

Status of Micro and Small Enterprises in BRICS Economies

Review and Recommendations
for Advancement

A Study by

COVA

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Abbreviations

Abbreviations

AIIB	: Asian Infrastructure Investment Bank
BEPS	: Base Erosion and Profit Shifting
BNDES	: Banco Nacional de Desenvolvimento Economico e Social
BRICS	: Association of five major emerging national economies: Brazil, Russia, India, China and South Africa.
CGTMSE	: Credit Guarantee Fund Trust for Micro and Small Enterprises
CUFE	: Central University of Finance and Economics
C&I	: Core Capital to Corporates and Industry
DC-MSME	: Development Commissioner - Micro, Small and Medium Enterprises
DDA	: Doha Development Round or Doha Development Agenda
DRI	: Differential Rate of Interest
ECOSOC	: United Nations Economic and Social Council
EDPs	: Entrepreneurship Development Programmes
EPC	: Export Promotion Council
ESDP	: Entrepreneur-cum-Skill Development Programme
ESDPs	: Entrepreneurship Skill Development Programme
EU	: European Union
FAMPYME	: Fondo de Apoyo a la Micro, Pequeña y Mediana Empresa
FFIs	: Formal Financial Institutions
FGD	: Focused Group Discussion
FIEO	: Federation of Indian Export Organisations
FIEG	: Financial Inclusion Expert Group
GoI	: Government of India
GPFI	: Global Partnership for Financial Inclusion
GVC	: Global Value Chains
G8	: Group of Eight (G8) highly industrialized nations—France, Germany, Italy, the United Kingdom, Japan, the United States, Canada, and Russia.
ICT	: Information and Communication Technology
IFC	: International Finance Corporation
IMCs	: Industrial Motivation Campaigns
IMF	: International Monetary Fund (IMF)
IPR	: Intellectual Property Rights
ISED	: Institute of Small Enterprises and Development

KIBO	: Korea Technology Finance Corporation
KVIC	: Khadi and Village Industries Corporation
KYC	: Know Your Costumer
MAI	: Market Access Initiative
MDPs	: Management Development Programmes
MNCs	: Multinational Corporations
MSMEs	: Micro, Small and Medium Enterprises
MUDRA	: Micro Units Development Refinance Agency
NABARD	: National Bank for Agriculture and Rural Development
NBFCs	: Non-Banking Financial Companies
NCEUS	: National Commission for Enterprises in the Un-organised Sector
NDB	: New Development Bank
NMCP	: National Manufacturing Competitiveness Program
NSIC	: National Small Industries Corporation
NSSO	: National Sample Survey Organisation
ODA	: Overseas Development Assistance
OECD	: Organisation on Economic Cooperation and Development
PMJDY	: Prime Minister's Jan DhanYojana
RBI	: Reserve bank of India
SFCs	: State Financial Corporations
SIDBI	: Small Industries Development Bank of India
SME	: Small and medium-sized enterprises
SMERA	: SME Rating Agency of India
VDPs	: Vendor Development Programmes

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Executive Summary

The BRICS Formation comprising of Brazil, Russia, India and China and South Africa has emerged at a time of increasing social unrest in different societies due to economic disparities, development induced displacement and rising unemployment. Consequently, there appears some orientation in BRICS for sustainable development and employment to eradicate poverty unlike most other multilateral formations like G8¹, World Bank and International Monetary Fund (IMF) that focus on mega projects, trade and investment. Indeed it is significant that the 8th BRICS Summit in Goa also deliberated on finalisation of a framework for cooperation for promoting MSME Sector.

Challenge of Unemployment

The prevailing approach of people and governments predominantly focuses on skill trainings with expectation that businesses and corporates will provide employment. This has not happened in the last two decades that have seen jobless growth and the most viable solution now seems through MSMEs and the BRICS formation can help chart a new course to make them the prime drivers to deal with the problem of unemployment.

In India the MSMEs account for 40% employment and in China it is as high as 80%². But in order to make micro, small and medium enterprises the engines for employment generation, three paradigm shifts seem necessary.

The Three Paradigm Shifts Required

1. Towards Entrepreneurial Economy- From Job Seekers to Job Creators:
The First Paradigm Shift would require transforming the mindset of people from being job seekers to becoming job creators through entrepreneurship.
2. The Second Paradigm Shift would consist of transforming financial architecture to make bank lending to the poor and to MSMEs a business opportunity instead of a social liability.
3. Third Paradigm Shift should make people aware of and provide all facilities to enable access of micro and small entrepreneurs to Global Markets.

These Paradigm Shifts can have an impact and deliver only when all these three processes are twined together and institutionalised in a manner to make them part of mass consciousness with easy and universal access.

Twelve Specific Actions Points

Each of these Paradigm Shifts could be achieved through specific actions recommended below.

- I. **Towards Entrepreneurial Economy: From Job Seekers to Job Creators**
 1. *Mass Awareness Campaigns and Counseling Centers for Exposure to Entrepreneurial Opportunities*

¹The Group of 8 nations that consists of the 8 largest industrialized democracies, Canada, France, Germany, Italy, Japan, Russia, the UK and the USA

²Report on "Vision 2020- Implications for MSMEs", *FICCI SMEs Summit 2011*, Grant Thornton International Ltd, New Delhi

There are numerous programs by governments, commercial, private and voluntary organisations to orient people- especially youth- to avenues and opportunities for acquiring skills to secure jobs. But there are very few initiatives from any organisations to introduce people to the possibility of and process for becoming entrepreneurs. Given that most countries are going through jobless growth for nearly two decades, it is now clear that corporates and businesses cannot absorb millions of job seekers increasing by the day. If more of the unemployed could be oriented and facilitated to become self-employed, they can also employ others and become a solution to unemployment instead of remaining a part of the problem.

2. *Inclusion of Courses on Introduction to Entrepreneurship as a Career Prospect* as part of the all school and college syllabi at appropriate levels.
3. *Aptitude Tests to Determine Entrepreneurial Abilities* should be administered to all those joining different skill trainings and professional courses from mobile repairing of 3 months to engineering and medical studies of 4 to 5 years. Those identified as having entrepreneurial abilities could be provided training in basic principle of entrepreneurship and management appropriate to their field concurrently with their skill training programs to enable them to start their own enterprises successfully once they finish their skill training courses.
4. *Online and On Site Trade Wise Entrepreneurship Courses* for select students of skill training programs and for petty businessmen and entrepreneurs already in business could help in sustenance and success of numerous businesses that could otherwise fail due to lack of appropriate management capabilities. International studies show that 50% businesses fail in the first year and 95% by the fifth year³.
5. *Free Business Registration and Accounts and Audit Centers* for MSMEs
In India, for every registered business, there are as many as 127 unregistered businesses⁴. This means they do not have appropriate licenses, accounts and audit records. This proves to be the biggest barriers to them for accessing cheaper credit from banks and formal financial institutions and linking up with marketing platforms at different levels. Facilities for acquiring documents easily and assistance for maintaining accounts could be a great help in transforming most Nano⁵, Micro and Small Enterprises' from being unregistered to becoming registered (unorganized to organised).

³Mathew, P M (2015), Manufacturing in India: New Perspectives and Imperatives, Manufacturing Sector: Growth and Challenges, April, p.p.6-11

⁴India home to second highest number of shadow businesses:
Study http://articles.economictimes.indiatimes.com/2014-05-27/news/50122903_1_entrepreneurs-shadow-league-table

⁵Nano Enterprises: Petty businesses with a total outlay of less than INR 15,000 or \$ 230

II. **New Banking Paradigms to make Lending to the Poor a Business Opportunity**

1. *Addressing People's Phobia of Banks and Banks' Phobia of Poor*

Massive and sustained Campaigns detailing the rules and provisions in place in different countries to enable people to access bank credits can embolden people to demand credit from banks as an entitlement. These Campaigns must also be aimed at bank officials at all levels. Mechanisms must be evolved and implemented to ensure easy and optimal repayments to make bankers breathe easy!

2. *Use of Entrepreneur OD (Over Draft) Cards⁶ and Mobile Bank Deposit Cards⁷* to bring to a bare minimal, the costs of lending and recovery and introduction of constituency appropriate repayment schedules⁸.

3. *New Assessment Parameters for Lending to Nano, MSMEs, and Start Ups:*

Banks started accepting Balance Sheets as adequate parameters for lending to businesses only from the 20th Century from the earlier requirements of property or personal guarantees as collaterals. Now time has come for banks to move to a new level where Community Endorsement should be used as a Balance Sheet and Social Worker as loan facilitator for lending to Nano and Micro enterprises⁹- Micro Finance Institutions (MFIs) and Self Help Groups (SHGs) have already started using these parameters for successful financial transactions with the poor. Similarly, it is time that new parameters for lending to Small Enterprises, Start ups and E-Commerce platforms should be evolved and operationalised.

4. *Orientation of New Development Bank for Socio- Financial Inclusion* through provisions for Priority Sector Lending¹⁰ to Agriculture, MSMEs and Social Entrepreneurs along with environment sustainability as a defining criteria for qualifying for a loan. There should also be a BRICS-AID Fund to be available to Civil Society Organisations for supporting green and

⁶Entrepreneur OD Cards to be automatically issued to all registered Nano and Micro Entrepreneurs from INR 10,000 or \$150 to INR 50,000 or \$750 depending on the credit limit determined by the banks after an initial assessment.

⁷ Mobile Bank Deposit Cards can be designed along the lines of Mobile Recharge Cards and will enable Nano and Micro businesspersons to deposit their daily earnings into bank accounts by using scratch cards that can be made easily and widely available at all times at negligible transaction costs. Entrepreneur OD Cards and Mobile Bank Deposit Cards can bring down cost for accessing credit and repayments / recovery to negligible levels and make lending to the poor profitable for banks.

⁸ While corporates prefer quarterly schedules for repayments and salaried classes want monthly instalments, the Nano and Micro enterprises can be most consistent with daily repayments as their turnover is on a daily basis. Mobile Bank Deposit Cards can facilitate daily repayments at no extra costs and ensure phenomenal repayments.

⁹ This Model is being implemented in Hyderabad India by COVA (Confederation of Voluntary Associations) with an average monthly repayment rate of 99.7%.

¹⁰ Government of India has stipulated that all banks must give 40% of their funds to Agriculture and MSMEs as Priority Sector Lending. Similar stipulation can be considered by NDB to promote Agriculture and MSMEs



sustainable community empowerment programs through National Financial institutions like NABARD in India and BNDES of Brazil.

III. Local Access to Global Markets

1. *Provision of E-Market(Electronic markets) Platforms* for MSMEs and Startups by the Governments for linkages to local and global clientele
2. *Formulation of a Holistic and Operationable BRICS Policy* with Export Facilitation Centers for MSMEs that would help in international operations for these sectors.
3. *Research and development(R&D) Initiatives by the Governments* in areas of technology up gradation, process modernization, market outreach etc on behalf of the MSME Sector to facilitate it to produce products of international quality and reach global markets.

Chapter I:

Looking Through BRICS: Context, Formation, Objectives and Potential

The Global Socio Economic Scenario

BRICS (a formation of **B**razil, **R**ussia, **I**ndia and **C**hina) has emerged at a time of increasing social unrest in different societies and across the globe due to economic disparities, rising unemployment, unsustainable development, displacement and deprivation induced by development, large-scale tax evasion, unfair trade practices and acute income inequities.

Indeed the world never had so much wealth or so many deprived people! The New World Wealth Report released on 5th Sept 2016 shows that the wealth concentration with Millionaires is 62% in Russia, 54% in India, 32% in US, 28% in Australia and the lowest in Japan of only 22%.

Strange but True: India is among the 10 richest countries in the world with a total individual wealth of \$5,600 billion but at the same time there are reported to be 276 million people in India or 23.6% of its population surviving below a mere \$ 1.25 per day on purchasing power parity as per the World Bank report of 2011.

This amply demonstrates that a country is not rich because of its wealth but because it is distributed equally.

Vanishing Jobs

A McKinsey Study shows that automation in the US threatens 73% of jobs in food service and accommodation, 66% in finance and insurance, 53% in retailing and 59% in manufacturing. *Foxconn*, which employs over a million workers in electronics manufacturing, says it plans to automate 70% of its work

The situation is equally scary the world over with BRICS nations being no exception. When Amroha municipality in India advertised job vacancies for 114 posts of “*safaikarmachari*” or sweepers, applications came from 19,000 people including MBAs and engineers.¹¹

NSSO (National Sample Survey Organisation) Report has shown that India has experienced jobless growth during the last two decades (May 2014). According to a Study by Delhi-based civil society group PRAHAR¹² “as many as 550 jobs have disappeared every day in last four years (in India) and if this trend continues, employment would shrink by 7 million by 2050 in the country while population would have grown by 600 million,” The Study adds that India created only 1.35 lakh jobs in 2015 in comparison to 4.19 lakh in 2013 and 9 lakh in 2011. Further, the organised sector contributes less than 1 percentage of employment in India- with just 30 million jobs in the organised sector and nearly 440 million in the unorganised sector.

¹¹Aiyar SA in Swaminomics | Economy, Edit Page, India | TOI September 4, 2016

¹²<http://timesofindia.indiatimes.com/india/7-million-jobs-can-disappear-by-2050-says-a-study/articleshow/54880692.cms>

The world over, formal sector, the fastest growing leg of the economy now provides barely 6% of all jobs.

Formation of BRICS:

By 2011 BRICS emerged as a new multilateral formation with Brazil, Russia, India, China and South Africa as member countries. The territories of these five BRICS member countries are home to 3.073 billion inhabitants (53.4% of the population) and in 2015 BRICS countries accounted for a total nominal GDP of 16.92 trillion, equivalent to 23.1% of world GDP that is about half that of the seven major advanced economies of the world.¹³

As a multilateral grouping, the five BRICS nations seem, on the surface, to have little in common. The five countries represent widely differing political systems: China is a one-party state; Russia's government is highly centralised; Brazil, India, and South Africa are democracies with significant corruption and/or ethnic strife still to be dealt with. They have also reached varying levels of economic development.¹⁴

But one common thing: these five nations will contribute greatly to the world's growing middle class.

Good Beginnings in Business

Since 2001, the BRICS have more than doubled their share of world exports. In that year, the group represented 8.1% of world's total exports; in 2015, they accounted for 19.1% of the total¹⁵.

Between 2006 and 2015, intra-BRICS trade increased 163%, from US \$ 93 to 244 billion¹⁶. In the same period, Brazil's exports to other BRICS countries increased 202%, from US \$ 14.25 to 43.05 billion. Imports have increased by 249%, from US \$ 10.84 to US \$ 37.87 billion. In 2015, Brazil recorded a positive trade balance of US \$ 5.1 billion with the BRICS.¹⁷

Objectives: Political and Diplomatic Clout

BRICS is no longer just a concept for financial markets but is emerging as powerful political-diplomatic entity. The two key objectives for BRICS that seem to be

- (i) Coordination in multilateral fora, with a focus on economic and political governance and
- (ii) Cooperation between member countries

¹³India can't use BRICS to raise stature till interests with China don't converge, September 30th, 2016 by [Geethanjali Nataraj](http://www.brookings.in/india-cant-use-brics-to-raise-stature-till-interests-with-china-dont-converge/), <http://www.brookings.in/india-cant-use-brics-to-raise-stature-till-interests-with-china-dont-converge/>

¹⁴Samir Saran, Ashok Kumar Singh and Vivan Sharan (2013), A Long-term Vision for BRICS, Observer Research Foundation

¹⁵Press release 392, 8th BRICS Summit – Goa, India, October 15-16, 2016, October 11, 2016, <http://www.itamaraty.gov.br/en/press-releases/14921-8th-brics-summit-go-a-india-october-15-16-2016>

¹⁶India can't use BRICS to raise stature till interests with China don't converge, September 30th, 2016 by [Geethanjali Nataraj](http://www.brookings.in/india-cant-use-brics-to-raise-stature-till-interests-with-china-dont-converge/), <http://www.brookings.in/india-cant-use-brics-to-raise-stature-till-interests-with-china-dont-converge/>

¹⁷Press release 392, 8th BRICS Summit – Goa, India, October 15-16, 2016, October 11, 2016, <http://www.itamaraty.gov.br/en/press-releases/14921-8th-brics-summit-go-a-india-october-15-16-2016>

are providing ever increasing political and diplomatic clout to the member nations.

