To

Chapter THREE of Vol.1

REORIENTING POLICIES FOR MSME GROWTH

Before we go through the details, let's go through a

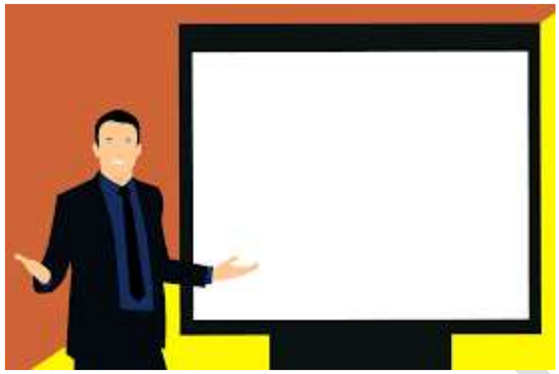
Quick Summary

- **MSMEs contribute to job creation and productivity in the economy.**
- **Job creation in India, however, suffers from policies that foster dwarfs, i.e., small firms that never grow, instead of infant firms that have the potential to grow and become giants rapidly.**
- **To unshackle MSMEs and thereby enable them to grow:**
  - **all size-based incentives must have a sunset clause.**
  - **labour law restrictions should be deregulated.**
- **Focus must be on service sectors such as tourism, which has high spillover effects on other sectors such as hotel & catering, transport, real estate, entertainment etc.**

Now, it's time for the

Details

INTRODUCTION



- **A well-paying job provides the best form of financial and social inclusion to not only the individual but also his/her entire family.**
- **MSMEs contribute to job creation and productivity in the economy.**
- **Our policies must, therefore, focus on enabling MSMEs to grow by unshackling them.**

DWARFISM

- **Firms employing less than 100 workers are categorized as small and firms employing 100 or more workers as relatively large.**
- **Firms that are both small and older than ten years are categorized as dwarfs as these firms have continued to be stunted in their growth despite surviving for more than 10 years.**

- **While dwarfs account for half of all the firms in organized manufacturing by number, their share in employment is only 14.1 per cent.**
- **In contrast, young large firms (firms that have more than 100 employees and are not more than 10 years old) account for only 5.5 per cent of firms by number but contribute 21.2 per cent of the employment.**
- **Large, but old, firms (firms that have more than 100 employees and are more than 10 years old) account for only 10.2 per cent of firms by number but contribute half of the employment.**
- **Thus, firms that are able to grow over time to become large are the biggest contributors to employment and productivity in the economy. In contrast, dwarfs that remain small despite becoming older remain the lowest contributors to employment and productivity in the economy.**
- **The proportion of small firms in organized manufacturing is around 85 per cent. In contrast, large firms account for only around 15 per cent of all the firms in organized manufacturing.**
- **The contribution of small firms to output and employment in the manufacturing sector is insignificant though they account for close to 85 per cent of all firms.**
- **The common notion that small firms generate the most employment is false. Small firms may generate a higher number of new jobs. However, they destroy as many jobs as well. Thus, higher levels of job creation in small firms co-exist with job destruction, thereby leading to lower levels of net job creation.**
- **As compared to the small firms, it is the young firms that contribute significantly to employment and value added. Firms less than 10 years of age account for about 30 per cent of employment.**

- **The comparison with other countries highlights that both employment creation and productivity do not grow adequately as firms age in India.**

ROLE OF POLICY IN FOSTERING DWARFISM

- **Our policies protect and foster dwarfs rather than infants. The key distinction here is that while infant firms are small and young, dwarfs are small but old. Thus, while infant firms can grow to become large firms that are not only more productive and generate significant employment, dwarfs remain small and contribute neither to productivity nor to jobs.**
- **Labour laws:**

  - **India has a plethora of labour laws, regulations and rules, both at the centre and the state levels that govern the employeremployee relationship. Each of these legislations exempts smaller firms from complying with these legislations. For instance, the Industrial Disputes Act (IDA), 1947 mandates**

companies to get permission from the Government before retrenchment of employees. This restriction is, however, applicable only to firms with more than 100 employees. Such labour legislation creates perverse incentives for firms to remain small.

