



Confederation of Indian Industry



MSME
Linkages 2010

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The Gujarat vision: Making MSMEs globally competitive*



*connectedthinking

PRICEWATERHOUSECOOPERS

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Foreword

MSME industries in Gujarat are at a crucial juncture today, with several large investments being undertaken by the public and private sector players, and developments promising a significant transformation of the sector. The sector is witnessing a fundamental shift that is opening up new business opportunities for the industry. At the same time, the competition for scarce resources is expected to intensify and support enablers in terms of infrastructure. With this background, CII had requested PricewaterhouseCoopers to probe two key themes that concern the Gujarat MSME sector – a) priorities for the Gujarat MSME industry and b) key recommendations for the Gujarat MSME industry. Buoyed by incentives and support from the government as well as advancements in the technology, MSMEs are all set to play a critical role in defining the future of the industry and ensuring “sustainability” of the Gujarat MSME sector.

This report analyses the MSME potential, policy, trends and priority sectors of the state from a pan-India Small & Medium Enterprises perspective. Priorities for Gujarat MSME have been identified and key recommendations suggested.

Although we have attempted to analyse various issues in the MSME sector, some issues may not have been included because of certain constraints. We request the readers of this report to highlight any issue which may not have been covered adequately.

I would like to take this opportunity on behalf of my team to thank all those who provided their valuable inputs and feedback in the preparation of this report.

We would like to thank PricewaterhouseCoopers for being our knowledge partner and for preparing and providing this insightful report.

I would also like to extend my appreciation to everyone who helped us in this effort.



Rajendra Shah

Chairman - CII MSME Linkages 2010 and
Managing Director
Harsha Engineers Ltd.

Foreword

The Micro, Small and Medium Enterprises (MSMEs) are aptly regarded as the backbone of the Indian economy. According to the Union Ministry of MSMEs, MSMEs, with the addition of medium enterprises in their fold, are now a sector that contributes up to 40% to the gross industrial manufacturing value added to the economy, 35% to India's exports directly and around 8% to India's GDP. With more than 13 million units and around 33 million people, the sector is proved to be the second largest employer after agriculture.

In spite of their immense contribution, the sector is largely informal: 90% of the units are not registered, they are not covered by annual formal data collection exercise like the Annual Survey of Industries; 97% of them are either proprietorship or partnership enterprises and close to 95% of them do not have access to any kind of formal institutional credit (from banks, financial institutions etc).

Their apparent informal characteristic notwithstanding, the sector is highly heterogeneous. It produces more than 8000 products ranging from handmade stuff to high-tech components and machines. Structured like a pyramid where the bottom has the bulk of largely informal micro enterprises, serving domestic niche markets in their geographical vicinity, the sophistication of processes and capabilities rise as we move upwards. Around 20% of the upper segment of MSMEs is a part of large domestic or global supply chains.

I would like to take this opportunity on behalf of my team to thank all those who provided their valuable inputs and feedback in the preparation of this report.

We thank Confederation of Indian Industry (CII) for giving us the opportunity to partner with them on this important initiative.



Anand Dikshit
Executive Director
PricewaterhouseCoopers

01

The economic crisis

The global economic meltdown of 2008 has been compared with the past big slowdowns of the 20th century, i.e. the 1907 banking crisis, the Great Depression of 1929 and the Stagflation of the 1970s and is believed to have been the severest of all. Triggered by sub-prime assets, the world saw a series of bank and insurance company failures across the developed world. The Lehman Brothers' bankruptcy and the buyout of Merrill Lynch by Bank of America were followed by the collapse of Wachovia Corporation and Washington Mutual Bank. These failures caused a crisis of confidence that made banks reluctant to lend money inter-se, or for that matter, to anyone. This crisis effectively stopped the functioning of global credit markets and required

unprecedented government intervention. While the worst seems to be behind us, the pace of recovery in many countries is expected to be slow and painful.

While India was not at the epicentre of the recent global meltdown, a number of factors affected the performance of India Inc. The global credit squeeze affected India's exports adding pressure to the export oriented industries such as textiles and gems and jewellery. Industries that were directly dependent on the availability of consumer credit such as automobiles and real estate, also took a hit. A number of companies across industries deferred their expansion projects as funds were not available. Crash in the commodity prices and a resultant slowdown in demand meant that

the companies in the commodity business such as metals or chemicals had a tough time. A number of companies ended up booking foreign exchange losses. Most services industries such as hospitality; shipping & logistics became indirect victims. It is over a year since Lehman filed for bankruptcy and the Indian economy is showing positive signs of economic revival. While in the last six months of FY09, India Inc. talked of survival, businesses have started looking at new growth opportunities. Given this background, we asked our respondents to revisit the past one year and asked them a few questions around this global downturn, its impact on their businesses, their response to downturn challenges and the key takeaways going forward.



Beyond the downturn

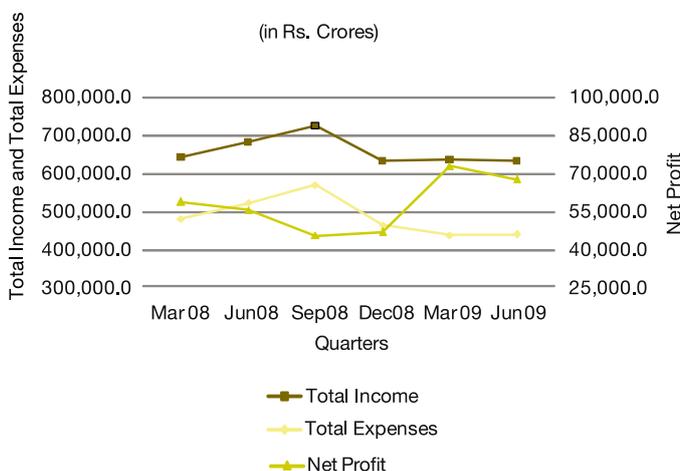
Recovery expectations from business

A recent analysis by Prowess on India Inc performance since March 2008, notes that the turnover for India Inc. in the quarter ending June 09 is almost at the same level (2% lower) as was in the quarter ending March 2008. At the same time, net profit has increased by almost 15%. While a part of decline in the turnover can be attributed to the general decline in commodity prices, it was observed that most of improvement in India Inc. performance (read net profit) over the past year can be attributed