Starting essentially with economic issues of mutual interest, the agenda of BRICS meetings has considerably widened over the years to encompass topical global issues such as international terrorism, climate change, food and energy security, international economic and financial situation, reform of the Bretton Woods Institutions, trade protectionism and the WTO/ Doha Development Round or Doha Development Agenda (DDA) and also MSMEs (Micro, Small and Medium Enterprises) as a topic for consideration for the 8th BRICS Summit in 2016 in GOA, India. Other issues of mutual interest also being covered by the BRICS formation collectively through different mechanisms are Trade, Health, S&T, Education, Agriculture, Communication, Labour, etc.

The 7th BRICS Summit at Ufa, Russia on 8-9 July 2015 was organised under the theme BRICS Partnership: A Powerful Factor for Global Development. This Summit generated some significant results that included Agreement on Cooperation in the Field of Culture, MoU on Creation of the Joint BRICS Website and MoU by BRICS Development Banks (EXIM Bank from India) on Cooperation with the New Development Bank (NDB) were signed at the Summit.

India has taken over the BRICS Chairmanship from Russia on 15 February 2016 and will hold it until 31 December 2016. The theme of India's BRICS Chairmanship in 2016 is "**Building Responsive, Inclusive and Collective Solutions**".

It appears that the advanced western powers are beginning to face a wall politically, economically and diplomatically through increasing consolidation of the BRICS formation.

BRICS: The Potential

Sharing of indigenous and development knowledge and innovation experiences across Key Sectors can be a great asset for the BRICS. This, along with the tremendous potential for resource and technology sharing and mutual research and development efforts, coordination across key sectors—such as information technology (IT), energy generation, and high-end manufacturing—could prove immensely beneficial for accelerating the BRICS development agenda. Moreover, the BRICS nations can also share indigenous practices and experiences to learn and respond to the immense socio-economic challenges from within and outside¹⁸.

¹⁸A Long Term Vision for BRICS- Samir Saran | Ashok Kumar Singh | VivanSharan

Chapter 2

Transforming the Framework of Multilateral Platforms: Attention to Sustainability, Inclusion and MSMEs

Though most multilateral formations including South-South interactions (BRICS is no exception) has been corporate-led with focus on trade and investment in pursuit of profit, but there appears some motivation in BRICS to democratise the interaction and work out ways in which the patterns of trade and investment flows can be altered to facilitate creation of sustainable development and employment to eradicate poverty.

Till recently, institutions like World Bank and IMF had taken only some token steps including publishing some reports and coming up with some frameworks but these did not reflect their seriousness in the directions of financial inclusion, sustainable development and poverty eradication. Among the multilateral bodies, the G20¹⁹ is one of the first to take some concrete steps to address these issues. In 2009, G 20 launched a Financial Inclusion Expert Group (FIEG) and initiated a programme called SMEs Finance Challenges acknowledging the need of 2 billion people and millions of SMEs who do not have access to formal and semi-formal financial services. Two key steps taken for implementation were the establishment of a Global Partnership for Financial Inclusion and a SME Trust Fund to ensure effective implementation of the actions and commitments. In 2010, G-20 created Global Partnership for Financial Inclusion (GPFI) with the aim of promoting the access to finance for individuals and businesses.

Two major developments that have happened post the G-20 initiative of GPFI are; first, the World Bank convened a group of leader's across the world to put forward a vision of financial inclusion and to realize it by 2020. The World Bank also came up with a framework document titled "Financial Inclusion Strategies: Reference Framework". Secondly, the director of IMF, at the inaugural speech of Mexico National Financial Inclusion, stressed the need of financial inclusion in the age of digital technology. Pursuing this vision of financial inclusion, the IMF came up with a report, "Financial Inclusion: Can it Meet Multiple Macro-Economic Goals"²⁰

BRICS, seems to be furthering the concern for social inclusion initiated by G 20 and giving a unique importance to issues of sustainable development and social inclusion including focused consideration of support for MSMEs.

6th BRICS Summit at Fortaleza, Brazil held in 2014 launched a new cycle for the BRICS with focus on social inclusion and sustainable development giving visibility to policies implemented by member countries, and to the contribution of the BRICS' economic growth to poverty reduction. The theme "inclusive growth, sustainable

¹⁹The **G20 (Group of Twenty)** is an international forum for the governments and central bank governors from 20 major economies

²⁰(Sahay et al (2015)

solutions" is not only in line with the member countries' social policies, but also highlights the need to tackle challenges in the social, economic and environmental fields, and creates new opportunities for the BRICS in different areas, including the negotiations on the post-2015 development agenda.

Though government estimates are that more than 40 per cent of the BRICS economies are driven by the MSME sector, Multilaterals don't take MSME and social sector seriously with focus mostly on Infra and corporate sector. The Fortaleza Summit launched a new cycle for the BRICS with focus on social inclusion and sustainable development. Very significantly, it emphasised on the need of greater co-operation in order to strengthen the area of MSMEs acknowledging the fundamental role played by small and medium-sized enterprises in the economies of their countries as major creators of jobs and wealth and pledged to enhance cooperation and recognize the need for strengthening intra-BRICS dialogue with a view to promote international exchange and cooperation and to foster innovation, research and development for promotion of MSMEs.

In October 2015 at the BRICS Summit in Moscow Ms. Sushma Swaraj the Minister of External Affairs of India said that among the various sectors identified for cooperation among BRICS countries would include the Micro Small & Medium Enterprises (MSME) sector which she said generates maximum employment.

As a follow up, India had presented a paper for integrating the MSME enterprises effectively in the regional and global value chains that can form the basis for the BRICS countries to implement new growth strategies for small and medium companies. The paper deals with a range of issues such as trade facilitation, cooperation between small and medium scale industries, industrial development, agriculture, telecommunication, energy security, tourism and science and technology.

In 2016, India which holds the Presidency of the BRICS for the year, has drafted a framework for a joint growth strategy for MSMEs in the region. The framework for cooperation amongst MSMEs, to identify the relative strengths of each country and also possible areas of joint ventures, was finalised at the BRICS ministerial meet in October 2016.

The 6th meeting of the BRICS Trade Ministers held on 13 October, 2016 in New Delhi issued a Communique that, among other trade related matters stated that:

"The Ministers recognised the importance of the Micro, Small and Medium Enterprises (MSME) to the balanced economic development of the BRICS countries. The Ministers acknowledge the role of MSMEs as the engines of export led growth and employment generation given the highest rate of employment per unit of investment in MSMEs; and their crucial role in addressing regional disparity and poverty alleviation. The MSME sector in many of the BRICS economies contribute directly or indirectly to nearly half of their exports, manufacturing output and GDP.

6. The Ministers were cognisant of the impediments faced by MSMEs and the need for cooperation among the BRICS countries to effectively address the barriers to trade and investment amongst the MSMEs.

7. With a view to ensuring greater business engagement amongst MSMEs in the BRICS region, the Ministers emphasised the importance of developing cooperation among MSMEs in the crucial areas of trade and investment. This cooperation can be in the form of exchange of information on the regulatory framework, rules, regulations and good regulatory practices governing MSMEs; interface among the major chambers of commerce and industry of the MSMEs; and participation of MSME stakeholders in BRICS economic events such as trade fairs, conferences, seminars etc.

8. The Ministers welcome continued efforts to foster cooperation and facilitate exchange of experiences between BRICS countries on MSMEs. In this regard, They welcome the “*BRICS Micro Small and Medium Enterprises (MSME) Cooperation Framework*” which encourages MSMEs in BRICS to strengthen mutually beneficial commercial relationship. The Framework sets the agenda of cooperation on SMEs by the BRICS countries. The Ministers look forward to constructive engagement on the elements of the cooperation framework by all BRICS Members in the future.”²¹

More important, the 8th BRICS Summit in Goa, India in October 2016 included in its Declaration extensive references to MSMEs, their importance and specific initiatives to be taken for their growth and strengthening in the BRICS economies. The Declaration states: “We agreed that MSMEs provide major employment opportunities, at comparatively lower capital cost, and create self-employment opportunities in rural and underdeveloped areas. MSMEs thus help assure equitable wealth distribution nationally and globally. We commend organisation of BRICS second round-table on MSMEs by India with a focus on technical and business alliances in MSMEs Sector. We agree to work for greater integration of MSMEs in Regional and Global Value Chains.

We welcome, in this context, the continued realisation of the major BRICS economic initiatives such as enhanced cooperation in e-commerce, “single window”, Intellectual Property Rights (IPR) cooperation, trade promotion and micro, small and medium enterprises (MSMEs)

We affirm that the value of sharing expertise and experiences among BRICS countries with regard to usage of Information and Communication Technology (ICT) in e-governance and financial inclusion and support efforts aimed at capacity building for effective participation in e-commerce trade to ensure shared benefits”²².

Indeed MSMEs in BRICS nations have a fairly positive environment. MSMEs in Brazil, for instance, are highly successful in participating in government procurements and capture almost 90 per cent of the business. Other countries could draw from Brazil’s legislative frameworks and other policy initiatives to help their small industry also

²¹6th Meeting of the BRICS Trade Ministers, Press Information Bureau, Government of India, Ministry of Commerce & Industry, 13-October-2016

²²Declaration of the 8th BRICS Summit, 15-16 October 2016, Goa, India



get a chunk of government business” reads a statement by Press Information Bureau, Government of India.

The policy commitments coming from New Development Bank for sustainable development further indicate the orientation of BRICS for social inclusion and sustainable development.

Indeed inclusive growth means economic growth that creates employment opportunities and helps in reducing poverty and BRICS is at least taking note.

Chapter 3

BRICS & MSMEs: Overview, Contribution and Potential

The Small and Medium Enterprises (SMEs) are becoming one of the critical components of growth for any nation. According to a report by International Finance Corporation (IFC)²³ that conducted a study of 132 countries, there are 125 million MSMEs with an estimated 85 million in emerging economies. On an average there tend to be about 31 MSMEs per 1000 people.

Globally MSMEs had grown by 6% from the year 2000-2009, with Europe and Central Asia experiencing a growth of 15%. In half of the high income economies, formal MSMEs employed at least 45% of the workforce, compared to only 27% in lower-income economies, this further highlights the importance of MSMEs to economic development and job creation. Globally MSMEs employ one-third of the working population. East Asia and the Pacific have the highest ratio of MSME employment to total employment with percentage in China being as high as 80%, therefore, highlighting the importance of MSMEs to the global economy and their importance in terms of the role they play in the GVC (Global Value Chains). Source: IFC 2011.

MSME and Developed Economies

In developed economies, for example, MSMEs account for some 50% of GDP, according to World Bank data. Within the EU, the European Commission says that, MSMEs account for two-thirds of employment and create 85% of net new jobs. In emerging economies, formal MSMEs account for 45% of total employment, according to the Global Partnership Financial Inclusion. Across the globe, small businesses are significant drivers of growth, job creation, competition, and innovation, with the focus on innovation being much greater in the developed economies than developing economies.

This leads to an interesting contrast on the contribution of MSMEs in different economies. MSMEs in the developed economies generally tend to focus increasingly on high value add activities like Research and Development, Branding and Innovation; whereas the MSMEs in developing economies focus on low value add activities like manufacturing.

MSMEs in China: Overview and Contribution to Growth

China has over 5 million MSMEs which contribute to 60% of China's GDP and 50% of the tax revenues. They make up over 99% of all enterprises in China today; employ over 200 million people to generating more than 82% of employment opportunities in China. The small and medium enterprises in China have achieved rapid and sustainable growth in the past two decades. Over the last 30 years, China's industry

²³Micro, Small and Medium Enterprises around the World: How Many are there and What Affects the Count- Krystyna Kushnir, Melina Laura Mirmulstein and Rita Ramalho, MSME Country Indicators, World Bank / IFC 2010 <http://www.ifc.org/wps/wcm/connect/9ae1dd80495860d6a482b519583b6d16/MSME-CI-AnalysisNote.pdf?MOD=AJPERES>

has produced a compounded growth rate of 15.6% in value-added manufacturing, from almost INR 1,742 billion in 1980 to over INR 117, 254 billion in 2009. During this advancement, Chinese companies have focused primarily on low value-added products.²⁴

Individually owned businesses and private enterprises, that are nothing but micro and small enterprises, have been growing rapidly into a key source of China's economic growth, fiscal revenue and employment, The number of individually owned businesses and private enterprises in China exceeded 40.6 million at the end of January 2013 to provide jobs for about 80 million people and reported two trillion yuan (\$321 billion) in capital, according to a Xinhua report. Of these individually owned concerns, 90% are in the services sector, 8% in secondary industry and only 2% are in primary industry²⁵. Xinhua reported that the country had registered only 140,000 such private businesses in 1978 before the number hit 31.6 million in 1999.

It is important to note that Chinese firms are allowed to buy /import inputs duty free provided they are further used to produce processed goods destined solely for export promotion to developed countries like USA, UK etc. This policy has helped the Chinese MSME markets to grow at a very high pace.

Despite this phenomenal contribution to employment and national economy, less than 3% of MSMEs in china are financed through formal channels like bank loans, they are primarily dependent on informal lending, such as family, friends, and —non-legal credit entities.

Classification of MSME in Different Countries

Enterprises can be classified in different categories according to their size; for this purpose different criteria may be used (e.g. number of persons employed, employees, balance sheet total, investments, etc.,) but the one most common classification used is the number of persons employed.

The generally accepted classification of MSMEs by European Union and some other countries is as follows:

- **Micro enterprises:** fewer than 10 persons employed;
- **Small enterprises:** 10 to 49 persons employed;
- **Medium-sized enterprises:** 50 to 249 persons employed;
- **Large enterprises:** 250 or more persons employed²⁶.

The latest classification in India is based on MSME Act 2006 and is as follows:

Classification	Manufacturing Sector	Service Sector
Criteria	investment in plant and machinery	Equipment
MICRO	Upto 25 lakhs	Upto 10 lakhs
SMALL	>25 lakhs	>10

²⁴FICCI- Grant Thornton, Integrating MSMEs with the Global Value Chain, 1013

²⁵China has 40.6 million private businesses Published: Feb 10, 2013 <http://www.marketwatch.com/story/china-has-406-million-private-businesses-2013-02-10>

²⁶Airaksinen Aarnoand, Henri Luomaranta (Statistics Finland), Pekka Alajääskö, Anton Roodhuijzen, Eurostat, Structural business statistics and global value chains

MEDIUM	<ul style="list-style-type: none"> >5 cr. Upper limit 10 cr. (proposal to raise it to 20 crores) 	<ul style="list-style-type: none"> >2 cr. Proposal to raise upper limit to 5 cr.
Distribution	32% of MSME are in manufacturing Sector	68% of MSME are in service sector

About 55% of MSME in India are located in rural areas.

