

## SMALL AND MEDIUM ENTERPRISES IN ANDHRA PRADESH: LEVERAGING GROWTH FINANCE FOR SUSTAINABLE DEVELOPMENT

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### **Abstract**

*MSME play pivotal role in Indian manufacturing sector and have become engine of economic growth in India with their effective, efficient, flexible and innovative entrepreneurial spirit. It is generating the highest rates of employment growth and account for a major share of industrial production. It is estimated that MSMEs account for almost 90% of industrial units in India and 40% of value addition in the manufacturing sector. This paper closely analyses the growth and development of the Indian Micro Small Medium Enterprises sector from opening of the economy in 1991. The Micro, Small and Medium Enterprises Act, 2006 is intended to boost the sector. The provisions of the Act are examined closely. The final part provides some future policy framework for the sustainability of the sector.*

*The policies of interest are state outlays and subsidies targeted towards this sector. More specifically, we analyze the impact of total financial subsidies to the sector, total state investment in industrial parks and clusters aimed at this sector and the total state expenditure to support technology within the MSME sector.*

*It is also noteworthy that not all the specific policies which have been implemented specifically for the development and growth of the MSME sector have had a great impact. Amongst these we find that pumping more financial subsidy into a sector is not necessarily the best way to encourage growth of a sector. This result is especially interesting when we juxtapose it against the role played by presence of bank branches. Both, banks and the government financial subsidies are ultimately aimed at providing improved access to credit to entrepreneurs within the MSME sector.*

**Keywords: MSME, GDP, Entrepreneur and Economic Development.**

### **Introduction**

The high population growth, high rates of unemployment and poverty, and the declining capacity of the public sector as a viable employer of last resort, many developing countries like India are turning to Small and Medium Enterprises (SMEs) as a potential lifeline to generate jobs and promote economic development. However, in order for SMEs to contribute meaningfully to GDP growth and play a critical role in economic development and job creation in the coming years, they must be provided with the right tools and resources.

This study assesses the state of a significant, segment of the SMEs market, needs and the challenges they face. It addresses how governments and other stakeholders can help them reach their potential for growth and job creation in the state of Andhra Pradesh.

This study shows that although there is a number of existing SMEs support programs in the region, they need to go beyond the provision of limited subsidized loans and pre-investment training to adequately support the SMEs throughout their business lifecycle. More specifically, the findings suggest that SMEs have four critical interrelated needs for sustainable success: 1) flexible capital structured to fit the needs of each SMEs; 2) sustainable and customized business development assistance targeted to each SMEs needs; 3) market linkages to supply chains to ensure SMEs have an adequate access to market opportunities; and 4) an enabling business environment that addresses the barriers to their development and growth. There is near unanimous agreement among SMEs and intermediaries interviewed in this study that addressing these needs in a focused and sustained manner would increase the survival rates and sustainability of SMEs businesses.

An integrated system that offers a one-stop-shop facility where SMEs can access a range of services from information about starting a business to support on how to effectively manage and sustain a growing business is much needed. Organizations in charge of these programs also need to build stronger execution capacity that enables them to provide services in a rigorous and sustained manner, to identify the deficiencies of entrepreneurs and managers of SMEs and address their specific skill set needs. To make SMEs support programs more effective, a more coordinated, customized and sustained model of support that is sustained throughout the various stages of business development and growth, and is capable of addressing not only barriers to starting up a business, but also barriers to operating a business and achieving growth, should be adopted. Beyond improving the core capabilities and offerings of SMEs support programs, there is a need to increase the synergy and coordination between them as well as to improve communication and information sharing between support programs and the clients they seek to serve entrepreneurs and SMEs.

SMEs have been widely recognized as effective and successful in developed markets, where they are responsible for much of the growth in new jobs, and contribute to over 60%–70% of employment and more than 50% of GDP. However, in spite of the acknowledgment those SMEs are critical to economic development, the Andhra Pradesh remains among the least effective at cultivating a business environment that is friendly to SMEs. Many SMEs face substantial barriers to growth and sustainability ranging from limited access to finance and an unfavorable regulatory environment, to the lack of business management skills and market linkages needed to grow and succeed. They often struggle to obtain the financing they need to expand and achieve sustainability due to their stage of development.