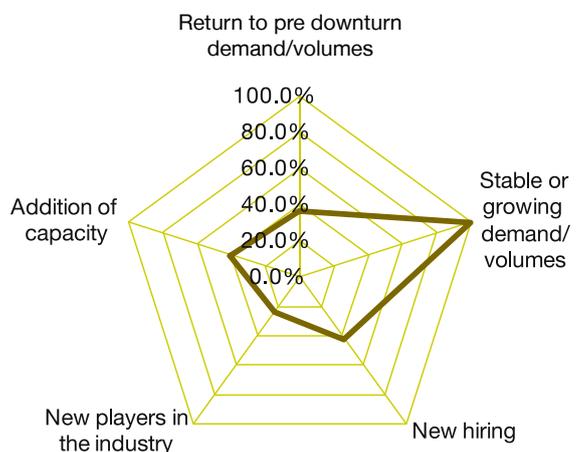
to the success in its cost saving efforts, including rationalisation of supply chain. However, going forward, revenue growth has to drive improvement in the financial performance of India Inc. A similar sentiment was echoed by our respondents when asked to describe recovery expectations for their businesses. They were asked to choose one or more options and nearly 99% of our respondents selected “stable/growth in demand” as their key recovery expectation with new hiring and capacity addition,

getting the second priority. Discussions with our respondents indicated that the growth in demand for their products is a key requisite for sustaining the ongoing recovery cycle. Before this financial meltdown and economic global crisis set in early 2008, many companies had undertaken capacity expansion projects, including overseas acquisitions and going forward the viability of those projects need strong demand volumes.

BSE 500 companies-quarterly performance



Recovery expectations from business



Opportunities and benefits

Over the last few years, taking advantage of benign liquidity conditions and the available growth opportunities, India Inc. embarked on ambitious expansion plans and also carried out “strategic”

acquisitions. The downturn had limited impact in sectors which were predominantly dependent on the domestic market but affected the international operations across a larger domain because of market shrinkage. The appetite for expansions/ acquisition came to a halt, as the money supply dried up and the demand for products vanished. Suddenly the focus was on survival vis-a-vis growth. Many companies became internally focused and

worked on achieving operational effectiveness and efficiencies. At the same time, the downturn has also presented many attractive acquisition opportunities which were/ are available at reasonable/ modest prices, especially as stressed companies are exploring divestures to realign the debt equity structures.

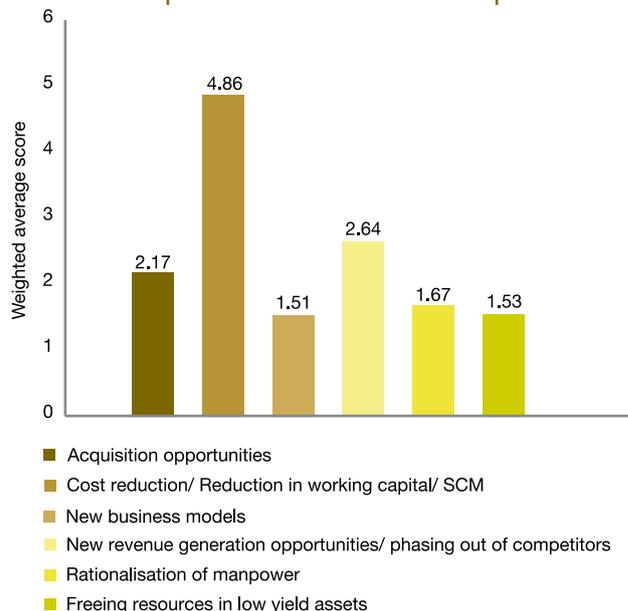
Respondents were asked on their perception of key benefits, which are/ may be available in the near to medium term. Their response indicates that they perceive that the downturn has provided them with both internal and external opportunities, i.e. harnessing operational effectiveness and efficiencies and achieving growth through strategic acquisitions.

The respondents mentioned that during the past few years, the aspect of operational effectiveness and efficiency did not get the required attention and now present a big opportunity over the short to medium term. They viewed cost reduction, reduction in working capital and optimisation of supply chain as key cornerstones for improving operational effectiveness and efficiencies. At the same time, the respondents expect a number of strategic acquisition opportunities to be available in the medium term. A number of respondents expect opportunities in revising existing business models and identification of new revenue generation opportunities.

Acquisition announced by India Inc. in early 2009

- Motherson’s acquisition of Visiocorp, a company in administration in UK
- Apollo Tyres’ acquisition of Vredestein Benden, accompany in administration in Netherlands
- HCL Tech acquisition of Axon

Opportunities/benefits available to business in the current phase as the situation improves



Note: Weighted average score on a 5-point scale with a score of 5 for rank 1 and vice-versa

Given the present economic outlook, which suggests that short term measures to meet macroeconomic challenges have been largely successful, the respondents were asked for their assessment of medium term strategic direction, India Inc. proposes to take to revert to the high growth path.