India also recognises and classifies Cottage and Village Industries. Their definition and classification is as follows:

Definition: Cottage V/ s Village industry

Cottage Industry	Village Industry
<ul style="list-style-type: none"> Family members managing it No hired employee. Negligible capital investment Handmade production using their own tools and material. 	<ul style="list-style-type: none"> In area below 10,000 population Less than Rs.15,000 capital investment (per worker)

European Definition of MSMEs

SME Thresholds

Enterprise Category	Headcount	Turnover	Balance sheet total
Medium sized	<250	Less than equal Euro 50 mn (In 1996: 40 mn)	Less than equal Euro 43 mn (In 1996: 27 mn)
Small	<50	Less than equal Euro 10 mn (In 1996: 7 mn)	Less than equal Euro 10 mn (In 1996: 5 mn)
Micro	<10	Less than equal Euro 2 mn (Previously not defined)	Less than equal Euro 2 mn (Previously not defined)

Source: European Commission

Classification for Micro, Very Small, Small and Medium Enterprises in South Africa

The definition of SMEs in South Africa is based on a combination of characteristics, such as number of employees, gross asset value and turnover value. Further the units are classified in to five major categories, viz., micro enterprises, very small enterprises, small enterprises, medium enterprises and large enterprises.

Quantitative definition of MSMEs, in a national context, enables to target macro policies towards development of MSME sector.

India and MSME Statistics

According to the Fourth All-India Census of Micro-Small and Medium Enterprises (reference period 2006-07), the size of the registered MSMEs was estimated to be 15.64 lakh units. This comprises of 67% of manufacturing enterprises and 33% of services enterprises. About 45% of the units were located in rural areas. Of the total

working enterprises, the proportion of micro, small and medium enterprises were 94.94%, 4.89%, and 0.17%, respectively.

About 90% of the registered enterprises in the MSME sector were proprietary concerns, about 4% were partnership firms, and about 3% were running as private companies and the balance were owned by public limited companies, cooperatives, trust etc. Share of women enterprises in total was around 14%²⁷.

It is clear that the MSME sector has emerged as a vibrant and dynamic sector of the Indian economy, contributing 37.5% of India's GDP, with its vast network of 48 million enterprises providing employment to 111.4 million persons²⁸ mostly in the rural areas of the country, making it the largest source of employment after the agriculture sector.

The MSME sector in India accounts for about 45 % of manufacturing output, 95 % of the industrial units and 40 % of exports²⁹. Although they employ 40% of India's workforce, they only contribute 17% to the Indian GDP. The sector produces a wide range of products, from simple consumer goods to high-precision, sophisticated finished products. It has emerged as a major supplier of mass consumption goods as well as a producer of electronic and electrical equipment and drugs and pharmaceuticals³⁰.

Micro and Small Enterprises in India and BRICS: The Potential

In India, the MSMEs sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. MSMEs not only play crucial role in providing large employment opportunities (next only to agriculture) at comparatively lower capital cost than large industries but also help in industrialization of rural & backward areas, thereby, reducing regional imbalances, assuring more equitable distribution of national income and wealth. MSMEs are complementary to large industries as ancillary units and contribute enormously to the socio-economic development of the country. The present Indian government has been trying to facilitate the sector with a view to encouraging entrepreneurship in order to stimulate manufacturing in line with their flagship schemes namely Make in India and Skill India.

Developing countries like India largely depend on manufacturing industry for growth and employment. Indian economy which has traditionally been agriculture based, is taking big leaps towards promoting manufacturing which constitutes 16 per cent of GDP in India. But, its contribution to employment sector and growth is well below its

²⁷Final Report-Fourth All-India Census of Micro-Small and Medium Enterprises, 2006-07: Unregistered Sector <http://dcmsme.gov.in/publications/Final%20Report%20of%20Fourth%20All%20India%20Census%20of%20SME%20Unregistered%20Sector%202006-07.pdf>

²⁸Mundra S. S. (2016), **Empowering MSMEs: Issues & Challenges**, CCIL Monthly Newsletter, May 2016 & 2nd Bankers Borrowers Business Meet 2016, held in New Delhi on 2016, April 6.

²⁹Chakrabarty Kasturi and Mishra M (2015), *The Need For 'Make In India'*, Manufacturing Sector: Growth and Challenges, April, p.p. 27-30.

³⁰ Report on "Vision 2020- Implications for MSMEs", *FICCI SMEs Summit 2011*, Grant Thornton International Ltd, New Delhi.



true potential due to abundance of unskilled workforce over skilled workforce and lack of technology innovations.³¹

The National Manufacturing Policy in India aims at enhancing the share of manufacturing in GDP to 25 per cent within a decade and creating 100 million jobs. The underlying presumption is: imparting necessary skill sets to people will make them employable and get them jobs. However, it is seen the world over that the last two decades have produced jobless growth and the situation is slated to get worse.

³¹ Comparative Statistics of employment – contribution to economy- GDP- for MSMEs and Corporate Sector Yojana (2015), Manufacturing Sector: Growth and Challenges, April, p. 5

Chapter 4

Challenges to MSMEs: Issues, Economic Policies, Informal Economy and Ineffective Institutional Provisions

Despite the critical role played by MSMEs, most countries – including BRICS economies- have a very unfavourable environment for the MSME Sector in all aspects including access to capital, support for technological innovations, facilitation with marketing, processes for standardization, quality control and opportunities for skill and capacity building. The most glaring gap for MSMEs is the near total absence of international collaborations to secure production inputs or market out reach. The sector indeed suffers from an overabundance of problems in terms of high cost of credit, technological obsolescence, inadequate infrastructure, scarcity of skills, among others which puts the MSME sector at a disadvantage.

Studies show that MSMEs are mainly concerned with both the inadequate availability of managerial and financial resources, and the poor ability to upgrade, protect in-house technology, and to innovate. MSMEs stress that they do not have the critical dimension necessary to support adequate R&D costs, training of personnel particularly with contexts involving increased participation in the Global Value Chains (GVCs), thus restricting their ability to grow further in the value chain.³²

A recent study reveals that MSMEs in India are broadly unaware of technology solutions and tools available to cater their marketing needs. According to the study, less than 6 per cent of Indian MSMEs with access to personal computers advertise online and a majority of these enterprises use traditional media. Many Indian MSMEs are also unaware of the effectiveness, measurability and predictability of using online advertising to reach the target audience³³.

Liberalisation: Negative Impact on MSMEs

Table 4.1: Downward Trend of MSMEs in India

Year	% Share of MSME in Total Manufacturing Output	Employment in MSME (in lakhs)	% share of MSME in the Total GDP
2006-07	42.02	805.23	7.73
2007-08	41.98	842	7.81
2008-09	40.79	880.84	7.52
2009-10	39.63	921.79	7.49
2010-11	38.48	965.15	7.42
2011-12	37.52	1011.8	7.28

Source: GoI (2014), Annual Report of MSME 2013-14, Ministry of MSME, New Delhi 28 May

³²Integrating MSMEs with the Global Value Chain, *Address of the FICCI MSME Summit 2013*, Grant Thornton International Ltd, New Delhi.

³³ Venkatesh, J and Lavanya Kumar, Role of Marketing Strategies in in the Context of MSME Sector, International Journal of research in Finance and Marketing, <http://euroasiapub.org/wp-content/uploads/2016/09/1FMAug-2445-1.pdf>

The Table above gives the story of the negative impact of liberalization on MSMEs in India. While the number of employed in the MSME Sector showed a consistent increase from 805.23 lakhs in 2006 to 1011.8 lakhs in 2011-12, paradoxically, during the same period, there is a defined decline both in per cent share in manufacturing output (from 42.02 to 37.52) and in share of GDP from 7.73% to 7.28%.

Liberalization and MSME:

With economic liberalisation and changes in the trade policy, MSMEs have now started facing increased competition from foreign companies. Generally, MSMEs form an integral part of almost every value chain and there is a symbiotic relationship between the large corporations and their relatively smaller sized suppliers. However, in a liberalised world, the relationships between the suppliers and buyers are undergoing dynamic changes with the dissolution of existing relationships and formation of new trade linkages that transcend the barriers of nationality and boundaries.

The domestic market is being flooded with many low cost, reasonable quality, bulk produced products giving tough competition to domestic MSMEs. With the opening up of the economy, MSMEs need to catch up with global standards in order to remain competitive and profitable. As global competitiveness becomes intensive, MSMEs are required to transit to a new business environment with emergence of global supply chains. It is here the sector realises the acute need for technological and modernisation initiatives.³⁴

Reasons for Low Performance of MSME after Liberalization

While quantitative restrictions and de-reservation policies are being fully implemented with Liberalisation, policies for export promotion facility, price preference and purchase preference are not formed properly or made properly operational. Further, subsidies are slashed and training policy is optional and at concessional charges; all these changes have decelerated the performance of Indian MSME³⁵.

MSMEs and Finance: Decrease in Operations of National Development Banks

Left to themselves, private financial markets in developing countries usually fail to provide enough long-term finance to undertake the investments necessary for economic and social development. Hence, alternative institutions are needed with objectives other than profitability. The National Development Banks were seen and introduced as a solution and can be defined as financial institution with an explicit legal mandate to reach socioeconomic goals in a region, sector or particular market

³⁴Integrating MSMEs with the Global Value Chain, *Address of the FICCI MSME Summit 2013*, Grant Thornton International Ltd, New Delhi.

³⁵Airaksinen, Aarno and Henri Luomaranta (Statistics Finland), Pekka Alajääskö, Anton Roodhuijzen (Eurostat, Structural business statistics and global value chains)

segment. Access to government support allowed development banks to offer credit at subsidised interest rates.

According to Nicholas Bruck (1998), there were over 550 development banks worldwide, of which 32 were in the nature of international, regional and sub-regional development banks, leaving around 520 national development banks (NDBs) in 185 countries, or an average of about 2.8 per country. Fifty per cent of these institutions surveyed had specific policy mandates, having been established to support the agriculture sector (13% of all DBs), SMEs through their lending, guarantee or advisory services (12%), export and import activities (9%), housing (6%), infrastructure projects (4%), local governments (3%), and other sectors (6%).

The example of Brazil, in particular the Banco Nacional de Desenvolvimento Econômico e Social (BNDES) in Brazil that was established in 1952 and entered areas and promoted activities that would not occur purely through the incentives determined by the market could provide some guidance about how this can occur even in a very open and largely market-driven economy. In Brazil, reform notwithstanding, the BNDES has grown in strength and has served Brazil well. The bank's role increased significantly when private activity slackened in the aftermath of the financial crisis. This countercyclical role helped Brazil face the crisis much better than many other developing countries.

On the other hand liberalisation led to a decline in development banking and the demise of the major development finance institutions in India. The absence of these specialized institutions is bound to limit access to long term capital for the manufacturing sector

The share of infrastructure in lending to industry by commercial banks in India has raised from less than 5 per cent in 1998 to 32 per cent in 2012, when aggregate credit provided by scheduled commercial banks rose from 21 per cent of GDP to 56 per cent of GDP³⁶.

The focus of the Indian establishment on development banks started right from the time of Independence and reached a major milestone in 1964 when the Industrial Development Bank of India was established. By the end of the 1980s, the industrial development banking infrastructure in India consisted of three all-India development banks (IFCI, ICICI and IDBI), and 18 State Financial Corporations. In 1990, the government established the Small Industries Development Bank of India (SIDBI) as an all-India financial institution for the financing of micro, small and medium enterprises.

However, India turned its back on this legacy in the mid-1990s. From 1993-94, the importance of development banking declined with the decline being particularly sharp after 2000-01, as liberalisation resulted in the conversion of some development banking institutions into commercial banks and in a decline in the

³⁶ Chandrashaker, C. P. JNU, New Delhi, India. National Development Banks PPT, policydialogue.org/files/events/IPD-AGW_CPChandrashekhar.ppt

resources mobilised by other firms. By 2011-12, assistance disbursed by the development Financial Institutions (DFIs) amounted to just 3.2 per cent of Gross Capital Formation³⁷ and there were only two all-India development banking institutions remaining: the National Bank for Agricultural and Rural Development (established in 1982) and the SIDBI.

Informal Economy: Consequences for MSMEs and National Economy

Shadow entrepreneurs operating in and making up the Informal Sector are defined as individuals who manage a business that sells legitimate goods and services but they do not register their businesses. The informal sector not only results in loss of tax revenue, but also leads to unfair competition to registered businesses, exploitation of labour and poor productivity - factors which ultimately hinder economic development. As these businesses are not registered it takes them beyond the reach of the law and makes informal economy entrepreneurs vulnerable to corrupt government officials.

In the Study on shadow entrepreneurs³⁸, Professors Autio and Dr Kun Fu estimate that business activities conducted by informal entrepreneurs can make up more than 80 per cent of the total economic activity in developing countries and the types of businesses include unlicensed taxicab services, roadside food stalls and small landscaping operations.

The Study says that government policies could play a big role in helping shadow economy entrepreneurs transition to the formal economy. This is important because shadow economy entrepreneurs are less likely to innovate, accumulate capital and invest in the economy, which hampers economic growth.

According to this Study, India has emerged as a country with some of the highest number of unregistered businesses in the world second only to Indonesia with maximum number of shadow businesses.

The 4th (All-India) Census of MSMEs also estimates that of the total number of MSMEs in India, only 1.5 million are in the registered segment while the remaining 24.5 million (94 per cent) are in the unregistered segment.³⁹

The average employment per unit among the unregistered enterprises was 2.05 persons with the average being 3.5 for the manufacturing enterprises and 1.5 for those in the services sector while the average employment per unit among the registered enterprises was 6.0 persons with the average being 7.7 for the manufacturing enterprises and 2.4 for those in the services sector⁴⁰.