### Objectives

1. To study the promotion and development of and enhancing the competitiveness of micro, small and medium, enterprises
2. To evaluate the economic growth and employment opportunities created by MSMEs
3. To identify and review what the government and support institutions are doing to facilitate and encourage entrepreneurship
4. To suggest the best methods to improve the SMEs growth prospectus

### Sample

Research for this study was conducted in four districts i.e. Krishna, Guntur, Prakasam, and Visakhapatnam that spanned different pockets of Andhra Pradesh. The study comprised over 50 interviews with experts, a quantitative survey of over 50 local SMEs owners and secondary research. The initial 50 interviews spanned expert from “intermediaries” across the four districts including governments, banks, academia SMEs focused nonprofit organizations. The quantitative survey focused specially on SMEs owners and key financial decision makers, to allow us to better understand their experiences, challenges and needs.

Current SMEs support initiatives in Andhra Pradesh do provide a range of financing and nonfinancial services but they have weaknesses that impede their ability to support sustainable businesses that can create jobs and contribute to economic growth over the long term.

These weaknesses can be summarized in three categories,

1. **Poor coordination:** SMEs support organizations suffer from poor coordination and limited execution capacity;
2. **Inadequate products and services:** The products and services provided lack suitable terms and capital structure and sustained business assistance.
3. **Weak ecosystem:** There are broad environmental factors including the lack of effective policy environment for SME formation and growth, inadequate educational programs and a high ratio of government employment, that make entrepreneurship unattractive and a less prestigious professional track.

This study will not only provide a better understanding of the current landscape and challenges of this sector, but also, through our recommendations, spawn proactive discussions and meaningful solutions from policymakers and the public and private sectors to enable SMEs particularly those in the Andhra Pradesh, to operate in a business and regulatory environment that supports their development, and to receive needed growth financing and business development assistance. This will allow them to grow sustainably, create jobs and ultimately contribute to economic growth and prosperity for the A.P.

### SMEs in Andhra Pradesh

In recent years, the need to support SMEs has become a top government priority in the Andhra Pradesh SMEs have been deemed a key tool to combating the present challenges facing the region, including the need to diversify the economy, improve competitiveness, raise living standards, create jobs and bridge the regional development imbalances within countries. The World Bank called SMEs essential engines of growth that contribute to effective markets and reduce poverty in developing countries where populations were growing rapidly and jobs desperately needed.