Organic growth was identified as a key strategy for growth over the medium term. A number of respondents indicated their preference to complete the expansion projects on table, which have been postponed due to liquidity crisis and low demand. Large number of respondents emphasised their willingness to explore and evaluate opportunities on acquisitions and alliances, both

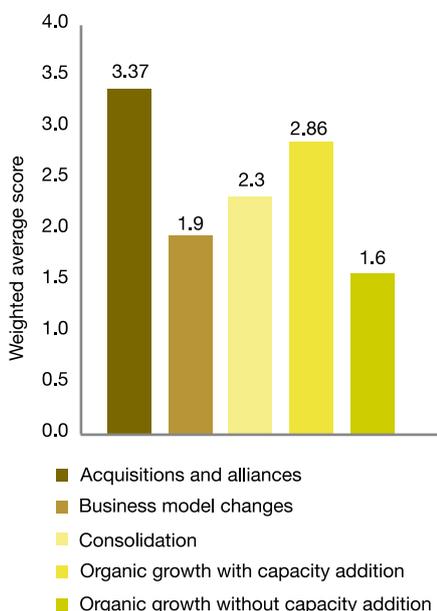
domestic and cross border. Most respondents believed that growth through acquisitions still holds true, however, the evaluation of acquisition opportunities will be more rigorous.

Respondents feel caution/reduced risk appetite [a score of 3.3] as a key constraining factor in taking advantage of existing/emerging opportunities, especially on alliances/ acquisitions. Despite ample liquidity, respondents expressed concerns on the availability of funding in short to medium term as they expect a cautious approach by fund providers (both debt & equity). It is widely expected that fund providers are likely to undertake wider and more extensive due diligence, incorporate appropriate covenants to protect their

interests, enforce and monitor performance. The respondents have also expressed a concern over the lack of growth in demand globally.

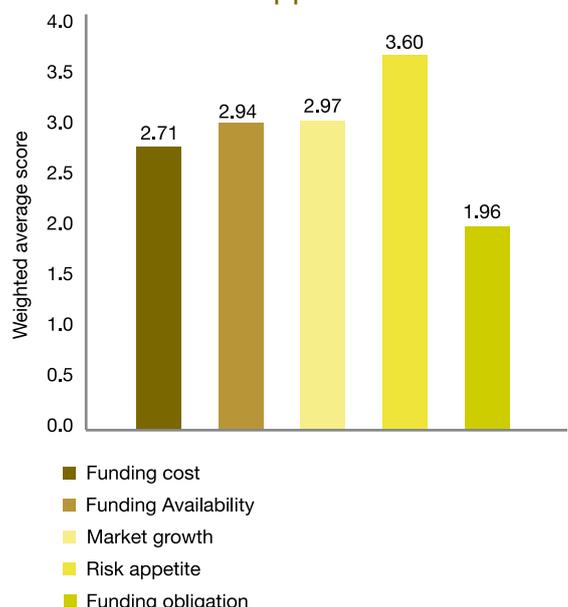
Will Indian businesses become more cautious about investing in growth opportunities, settling instead for a slow organic growth? The survey results do not provide a definitive answer. We, at PwC, believe that the focus is more on organic growth and acquisition opportunities will be more rigorously scrutinised but the post Lehman world provides an unparalleled opportunity to Indian companies buoyed up with domestic demand to achieve world class scale. We believe that the Indian entrepreneurs will not let this opportunity go.

Likely strategy over the next 3years



Note: Weighted average score on a 5-point scale with a score of 5 for rank 1 and vice-versa

Key constraints in taking advantage of available opportunities



02

Significance of MSMEs for the Indian economy

The Indian industrial economy is largely characterised by a dynamic and versatile set of entrepreneurs, who though are small and medium in terms of scale of operations, make huge contributions of varied kind to the economy.

The MSME sector has the ability to make available cost effective, low-volume customised products and also enjoys flexibility in its working to deliver as per the specific requirements.

The other typical behavior of these MSMEs is that in most of the cases, depending upon their specializstion, they have evolved as clusters.

The importance of MSME for the Indian economic growth is well established. However with the changing focus from economic growth to inclusive growth, MSME sector's role in the socio economic development of India now needs to be understood, explored and facilitated.

Currently, MSMEs share in national GDP is about 17% and is projected to touch 22% by 2012. This is due to the fact that over 55% of MSMEs are aggressively upgrading themselves technologically to reduce their input costs and increase production and exports. MSMEs had been growing at the rate of 35% over the last two years

and now onwards are expected to register a 40% growth rate which will be technology driven and contribute 46% share to the country's manufacturing output.

MSMEs share of national exports currently is estimated at around 38%, which will surge to 44% in the next five years. Currently, this sector accounts for 95% of industrial units and is contributing about 40% in terms of value addition in the manufacturing sector. More than 13 million MSMEs are spread over the country producing about 7,500 items and providing employment to more than 40 million people.

MSMEs in India

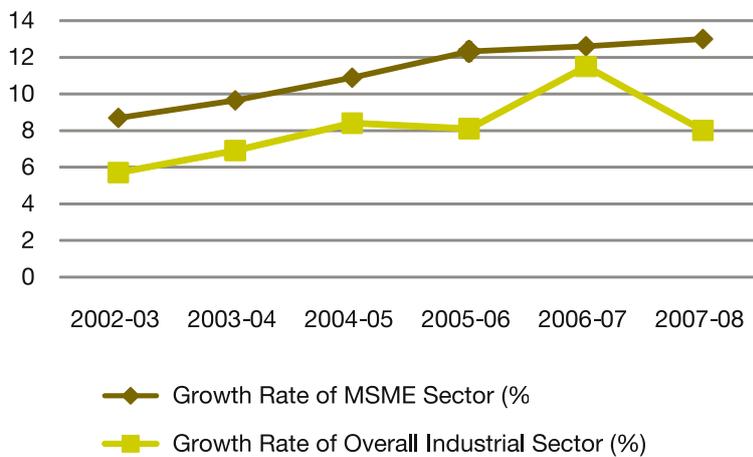
Small enterprise promotion has continued to remain an important and integral part of Indian development strategy much before the First Five-Year Plan, even dating back to 1938 when the National Planning Committee documents were being prepared. The concerted policy emphasis upon small firms as a vital vehicle of progress draws upon this sector's crucial historical role in generating substantial employment and income at the regional level and acting as a

shock-absorber during periods of economic crisis.