³⁷ Chandrashaker, C. P. JNU, New Delhi, India. National Development Banks PPT, policydialogue.org/files/events/IPD-AGW_CPChandrashekhar.ppt

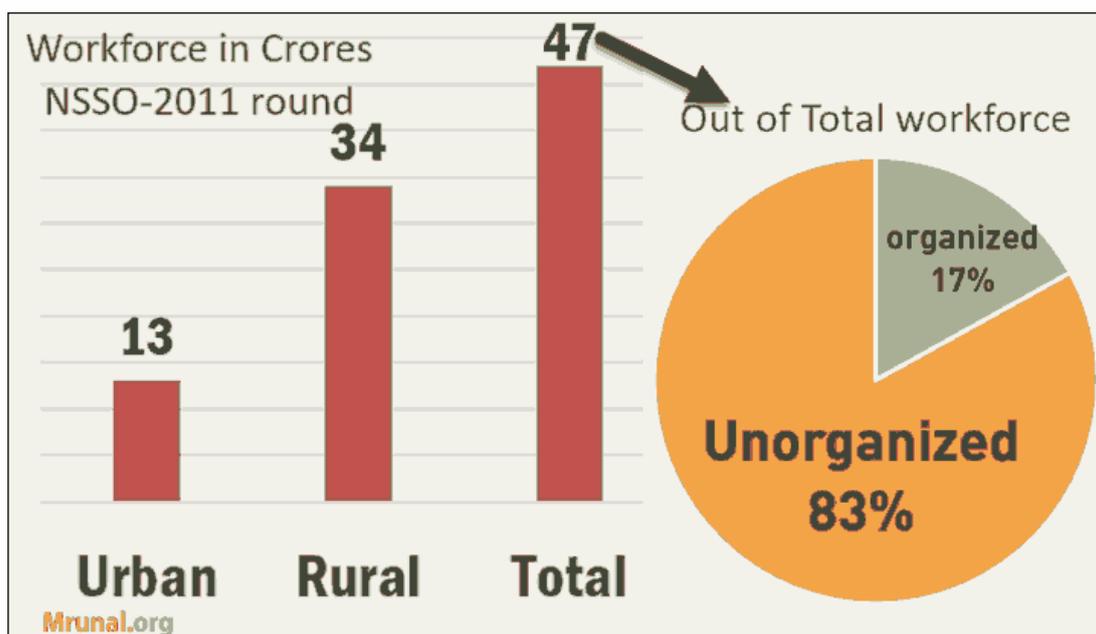
³⁸ India home to second highest number of shadow businesses: Study http://articles.economictimes.indiatimes.com/2014-05-27/news/50122903_1_entrepreneurs-shadow-league-table

³⁹ Annual Report, 2009-2010, Ministry of Micro, Small and Medium Enterprises

⁴⁰ MSME Annual Report 2011-12

While 26.1 million enterprises have been estimated by fourth All India Survey of MSMEs; the National Commission for Enterprises in the Un-organised Sector (NCEUS) estimates that there are a total of 58 million enterprises in unorganized sector employing around 104 million persons. It defines unorganized sector as an enterprise employing less than 10 workers. Of the 104 million persons, more than half are classified as 'self-employed' who are engaged in nonfarm activities. NCEUS was constituted in 2004 and its estimate of number of microenterprises is of around 2006-07. But NCEUS had projected number of microenterprises for the end of March 2012 to be around 70 million.

Graphic Illustration of Organized V/s Unorganized Sector in India



Source: NSSO -2011 Round- Graphic from <http://mrunal.org>

The researchers suggest that if India improved the quality of its democratic institutions to match that of Malaysia, it could boost its rate of formal economy entrepreneurs by up to 50 per cent, while cutting the rate of entrepreneurs working in the shadow economy by up to a third leading to all round benefits to the government, workers, national economy and the entrepreneurs themselves.

In South Africa, it is estimated that at least two-thirds of small, medium and micro enterprises are in the informal sector. It is further estimated that about 80% of the formal business sector and 95% of the total business sector (including informal) can be considered to be SMEs.

Existing Support Systems in India

India's strategy of MSME development has broadly undergone three generations of strategies: First, there was the traditional strategy of protection and reservation. This was followed by a strategy which was closer to a rights- based approach. Thirdly, and

more recently, the country follows a “capabilities approach”. Under this approach, it is assumed that, given proper capabilities, the country can take its MSME sector into the mainstream of the development agenda⁴¹.

The major schemes run by the Government through National Manufacturing Competitiveness Programme, Credit Guarantee scheme, Cluster development, and the announcement of Micro Units Development Refinance Agency (MUDRA) bank with a corpus of 20,000 crores is a welcome step to strengthen this sector’s contribution in ‘Make in India’. The *Apprentice Protsahan Yojana*⁴² would boost the manufacturing sector of MSME. An innovative initiative is the launch of low cost and high quality MSME products on-line delivery system via www.msmeshopping.com facilitated by National Small Industries Corporation (NSIC).⁴³

Indian Government’s Support to MSMEs⁴⁴

The Ministry of MSME has also formulated two schemes under the National Manufacturing Competitiveness Program (NMCP) to smoothen the marketing of MSME products. The activities supported under these components include assistance for adoption of bar code, technology upgradation in packaging and skill upgradation/development for modern marketing techniques. Further, the National Small Industries Corporation (NSIC) has launched a B2B web portal and established a Marketing Intelligence Cell for providing domestic and global market information to the MSMEs. The Ministry has also formulated a public procurement policy for MSMEs, which will provide them support in marketing their products and developing long-term relationships in production/service value chains with the public sector.⁴⁵ Government has been providing Marketing Development Assistance Scheme to MSMEs in order for them to get exposure in the international market, and with the objective of exploring the possible export opportunities for their products by exhibiting them through participation in International Trade Fairs under MSME-India umbrella. Technological up gradation needs of MSMEs are also being supported by a host of institutions and policies.

Entrepreneurship Development Support

MSME-DIs are imparting varieties of training programmes for first generation potential entrepreneurs, existing industrial workers and managers. The ultimate aim is to promote the MSME sector of the country by inculcating entrepreneurial culture in the respective area as well as to enhance productivity of the existing industries of that State/Area. Different types of training programmes conducted for

⁴¹Mathew. P M (2015), MSMEs in the Inclusive Growth Agenda: A Perspective, Yojana, August

⁴² A Scheme has been started on 16.10.2014 to share 50% of prescribed stipend to the apprentices by GoI for the first two years of training engaged by eligible establishments particularly in manufacturing sector and other establishments covered under the Apprentices Act, 1961.

⁴³Sharma Mohi et., al (2014), Microfinance: A Good Strategy for Small Scale Entrepreneurship, International Research Journal of Management Sociology & Humanity (IRJMSH), Vol 5 Issue 9

⁴⁴Export-Import Bank of India (2012), Strategic Development of MSMEs: Comparison of Policy Framework and Institutional Support Systems in India and Select Countries, Occasional Paper NO. 153, March.

⁴⁵Report on “Vision 2020- Implications for MSMEs”, *FICCI SMEs Summit 2011*, Grant Thornton International Ltd, New Delhi

entrepreneurship development and promotion are: Industrial Motivation Campaigns (IMCs), Entrepreneurship Development Programmes (EDPs), Entrepreneurship Skill Development Programme (ESDPs), Management Development Programmes (MDPs), Business Skill Development Programme (Tailor made Course), and Entrepreneur-cum-Skill Development Programme (ESDP) on Biotechnology.

SIDBI, along with Dun & Bradstreet Information Services India (P) Ltd., and many leading Indian banks, has established SME Rating Agency of India Ltd (SMERA). The rating scale and rating process of SMERA have been developed with the objective of enhancing the market standing of SMEs enabling flow of faster credit on better terms.

Marketing Support

DC (MSME) has been providing Marketing Development Assistance Scheme to MSMEs in order for them to get exposure in the international market. The objective is to explore the possible export opportunities for their products by exhibiting them through participation in International Trade Fairs under the MSME-India umbrella. KVIC (Khadi and Village Industries Corporation) has been granted the status of 'deemed' by the Export Promotion Council (EPC) of the Ministry of Commerce and Industry, Government of India, for availing support under Market Development Assistance (MDA) and Market Access Initiative (MAI) for participation in international exhibitions and fairs.

Vendor Development Programmes (VDPs) are being organized by MSMEDIs in different parts of the country.

Financial Support

Small Industries Development Bank of India (SIDBI) was established in 1990 with the mandate of promoting, financing and developing small scale sector, and to co-ordinate the functions of the institutions engaged in the promotion and financing or developing the small scale sector. IDBI has been providing refinance to institutions such as State Financial Corporations (SFCs), State Industrial Development Corporations (SIDCs), and Commercial Banks against the loans granted to small-scale sector. A Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has been established jointly by SIDBI and the Government of India to provide the much needed comfort to banks and other lending institutions for extending credit facilities to micro and small enterprises sector. SIDBI also operates a Credit Linked Capital Subsidy Scheme, aiming at facilitating Technology Upgradation of Micro and Small Enterprises.

Technology Support

In India, technological up gradation needs of SMEs are being supported by a host of institutions and policies. Office of the Development Commissioner - Micro, Small and Medium Enterprises (DC-MSME), Ministry of Micro, Small and Medium Enterprises, Government of India, serves as an umbrella organization for plethora of support provided to MSME sector in India. A network of 30 MSME Development Institutes

(MSME - DIs); 28 Branch MSME-DIs; 4 MSME Testing Centres (MSMETCs); 7 Field Testing Stations (MSME-TS); 18 Autonomous Bodies - which include 10 MSME Tool Rooms (MSME-TRs); 6 MSME Technology Development Centres (MSME-TDCs); 2 MSME Footwear Training Institutes (MSME-TDCCFTIs); and 2 Departmental Training Institutes (MSME-TIs), function under DC-MSME. Policy guidelines have been issued by the Ministry of MSME, Government of India for technological support of MSMEs through programmes such as National Manufacturing Competitiveness Programme (NMCP), and through organizations such as KVIC and NSIC (National Small Industries Corporation Limited).

Problems Faced by MSMEs

These steps, if implemented properly, will help the youth create jobs for themselves. The Government, by keeping a check on the quality and facilitating the sale of products, could create income sources around homes in rural areas and for the urban poor.

However, many entrepreneurs do not know about the existence of the different schemes and programs introduced by the Government, including SIDBI and MUDRA. Hence, a top requirement is creation of awareness regarding all these among the entrepreneurs. Second, Government should more urgently look into the infrastructural decay in the country especially on which most Small Scale Enterprises depend. Third, associations of small scale entrepreneurs should try to educate small business entrepreneurs. Fourth, many enterprises are owned by male entrepreneurs, showing that there is necessity to create entrepreneurial awareness among women. Such steps will be helpful for the success of the MSMEs and their sustainability⁴⁶.

Further, while the SME sector is characterized by the vast diversity of its products, the state of R&D is dismally low. This has been indicated very significantly by the Studies at the Institute of Small Enterprises and Development (ISED) study on IPR(ISED, 2009). Studies at the Institute of Small Enterprises and Development have also shown that despite the series of public programmes and schemes of the concerned Ministries, none of them are really capable of addressing the issues and problems faced by MSMEs or providing them the intended support.

⁴⁶Sharma, Mohit et., al (2014), Microfinance: A Good Strategy for Small Scale Entrepreneurship, International Research Journal of Management Sociology & Humanity (IRJMSSH), Vol 5 Issue 9 pp.73-78.

Chapter 5

Access to Capital from Banks and Formal Financial Institutions

All governments and banks the world over are talking of financial inclusion. But unfortunately, financial inclusion seems to be mostly limited to opening bank accounts and no serious efforts are underway to also ensure that common people get access to bank credit.

In India, the poor, the salaried class and the lower-middle class put their money in banks, which constitutes over 60% to 65% of the deposits in the banking system (savings accounts), whereas Government deposits are around 15% to 20%. The rich, the domestic corporates, the multinationals and other businesses make up hardly 20% of the deposits in banks (current accounts), as they invest their money in businesses. However, over 80% of loans given by banks are to the business sector, the rich and the middle classes (who benefit even from some portions of priority sector allocations obtained in the name of medium ventures and housing loans). The lower-middle class and the poor self-employed, who could easily constitute over 90% of the population, and operate in the category of micro and small enterprises are unable to access even 10% of the bank loans and are exposed to the mercy of loan sharks even for their very rudimentary business needs and are unable to grow and prosper due to the very exorbitant interest rates charged.

A Study conducted by the International Finance Corporation estimates the credit gap in the formal and informal sectors to be INR 1 trillion (\$ 20 billion) and INR 8.9 trillion (\$ 178 billion), respectively. The short-term debt requirement is as high as 60% of the total demand (INR 6 trillion; \$ 120 billion) indicating that a vast section of enterprises still remains excluded from formal financial institutions (FFIs). Most of the gap is in working capital loan as the total working capital loan demand in the cluster is Rs. 1632.31 lakh which is more than 95% of the total loan demand. The working capital supply is estimated to be about Rs. 41.32 lakh. These figures indicate an extremely low base for the industry to have an appetite for credit based fund.⁴⁷

According to the 4th Census in India on MSME Sector 2006-07 published in 2011, only 5.18% of units (both registered and unregistered) had availed of finance through institutional sources, 94.82 % had no finance or depended on self-finance mostly through money lenders. This, despite the stipulation of the Government for priority sector lending introduced since 1974 with the directives to banks to lend 40 % of their advances to Priority Sector comprising of agriculture (at least 18%), and the remaining to MSMEs. Banks are also required to give 1% of their advances for Differential Rate of Interest (DRI) loans of up to Rs. 15,000 to those below poverty line and engaged in nano enterprises. The interest rate for DRI Loans is just 4% per annum. However, all banks across India since the introduction of the scheme in 1974 have advanced a paltry 0.02% under DRI instead of 1% that is mandated!

⁴⁷Agartala Bamboo Cluster (2014), Small Industries Development Bank of India, Mapping of financial gaps in select MSME clusters, KPMC.

In an analysis by IFC and *Intelicap* in 2012 (IFC 2012), almost 78% of SMEs' financing demand was met through informal sources or self-financing, and only 22% through formal sources. Banks and government financing agencies account for almost 90% of the formal sources, while the remaining 10% is supplied by non-banking financial companies (NBFCs). Public banks account for 70% of the banking debt to the MSME sector, while private and foreign banks 22% and small banks such as regional rural banks and urban co-operative banks 8%.⁴⁸

Hence, in reality, the potential borrowers from the MSME Sector continue to face uncertainty over quantum and timelines after making a loan application. To ease the process, bridge information gaps, enable monitoring of processing time and reducing transaction costs, the RBI is in active discussions with the GoI, IBA, SIDBI and e-governance experts to set up a universal 'Udyami' Portal for access by small entrepreneurs.⁴⁹

The Chinese Experience

There are four groups of people in China with very limited access to financial services: rural households, low-wage workers, MSMEs and unemployed people. On the other hand, there are four primary rural credit providers in China: informal lenders, government agencies, formal financial institutions, and NGO-MFIs. They have different impacts on the poor and the low-income.

There are a large number of MSMEs in China and this number keeps increasing rapidly. Shown by the statistics at the end of June 2007, there were more than 42 million legally registered MSMEs, accounting for 99.8% of the total number of enterprises in China (He, 2008). As it is uncertain whether they can make a profit or loss in the near future, formal financial institutions are less willing to offer loans to MSMEs. The conventional financial institutions in China are reluctant to provide credit to the rural population also because of asymmetrical information, lack of collateral, high costs of lending small loans, and high risks of defaults.⁵⁰

There are five main reasons why the most productive, market-oriented sector of China's economy is marginalised by the state banking system. The first is rooted in political concerns about supporting the state sector and maintaining social stability. State banks have been pressured by local governments to provide soft loans to SOEs (State Owned Enterprises) as a means to avoid mass unemployment. This is one of the main reasons why state banks had accumulated such high levels of non-performing loans (NPLs) by the 1990s.

A World Bank survey of 2,700 private firms in 2011 to 2013 found that only 25 per cent had bank credit and 90 per cent drew on internal financing [World Bank, 2012].

⁴⁸Sanyal, Sanjoy, Frederik Eisinger / adelphi (2016), Enabling SME access to finance for sustainable consumption and production in Asia: **An overview of finance trends and barriers in India** SWITCH-Asia Network Facility, February.