### SMEs Survival Issues

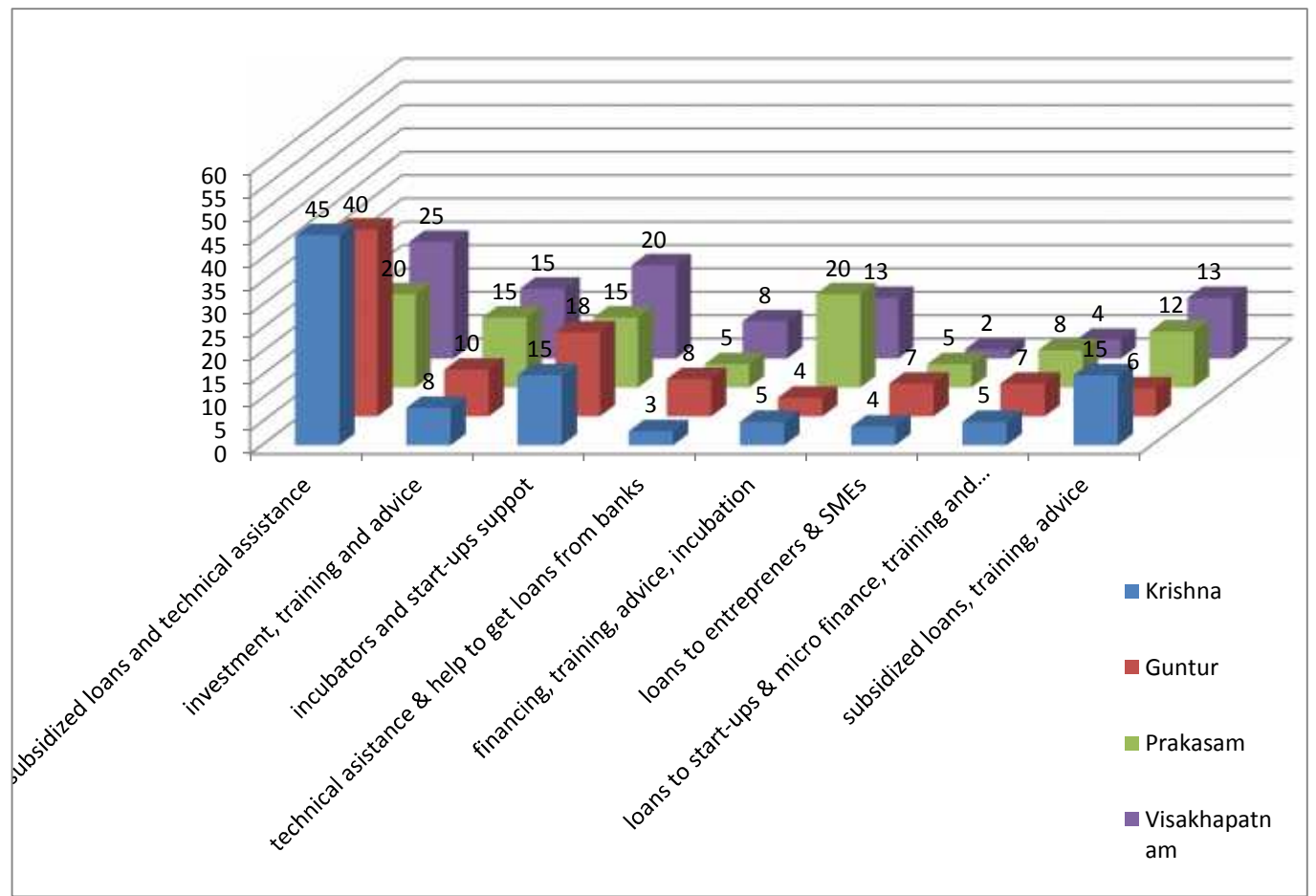
1. **Access to flexible patient capital:** Debt and equity financing on appropriate terms (capital requirement, pricing and tenor) structured to fit the specific needs of each SME across the lifecycle of the business.
2. **Business development assistance:** Customized, robust and sustained business training and solutions, including market information, marketing, management and finance, strategic planning and technology to bolster the business skills and knowledge of the entrepreneurs.
3. **Market linkages:** Linking SMEs to supply chains and to the vast potential business and community development opportunities and investment projects that will ensure the growth and sustainability of SMEs.
4. **Enabling business environment:** Removing regulatory barriers that are harder for small and mid-sized enterprises to overcome than for large enterprises.
5. **Data analysis:** A study has been conducted towards the growth and sustainability of SMEs and bank financing issues in the selected sample districts of Andhra Pradesh.

**Table 1.1 Government liked SME support programs in Andhra Pradesh.**

Level of satisfaction towards SME support programs in Andhra Pradesh	Krishna	Guntur	Prakasam	Visakhapatnam
Subsidized loans, training, advice	45	40	20	25
Loans to start-ups & micro-finance training and advice	8	10	15	15
Loans to entrepreneurs & SMEs	15	18	15	20
Financing, training, advice, incubation	3	8	5	8
Technical assistance & help to get loans from banks	5	4	20	13
Incubators and start-up support	4	7	5	2
Investment, training and advice	5	7	8	4
Subsidized loans and technical assistance	15	6	12	13
Total	100	100	100	100