- **To examine the impact of labour regulations, states are classified as flexible and inflexible based on the restrictiveness of their labour regulations.No major labour reforms were initiated by the states from 2007 to 2014. In 2014, Rajasthan was the first State that introduced labour reforms in the major Acts.**

• Flexible and inflexible states

- **To examine the impact of labour regulations, states are classified as flexible and inflexible based on the restrictiveness of their labour regulations.**
- **No major labour reforms were initiated by the states from 2007 to 2014. In 2014, Rajasthan was the first State that introduced labour reforms in the major Acts. Thereafter many States followed on the path of Rajasthan.**
- **The year 2014 is, therefore, fixed as the cut off year to classify and rank States as Flexible and Inflexible.**
- **Flexible states include those states that score 20 or more out of a maximum score of 50, i.e., states that have reduced transaction**

costs by at least 40 per cent. Other states are denoted as Inflexible.

- The Flexible States contribute disproportionately more, on average, to labour, capital and productivity when compared to the Inflexible States.
- The average number of workers per factory, capital per factory and wages per factory are also higher in the Flexible states than in the Inflexible states.
- Due to rigidity in the labour laws, employers in Inflexible States prefer substituting labour with capital.

Small Scale Reservation

- The policies targeted at the small firms referred to as the MSMEs include priority sector lending, incentives/exemptions till they reach an investment upper limit. All these policies promote small firms irrespective of their age.
- Incentives Available to Small Scale Firms are as follows:
  - Priority Sector Lending: Direct and indirect finance at subsidized interest rates shall include all loans given to micro and small enterprises, irrespective of their age.
  - Credit Guarantee Fund Scheme: This scheme makes available collateral-free credit to the micro and small enterprises, irrespective of their age.

- **Purchase Preference Policy:** **A group of items (Group IV) are reserved for exclusive purchase from small scale units, irrespective of their age. Group V items are to be purchased from MSMEs, irrespective of their age, up to 75 percent of the requirement.**

- **Price Preference Policy:** **For selected items that are produced by both small scale and large-scale units, price preference is provided to small firms, irrespective of their age. This price preference amounts to a 15 per cent premium over the lowest quotation of the large-scale units.**

- **Benefits in tendering:** **MSMEs, irrespective of their age, can avail benefits such as availability of tender sets free of cost, exemption from payment of earnest money deposit, exemption from payment of security deposit.**

- **Raw Material Assistance Scheme of National Small Industries Corporation (NSIC):** **This scheme aims to help MSMEs, irrespective of their age, with financing the purchase of raw material (both indigenous and imported).**

- **Marketing Assistance Scheme:** **Provides assistance to MSMEs, irrespective of their age, for the following activities: organization of exhibitions abroad, cosponsoring of exhibitions organized by other organizations, organizing buyer-seller meets, intensive campaigns and marketing promotion activities.**

- **GST Composition scheme:** **Scheme allows MSME firms, irrespective of their age, to pay GST at a flat rate. The turnover limit for businesses availing of the GST composition scheme is set at `1.5 crore.**

- **Exemption under Central:** **Excise law Small scale units below a turnover of `4 crore, irrespective of their age,** manufacturing good specified in SSI are eligible for exemption

- The Small-Scale Industries (SSI) reservation policy was introduced in 1967 to promote employment growth and income re-distribution. Given the predominance of dwarfs in the Indian economy and the low productivity and employment generation, as shown above, it is crucial to examine the role of the SSI reservation policy.

WAY FORWARD

- **Incentivizing 'infant' firms rather than 'small' firms**: With the appropriate grandfathering of existing incentives, they need to be shifted away from dwarfs to infants.
- **Re-orienting Priority Sector Lending (PSL):** Under MSME's PSL targets, it is necessary to prioritize 'start ups' and 'infants' in high employment elastic sectors. This would enhance direct credit flow to sectors that can create the most jobs in the economy.
- **Sunset Clause for Incentives:** With appropriate grandfathering, every incentive for fostering growth should have a 'sunset' clause, say, for a period of five to seven years after which the firm should be able to sustain itself. The policy focus would thereby remain on infant firms.
- **Focus on High Employment Elastic Sectors**: The manufacture of rubber and plastic products, electronic and optical products, transport equipment, machinery, basic metals and fabricated

metal products, chemicals and chemical products, textiles and leather & leather products, are the subsectors with highest employment elasticities. To step up the impact of economy growth on employment, the focus has to be on such high employment elastic sectors.

- **Focus on Service Sectors with high Spillover Effects such as Tourism:** **Developing key tourist centres will have ripple effects on job creation in areas such as tour and safari guides, hotels, catering and housekeeping staff, shops at tourist spots etc.**