⁴⁹Mundra S. S. (2016), **Empowering MSMEs: Issues & Challenges**, CCIL Monthly Newsletter, May 2016 & 2nd Bankers Borrowers Business Meet 2016, held in New Delhi on 2016, April 6.**

⁵⁰Challenges of Rural Micro-finance in China What can China learn from Bangladesh and Indonesia, Shuyang Zhu

Within that period, a 2012 survey of SMEs in fifteen provinces conducted by China's Central University of Finance and Economics (CUFE) found that 57.5 per cent had participated in informal credit markets.⁵¹

Hence, despite their on-going contributions to China's economic development, MSMEs face significant barriers in accessing credit from state-owned commercial banks. In 2013, only 23.2 per cent of bank loans were extended to SMEs. Access to working capital loans is even more restricted: only 4.7 per cent of short-term loans went to SMEs. Indeed, this is an enduring Chinese paradox!

Researchers have nonetheless found evidence of spontaneous forms of village credit mechanisms and of a vast network of informal lenders which pre-date the introduction of the current methodologies. From 2000, it is seen that rural credit co-operatives (RCCs) are becoming the main pillar holding the microfinance effort, while projects run by NGOs held up, but had to acknowledge both successes and failures.⁵²

Russian MSMEs: Increasing Access to Credit

In Russia, many banks have recorded substantial growth rates in their MSME portfolios since 2010. Some of the largest banks in particular have rediscovered the segment as a potential driver of growth and have begun offering an increasing range of products and services dedicated to the target group of MSMEs. Ten banks predicted more than 20% growth in their MSME portfolios for 2013. Almost all banks interviewed reported a relatively good portfolio quality with NPL (non-performing loan) ratios of less than 2% for portfolios generated after the crisis.⁵³

While Russia's banks are trying to expand their services to MSMEs, they are at the same time looking for new approaches to lowering transaction costs and to providing services to the segment in a more cost-efficient manner, especially for lower loan amounts⁵⁴. The term "credit factory" has been coined for highly centralised and automated lending technologies which, however, tend to ignore individual traits of a business' real economic and financial situation and may not reflect underlying business risks adequately.

Factors Discouraging Financial Institutions from Lending to MSMEs

- * Higher perceived risk, as compared to loans to large SOEs (State Owned Enterprises) or public infrastructure projects.
- * Higher costs relative to loan size.
- * Weak and uncertain legal framework protecting creditor rights.
- * Unreliable MSME financial statements.

⁵¹Li and Hu, 2013

⁵²Access to Finance for Chinese Poor Households and Micro, Small and Medium Enterprise, Marco Saladini

⁵³MSME Finance in Russia: Post Crisis Dynamic By Russian Small Business Fund

⁵⁴MSME Finance in Russia: Post Crisis Dynamic By Russian Small Business Fund

- * Unreliable audits of MSME financial statements.
- * Pre-privatization hold-over contractual obligations as, for example, to maintain redundant workers
- * Excessive debt.
- * Less safe assets (mostly inventory, receivables, and intellectual property).
- * Lack of reliable credit information on potential clients.
- * Underdeveloped credit assessment skills of bank loan officers, especially as far as company cashflow is concerned.
- * Lack of incentive schemes to reward loan officers who lend to MSME.
- * Increased risk for the loan officer to be held accountable for MSME loans gone bad.
- * Complexity of loan approval process, often disproportionate in the light of the modest amount of atypical MSME credit.
- * Ceiling on interest rate charges (now close to being eliminated, as we have seen)⁵⁵.
- * Underdeveloped non-bank sources of SME financing – e.g., equity financing, leasing companies (World Bank 2004).
- * Governance and ownership ambiguity at the regional level for non- and banking financial institutions.
- * The culture of the welfare state (wherein poor farmers expect to be provided relief by the government (Tsien, 2004).

⁵⁵Marco Saladini, Access to Finance for Chinese Poor Households and Micro, Small and Medium Enterprise.

Chapter 6

Failures of MSMEs: Need for Radical Changes and Paradigm Shifts

Inexperienced Entrepreneurs

According to international statistics, over 50 per cent of small businesses fail within the first year and 95 per cent fail within the first five years⁵⁶. Apart from the usual causes of business failure like lack of capital for growth, access to markets, poor locations and unfavourable operational environments in terms of statutory provisions and institutional support, the main challenge is inexperienced entrepreneurs⁵⁷.

Indeed technological obsolescence and financing problems have been associated with the sector since long but there are other constraints also such as high cost of credit, low access to new technology, poor adaptability to changing trends, lack of access to international markets, lack of skilled manpower, inadequate infrastructure facilities, including power, water, roads, etc., and regulatory issues related to taxation (state central), labour laws, environmental issues etc.

Further, while the SME sector is characterized by the vast diversity of its products, the state of R&D is dismally low. This has been indicated very significantly by the ISED study on IPR. (ISED, 2009). Studies at the Institute of Small Enterprises and Development (ISED) have also shown that despite the series of public programmes and schemes of the concerned Ministries of the Government of India, none of them are really capable of addressing these issues adequately.

According to a Study on performance of Indian MSMEs⁵⁸ the reasons of sickness were poor financial position, lack of raw materials, technology and skilled labour, mismanagement, wrong business policies and diversion of funds. According to the Study, the reasons for closure for the units studied were lack of finance for 34.7 per cent units, marketing problems for 14.4 per cent, raw material crisis for 5.6 per cent, disputes among owners for 3.7 per cent, natural calamities for 3.4 per cent, labour problems for 2.2 per cent, more than one reason for 16.5 per cent and other reasons for 19.4 per cent.

A Study in China found some barriers hindering the expansion of Ningxia's SMEs. These barriers were grouped into four main areas: (1) Product, including Price, Labels and Design; (2) Operations and Logistics, including PostSales and DistAccess; (3) Knowledge of International Finance, including Credit, Payment and Exchange Rate; and finally (4) Skills including Assistance, Communication and Time. This

⁵⁶ Mathew, P M (2015), Manufacturing in India: New Perspectives and Imperatives, Manufacturing Sector: Growth and Challenges, April, p.p.6-11

⁵⁷ Mathew, P M (2015), Manufacturing in India: New Perspectives and Imperatives, Manufacturing Sector: Growth and Challenges, April, p.p.6-11

⁵⁸ Kumar, Pankaj (2014), An Empirical Study on Performance of Indian MSME, *Asia-Pacific Journal of Management Research and Innovation*, 10.

grouping shows that the barriers are related mainly to weak management skills and knowledge.⁵⁹

Informality of MSMEs as an Obstacle to Access Finance

MSMEs are often unregistered and work outside the formal company law and banking systems. These MSMEs conduct financial transactions in cash and do not have financial records. This makes it very difficult for banks and other lenders to assess their credit-worthiness. As a result MSMEs find it challenging to access external finance. Lack of awareness on financing options resulting from the unavailability of information is another major challenge for MSMEs in accessing finance. In a recent survey, 71% of MSMEs in India reported that they were unaware of the CGTMSE programme. Out of the 29% of MSMEs that were aware, 99% found it difficult to obtain information from banks.⁶⁰

Problems in Bank Finance:

However, banks also bring their own set of problems. More than 40% of those surveyed complained that chief problems include banks placing too much emphasis on collaterals and the large amount of paper work involved. Further, 18% felt that project appraisal system is un-standardised and 35% felt that procedures for sanctions are cumbersome, and even once approved there is a delay in disbursement of funds (28%). Other hardships faced by MSMEs include a high rate of interest, a lack of personalised service and often a lack of justification for denial of finance.

On the other hand, banks have their own constraints and concerns regarding lending to microenterprises on account of:

1. Small amount of credit requirement per unit is not financially attractive for banks.
2. Lack of credit information with these units
3. Inability to fulfill KYC (Know Your Customer) requirements
4. Inability to offer collateral
5. Lack of formal accounting records
6. Lack of formal registrations
7. Difficulty in ascertaining cash flows and profits

Focused Group Discussions with Bank Managers:

Two Focused Group Discussions (FDGs) with 7 branch managers and field officers of State Bank of Hyderabad in New Delhi and 10 Branch Managers and Field officers of State Bank of Hyderabad in Hyderabad were very revealing.

Initial observations were:

- Lending to Micro Enterprises and the poor is a social liability because it is generally used for consumption and is not translated into any meaningful source of income for both: the parties and the bank.
- The perception among the people is that the loan which is obtained through the government schemes need not to be paid back unlike the loan which have been

⁵⁹The Internationalization of SMEs from China: The Case of Ningxia Hui Autonomous Region, Guillermo Cardoza & Gaston Fornes

⁶⁰Firstbiz-Greyhound Knowledge Group Initiative 2014

taken otherwise i.e. from the bank without any government scheme.

- The government does not have any concrete recovery mechanism but corrupts people through loan waiver schemes for political reasons.
- Hence chances of recovery of loans in the government schemes and priority sector are very low.

But most admitted to mixed experiences after lending to the poor and acknowledged that:

- The success rate of bank loan recovery is more in loans given by banks to self help groups in comparison to the loan extend by banks through government schemes.
- Before giving such loans to the poor, there was high skepticism but after giving, the experience is of 100 percent recovery. Recovery in DRI loans is also high.
- Rejection percentage is very high in giving loan to the poor but at the same time recovery is close to 100 percent for the loans given.

Hence, it is more on account of some acquired perceptions of default by the poor and MSMEs rather than the actual experiences that banks typically refrain from venturing to extend credit to these segments.

Further, micro entrepreneurs also often self-exclude themselves on account of the perception that:

1. Banks only finance big businesses
2. Banks will have long and complicated due diligence process and
3. And the Entrepreneurs' discomfort in revealing business details particularly financial details to avoid tax and other regulatory implications.⁶¹

Hence, internal sources of funds remained the most popular source of alternate finance for 37% of respondents, closely followed by 'family and friends' for 15% of those surveyed. In terms of institutional sources, 17.6% accessed NBFCs for finance and 13.7% looked at private placements⁶²

Access to equity capital is a genuine problem. At present, there is almost negligible flow of equity capital into this sector. Absence of equity capital may pose a serious challenge to development of knowledge-based industries, particularly those that are sought to be promoted by the first-generation entrepreneurs with the requisite expertise and knowledge.

But for this, bank staff should be trained through customised training programmes to meet the specific needs of MSMEs such as knowledge of markets, both domestic and global, use of technology, etc. Banks need to innovate to create products specifically suited to the requirements of MSMEs and should take a longer term view of its relationship with such entities while pricing such products. Bank staff has to be sensitised to the need to nurture these enterprises and to ensure that they get the necessary support during the initial phase. The performance of branch managers in

⁶¹Study Conducted by M2i Consulting, MSME Knowledge Series, Missing Middle Enterprise Finance: Vol. 1, State of Financial Inclusion of Microenterprises, New Delhi, <https://www.giz.de/en/downloads/giz2013-en-msme-knowledge-series.pdf>

⁶²Report on "Vision 2020- Implications for MSMEs", *FICCI SMEs Summit 2011*, Grant Thornton International Ltd, New Delhi.

dealing with the sector should be included as a criterion for evaluation of their performance.⁶³.

Challenges from ICT

SMEs are described as the slowest sector to embrace e-commerce (Mehling, 1998; Poon and Swatman, 1999). According to the TRICTSME Report (University of Economics, 2000), this might be attributed to:

1. Lack of adequate technical infrastructure;
2. Insufficient awareness of the opportunities offered by the latest technology solutions;
3. Shortage of competent and experienced workforce;
4. Negative attitudes toward the Internet and the mass media; and
5. Lack of specialised training

Research shows that most SME managers are not aware of the opportunities presented to them by advanced information technology, especially newly emerging e-commerce and Internet business platforms by (DTI 1998; 1999). Other surveys show similar results suggesting SME managers are willing to use these technologies, but they do not know where to start and suffer from a lack of guidance in using appropriate approaches for effective technology implementation (Auger and Gallagher, 1997; Duan and Kinman, 2000).

In the MSME sector, technology is mainly sought in the form of processes and product know-how. Some of the other sources from which technology flows into the MSMEs are:-

- Government institutions;
- Local suppliers of machinery and equipment;
- Foreign suppliers;
- Research and development institutions;
- Industry associations;
- Parent companies in case of ancillary and subcontracting units; and
- Collaborators.

Hence MSMEs are mostly dependent on others, especially the governments, for introduction and source of access to ICT and e-Commerce opportunities.

Finally, there is very little understanding among MSMEs that with the internet and e-Commerce platforms, even a small business can get linked to global markets. The predominant perception still continues to be that global markets are for big business and micro and small enterprises can only operate in local markets. Till this misperception is addressed and rectified through introduction to and provision of e-Commerce platforms, the full potential of MSMEs cannot be realized and they will always face the threat of closure due to self-imposed market limitations.

⁶³Chakrabarty K C (2012), Empowering MSMEs for financial inclusion and growth – the role of banks and industry associations, *Address at the "SME Banking Conclave 2012"* organised by the SME Chamber of India, Mumbai, 4 February.



Management orientation, easy access to credit and harnessing of ICT for market outreach: There lies the need for radical changes and Paradigm Shifts.

Chapter 7

Towards Entrepreneurial Economies: From Job Seekers to Job Creators

Growth-Unemployment Paradox: The tacit understanding in economic philosophy has been that businesses and corporations are the prime job creators and people should be given appropriate training to become workers and employees. However, facts show that technological innovations, even when industry and service sector grow in a healthy manner, employ less and less people. With ever-growing populations and limits to employment opportunities in businesses – both in national and multinational corporations – unemployment is bound to grow, resulting in a variety of social problems. The only way to create adequate employment opportunities for our teeming billions seems to be through the promotion of entrepreneurship- micro, small and medium- instead of just depending on the business-corporate sector for securing jobs.

Entrepreneurship: The Requirements

There seem to be just four simple requirements that could enable the emergence of successful entrepreneurs at different levels:

First, identification of candidates from the skill training programs with potential for entrepreneurship and orienting them to basic principles of business management through supplementary courses.

Second, enabling their access to bank loans to start business,

Third, establish common platforms for R&D to enable them to benefit from new innovations, technologies and management practices and

Fourth, establish joint mechanisms using internet and modern technology to facilitate in marketing and delivery of their products to a larger, and possibly, global clientele at very low costs.

With these supports, the entrepreneurs will not only employ themselves but also some of their batch mates and others through their ventures to contribute to reduction in unemployment and increase in economic growth.

Socio-Economic Impact: Millions of skilled youth with entrepreneur ability and who are unable to find employment will be able to start their own ventures, provide employment to others and boost economic development of their countries.

The answer to the growing global unemployment seems to be Entrepreneurship

Entrepreneurship Development- The Way Out:

It can be reasonably surmised that one out of every 10 to 15 persons will have some leadership qualities, high motivation levels and will to succeed that are all ingredients for successful entrepreneurship. Unfortunately, our system is geared towards training everyone only in skill development to become employees and not to take up entrepreneurship. Some places where entrepreneurship orientation is being given along with skill training, it is being given to the entire batch and with inappropriate content that is not producing the desired results.

Hence the immediate requirement is to identify candidates with potential for entrepreneurship in every batch from courses ranging from 3 months to 4 years like mobile repair, electrician, plumbing, motor mechanic to medicine and engineering etc. and provide them additional training in accounts, inventory control, production, personal management, marketing etc, as per the requirements of their trades and to enable them to start their own enterprises successfully. The only thing required would be provision for mentoring or apprenticeship and capital for which arrangements should be made with banks for easy and quick processing as part of the Financial Inclusion program.

