

ROLE OF INDUSTRIAL POLICY IN DEVELOPMENT OF MSME SECTOR

A Discussion Paper

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January 2015

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Executive Summary

In light of the announcement of the new industrial policy framework by the GOT Telangana, Center for Economic and Social Studies (CESS) is organizing a seminar to deliberate on the policy. In this regard, CESS invited Finetrain LLP to formulate an approach paper on the role of industrial policy in promoting the MSME sector. This paper is based on a detailed review of policy documents and interaction with MSME entrepreneurs.

Telangana is 12th largest economy in the country. The MSME sector in Telangana is sizable, comprising over 90,000 units in the registered sector. The key industries include engineering, agri products (rice/dal, dairy), life sciences, and information technology. The MSME sector in the state has suffered over the past three years, as a result of issues related to the bifurcation of the erstwhile state of Andhra Pradesh, a weak macro-economic scenario, long approval process, lack of power availability and difficulty in securing bank funding.

The policy framework of GOT provides a robust road map for the industrial development of the state. It emphasizes the importance of developing backward regions and marginalized communities, promoting MSME sectors and providing hassle free approval/inspection process. It also incorporates measures to boost entrepreneurship and to provide consulting/advisory support to MSMEs.

While policy roadmap is a good starting point, the efficacy of the policy in making MSME competitive would lie in its effective implementation. This paper suggests an implementation framework including aligning policy objectives to MSME specific challenges, revamping policy delivery mechanism to ensure transparency and extending the reach of policy to even unregistered MSMEs.

This paper is divided into three sections: Section 1 provides an overview of MSME sector in Telangana; section 2 describes the challenges being faced by the MSMEs in the state; section 3 elaborates the current industrial policy roadmap and suggests implementation framework for the same.

Finetrain would like to acknowledge the valuable support, inputs and guidance received from Dr. Yerram Raju towards formulation of this paper.

1. Introduction to MSME Sector in Telangana

Telangana is 12th largest economy in the country. Its economy is driven by industry and service sectors, which together contribute to almost 83 per cent of the GSDP (Gross State Domestic Product)¹.

The Micro and Small enterprises (MSME) sector in Telangana is sizable, comprising over 90,000 units in the registered sector; the actual size of the sector would be much larger as registered enterprises constitute only 10 per cent of this sector. The key industries in MSME manufacturing include engineering, agri products (rice/dal mills, dairy), life sciences and textiles. The important service industries comprise construction and allied services, information technology, transport services, hotels and restaurants (See Table 1).

Table 1: MSME industries in Telangana			
Districts	Units²	Investment (Rs. Crore)	Industry
Ranga Reddy	22,083	14,454	Engineering, pharmaceuticals, plastics, miscellaneous
Medak	12,291	13,916	Chemical based, steel fabrication, food products
Hyderabad	11,923	7,753	Electrical/electronics, paper products, metal products, repair services
Khammam	10,633	8,069	Granite, rice mills
Nalgonda	6,500	8,960	Clay bricks, pharmaceuticals, rice mills, power looms
Nizamabad	5,701	616	Agro based, cotton, repair and servicing
Warangal	5,624	763	Rice mills, stone crushing, leather tanning
Mahabubnagar	5,292	2,890	Sponge iron, textile, plastic, food and agro
Karimnagar	5,163	2,187	Rice mill, textile, paper products
Adilabad	2,131	3,345	Rice mill, dal mill, wood products, steel fabrication

Source: Commissioner of industries of combined Andhra Pradesh and district profiles

¹ Socio Economic Outlook, Telangana, 2014

² Based on Entrepreneurs Memorandum 2 filed in the State

1.1 Key features

1. The state's industrialization is very uneven with majority of development being confined to the three districts of Hyderabad, Ranga Reddy and Medak which contribute to over 50 per cent of the GSDP³. The remaining districts, including Nizamabad, Adilabad and Karimnagar which enjoy abundant natural resources, do not have adequate processing facilities for harnessing their agro based resources. Most of the produce is sent to other states for further processing or exported in raw form.
2. MSME manufacturing industry in the state has developed around key anchors in the heavy engineering, defense and pharmaceuticals sector. The anchor companies include large enterprises such as BHEL, BEL, ECIL in the engineering sector, DRDO in defense and IDPL Dr. Reddys, Aurobindo Pharmaceuticals in life sciences. Recently, the state has been able to attract Mahindra and Mahindra's tractor manufacturing unit and Tata's Aerospace unit engendering opportunities for MSMEs in automobile and aerospace as well.
3. Other than manufacturing, the state also has significant number of MSMEs in agro allied sectors such as rice mills, dal mills, dairy farms and textile mills.
4. The MSME service sector includes Information Technology, Construction, Trade, Hospitality and Transport. The Tourism industry is also expected to gain momentum as GOT is promoting it aggressively.
5. The State has robust physical and knowledge infrastructure to support its industries. Its physical infrastructure includes a number of industrial parks such as IT Parks in Ranga Reddy, Aerospace SEZ at Adibatla, and Genome Valley Life Sciences Park in Hyderabad. Further, over fifty central government training and education establishments that include NGRI, IICT, CCMB, Central University, NALSAR, and NIRD also support its knowledge based industries.