The MSME sector contributes significantly to the manufacturing output, employment and exports of the country. In terms of value, the sector accounts for about 45% of the manufacturing output and 40% is estimated to employ about 42 million people in over 13 million units throughout the country¹. Further, as the table below illustrates, this sector has consistently registered a higher growth rate than the rest of the industrial sector.

¹Source: Annual Report 2008-09, Ministry of Micro, Small & Medium Enterprises, Government of India

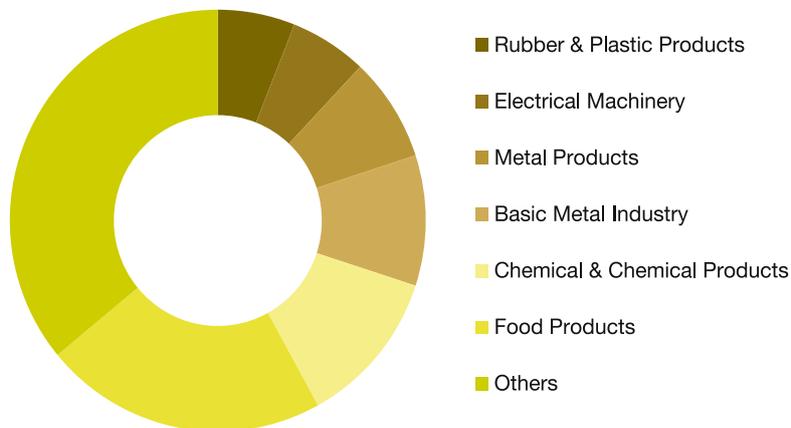
Growth trend of MSME sector in India



(Source: Annual Report 2008-09, Ministry of Micro, Small & Medium Enterprises, Government of India)

There are over 6,000 products ranging from traditional to high-tech items, which are being manufactured by the MSMEs in India.

Products of MSMEs in India



(Source: Annual Report 2008-09, Ministry of Micro, Small & Medium Enterprises, Government of India)

The Micro, Small and Medium Enterprises Development Act, 2006, being operational from October 2006, fixed the ceiling for all small enterprises at Rs. 50 million.

The Gujarat vision

With its inherent strengths and the strong positioning, both from the national and international perspectives, and being in the forefront to promote excellence, the vision for the state of Gujarat could be:

- Business – a way of life with the government facilitating and encouraging investment and holistic growth.
- Achieving highest levels in human development indicators in the country.
- Attaining high standards of quality with the 'Made in Gujarat' brand receiving international recognition.

In line with the above mentioned parameters, the vision for the state could be as summarised as:

“Gujarat aspires to become a beacon of comprehensive social and economic development”

The new Industrial Policy has been formulated with the aim of supplementing the existing growth pattern in the state and augmenting the same way of well thought out and sustainable policy measures. These policies aim at ensuring maximum utilisation of the existing natural resource base and maximising sector specification facilitation.

Accordingly, all the policy measures proposed are presented along the parameters used to measure global competitiveness:

- Promoting geographical strengths to ensure balanced regional development
- Leveraging existing strengths and resources
- Increasing the efficiency of institutions available in the state
- Upgrading infrastructure available in the state
- Enhancing technical competence and manpower
- Creating labour market efficiencies
- Rewarding adoption of new technologies, business sophistication and innovation
- Improving environmental infrastructure
- Promoting holistic development
- Responding to changing domestic and global environment.

The new Industrial Policy has taken these into account and has designed interventions to make Gujarat a favoured global investment destination.

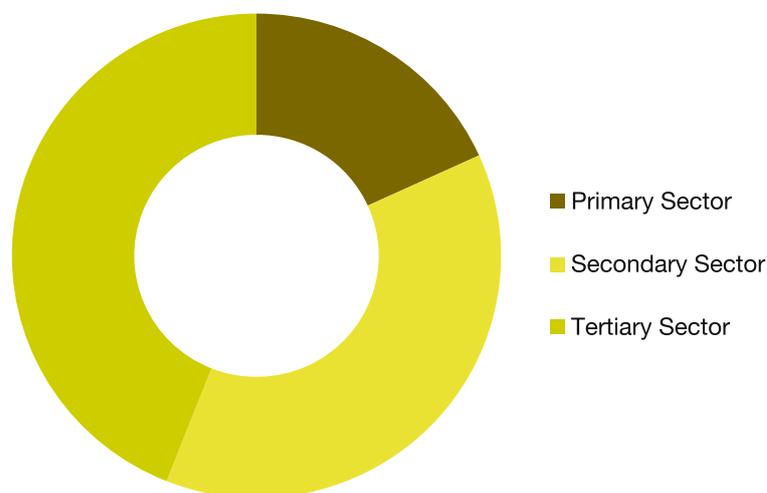


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Gujarat: An enduring economy