Promoting Entrepreneurship in a Job Seeking World

Though there are scores of counselling centres, online portals, training courses and facilitation centres to service those seeking jobs, there is hardly any environment to make people aware about the possibility of entering into entrepreneurship and facilitation processes to guide and assist someone with potential. Hence the following services in large numbers and with easy accessibility are required to enable entrepreneurship and address the ever growing problem of unemployment:

Towards Entrepreneurial Economy: From Job Seekers to Job Creators

b) Mass Awareness Campaigns and Counseling Centers for Exposure to Entrepreneurial Opportunities

There are numerous programs by governments, commercial, private and voluntary organisations to orient people- especially youth- to avenues and opportunities for acquiring skills to secure jobs. But there are very few initiatives from any organisations to introduce people to the possibility of and process for becoming entrepreneurs. Given that most countries are going through jobless growth for nearly two decades, it is now clear that corporates and businesses cannot absorb millions of job seekers increasing by the day. If more of the unemployed could be oriented and facilitated to become self employed, they can also employ others and become a solution to unemployment instead of remaining as part of the problem.

c) Inclusion of Courses on Introduction to Entrepreneurship as a Career Prospectas part of the all school and college syllabi at appropriate levels.

d) Aptitude Tests to Determine Entrepreneurial Abilities should be administered to all those joining different skill trainings and professional courses from mobile repairing of 3 months to engineering and medical studies of 4 to 5 years. Those identified as having entrepreneurial abilities could be provided training in basic principle of entrepreneurship and management appropriate to their field concurrently with their skill training programs to enable them to start their own enterprises successfully once they finish their skill training courses.

It may seem strange but it is true that there are hardly any online entrepreneurship assessment tests. Just a few that are available are designed by some US universities and are more like personality assessment tests.

e) *Online and On Site Trade Wise Entrepreneurship Courses* for select students of skill training programs and for petty businessmen and entrepreneurs already in business could help in sustenance and success of numerous businesses that could otherwise fail due to lack of appropriate management capabilities. International studies show that 50% businesses fail in the first year and 95% by the fifth year.

f) *Free Business Registration and Accounts and Audit Centers* for MSMEs
In India, for every registered business, there are as many as 127 unregistered businesses. This means they do not have appropriate licenses, accounts and audit records. This proves to be the biggest barriers to them for accessing cheaper credit from banks and formal financial institutions and linking up with marketing platforms at different levels. Facilities for acquiring documents easily and assistance for maintaining accounts could be a great help in transforming most Nano⁶⁴, Micro and Small Enterprises' from being unregistered to becoming registered (unorganized to organised).

⁶⁴ Nano Enterprises: Petty businesses with a total outlay of less than INR 15,000 or \$ 230

Chapter 8

Transforming Financial Architecture: Making Lending to the Poor a Business Opportunity

Financial Inclusion is generally understood as having a bank account or at most getting a loan from banks. This needs a radical redefinition to become genuinely operational and productive. Genuine financial inclusion should be defined as provision of access to appropriate processes and inculcation of holistic capacities to gain access to and operate in markets- Linkages with Banks being only the first step in gaining access to Markets.

Pro-Rich Attitude and Systems

There is reluctance on the part of bankers to lend to the poor for two reasons:

1. General, but largely misplaced perception that the poor default on loans (All banks in India have together written off one lakh crore rupees in thirteen years from 2000 to 2013 and 95 percent of these write off were for Corporate and Industry and only 5 per cent for all other segments including the Priority Sector).
2. That the processing time and effort for small loans are also almost the same as medium and large loans and bankers feel it easier to give larger loans and achieve their targets.

While the general understanding for financial inclusion seems to be limited only to educating people on accessing banking facilities, the real requirement is to bring about an attitudinal change amongst bankers, especially at the branch level, to give loans without bias to lower sections of society for small business ventures even if it requires some additional effort.

Further, the entire banking system seems to be structured to serve the salaried classes, big business and corporate sector that prefer monthly or quarterly repayment schedules. However petty and small businesses with small margins operate on a daily basis and for them payments of monthly installments become difficult and could lead to defaults. Hence, new financial products suitable to small entrepreneur, based on daily recovery rather than monthly payments will have to be explored and introduced.

Requirements for a Changed Financial Architecture

Financial institutions need to move away from a collateral-based funding approach towards project finance. Project finance would significantly help SMEs in raising finance.

A reform of the credit guarantee system is necessary. The experience drawn from the Credit Guarantee Fund Trust (CGTMSE) scheme shows that the scheme needs to be marketed across the banks' branch networks, to support bank officers in actually applying the scheme.

Banks need a more streamlined loan application process and a shared due diligence process. This would significantly ease the process of accessing finance for SMEs. In addition, it would reduce the time required for a loan to be approved and it

would make it easier for MSMEs to submit a loan application to several financial institutions. It is recommended that, in consultation with other financial institutions, application forms and key documents are standardised. These standard documents, together with information on financing schemes, can then be made available to MSMEs through an internet portal. Technical assistance should be provided to financial institutions to support them in achieving this task⁶⁵.

Assessing non-financial parameters of MSMEs

Banks and financial institutions are generally adopting conventional lending structure and norms for SME financing. It may be mentioned that the challenge of low access to institutional financing for SMEs is further accentuated due to information asymmetry between the SMEs and loan officers in the banks. The international norm, Basel II, requires financial institutions to implement an enterprise-wide risk management framework that encompasses operational risks. In this context, enhancing credit flow to the SME sector has always been a challenge to the banking sector. Traditional method of credit assessment based on past financials may not be the most appropriate method of assessing credit needs of the SME sector. The screening methodology of financing institutions needs to consider non-financial parameters and management competencies, while evaluating loan proposals from SME units.

One such non-financial parameter is the technological competency of MSMEs. Government of Korea has instituted Korea Technology Finance Corporation (Kibo) which appraises technological expertise of SMEs thereby enabling the banks to accept technology as collateral for extending financial support. Kibo has also launched a technology guarantee services programme,

The existing financial architecture that governs banks and financial institutions and stifles access of the poor and middle classes to credit can be transformed to insure genuine financial inclusion through the following initiatives:

1. Addressing People's Phobia of Banks and Banks' Phobia of Poor
2. New Assessment Parameters for lending to Nano, SMEs, E commerce and start ups- (eg. Community as Balance Sheet and social worker as loan facilitator)
3. Technological innovations for creating financial histories and reducing costs of lending and repayment
4. Recognition of and OD Facilities to Nano Enterprises (with investment below Rs.10 Thousand)
5. Orientation of New Development Bank for socio- financial inclusion through provisions for Assessment of Sustainability and Priority Sector Lending

⁶⁵Sanyal, Sanjoy, Frederik Eisinger / adelphi (2016), Enabling SME access to finance for sustainable consumption and production in Asia: An overview of finance trends and barriers in India SWITCH-Asia Network Facility, February.



With existing internet and mobile technologies, it should be possible to evolve mechanisms to make deposits in banks on a daily basis through mobile cash cards without visiting banks and thus reducing daily transaction time and costs. Please See ***Annexure 1 - Mobile Bank Deposit Cards***

Chapter 9

New Development Bank and MSMEs: The Context, Opportunities and Challenges

There have been fundamental changes and shifts in the global economy in the past decade and a half. These changes include a radical shift in the world economy towards developing countries, and Asia in particular. Among these countries, the BRICS bloc constitutes 43% of the world's population and generates roughly 22% of global GDP. Several past attempts to reorganize the governance structures of the World Bank and the IMF to give a bigger voice to developing countries have failed.

BRICS started as a resistance against this domination of developed western countries and multilateral bodies like the World Bank and IMF etc. but from this negative impetus BRICS is fast acquiring a positive direction. As some commentators acknowledge, the New Development Bank (NDB) is a response to a failure on the part of western nations, especially the United States, to give the BRICS countries their due in terms of voting power in the two leading multilateral financial institutions – the IMF and the World Bank. The BRICS countries have a share in the vote of only 11% at the IMF although they account for nearly 25% of the global economic output.

Further, BRICS is attempting to show that it is possible to run a multilateral institution (whose members vary in their political and economic clout) along egalitarian lines. Second, it has the potential to reduce, over time, the dependence of the NDB's member countries on the IMF/World Bank as also western financial markets. Decisions involving important policy matters are to be taken by consensus, in effect giving veto powers to all members.

Old Economic Policies and New Challenges: From the early 1990s, India has set about destroying the potential of its own development banks, in both agriculture and industry – but there is still scope for their renewal and rejuvenation. There are also immense possibilities for technology sharing and even co-ordinating technology development, in a world where intellectual property rights are still largely controlled by Northern multinational companies that become major constraint on development in the developing and under developing countries.

In this context, the development banks themselves need to be not just be strengthened but also reformed, so as expand their ambit to be more explicitly concerned with micro and small enterprises, which have been hitherto relatively neglected in credit allocation. Indeed, the focus could be not just on credit per se, but strategies to ensure technology development in micro enterprises as well as better access to markets. For example, it is possible to think of dedicated export credit lines of Exim banks devoted to the products of micro and small enterprises.

It is increasingly necessary for innovative financial strategies to promote more universal provision of necessary services and utilities. Such credit cannot focus only on "public private partnerships" but must increasingly be oriented towards

municipalities and locally elected bodies who are often directly responsible for such provision but tend to be cash starved and denied finance.

Finally, recent growth in all the BRICS countries has been associated with a construction and real estate boom, and it is interesting to note that this boom is also in the process of winding down in all five countries. This creates all sorts of difficulties, both in terms of the employment losses as well as the health of the financial sector, and it is particularly galling given the continued shortage of adequate mass housing. All of these countries will need effective strategies to deal with this challenge, even while they continue to promote affordable and better quality mass housing, and so surely there are opportunities here for creative policy thinking that can be shared.

What is New about the New Development Bank

New Development Bank is different because most existing development banks are in terms of shareholding, voting rights and management dominated by one or the other developed country. Since the NDB is owned and backed by governments in a set of “emerging economies”, and as the allocation of its resources would be determined by the representatives of the five BRICS countries, it could direct resources to projects that are more in keeping with the requirements of the South. The terms on which the institution lends could in time reflect “Southern” requirements and sensitivities. Therein lays the potential of NDB to alter the global financial architecture to orient it from the Perspective and requirements of the South.

It must be noted, however, that even if a development bank (set up as a tool of state-guided development by governments) can indeed contribute to furthering goals of more equitable and sustainable development, it must ensure its own commercial viability by virtue of being a bank. Any form of socially concerned lending that does not yield a return adequate to cover costs and deliver at least a nominal profit should be ruled out in the interest of sustainability and viability.

In 2013, a [Mckinsey Global Institute report](#)⁶⁶ found that “globally, \$62 trillion in new infrastructure investment would be required in the period up to 2030, simply to keep up with projected GDP growth. This estimate suggests a requirement of \$3.4 trillion investment a year.” When assessed against current infrastructure spend by all the multilateral development banks combined, this leaves a huge financing gap.

The NDB and other new institutions such as the AIIB can strive to contribute to closing this funding gap as building essential infrastructure is an important element of economic development and a priority for the continued industrialization of the BRICS countries. Investment in infrastructure, including modern ports and gateways, intelligent transportation, pipelines, telecommunications and power, provides the pillars of national prosperity and economic development of any country. With

⁶⁶ [Mckinsey Global Institute report, 2013, P-13,](#)
file:///C:/Users/kc/Desktop/MGI%20Infrastructure_Full%20report_Jan%202013.pdf

an authorized capital base of \$100 billion, the NDB will provide an additional pool of capital to the BRICS nations to fund their infrastructure plans.

India, Brazil and South Africa could use the funds available from the NDB to meet their large requirement for infrastructure and development.

NDB the Directions

NDB President K. V. Kamath has stated “the objective is not to challenge or replace the existing system of development finance... it is instead to improve and complement the system. More formally, the purpose of the bank, as expressed in our articles, is to “mobilize resources for infrastructure and sustainable development projects in BRICS”

According to Leslie Maasdorp, a Vice-President at the Bank NDB, “sustainability and clean energy will be an essential ingredient of our approach to development.... And the “new” in NDB is a license to experiment relentlessly, within certain risk parameters... Finally, and most importantly perhaps, is the NDB’s aim to embrace innovation. We intend to use our newness as a source of strength by looking at old problems through fresh lenses. Leveraging new technologies, we will aim to unlock new business models. There is a definite keenness to develop new approaches to development, including new tools and methods.

Muhammad Yunus of Grameen Bank, Bangladesh, agrees with the statement of new approaches to development by the NDB and recommends that “it should be based on entirely new objectives, to be carried out with new strategies.” He further suggested that the primary objectives of the NDB should be to achieve three zeros by 2050: zero poverty, zero unemployment, and zero net carbon emissions. Going further, Muhammad Yunus outlines four strategies that could help in achieving these objectives.

“The first strategy would be to unleash the creative power and commitment of the new generation of youth...the second strategy would be to focus on technological innovations to solve human problems. .and socially committed drivers must take charge of technology. Combining the power of the youth with that of technology will create an unshakeable force... the third strategy will be building social businesses to mobilise their creative power to solve long-standing and complex social, economic, and environmental problems.”⁶⁷

He goes on to add that “Conventional businesses cannot solve social problems. Other actors such as the state and private charities may be unsustainable and inefficient. Social business is a new variety of business which delinks itself from a profit motive and can bring about positive social transformation. Social businesses are sustainable,

⁶⁷ Mohammed Yunus, A New Era for a New Bank, The Hindu, 3rd April 2016, <http://www.thehindu.com/opinion/op-ed/annual-brics-summit-a-new-brics-bank-for-a-new-era/article7396012.ece>

efficient, replicable, and transferable and they should be the centrepiece of the NDB's institutional structure and policy package.”

NDB: Challenges and Opportunities for MSMEs

The formation of the New Development Bank by the BRICS bloc could also undermine the availability of capital from banks for MSMEs if appropriate measures are not put in place immediately.

Presently, Indian Banks follow a practice of lending as much as 55% of their Core Capital to Corporates and Industry (C&I). However, International Financial stipulations require that only 25% of the core capital can be advanced to C&I sector and the remaining should go to other sectors including personal, education, vehicle, housing and MSME etc. Under pressure from international financial institutions, the Reserve Bank of India has started work to reduce the practice of Indian Banks lending 55% of their Core Capital to Corporates and Industry (C&I) to only 25% by 2019⁶⁸. This means the banks will have to withdraw 30% of their Core Capital from C&I and advance to some other constituencies. The only unsaturated constituencies that are available to the banks for lending this 30% of their Core Capital are the Micro and Small Enterprises that will benefit the poor and lower middle classes. This means lakhs of crores could be available to the poor and middle classes in a few years from different banks of the country if the confidence of the banks can be developed in the integrity of the poor and middle classes and mechanisms could be evolved to facilitate filing of loan applications and follow up with recovery of EMIs.

However it is also possible that the New Development Bank could be used to mop up large portions of the Core Capital of the banks and divert them back to C&I in the name of support to infrastructure and thus deprive MSMEs of their rightful share that would otherwise be available.

On the other hand, professed commitment of BRICS and NDB for sustainable development and social inclusion, the practice of Priority Sector Lending should be adopted by BRICS for the NDB with a provision of at least 25% lending to be reserved for MSMEs and agricultural advancement. Of course, platforms like the SIDBI, MUDRA and even commercial banks can be used for the utilisation of the resources earmarked for Priority Sector Lending. Indian Banks are following this practice of Priority Sector Lending and despite unsatisfactory implementation record; it is leading to positive social transformations and empowerment of the poor and marginalised.