*Source: data compiled from field level survey.*

Figure 1.1



Source: Data Compiled from field level survey

**Interpretation:** A study has been conducted towards the growth sustainability of SMEs and bank financing issues in the selected sample districts of Andhra Pradesh and analyzed the government linked SME support programs. The data analysis reveals that subsidized loans, training is not encouraging in comparison to them other selected parameters and also the level satisfaction is not encouraging in respect of micro finance, incubators and start-up support almost in the entire four selected district

### Obstacles facing SMEs in Andhra Pradesh

This section addresses the barriers to the four common needs of SMEs that we identified i.e. “How to transition from small grocery shop to supermarket can be challenging to traditional owners. I know a small but successful business that failed when it tried to transform itself into a bigger business for lack of business and management skills. The owner did not have the skills to set up an accounting and HR system.”

SMEs face many other challenges that may lead to failure, including the lack of business and managerial skills, insufficient access to markets, lack of a vibrant entrepreneurial culture and competition from bigger, more powerful businesses.

### Barriers to bank funding at sample districts of Andhra Pradesh

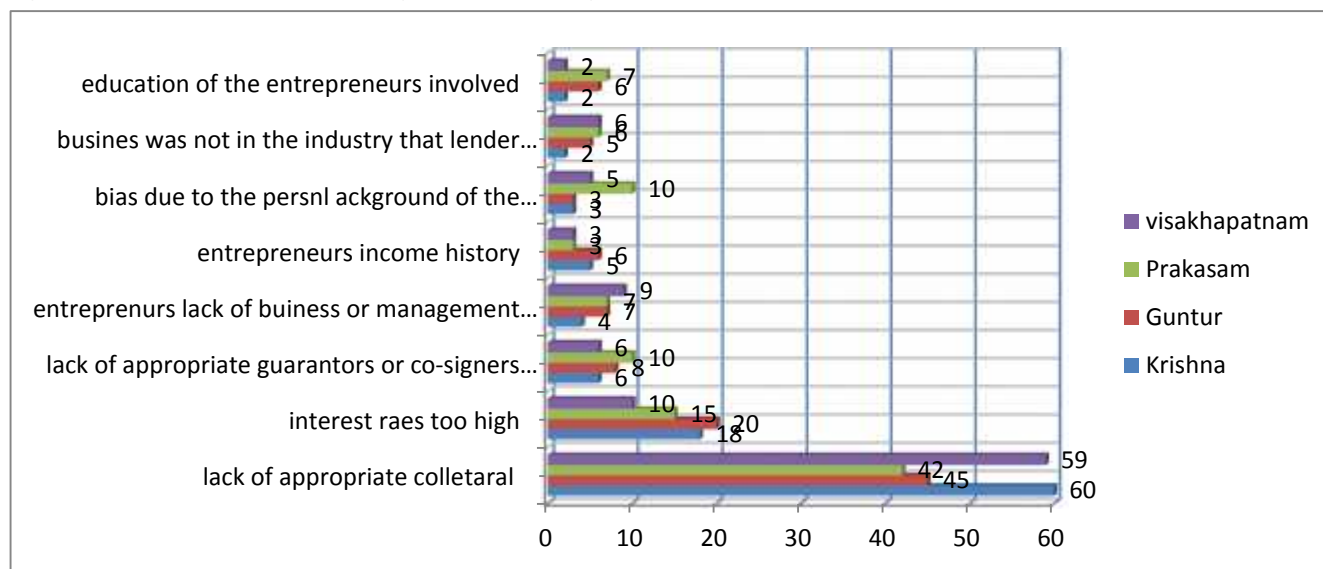
Q: Which if, any of the following do you consider barriers or obstacles facing your business in terms of our ability to receive this level of funding?