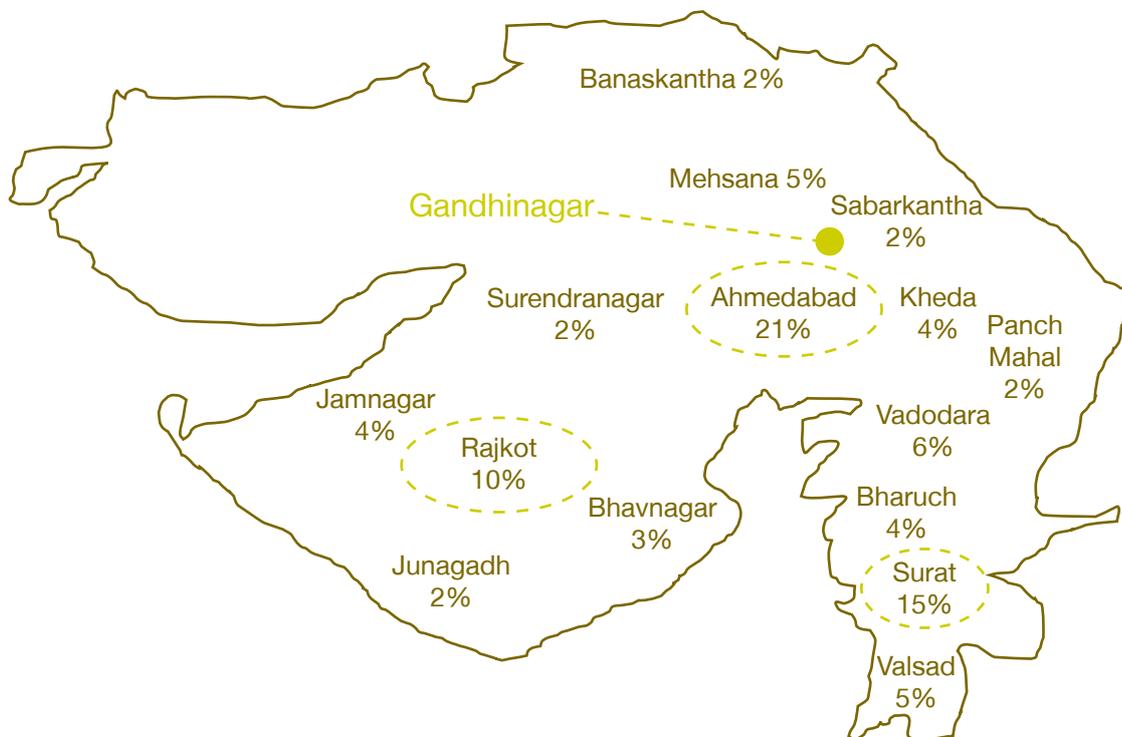
- Population: Over 50 million (5.0% of India)
- Geographical area: 1,96,000 sq.km (6.2% of India)
- Gross State Domestic Product (GSDP): US\$ 45.3 billion
- Per Capita Income: US\$ 915 at current prices
- Urbanisation: 37.4%
- High industrial growth: Gujarat has demonstrated a high industrial growth rate of 12.5% from 2002-2007
- Industrialisation: Gujarat is home to over 800 large industries and 3, 20,000 micro, small and medium enterprises

Composition of GSDP as per economic activity (2006-07)



Source: Socio Economic Review 2007-08

District wise dispersal of MSMEs in Gujarat



- Ahmedabad has the highest number of registered MSMEs in Gujarat, constituting 21% of the total MSMEs present in the state.
- Ahmedabad, Surat, Rajkot, Vadodara and Valsad are the major MSME clusters in the state.
- Surat ranks second with 15% of the total MSME units registered in the state followed by Rajkot with 10% of the total registered MSME units.
- Ahmedabad, Surat and Rajkot together constitute approximately 50% of the total registered MSMEs in the state.
- Central Gujarat constitutes 39.65% of the total MSMEs followed by Saurashtra (26%), South Gujarat (24.35%), North Gujarat (8%), and Kutch (2%) region.

Source: Industries in Gujarat 2007

04

Gujarat – Industry profile

• Population	50.5 million (5%)
• Area	196,000 sq. km. (60%)
• NSDP (2003-04)	US\$ 19.27 billion (6.3%)
• Manufacturing sector	US\$ 5.17 billion
• Fixed capital investment	US\$ 17.9 billion (18.5%)
• Industrial production	US\$ 39.72 billion (16.2%)
• Exports	14% of India

Source: Annual Survey of Industries

Figures in bracket show % share of the country

With **5%** of the country's population, Gujarat has **16%** of its industrial production. Gujarat has an annual average growth of **9%** in the last 3 years and an average industrial growth of **15%**

Gujarat strengths: Resources

Rich availability of feedback for chemical industries	
– Oil (418 MMT) & Natural Gas (34 MMCD)	
– Lignite (1072 MMT)	
– Petroleum refining (57.2 + 30 MMT) and petrochemicals	
– Mineral Reserves	
• Bauxite	105 MMT
• Bentonite	105 MMT
• Limestone	11,860 MMT
– Salt	10 MMT
– Castor Oil	237,000 MMT (45% of world production)

Gujarat strengths: Infrastructure

- Longest coastline – 1600 km.
- Chemical port terminal (3.0 MMT capacity) – the only one in India
- LNG terminals at Dahej (5 MMT) & Hazira (5 MMT)
- Gas land fall point at Hazira
- 41 Ports (including one major port at Kandla)
 - Cargo handled at Kandla is 41.5 MMT (12% of India)
 - Cargo handled by others ports is 89.3 MMT (80% of India)
- Container handling – P&O at Mundra and Maersk at Pipavav
- Mundra & Pipavav – Important ports in private sector
- Broad gauge rail network connecting all major locations
- 11 airports with an International airport at Ahmedabad