³ As per Socio Economic Outlook ,Telangana, 2014

2. Challenges of the MSME sector

The MSME sector has not been able to grow in line with the industrial growth of Telangana. The share of MSME sector) in Telangana GSDP has declined over the last decade (see Table 2) due to a number of reasons including issues related to the bifurcation of the erstwhile state of Andhra Pradesh, a sluggish macro-economic scenario, long approval process, lack of power availability and difficulty in securing bank funding.

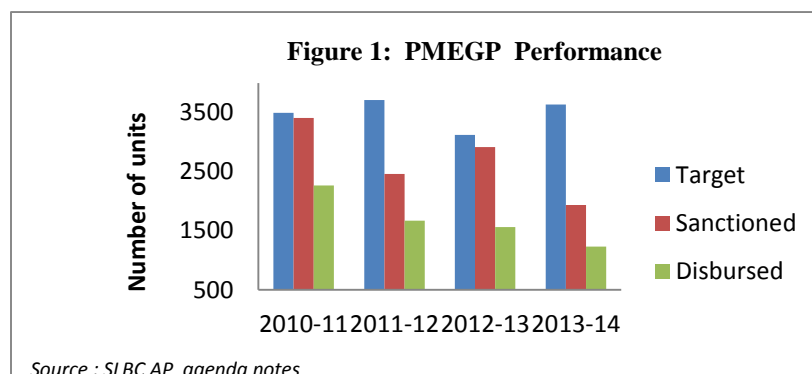
Table 2: Sectoral share (%) in GSDP at Constant (2004-05) prices		
Sub sector contribution to GSDP	2004-05	2013-14
Mining and Quarrying	4.75	2.78
Manufacturing		
<i>Registered</i>	9.96	13.32
<i>Unregistered (MSME)</i>	3.23	2.05
Electricity, gas and water supply	2.79	2.59
Construction	7.54	6.58
Total Industrial Sector	28.28	27.12
<i>Source: Socio economic outlook of Telangana 2014</i>		

Our discussion with various public sector banks indicate that there has been little or no new MSME proposals in the past two years. Specific reasons for poor performance of the sector are:

- The demand for MSME products has declined with a decline in orders from large anchors such as BHEL, ECIL and an increase in competition from new vendors. Since a majority of MSMEs (engineering components, metal casting, and fan components) do not sell value added products (with little differentiation among them), their pricing power has been eroded due to competition from new vendors. This increasing competition, coupled with decreasing demand has dented profitability of MSMEs.
- MSMEs have been facing difficulty in getting institutional finance. The performance of collateral free lending scheme in the state is a matter of concern, with less than 10 per cent of MSE lending securing the CGTMSE

guarantee cover.⁴ While finding funds has become difficult, funding requirements of MSMEs have escalated due to rising working capital needs. Many of the vendors of large public and private sector units have not been receiving their payments on time, leading to net working capital crises.

- The MSME start-ups are worst affected, as they typically do not have stable revenues and collateral. Performance of credit linked schemes of GOI such as Prime Minister Employment Generation Programme (PMEGP), Swarna Jayanti Shahari Rozgar Yojana (SJSRY) that facilitate credit to start up remains far below target. Further, there are high instances of loans under these schemes going bad as reflected in the NPA levels of over 12% in these loans under important schemes such as PMEGP, and GOAP schemes (see Figure 1).



- MSMEs also suffer from delays in obtaining approvals due to lack of coordination among various state government departments. Government staff is also not equipped to counsel entrepreneurs on issues related to eligibility of subsidy, time taken in processing of claims etc (see Box 1 for a case study).
- While power availability remains a constraint, the situation has somewhat eased as SMEs power needs have decreased following weak demand. Most industrial estates in Telangana have at least one day of scheduled power holiday. While MSMEs can cope with scheduled power holiday, they find it difficult to manage when there are unexpected power cuts.

⁴ As per SLBC agenda notes the overall MSE lending in the united AP was Rs. 10, 475 crores, and lending against CGTMSE was Rs. 673 crores.

Box 1: Lack of understanding of approval processes

Mrs. Usha runs a noodle manufacturing unit called Tasty Noodles, which has an annual turnover of around Rs. 2-3 crores. She started her unit in 2004, with a capital of Rs. 5 lakhs. Her clients include large retailers/ schools and residential hostels. The unit is co-located very close in her residence.