**Table 1.2 Barriers to Receiving Bank Funding**

Barriers or obstacles to receiving bank funding	Sample respondents			
	Krishna	Guntur	Prakasam	Visakhapatnam
Lack of appropriate collateral	60	45	42	59
Interest rates too high	18	20	15	10
Lack of appropriate guarantors or co-signers for loans	6	8	10	6
Entrepreneurs' lack of business or management skills/expertise	4	7	7	9
Entrepreneurs incomes history	5	6	3	3
Bias due to the personal background of the entrepreneurs involved	3	3	10	5
Business was not in the industry that lender specifies	2	5	6	6
Education of the entrepreneurs involved	2	6	7	2
Total	100	100	100	100

Source: data compiled from field level survey

**Figure: 1.2 Barriers to Receiving Bank Funding**



Source: Data compiled from field level survey

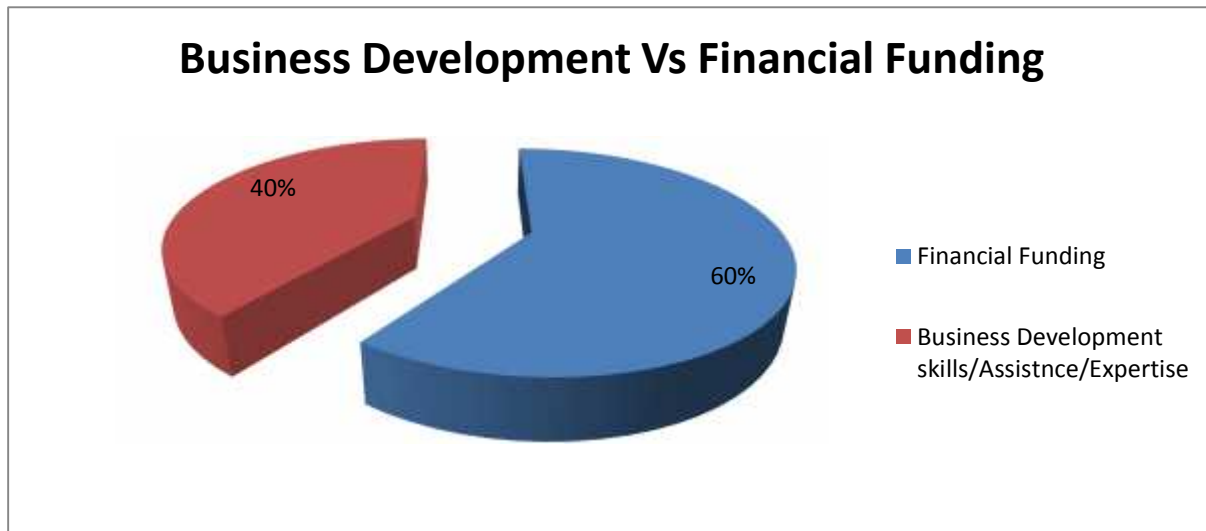
**Interpretation:** Barriers to receiving bank funding in respect of collateral security, interest rate, entrepreneurs personnel and income details were shown in table 1.2. It reveals that majority of the respondents are facing number of problems particularly in respect of providing collateral security, high rate of interest, bias due to the personnel background of the entrepreneurs involved.

### C. Market Linkages

A dearth of market linkages and supply chain opportunities for SMEs also hampers their ability to survive in A.P. In developed economies, large firms increasingly place part of their work outside the organization since subcontracting and outsourcing can reduce production costs. This provides opportunities for smaller firms to fill those needs. In A.P however, large firms tend to build their own supply chain and support systems in-house,

which cover a broad range of functions like human resources, web development, marketing, and maintenance to distribution, insurance and customer service, rather than outsourcing.