Environmental management

- Six hazardous solid waste disposal sites at Vatva, Naroda, Nandesari, Ankleshwar*, Surat*, Vapi*
(* ISO 14001 Certified)
- Four incinerators for hazardous industrial waste at Nandesari, Ankleshwar, Surat, Vapi
- Six treated effluent conveyance pipelines at Ahmedabad, Vadodara, Dahej, Ankleshwar, Sachin, Sarigam
- 19 Common Effluent Treatment Plants
- Gujarat Cleaner Production Centre

Gujarat strengths: PPP in infrastructure

- The first state to enact the Infrastructure Development Act encouraging public-private partnership in infrastructure projects
- Various models in place
- Successful implementation in the following sectors:
 - Seaports
 - Power plants
 - Highways & roads
 - Piped gas distribution

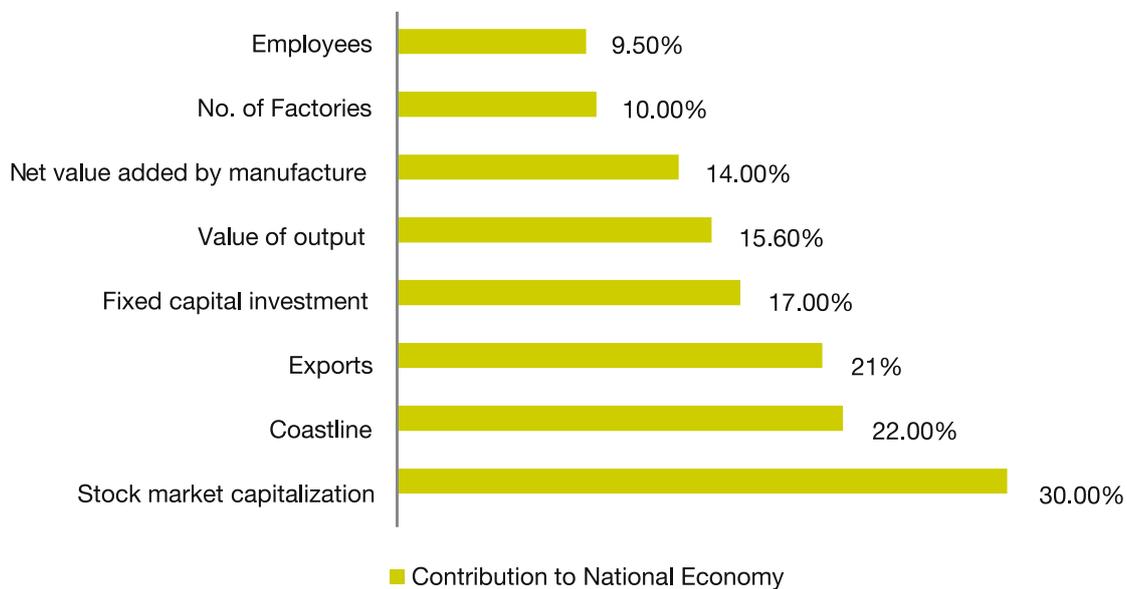
Source: Industries in Gujarat 2007



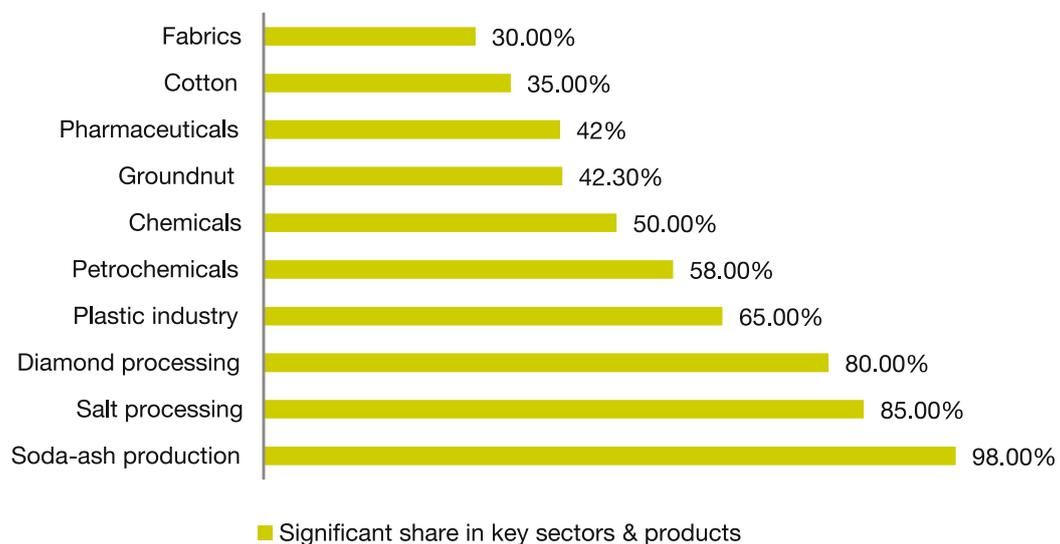
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Gujarat: An industrial state