In 2005, she came to know of a scheme of the GOI Ministry of Food Processing under which she could get a subsidy of 35 per cent on her loan. Since the loan was cheaper because of subsidy, Mrs. Usha decided to borrow for her future requirements as well and invested in a new transport vehicle and several new machines. While she obtained the loan, the bankers refused to consider the subsidy element of the loan until she got a letter from local DIC for the same. But, the DIC refused to issue such a letter, as she did not have the right documentation and also since her factory was in residential area, which is non-compliant with State Government norms.

Mrs Usha had to follow up for three years, including repeated visits to the Commissioner of Industries, GHMC and AP Pollution Control Board to get NOCs from each of them. As a result, she was not able to spend enough time on her business and her sales declined. Further, the demand for noodles also decreased as a result of agitations across the state prior to its bifurcation, which resulted in closure of schools/hostels for a long time. Lower demand, high interest and principal payments (which she had not factored in as she had believed that she would get the subsidy), resulted in a dip in the financial performance of Tasty Noodles and it became an NPA in 2012. Mrs. Usha is still trying to get the letter from DIC for the subsidy, post which the bank is planning to restructure her account.

3. Industrial policy’s role in promoting MSME sector

The GOT has recently unveiled its industrial policy document entitled *Industrial Policy Framework of Telangana (2014)*. It provides a robust road map for the industrial development of Telangana. The framework emphasizes the importance of developing backward regions and marginalized communities, promoting MSME oriented sectors and providing hassle free approval/inspection process (See Table 3).

Table 3: Key features of Industrial policy for MSME sector	
Objective	Proposed measure
Ease of doing Business	<ul style="list-style-type: none"> • Single Window Act • Reduced inspections/lower corruption • Smaller plots for MSME units in Industrial parks/SEZs
Industrialization of backward districts	<ul style="list-style-type: none"> • Development of industrial corridor along Hyderabad-Warangal, Hyderabad-Nagpur, Hyderabad-Bengaluru highways in the first phase, second phase of development connecting Nalgonda, Khammam to Hyderabad to follow • Development of sector specific industrial parks in backward districts
Promoting MSMES	<ul style="list-style-type: none"> • Food processing, Plastics are among the 14 sectors identified as priority sectors, sector specific industrial policy is proposed • Development of small industrial plots for vendors/ancillary units in Industrial parks • Development of Warangal as Textile hub
Entrepreneurship promotion	<ul style="list-style-type: none"> • TS-PRIDE, a Program for /Dalit entrepreneurs • T-hub, a program for technology start ups
Providing finance	<ul style="list-style-type: none"> • Dalit entrepreneurs would be provided margin financing by the state • Telangana State level banker committee to have a specific subcommittee for MSME
Preventing sickness	<ul style="list-style-type: none"> • A fund to help sick MSMEs has been proposed
Other Measures	<ul style="list-style-type: none"> • Consultant panel to respond to MSME needs • Funds to assist MSME in technology procurement • Skill development programmes for providing trained manpower

3.1 Policy implementation framework

The efficacy of policy would lie in efficient implementation of the suggested policy measures. We recommend an implementation framework (see figure 2) including aligning policy objectives to MSME specific challenges, revamping policy delivery mechanism and increasing the reach of policy to even unregistered MSMEs.

Figure 2: Policy implementation framework



3.1.1 Redefining policy objectives

Policy objectives could be defined in terms of addressing challenges faced by MSMEs such as facilitating access to technology, market, infrastructure and finance. The performance of policy measures could also be measured by the number of MSME enterprises who avail of the benefits/services/incentives (see Figure 3).

Figure 3: Recommended objectives of MSME Industrial Policy

Access to markets	Access to technology	Access to finance	Ease of business
<ul style="list-style-type: none"> •Market development fund, marketing consultants, trade fair participation, utilising GOI schemes for cluster development •Inviting anchor industries 	<ul style="list-style-type: none"> •Technology up gradation fund, utilising GOI schemes for technology up gradation •Technology consultants 	<ul style="list-style-type: none"> •Through MSME committee in SLBC •Branch manager contact programme •Seed fund scheme •Better utilisation of PMEGP and other GOI schemes 	<ul style="list-style-type: none"> •Single window Act •Infrastructure such Industrial parks, SEZ •Entrepreneurship promotion programmes

Most of the measures for enabling the policy objectives have already been provided in the industrial road map document of GOT. Additionally, utilizing GOI schemes such

as Cluster development Programme (CDP), and National manufacturing competitiveness Programme (NMCP), PMEGP should also be a priority for the state. The CDP is an ideal mechanism to boost industrial growth in the backward areas as it promotes local economic development without putting significant burden on the financial resources of the state. Some of the clusters such as electronics cluster in Hyderabad and Maheshwaram that have already received in principal approval should be developed on a priority basis. Similarly, the state needs to make use of PMEGP to promote entrepreneurship in the state.

