficiently under this management approach. Lack of planning and control, lack of finances, no goals, no budgets, and lack of proper management leads to a lack of utilisation of the resources that are available [22]. MSMEs have only a limited understanding of risk, profitability, and feasibility [23].

There are a variety of financial tactics employed to maximise the usage of available funds. The idea of a strategy is that it serves the needs of an organisation and its competitors at the same time. It is described as the company's plans and actions that affect the company's portfolio of activities. It's possible to think of this operationally as the degree of diversification that has been achieved, how that diversification is managed, and how it was obtained [24]. Two aspects of competitive strategy are investing in firm-specific assets and positioning the firm in the marketplace. It was determined that investments are needed in assets like expertise, R&D capabilities, etc. Competitive advancement and the uniqueness of a firm may be enhanced by firm-specific assets that are difficult to use as security for borrowing and cannot be unnecessarily redeployed [25].

Technical competency

Technology is essential to the growth of any organisation because it aids in the formulation of a multi-pronged strategy as well as in maximising commercial opportunities. Business agility and innovation can be fuelled by MSMEs' use of technology [26] [27]. Traditional methods and out modelled technologies are being used by the majority of rural MSMEs today. Unlike in the past, the competition today is fierce, and large enterprises continuously look for a way to enhance their competitive edge.

These are additional challenges to be met in today's globalised world. Businesses not only compete with other businesses in the same area but also with multinational corporates from other countries. China is considered the world's manufacturing backyard, and its companies have undercut the profit of all kinds of businesses in India and elsewhere [28]. An industry's success is directly linked to the efficiency and effectiveness of its manufacturing methods and the technologies they employ, its ability to market its products, and efficiency in terms of cost, time, and logistics. Businesses that have been successful in the past may not continue to be so in the future [29]. As time and the environment change, entrepreneurs will have to constantly alter their businesses to keep up. Entrepreneurs will have to put in the effort, time, and money to be up to date and be aware of the latest developments. The failure to keep up with the rapid changes occurring around them results in industrial losses and illnesses. They are left out. It is traditional wisdom to invest a portion of a company's profits towards future growth in the form of education, research and development (R&D), or tie-ups with educational institutions and research laboratories [30] [31].

The MSME industry in India's expanding global market is hindered by poor technological levels. As a result, the long-term viability of most small and medium-sized enterprises is in jeopardy because of cheap foreign imports and multinational corporations [32]. In summary, studies have shown that technical innovation is critical to the growth of small and medium-sized enterprises' global competitiveness [33] [34].

Procurement of raw material and logistics

Nearly 60% of all MSMEs in India are manufacturing enterprises. For these enterprises, raw materials are the base components, and without these, there is no production and no enterprise [35]. The translation of raw materials into completed commodities is an integral part of any nation's economic growth, and raw resources are an important part of this process. Reality and experience have demonstrated that in order for an economy to grow, the proportion of industrial production in the economic activity must grow exponentially. As a result, the world's most advanced countries are industrialised nations since a major part of their GDP comes from manufacturing and industrial sectors [36] [37].

Agriculture, chemicals, mining, and most recently, petrochemicals are the primary sources of raw materials for industrial production. When it comes to industrial manufacturing, a huge number of companies in less developed countries rely on raw materials from other countries. To put it another way, they import raw materials from other countries in order to continue their industrial output. As a result of this circumstance, developing countries have abundant raw materials to produce their own goods [38].

As a result of limited resources and logistical issues, small businesses are increasingly forced to source raw materials from within their own region. Raw materials are scarce in some locations, or if they are available, they are either of poor quality or extremely expensive. The lack of manufacturing capacity results in higher production costs and decreased profitability for small businesses [32]. A company's market share is directly related to its ability to efficiently manage its raw materials [39] [40]. The paucity of raw material sources is one of the most severe restraints on the production capacity of small and medium-sized enterprises (SMEs). According to a study, MSMEs are often unable to take advantage of economies of scale in procuring materials due to their small size and lack of purchasing power [41]. Because they buy in modest quantities, these companies only buy a small amount of raw materials. Compared to bulk purchases, the price per unit is higher. On the other hand, corporates can even deal with the producer of the raw material directly, as in the case of Pepsi co., which directly deals with farmers for the procurement of potatoes for the production of its Lays chips. This allows corporates to secure an adequate amount of raw materials at a much cheaper cost well ahead of production.

If your manufacturing facility is located in an area with poor transportation infrastructure, the importance of logistics will be even more critical to your success [42]. Transport costs for completed goods and raw materials directly impact the manufacturing facility's profitability. There are few transportation options for a company unit in a poor location, and those available charges a premium for their service. Because there are fewer competitors in transportation, the reliability of these fewer services that are available is also a problem.

Human resources

Employees are the most potent asset of any enterprise in the new skill-based economy, and small firms face difficulty attracting and retaining talents [43]. There are different factors affecting the talent retention rate, some within the scope of the management to correct while others outside their scope. Organisational culture, training of employees, and keeping them motivated are a few things within the management's scope to retain employees. Employees may as well seek better opportunities which big corporates offer and which is outside the management’s realm to retain such talents seeking growth elsewhere.