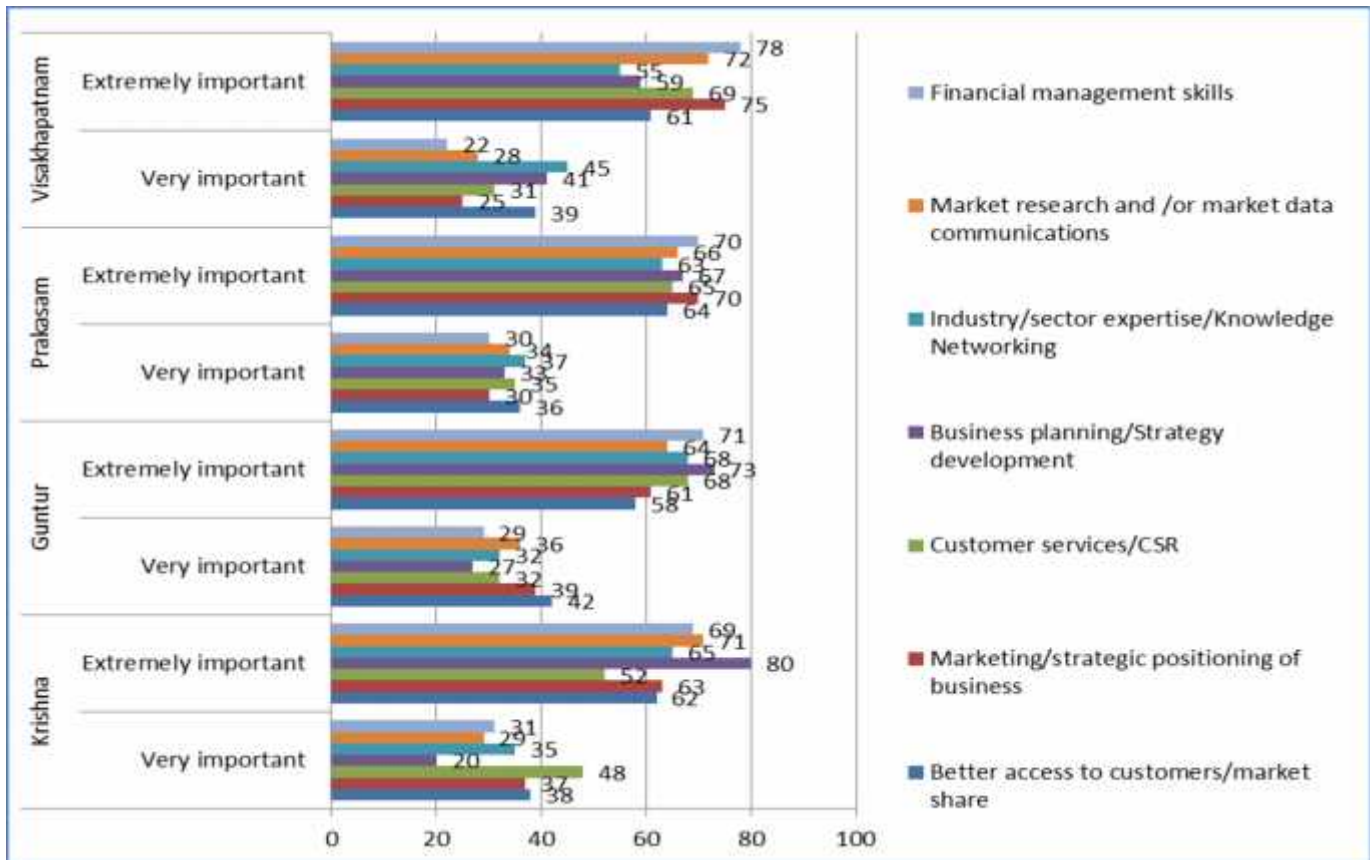
**Fig 1.3: Business Development vs. Financial Funding.**



Source: Data compiled from field level survey

Q: For each of the following business skills/support services, rate how important they are for helping your SME to grow and succeed for the long term?

Important business skills/support services	Krishna		Guntur		Prakasam		Visakhapatnam	
	Very important	Extremely important	Very important	Extremely important	Very important	Extremely important	Very important	Extremely important
Better access to customers/market share	38	62	42	58	36	64	39	61
Marketing/strategic positioning of business	37	63	39	61	30	70	25	75
Customer services/CSR	48	52	32	68	35	65	31	69
Business planning/Strategy development	20	80	27	73	33	67	41	59
Industry/sector expertise/Knowledge Networking	35	65	32	68	37	63	45	55
Market research and /or market data communications	29	71	36	64	34	66	28	72
Financial management skills	31	69	29	71	30	70	22	78



**Interpretation :** Important business skills services in respect of Better access to customers, strategic positioning of business, CSR, Business planning, sector expertise, Market research, Financial management skills are presented in table 1.3.