3.1.2 Overhauling implementation machinery: The report's recommendations for robust implementation of policy measures are:

3.1.2.1 Capacity building of Industrial promotion officers (IPOs)/other DIC staff:

IPOs are the first contact point with MSMEs and are also responsible for providing clearances as part of new policy framework. IPO's should be extensively trained on various State government and GOI schemes. In this regard, the GOT may want to create a training manual for the Department of Industries along the lines of one developed by Himachal Pradesh (See Box 2).

Box 2: Training DIC staff- Best practices from Himachal Pradesh

The Department of Industries of Himachal Pradesh has a training manual which can be used by senior officers to make training plans for their department. It provides information on staff strength across various divisions, their functions and the government schemes that are being implemented. It also provides guidance on design and implementation of training programmes.

Further, senior DIC staff should be provided incentives to attend and actively participate in national conferences on industrial development. The GOT should also ensure that each DIC should is adequately resourced with an e-library.

DIC should work in tandem with other GOI organizations that are involved in MSME development such as MSME development institute, ni msme so that there is no duplication of training/outreach programmes among these institutions.

3.1.2.2 Transparency in Delivery

To ensure transparency in delivery, it is desirable that the DICs display disseminate the following aspects:

- **Information on services/registration required for a start ups:** It should include at a minimum, the name of officer in charge for MSME, requisite forms to be submitted, cost of forms and services, and the timelines for delivery of various services under the Single Window Scheme;
- Time line for clearance of proposals for rehabilitation of sick MSMEs

3.1.2.3 Empanelment of Business Development Service (BDS) providers: For fast delivery of MSME services, the government needs the assistance of business development services providers (such as MSME industry associations, consultants) who provide a range of services such as training, technical consultancy and financial consultancy. The industrial policy refers to empanelment of MSME consultants; it can perhaps be supplemented with norms for empanelling these service providers; the norms could be specified in terms of minimum 3 years of track record of the organization, availability of audited financials etc. These service providers can provide training/consultancy services to entrepreneurs at pre-determined tariff, which should be displayed at both DIC and agency's office.

3.1.2.4 Branch Manager Contact Programme: We also recommend a branch manager contact Programme by Commissioner of Industries (COI), Telangana to address bankers' concern regarding financing MSMEs. The branch managers are the decision makers with regards to funding MSMEs, and so their support would be critical specifically for providing finance as part of GOT schemes.

3.1.2.5 Dispute Resolution mechanism between MSMEs and their creditors/debtors: GOT needs to provide a mechanism for faster resolution of disputes between MSMEs and their creditors. It has already set up a Micro and Small Enterprises Facilitation Council, which needs to be strengthened with dedicated full time staff. Also, the awareness of the council as a faster dispute resolution mechanism has to be generated. It would help if DICs also disseminate information on number of cases cleared by the council every year and money /overdue amount collected by Micro and Small enterprise.

3.1.3 Reaching out to MSMES

The benefits of policy should flow to unregistered MSMEs as well, who comprise almost 90 per cent of the sector. There is a need for spreading mass awareness of benefits of registration among MSMEs. Since MSMEs face difficulty in filing online registration process (and end up paying a fee to consultants for the same), the government could facilitate online registration process at its mee seva centers.

There is also a need to spread awareness about various initiatives of the government and how these are benefitting MSMEs. GOT could disseminate its annual policy document detailing various initiatives undertaken during the year on its website as is being done by the state of Tamil Nadu (See Box 3). A hard copy of the document can also be made available at various departments such as Commissioner of Industries office, DIC, Animal husbandry, Horticulture that are frequented by MSMES.

Box 3: Spreading awareness of policy measures - Best practices from Tamil Nadu

The Government of Tamil Nadu (www.tn.gov.in) routinely disseminates its annual *MSME department policy note* on the website of Directorate of industries of Tamil Nadu (www.indcom.tn.gov.in). It comprises important statistics related to MSMEs, progress on MSME schemes and new initiatives. Specific information in the document includes:

1. Number of EMs (Entrepreneurs memorandum) filed
2. Number of meetings of MSME facilitation council held during the year, cases resolved
3. Credit availed by MSMEs
4. Ongoing cluster development Programme
5. Creation of infrastructure at industrial estates etc.

4. Conclusion

MSME sector in Telangana is in critical need of policy support from the government to ensure its survival. The industrial policy road map is a good first step in the direction of providing MSMEs business opportunities, infrastructure and a hassle free approval process. The policy when implemented effectively can improve the competitiveness of the industry. This paper suggests that policy objectives should be defined and measured against providing access to market, finance, technology and infrastructure to MSMEs. The delivery mechanism should be enhanced via capacity building of DICs and bringing transparency in cost and time taken for delivery of various services. Further, the benefits of policy initiatives should also be extended to unregistered MSMEs.