⁶⁸<http://www.ibtimes.co.in/rbis-draft-corporate-lending-norms-nudging-banks-towards-retail-says-sbi-chairperson-arundhati-693353>

Chapter 10

Local Access to Domestic and Global Markets through ICT

MSMEs and Global Participation-

As seen in Chapter 6, MSMEs are described as the slowest sector to embrace e-commerce (Mehling, 1998; Poon and Swatman, 1999). According to the TRICTSME Report (University of Economics, 2000)⁶⁹, this might be attributed to:

1. Lack of adequate technical infrastructure;
2. Insufficient awareness of the opportunities offered by the latest technology solutions;
3. Shortage of competent and experienced workforce;
4. Negative attitudes toward the Internet and the mass media; and
5. Lack of specialised training

Research shows that most SME managers are not aware of the opportunities presented to them by advanced information technology, especially newly emerging e-commerce and Internet business platforms by (DTI 1998; 1999). Other surveys show similar results suggesting SME managers are willing to use these technologies, but they do not know where to start and suffer from a lack of guidance in using appropriate approaches for effective technology implementation (Auger and Gallagher, 1997; Duan and Kinman, 2000).

Even as some SMEs are eager to embrace e-commerce and e-business and attempt to turn the e-commerce opportunities into real business benefits, lack of skills and expertise become a major barrier for e-commerce adoption and successful implementation

Participation through indirect contribution to exports: Available data and survey-based evidence suggest that SME participation in GVCs is mostly taking place through indirect contribution to exports, rather than through exporting directly. Most SMEs in developed economies are very well plugged into GVCs as domestic suppliers of exporters. As a result, SMEs are vastly under-represented in GVCs when looking at direct exports only⁷⁰.

Addressing ICT Skill Challenges in SMSEs

The rapid advancement in information and communication technologies (ICTs) has brought enormous business opportunities as well as challenges. One of these challenges is the demand for ICTs skills and expertise in adopting and implementing these emerging technologies. Lack of ICTs skills and knowledge is more evident in small- and medium-sized enterprises (SMEs).

⁶⁹<http://impact.ref.ac.uk/casestudies2/refservice.svc/GetCaseStudyPDF/40387>

⁷⁰OECD (2015), Inclusive Global Value Chains Policy options in trade and complementary areas for GVC Integration by small and medium enterprises and low-income developing countries, Report prepared for submission to G20 Trade Ministers Meeting Istanbul, Turkey, 6 October.

However, the abilities and skills of employees will be crucial to the prosperity of SMEs (Clarke and Gibson-Sweet, 1998) as an acute skill shortage could hamper a company's ability to stay competitive and sustainable. To help SMEs to cope with the increasing demand on improving their skills for adopting e-commerce and e-business, training is often seen as the most effective way to fulfill this task⁷¹.

Patricia R. Todd, Rajshekhar (Raj) G. Javalgi report that several factors are identified that must be addressed before the SME can achieve international growth, specifically the utilization of technology. They propose that the primary method for fostering or promoting the growth of entrepreneurship is through the utilization of technology. Managers of non-exporting SMEs perceive the international environment as being risky, unprofitable and unmanageable, due primarily to misinformation and lack of experience with global business⁷². Finally, new technologies usually challenge developing countries that lack the necessary capabilities, as well as the financial and institutional resources to catch up to advanced countries⁷³. .

Many businesses and consumers continue to be concerned about conducting business on the internet because of the lack of privacy, security, and liability. E-commerce users are also concerned about the possibility that their governments will impose extensive regulations on the internet in such areas as tax and duties, content restrictions, and non-cooperation to induce trade barriers for certain goods and services that are vital to build information infrastructure. The future and international growth of e-commerce depends upon the extent to which the country's government protects, supports, and educates its citizens. Governmental policies in such areas as support for R&D, privacy, security, and needed education to compete in the information age, greatly influence the growth of e-services.

Modern technologies have greatly reduced the cost of information and the capabilities to participate in the global economy. Technology tools like SMS, digital newsletter and electronic direct mail can be used efficiently to target segmented population. Broadly classified as push marketing, these media tools are cost efficient and easily accessible. To add to this, websites, yellow pages, directory listings help pull the prospective buyer with rational efforts⁷⁴.

In "Fueling Innovation through Information Technology in SMEs" Clay Dibrell, Peter S. David, Justin Craig write that substantial evidence has begun to accumulate that suggests that appropriate strategic employment of information technology (IT) may be essential in translating strategies (e.g., innovation) into enhanced firm

⁷¹M. Mohd Rosli and Syamsuriana Sidek, The Impact of Innovation on the Performance of Small and Medium Manufacturing Enterprises: Evidence from Malaysia.

⁷²Patricia R and Rajshekhar (Raj) G. Javalgi. Internationalization of SMEs in India: Fostering entrepreneurship by leveraging information technology.

⁷³Tigre, 2003

⁷⁴FICCI (2011), Report on "Vision 2020- Implications for MSMEs", *FICCI SMEs Summit 2011*, Grant Thornton International Ltd, New Delhi.

performance (e.g., Ray, Muhanna, and Barney 2005; Sakaguchi, Nicovich, and Dibrell 2004). A direct linkage between IT and firm performance was established by Powell and Dent-Micallef (1997). Bharadwaj (2000) found that high IT-capable firms (those that invest heavily in IT) outperform competitors that do not invest to the same extent (also see, Sambamurthy, Bharadwaj, and Grover 2003).

Consequently, firms often invest substantial resources in IT assets (e.g., computer hardware, computer software, and personnel) (Krishnan and Sriram 2000). Over time, firms that invest more than their competitors in IT tend to realize greater returns from the marketplace (Bharadwaj 2000).⁷⁵

Case for Internationalisation of MSMEs⁷⁶

As suggested by (Evangelista 2005; Hymer 1976; Lu and Beamish 2001), entry into foreign markets can, in fact, provide expansion opportunities that increase SME survival.

On the other hand, internationalization may instead resolve some liabilities of newness. It can help small firms extend beyond the limits of domestic markets, enhancing their growth and likelihood of survival (Coviello and Munro 1997).

As such, researchers have shown a link between resources and the early performance and survival of new firms (Bruderl and Schussler 1990; Carroll et al. 1996; Fichman and Levinthal 1991).

Analysis suggests that expanding an SME's markets beyond its national borders, with increasing levels of commitment, can increase the probability of survival. Liabilities of newness and smallness may put SMEs at a disadvantage in domestic markets where mature organizations can leverage benefits such as brand recognition, market acceptance of their products and supply chain control (Aldrich and Auster 1986). Internationalization, however, may enable new, small firms to escape the challenges of competing in these markets with older, larger firms. The unfamiliarity of foreign markets for any entering firm, both large and small, may reduce the margin of advantage established firms otherwise enjoy at home. SMEs may therefore benefit from expanding their market reach to foreign customers. (Singh, House, and Tucker 1986; Stinchcombe 1965; Venkataraman et al. 1990).

Studies also suggest that R&D alliances can play a role in boosting an SME's survival rate more generally yet not exclusively for internationalizing firms. On the other hand, technology resources did significantly moderate the relationship between internationalization and survival.

In summary, research finds that both R&D alliances and expansion to international markets are associated with better survival prospects in SMEs. The possession of

⁷⁵Dibrell, Clay and Peter S. David and Justin Craig, Fueling Innovation through Information Technology in SMEs.

⁷⁶Lee, Hyunsuk and Donna Kelley. etl, SME Survival: The Impact of Internationalization, Technology Resources, and Alliances.



technology resources, however, does not directly impact survival, but R&D intensity may boost the survival of internationalizing firms. Both internationalization and alliances can create an additional layer of complexity for new small firms. Those seeking markets in other countries must compete with indigenous firms that have experience and knowledge about markets they are unfamiliar with (Oviatt and McDougall 1995).

Despite the vast and increasing potential of ICT (Information and Communication Technology) for publicity and marketing that can have a global outreach at a miniscule expense, most MSMEs are unable to take advantage of this arena and need facilitation and platforms to link up. Here the BRICS Governments can play a game changing role through:

- a) Provision of E-Commerce Platforms for MSMEs and Startups for linkages to local and global clientele
- b) Formulation of a Holistic and Operationable BRICS Policy for MSMEs
- c) Export Facilitation Centers for MSMEs
- d) Undertake R&D in areas of technology up gradation, process modernization, market outreach etc on behalf of the MSME Sector and proactive and universal sharing of results and findings to facilitate international quality and global participation

Chapter 11 Good Practices

The South Korean Case

Among the factors responsible for Korea's success with its outward-oriented industrialisation and mercantilist strategy of growth based on rapid acquisition of larger shares in segments of the world market for manufactures, was the role of the state in guiding industry to the segments of the global market that were targeted.

For this to work, the State must, through its financial policies ensure an adequate flow of credit at favourable interest rates to firms investing in these sectors, so that they can not only make investments in frontline technologies and internationally competitive scales of production, but also have the means to sustain themselves during the long period when they acquire and expand market share.

Chinese Experience: Support to MSMEs for Exports

They make up over 99% of all enterprises in China today. MSMEs account for generating more than 82% of employment opportunities in China. Under processing trade regime, firms are allowed to buy /import inputs duty free provided they are further used to produce further processed goods destined solely for export promotion to developed countries like USA, UK etc. This policy, in fact has helped the Chinese MSME markets to grow at such a high pace in China⁷⁷.

This interplay between government intervention and the entrepreneurial spirit implicit in mainstream theory was studied by Zhang and Van Den Bulcke (1996), who claimed that the Chinese internationalisation process in the early 1990s was the result of a balance between “the influence of the governmental bureaucratic system” and the “development of a real entrepreneurial logic. Support from the state in the form of funding seems to be instrumental in the first stages of their (local and regional) expansion, and (2) support from private sources is relevant to cross national boundaries.

Factors potentially pushing China up in the Value Chain

China's manufacturing sector has enjoyed high and sustained rates of growth, with shares of GNP (Gross National Product) and exports rising gradually. The emergence of dynamic small and medium enterprises is, above all, one of the most important outcomes of the entire reform process.

Globalisation has produced opportunities for Chinese MSMEs to dynamically enter and participate in the global markets. Due to the nature of high competition, this opportunity has also created remarkable pressure on the Chinese MSMEs to increase their abilities to adapt to the market changes, advanced ways to develop the new market, and the entrepreneurial skills to meet global consumer needs.

⁷⁷Cardoza ,Guillermo and Gaston Fornes, The Internationalization of SMEs from China: The Case of Ningxia Hui Autonomous Region.

The Chinese Government published the SME Growth Project in 2006. Its aims were as follows:

- a. To promote the system building of policy and regulation for SMEs;
- b. To cultivate the social service system of SME;
- c. To facilitate SME structural adjustment;
- d. To sustain the SME reforms;
- e. To strengthen SME training;
- f. To improve innovative ability;
- g. To resolve financing difficulties affecting SMEs;
- h. To encourage SMEs to expand offshore through the provision of FDI incentives, among others;
- i. To improve the overall supervision of SMEs⁷⁸.

At present, government procurement system tends to favor products and services generated by SMEs.

The Brazil Support Environment:

The example of Brazil, in particular the Banco Nacional de Desenvolvimento Econômico e Social (BNDES) in Brazil that was established in 1952 and entered areas and promoted activities that would not occur purely through the incentives determined by the market could provide some guidance about how this can occur even in a very open and largely market-driven economy. In Brazil, reform notwithstanding, the BNDES has grown in strength and has served Brazil well. The bank's role increased significantly when private activity slackened in the aftermath of the financial crisis. This countercyclical role helped Brazil face the crisis much better than many other developing countries.

Promoting Entrepreneurship: Malaysia

Government of Malaysia, through several institutional networks, has been improving management and business practices of SMEs, especially in generating economic value creation.

SME Corp, an agency established by the Government of Malaysia, is implementing skills development programme aimed at enhancing the skills and capabilities of workers of SMEs at technical, supervisory and managerial levels. SME Corp will finance 80% of the training cost paid by employers to train their employees in accredited training centres.

Government of Malaysia, through Malaysia External Trade Development Corporation (MATRADE), also provides grant support (to an extent of RM 1 million per company/per brand) to Malaysian SMEs to develop and promote Malaysian brands, both in products and services. Government of Malaysia also provides concessional financing (maximum of RM 3 million) through Malaysia Industrial Development Finance (MIDF) to undertake branding/rebranding exercises of SMEs.

⁷⁸Xiangfeng, Liu, , SME Development in China: A Policy Perspective on SME Industrial Clustering.

Mexico Government has established The Micro and Small and Medium Enterprises Support Fund (FAMPYME)⁷⁹ with the objective of increasing the competitiveness and knowledge development of SMEs. Support is being provided through this Fund for activities related to consultancy, training, studies, innovation and technology development. On these lines, India may also institute the skill development and entrepreneurship promotion strategy that should go beyond the public sector and its agencies, encompassing the private sector and its organizations, including academic institutions and non-governmental organizations. MNCs/large enterprises that source their requirements from SMEs should also be encouraged to take a lead role in infusing enterprise education, skill upgradation, and management induction programmes of SMEs.

Government of **Mexico**, through the Implusoras Programme also provides tailor-made consultancies to inform SME exporters about technical specifications, regulations and quality requirements in target markets. Mexico has also established a Consolidation of Exportable Goods Support Fund (FACOE) to enhance competitiveness of export oriented SMEs.

Finally and very important, Government of **Vietnam**, through pilot projects, help integrate specific enterprise-related training modules into education schemes at high schools, colleges and universities with the objective of fostering entrepreneurial spirit and entrepreneur culture.

⁷⁹Fondo de apoyo a la Micro, Pequeña y Mediana Empresa (FAMPYME)

Annexure I
Mobile Bank Deposit Cards
Securing Petty Markets Cash for Banks
Facilitating Access to Credit for Micro and Small Business
A Concept Note by Mazher Hussain

Financial Inclusion

The Government of India has launched the Prime Minister's Jan DhanYojna for financial inclusion of the poor. Effective financial inclusion requires easy access to credit from banks and convenient modes for financial interactions.

Daily Repayment Option for the Poor

The entire banking system seems to be structured to serve big business and corporate sector that prefer a monthly or quarterly repayment schedules. However most petty and small businesses with small margins operate on a daily basis and for them payments of monthly instalments become difficult and could lead to defaults. Janta Deposit and other similar schemes introduced by some banks in India to undertake daily deposits / recovery from clients could not succeed due to a variety of reasons including high personal costs etc. Hence, new financial products suitable to the petty businessmen and small entrepreneur based on daily recovery / deposits rather than monthly payments will have to be explored and introduced.

Mobile Bank Deposit Cards

With the existing internet and mobile technology, it should be possible to evolve mechanism to make deposits in banks on a daily basis through **Mobile Bank Deposit Cards** without visit to banks and thus save daily transaction time and costs.

Daily Deposits: Most micro and informal businesses in India make on an average a profit of Rs. 5000 to 30,000 and above every month. These profits are made in small amounts on a daily basis and retained by the concerned persons and not deposited anywhere. Most also do not have bank accounts. But around 50% or more of their expenses like rents, schools fees, payments for utilities like electricity and water bills etc. are required to be made mostly in the first week of every month. Hence significant sums remain with them through the month with the possibility of some emergency diversions that could lead to difficulties at the time of monthly payments.