An important focus of organisational climate literature has been on the impact of interpersonal interactions within the workplace. Employees' feelings, thoughts, beliefs, and responses to the organisation are all tied to the organisation's climate. However, persons in positions of authority inside the organisation may attempt to manipulate this [44]. Shim [45] described the organisational atmosphere as "Employees' mutual knowledge and opinion with others in their workplace". Small businesses have a more informal work environment, but not necessarily more relaxed. As a result, there are fewer written records and instructions. People who aren't familiar with this way of life tend to think that informality equates to careless behaviour. There is a major difference between small and large organisations in the level of managerial participation.

In order to fulfil an organisation's goals, creating an environment where employees are motivated to work with fervour, initiative, and excitement while maintaining a feeling of discipline, responsibility, and loyalty is the primary goal of motivation [46]. Employees are encouraged to grow through the employment of motivational approaches. Reward systems and formal authority are two methods used by some managers to entice their staff. The concept of growth, learning, teamwork, compensation and other advantages are all part of it [47].

Training is one of the most important ways in which technological knowledge and skills are transferred and innovative capabilities are established and improved. However, the majority of MSMEs prefer to do their training in an informal manner. Even though public training institutes play a critical role in providing information and skills to production workers such as technicians, craftsmen, and other middle-level employees, its impact on the innovative capacities of those trained has been minor [48] [49]. Unfortunately, training is the first thing to receive a cut in difficult times.

Future Prospects

Ease of doing business

Incentives, regulatory clearances, and labour regulations at the state and federal levels can all help to make business easier for India's MSME sector, which has the potential to drive the country's economic growth. Streamlining laws and processes, as well as offering clear guidance on future regulatory requirements, could continue to improve the ease of doing business in India. Many small and medium-sized businesses benefit significantly from industrial strategies that target to promote the growth of specific industries and activities. Economic growth is shifted from the service sector to manufacturing in order to gain productivity gains and access to global value chains. Manufacturing is an essential aspect of huge corporations.

Promotion of foreign direct investment (FDI)

India's FDI policy is one of the most liberal in the world, allowing 100% FDI under the automatic route in several industries. It is equally applicable to small and medium-sized enterprises (SMEs). Modern and cutting-edge technology can help boost the productivity and competitiveness of small and medium-sized enterprises (SMEs) by attracting investment and bringing it into the country. It is possible that foreign direct investment (FDI) can bring in multinational corporations that enhance job creation, tax income, and aggregate productivity. In most countries, policies and investment strategies are designed to attract huge multinational corporations. These tactics have the potential to rapidly boost the market share of huge corporations.

Development of MSME clusters

As much as practicable, a cluster is a collection of businesses that operate within the same general geographic area and offer products and services that are similar or identical. For example, autos, food processing, textiles, and pharmaceutical industries should benefit from initiatives that support MSME clusters. The government has embraced the Cluster Development method, aiming to boost MSMEs' productivity and competitiveness while also boosting their collective potential. As a collective, these clusters can benefit from the advantages of scale and scope in order to boost productivity and employment in their respective areas of focus.

Use of technology

Increasingly, technology is being viewed as a business enabler and a critical tool for streamlining and standardising processes. A strong emphasis on implementing new-age technology, developing indigenous technology, and collaborating with global technology partners is anticipated to play a significant role in developing a competitive advantage for MSMEs in the global market. Scaling up and becoming a part of global value chains is critical for MSME, which relies heavily on technology.

Access to capital

The potential of small and medium-sized enterprises (SMEs) to stimulate economic growth and create jobs is hindered by their inability to secure enough financing. IFC's 2018 MSME finance gap report indicates that MSMEs in India need $1.4 trillion in debt and equity financing, which amounts to $1.1 trillion in debt and $283 billion in equity. The government can help small and medium-sized enterprises (SMEs) compete and expand globally with the right policy interventions and support for the MSME sector. A mid-sized company's ability to expand into a large one should not be hindered by a lack of access to institutional financing. A variety of programmes, including the Credit Guarantee Trust Fund for Micro and Small Enterprises (CGTMSE), the Micro and Small Enterprise Cluster Development Programme (MSE-CDP), and the Scheme for Promotion of Rural Industries and Entrepreneurship (ASPIRE), have been designed to help MSMEs get the capital they need.

Conclusion

The MSME sector has changed over the last decade: from a two-fold growth in registered enterprises to the rise of services enterprises. The MSME sector accounts for nearly a third of India's GDP and contributes significantly to the Indian society. The sector is an indispensable part of the Indian society, and policymakers have attempted to support it as such. Yet, MSMEs continue to face challenges from the lack of access to bank credits to lengthy paperwork required to start a business in the country. The globalisation of the world's economies has sparked an unprecedented level of rivalry because of technological advancements. Rivalry from low-cost producers in emerging economies at home and abroad is increasingly significant in today's price-oriented competition [50]. There are numerous impediments to innovation, such as resource constraints, that limit the ability of small and medium-sized enterprises (SMEs) to develop and commercialise new goods, processes, or services [51]. Studies have pointed out several problems common to many MSMEs: financial management, access to credit, lack of skilled talent, procurement of raw materials, and logistics. Lack of expertise and archaic technology also hold these enterprises back from competing with corporates that are increasingly eating their business. Challenges like these affect the growth of an important sector that contributes a third to India's GDP, employs over 11 crore workers, and is a catalyst to the wellbeing of the Indian society.

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