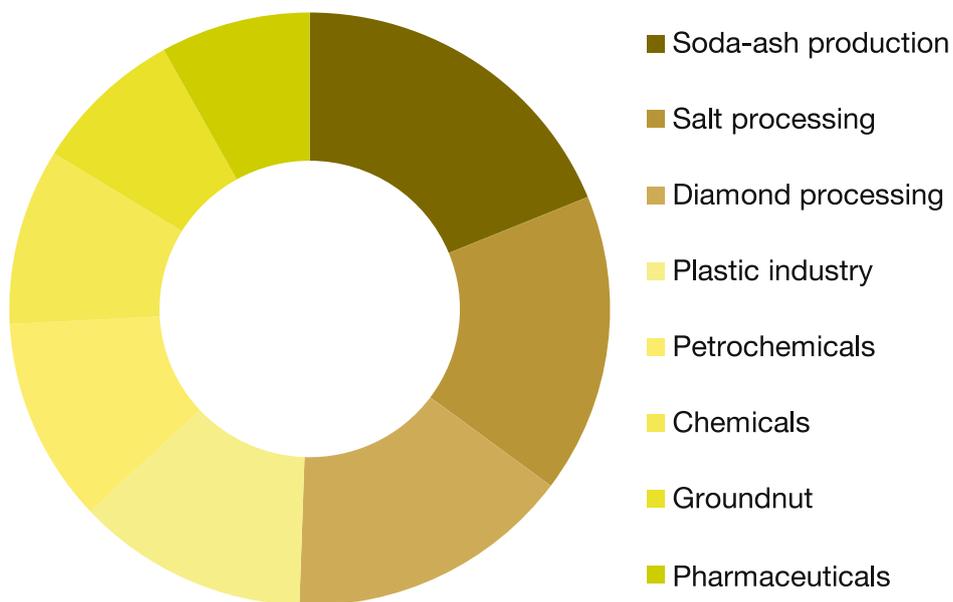
Contribution to National Economy



Significant share in key sectors & products



Presence across industry sectors



Source: Socio Economic Review 2007-08

- World's largest producer of castor and cumin
- World's largest gas-based single location sponge iron plant
- World's largest producer of processed diamonds
- World's third largest producer of denim
- Asia's largest grass root petroleum refinery at Jamnagar
- India's largest producer of cotton
- India's first LNG chemical port terminal at Hazira

MSMEs in Gujarat: An overview

- The strength of Gujarat's manufacturing sector lies in its strong base of micro, small and medium scale enterprises (MSMEs).
- MSMEs have played a pivotal role in the industrial dispersal and the overall industrial development of the state.
- MSMEs have proved to be a major contributor to the economy of the state, especially in terms of value addition, employment generation and entrepreneurship development.
- There are at present over 320,000 MSMEs in Gujarat.
- The Government of India, under the Ministry of MSMEs, has enacted the MSME Development Act 2006 and put into operation, w.e.f., 2 October, 2006.

In accordance with the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the MSMEs are classified in two classes.

- **Manufacturing enterprises** – The enterprises engaged in the manufacturing or production of goods pertaining to any industry specified in the first schedule to the industries (Development and Regulation Act, 1951). The manufacturing enterprise is defined in terms of investment in plant & machinery.

- **Service enterprises** - The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment.

Within the enterprises engaged in the manufacture/ production, processing or preservation of goods:

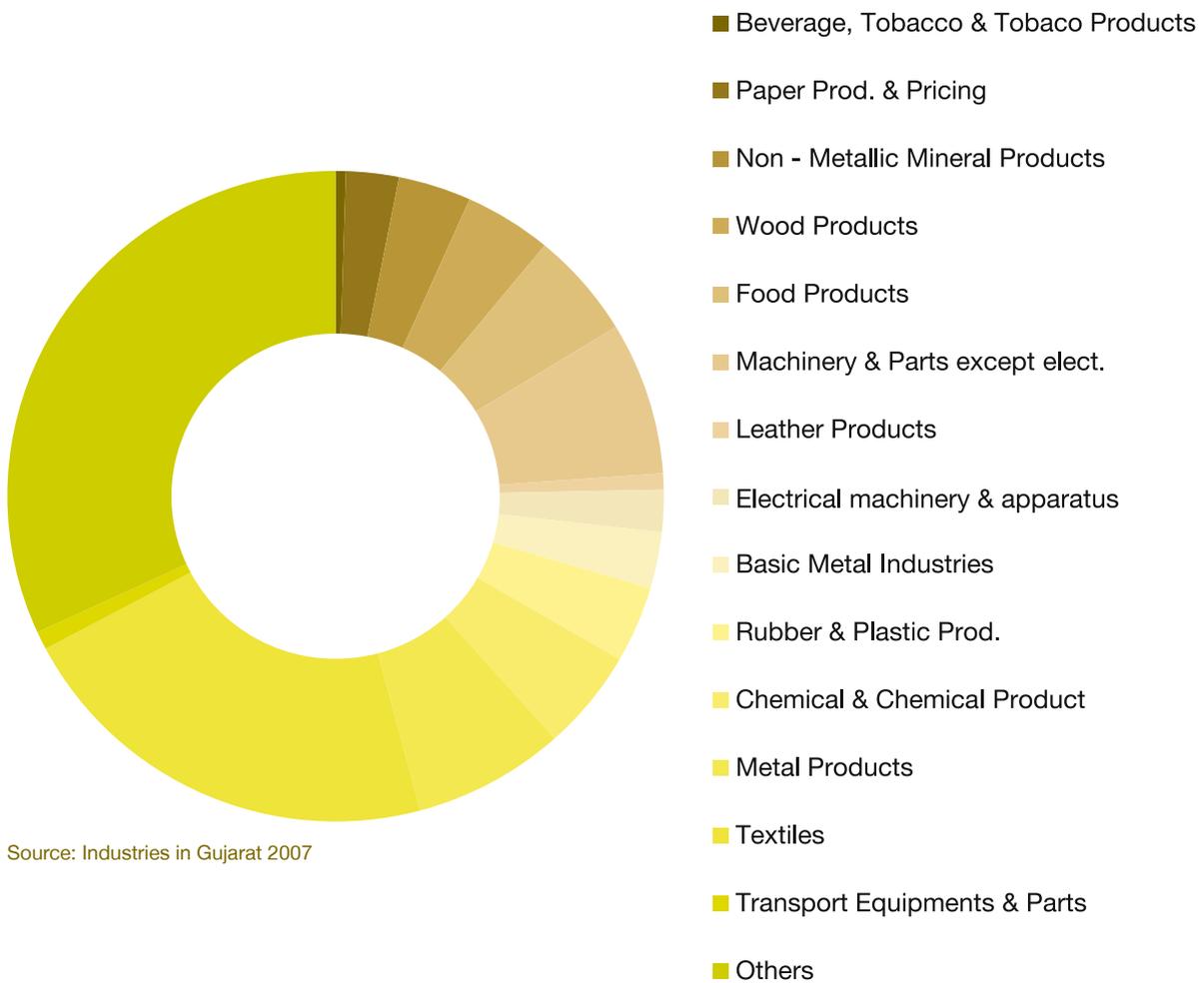
- **Micro enterprise** is one where the investment in plant and machinery does not exceed Rs. 25 lakh.
- **Small enterprise** is one where the investment in plant and machinery can be more than Rs. 5 crore.
- **Medium enterprise** is where the investment in plant and machinery can be more than Rs.5 crore but should not exceed Rs.10 crore.