The creation of specialized SMEs authorities, which understand the special needs and challenges of SMEs, represents and lobbies for them, champions MSME-enabling policies, and oversees and coordinates the provision of targeted services and programs to the sector, can help address many of the structural challenges faced by SMEs in A.P. Successful global experiences from developed and emerging economies, suggest that independent SMEs

Authorities are effective in

1. Facilitating the development of policies that encourage SME sector growth.
2. Enabling the accurate evaluation of the sector so that the impact of regulatory reform and financial and non-financial programs can be monitored and assessed.
3. Developing a better understanding of the impact of SMEs in economic development.

### Findings

With a deeper understanding of the unique needs of and challenges facing SMEs, policymakers, practitioners and academics can turn their attention to solutions that address those needs, mitigate the challenges, eliminate barriers and ultimately create an enabling environment for SMEs to flourish. An ideal support model for SMEs development is one that is integrated and coordinated, and provides both growth, capital, structured with terms that are appropriate to the needs of SMEs, as well as customized business development assistance over the life cycle of the business. In adopting an integrated model, the following features should be considered:

1. Loan applications that are assessed on the basis of the potential of the businesses and credibility of the entrepreneurs, not solely on the basis of collateral, guarantors or length of operations.

2. Specialized SMEs loan funds or loan guarantee schemes that would encourage more lending to the SMEs.
3. Access to focused, well-coordinated local support and expertise. SMEs face unique challenges particular to their sector and market. They need access to teams of specialists who understand the unique set of challenges facing a business in a particular local market
4. Providing support and guidance to rigorously plan and professionally manage businesses in a manner that drives positive cash flows, higher revenues and profits, greater likelihood of business success and, ultimately, business sustainability.
5. Introducing good corporate governance to SMEs to enhance transparency and confidence in management, which will in turn make them more likely to get the support they seek from banks and potential investors.
6. Better communications and information systems to reach SMEs and inform them of available support programs and how to access them.
7. This sector contributes 8 % of the country GDP, 45 % of the manufactured output and 40 % of its total exports of the country.
8. The sector provides employment nearly 60 million persons, in over 26 million units throughout the country.
9. This sector has consistently registered a higher growth rate than the rest of the industrial sector.
10. The number of MSMEs units has increased from 105.21 lakh units in 2001-02 to 298.08 lakh units in 2009-10.
11. The investment and production increased from 154389 crore and 282270 crore in 2001-02 to 693835 crore and 982919 crore in 2009-10 respectively at current prices.
12. The employment in MSMEs units increased from 249.33 lakh in 2001-02 to 695.38 lakh in 2009-10.
13. During the same period the exports have increased from Rs.71244 crore to Rs.202017 crore.

### Conclusion

The micro, small and medium (MSMEs) enterprises constitute a very important segment of the Indian economy. MSME's contribution to the development of our economy is significant as it evident in terms of MSMEs being the major constituent sector in the production system, employment generation, GDP etc. MSMEs also have an aptitude for innovation, creativity, and flexibility which enabling them to respond with more quickly to structural changes and to adapt the dynamic demand patterns of consumers.

It is also clear that MSMEs sector has performed exceedingly well and enabled our country to achieve a wide measure of industrial growth and versification. If government policies towards MSMEs are closer towards its various problems and prospect it can be nearer contributors with agriculture in respect in future. To keep this growth engine on the right way and direction it is time to put emphasis on formulation of MSME friendly policies, conducive operating environment, improvement of proper infrastructure, securing peace and security, arranging proper finance, efficient manager and arranging appropriate modern technology. Considering MSMEs contribution towards every aspect of economic development it should be considered at equal recognition with agriculture.

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