The proposed **Mobile Bank Deposit Cards** can also be used to deposit their daily earnings and extra working capital funds apart from repayment of loans if any.

Creation of Financial Histories: More important, if these small business enterprises can have a facility of depositing their profits and their residue from working capital on a daily basis in banks, then apart from earning interest, they will also be able to develop a financial history with banks that could lead to banks developing confidence in their financial status and encourage banks to start lending to these sections also. This does not happen now as most do not have any official financial histories with banks or other financial institutions despite earning handsomely.

Benefits to Banks and the Financial System: Hawkers, petty businessmen and small entrepreneurs constitute at least 10 to 15% of the population. Majority of them do not have active bank linkages. Interactions have revealed that most of them make their profits on a day to day basis and their average earnings range from 5,000 to 30,000 per month and above. These funds that could run into lakhs of crores monthly- and that are now totally

outside the banking system- could be easily tapped if systems could be put in place to facilitate easy daily deposits where the clients are not required to personally visit banks to make their deposits and overheads for deposit collections could be minimised. The Clients could use the existing debit card facilities for easy retrieval of funds when required.

Mobile Bank Deposit Cards:

The Mobile Bank Deposit Cards is proposed as a simple and convenient arrangement to facilitate daily deposits in banks by clients without visiting the bank and with minimal costs and time investment. The five main parties involved could be:

1. The Bank (could be any bank)
2. Mobile Service Provider- mobile networks of any and all mobile service providers could be utilised for transmission and processing required for this Scheme.
3. Mobile Service Provider or any other entity with a retail network for marketing the Mobile Bank Deposit Cards on behalf of the concerned Bank
4. The Retail Vendor- who procures the Mobile Bank Deposit Cards from the Bank or any of the networks authorized by the concerned Bank to sell it to the Clients.
5. The Client (who wants to deposit money in his / her Bank account using the Mobile Bank Deposit Cards).

Any of these parties could involve other parties to facilitate their roles.

The Process:

1. The Bank or any of its authorised entities would produce Mobile Bank Deposit Cards of different monetary denominations (for example Rs. 50 /100/ 500 etc. in India) with specific individual codes.
2. These Mobile Bank Deposit Cards would then be made available to Mobile service providers or any other networks with retail outlets like supermarkets, petrol pumps, etc. to be called Marketing Chains. Banks could also make them available to retail vendors directly.
3. The banks and these Marketing Chains / retail vendors could enter into different arrangements for financial transfers of the funds equal to the value of the cards that could be either at the time of making the cards available to the chains / retailers or at the time when the card is used.
4. Marketing Chains and retailers could charge a mutually agreed and predetermined service fees.
5. The client would be able to purchase the Mobile Bank Deposit Card from any of the outlets – and in principle these could be available to the Client 24/7 and in most cases in their vicinity.
6. The Clients would purchase the Card of the denomination they want to deposit into their account, punch in the code on the card and the money would get deposited into their account instantly.
7. An SMS alert would come on their mobile to indicate successful completion of the transaction and this could also serve as a receipt for the deposit.
8. As many of these Clients could be semiliterate, their mobile numbers could be registered with the banks to be directly linked to their personal / designated accounts such that any Mobile Bank Card transaction from their phone would go directly into their accounts without putting in any codes for their accounts and only the code on the Card would be sufficient to ensure that the money transferred from a specific mobile gets deposited into a specific account.

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9. Anyone would be able to deposit money into any account in any bank all over the country (if that bank is connected into this Mobile Bank Deposit Card Network) by punching in the Bank account Code and the Code on the Mobile Bank Deposit Card into their mobiles or telephones.
 10. While this would be a great facility, processes and checks have to be evolved to ensure that this process is not misused to violate /circumvent laws and commit fraud.

Advantages to the Clients

- Clients will be able to deposit their money into banks at any time and any number of times without visiting banks and with very little overheads saving time and money.
- Clients, especially the small business groups will be able to develop financial histories that could facilitate loan and other transactions with Banks
- Provide protection for money and prevent avoidable diversion of funds

Advantages to Banks

- Enable them to mobilise funds running into lakhs of crores every month that now remain outside the banking systems.
- Increase the circle of clients for deposits and loans thus increasing their business manifold.

Advantages to Mobile Service Providers and Vendors

Mobile Service Providers and Vendors will be able to get additional business

Annexure II
Last Mile Connect for Banks
AjoyNaquib
Department of Financial Services,
Ministry of Finance, Government of India

Bank Mitr - New Face of Indian Banking

Banking has traditionally been carried out in India through brick & mortar branches. As a result, for reasons of viability, the rural areas have remained neglected in spite of nationalisation of banks in 1969. The larger chunk of branches have been opened in metro, urban & semi urban areas & rural population remained deprived for a banking outlet at a reasonable distance (in some places it exceeded 50 kms). As a result, 55 % of Indian population did not have a bank account till recently.

As an alternative, to cover the last mile, for the past ten years, the model of banking correspondent has been explored, though with no significant success.

A significant milestone has however been achieved with launch of (Prime Minister's Jan DhanYojana) PMJDY scheme in 2014. Two major gains of the scheme are:

- (i) At least one adult in every household has been covered for a bank account &
- (ii) All villages numbering around 650,000 have been proposed to be covered through a network of 159, 000 SSAs (comprising of 3-4 villages in a periphery of maximum 5 kms) which are to be serviced either through brick & mortar branch (presently around 34,000) or a business correspondent (around 125,000) linked to a branch. These business correspondents are popularly now known as

Bank Mitr.

This network of Bank Mitr is being consolidated & strengthened presently and is supposed to be providing a number of banking & insurance services as a last mile coverage to rural population.

If implemented properly, the Bank Mitr scheme can essentially become the new face of banking in India with benefits to both the people and the banking sector:

- i) The Bank Mitr will be one among the local people, speaking their language, using their metaphors for interaction/ accessibility & will not be like an alien across a counter in a bank branch;
- ii) With suitable training, the Bank Mitr can be the grass root agent of the bank to source credit & loan applications for agriculture, allied activities & small businesses. Being one among the villagers, the Bank Mitr will also be better equipped to assess credit worthiness & ensure better recovery.
- iii) Commission on transactions & other services being their source of income, the Bank Mitr will always be driven to make efforts to canvass for more business.
- iv) The link bank branches with their back office support can ensure standardised appraisals and sanctions to speed up the loan processes along with ensuring due diligence.

Participatory Finance: An Alternative Model for Financial Inclusion: The Experience of BASIX in Mewat, India

Syed Zahid Ahmad, Anoop Kaul and S.N. Rahaman⁸⁰

India is home to the world's second largest Muslim population of nearly 180 million and yet a majority of Muslims stay away from formal financial institutions as they give interest on deposits and charge interest on loans, while earning or giving of interest is not approved in Islam. Mr Vijay Mahajan, the founder of Basix, studied the underlying principles of Islamic finance during 2005-2010 and came to the view that *Shari'ah*-compliant finance was more just and equitable as the financier shared the prosperity as well as the adversity of those financed. Given the underlying nature of the contract, it was decided to call it participatory finance and a pilot project was started with a team from BASIX.

The team initiated dialogue with several Muslim organisations around the country and studied their work for financial inclusion based on principles of Islamic *Shari'ah*. In 2012 the pilot was established in the Mewat District of Haryana, about 70 kilometres south of Delhi, where a particular group of Muslims, known as Meos, constituted over 70% of the population with main sources of livelihood as agriculture and animal husbandry. Non-farm activities included stone quarrying and small trading.

Initially it was a challenging task to convince people and create awareness about *Shari'ah* finance, addressing questions such as how was it *Shari'ah* compliant? And how would BASIX go about participating in their microenterprise and sharing their risk? The team also met local religious leaders to brief them about its model and to receive their support and finally started the project for extending microfinance as per *Shari'ah* in September 2012.

BASIX designed and introduced four *Shari'ah* compliant financial products:

- *Murabaha*(cost plus mark-up) - BASIX purchases the materials from the supplier, adds a certain profit margin and re-sells the materials to customers on credit for between 12 and 24 months. The profit percentage is adjusted so that the effective rate of interest on the transaction does not exceed the RBI limits.
- Diminishing *Musharaka*(diminishing equity finance)- BASIX enters into a partnership with the customer to purchase an asset, such as a buffalo. The customer and BASIX jointly purchase the buffalo and then BASIX allows the customer to use the buffalo by paying monthly rent to BASIX against use of BASIX's outstanding share in that asset and also to buy part of BASIX's share every month. The rent amount decreases in accordance with a diminishing share of

⁸⁰The three co-authors work with the BASIX Social Enterprise Group and its NBFC MFI BhartiyaSamruddhi Finance Ltd (BSFL, referred to in this case as BASIX). They have received guidance and inputs from Vijay Mahajan, Mehmood Khan, Mohammed Riaz, Raja Khan, and field support from MohammedSajid, WaseemAkram, Arshad Hussain and Ms Zarin. The programme was headed by SN Rahaman.

BASIX in the asset. After buying back all BASIX's share in the asset, the customer becomes complete owner of the asset and does not have to pay further to BASIX. In the event of any loss in the asset, BASIX, along with the customer, is liable to share the risk.

- *Baisalam*(advance purchase)- BASIX signs a forward sale agreement with farmers at the time of sowing wheat or barley. BASIX specifies the quality, quantity and price at the time of agreement and makes full payment in advance for the crop; the date of supply is deferred until harvest. After receiving the crop, BASIX sells it at the prevailing price including tax (VAT) in the open market.

Unlike conventional interest based microfinance, under participatory finance BASIX's focus is on increasing customers' income levels through livelihood promotion rather than merely extending loans and recovering debts.

BASIX of course makes no distinction between Muslims and non-Muslims in its loans; the terms and conditions are the same for everyone, and the Nuh branch has a number of non-Muslim clients.

Performance So Far

Up until 31st March 2016, the project had cumulatively financed 589 people, 76% Muslims and 24% non-Muslim, 81% male and 19% female, spread over 92 villages of Mawat District, in 34 months. The cumulative financing was Rs. 13.5 million or US\$225,000 with an average investment by BASIX of Rs. 19,904 (\$330). Due to rigorous follow up by field staff and the network of outlets where clients could locally repay their instalment to BASIX, it was able to maintain nearly 100% recovery. There were 17 borrowers in default out of 396 current clients with a total overdue amount of US\$800; this was about 1.2% of the total outstanding. In the majority of these cases the business activities had closed and in some cases the borrowers had left the area.

The pilot operation in Nuh demonstrated that *Shari'ah* compliant financing has a market and that it is potentially profitable. In spite of its unfamiliarity, and the apparent complexity of the various types of financial products, the experiment has shown that it does have some advantages over conventional fixed interest financing.

The following short cases describe four of BASIX's participatory finance partners, and show how their businesses benefited from the partnerships.

Haroon, 60 years old, is a rural doctor from Khodbasi a village near Nuh. He has about 300 patients and often has to give medicines to his poor patients on credit. He therefore went to BASIX and has since taken two *murabaha* loans, for \$250 and \$330 respectively, and this has enabled him to increase his stocks of medicines and raw materials from \$250 to \$420. He estimates that his earnings have gone up by about \$1000 a year, and he is also able to offer a better service to his patients. Haroon has paid back his loans in full and as a result BASIX could book a profit of \$ 77 from this investment.

Sadi has a cycle rickshaw in Nuh, and used to earn about \$150 a month with his old rickshaw. He has taken two loans from BASIX, for \$155 and \$250, and this has enabled him to buy three more rickshaws, He still pedals himself from time to time, and rents out the other three, and he has increased his monthly earnings from \$150 to \$200. His old rickshaw is worth about \$40 but his assets now amount to almost \$550. He too has paid his dues completely and BASIX has in turn earned from him \$54 as their share from his profit.

Hafijan, 37 years old and just 4th Standard pass, sells cosmetics and shoes in Ghasera, a small town about ten kilometres from Nuh has been in business for five years to supplement her husband's income. She has taken two *murabaha* loans from BASIX, for \$330 and \$420. The extra finance has enabled her to add bangles to her stocks, and the loans, along with the additional profits she has earned, have allowed her to double the value of her stock, from \$2500 to \$5000. To accommodate the stock she had to hire a larger shop just two years back and she is now looking at a still more spacious premises. She estimates that her annual income has increased by about \$750 as a result and from this she could pay back to BASIX the loans as well as yield a profit for BASIX of \$ 100. Now her husband plans to leave his job and join her in business as it has become more profitable!

Mukesh is from the Hindu community in Tauru, a small town some 20 kilometres from Nuh. He and his wife Santosh started their business of cosmetics and bangles as they had no land to fall back on. They took their first loan in 2013 from BASIX of \$330 and followed it up with another loan of \$420. This has enabled them to increase their stocks from around \$650 to \$2500. They estimate that their profits have gone up by about \$750 a year, out of which they have shared about \$ 100 with BASIX. The loan is on the same interest-free basis as all the loans from BASIX's branch in Nuh; most of the people in the Mewat area are Muslims, but non-Muslims also find the terms to be attractive. Mukesh has paid his loans on time and he is now looking for another loan from BASIX as they have decided to get into the business of selling artificial jewellery.

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COVA: Brief Overview

Networking for Responsible Citizenship and Global Peace

COVA is a national network of over 700 organisations working for communal harmony and social justice in India and for promotion of peace in South Asia. COVA works with women, children, youth and professionals from different sections and communities on the issues of peace, communal harmony, women's empowerment, child rights, youth advancement, education, health, financial inclusion, environment, compassionate citizenship and responsible activism, natural disasters and man-made conflicts like communal riots.

The range of activities of COVA include programs at the grassroots, networking of organisations and institutions at the local, state, national and international levels involving community outreach, campaigns, trainings, research, advocacy and policy interventions.

On Going Programs: Six Game Changers of COVA

COVA was able to initiate and is currently working on Six Game Changers in the fields of

- (1) Use of Social Media for promotion of peace through COFI (Countering Online Fanatic Indoctrination) Networks in 9 countries of South Asia and Far East
- (2) Initiatives for People's Participation in Governance Processes through invocation of Article 243 of the Constitution of India;
- (3) Access to Education to Poor Students in Private Schools on the basis of RTE Act of 2009;
- (4) Financial Inclusion of the Poor by enabling access to bank loans for the poor;
- (5) Strategic Recommendations for enabling MSMEs to become avenues for mass employment and
- (6) Transforming Philanthropy: From Charity to Empowerment.

As a Partner of UNHCR (United Nations High Commissioner for Refugees), COVA works with over 4000 refugees from 12 countries living in Hyderabad and has a theatre group by name Koshish that has award winning plays on social issues like communal harmony, national integration, Right to Education act, taxation and the poor, peoples' participation in governance, environment protection etc to educate people and transform their perspectives on social issues.

Research and Advocacy Lead: Mazher Hussain

Founder and Executive Director of COVA, Mazher Hussain has a doctorate in Philosophy, started career in computer field and is engaged in social activism from 1997. He has served on Boards of many national and international organisations including the State Bank of Hyderabad. Specialisations include conflict management, Track II, participatory governance, financial inclusion, disaster management and policy advocacy. He is a recipient of South Asia Star Peace Award.