Service enterprise is further classified as under:

- **Micro enterprise** is an enterprise where the investment in equipment does not exceed Rs.10 lakh;
- **Small enterprise** is one where the investment in equipment is more than Rs.10 lakh but does not exceed Rs.2 crore;
- **Medium enterprise** is that where the investment in equipment is more than Rs. 2 crore but does not exceed Rs. 5 crore.



Industry sector wise MSMEs



Source: Industries in Gujarat 2007

Opportunities and challenges for MSMEs

Defence

The MSME sector in India

The significant contribution made by SMEs in a nation's economy has been well acknowledged globally. According to the Ministry of Micro, Small and Medium Enterprises, SMEs, along with the units falling under the Micro sector, contribute up to 40% of the gross industrial manufacturing value added to the economy, 35% to India's exports directly and 8% of India's GDP. With over 13 million units, the MSME sector provides employment to more than 33 million people in India.

Despite this immense economic contribution, the sector is largely informal and highly heterogeneous. It produces over 8,000 products ranging from hand-made articles to highly sophisticated machines and components.

The official definition of a firm in the SMEs sector is one that has investments in fixed assets of plant and machinery from Rs. 2.5 million to Rs. 100 million at original cost. The SME sector includes the small scale industry (SSI) sector, where a firm (mostly manufacturing) has fixed assets for less than Rs. 50 million and the medium sector, where firms' fixed assets range from Rs. 50 million to Rs. 100 million.

The defence sector

India's defence budget (capital plus revenue expenditure) at present stands at US\$ 26.5 billion, making it one of the top 10 countries in the world in terms of military expenditure. Budgeted defence expenditure is growing at 7% - 8% annually and India is expected to spend close to US\$ 100 billion on defence procurements during the Eleventh Five Year Plan (2007-2012) period.

Private ownership was allowed in the defence sector as recently as 2001. Indian defence companies hitherto catered to only one buyer – the government. New defence procurement policies in 2006 and 2008 changed that due to the mandatory offset clause.

The offset policy has been incorporated in the Defence Procurement Procedure (DPP) since 2005 which mandates a 30% offset obligation for procurement proposals where the indicative cost is Rs. 3 billion or more and the schemes are categorised as 'Buy (Global)' involving outright purchase from foreign/Indian vendors and 'Buy and Make with Transfer of Technology' i.e. purchase from foreign vendor followed by Licensed Production.

India's domestic production capacity, which in revenue terms currently stands at around US\$ 4

billion annually, is predominantly state-owned with the private sector accounting for less than 10% of the total turnover. These revenue numbers are set for a quantum growth over the next decade as local production is forecast to reach US\$ 13 billion annually. The growth potential, coupled with the procurement policy, creates a multi-billion dollar opportunity for the Indian private sector defence companies.

Following the recommendations of the Kelkar Committee, the government, through amendments to the DPP in 2009, announced that a 15 year Long Term Perspective Plan of the armed forces, outlining technology perspective and capability roadmap would be made public. Once implemented, this will provide the manufacturing industry with direction on technology and capability ramp-up needed in future.

International defence original equipment manufacturers (OEMs) under cost pressure are exploring tie-ups with Indian companies. India's stable democratic regime coupled with the country's record on non-proliferation and manufacturing expertise make it an attractive destination for international defence OEMs to outsource production with the offset requirement acting as a catalyst.

Role of SMEs in the defence sector

The increase in spending on defence procurements as well as the requirement of offsets will open up significant business opportunities for Indian SMEs. A recent industry study estimates that the Indian defence sector currently comprises over 6,000 SMEs, which supply around 20%-25% of components and sub-assemblies to the Defence Public Sector Undertakings (DPSUs), ordinance factories, Defence Research and Development Organisation (DRDO) and the armed forces.

To make the most of this increased spending, SMEs can integrate themselves into the supply chains of national and international defence majors.

Indian SMEs have some inherent advantages – innovative capabilities in niche manufacturing, ability to absorb new technologies and lower overhead costs - while the offset requirements propel global OEMs to work in close coordination with SMEs. The defence sector is thus emerging as a lucrative market for the SMEs.

It is the respective state governments that are primarily responsible for the promotion and development of micro, small and medium enterprises (MSMEs). The Central Government,

however, supplements the efforts by providing supportive measures aiming to boost MSMEs through specific schemes (such as technology upgradation, development of clusters, market assessment, improved infrastructure, facilities for training and capacity building of entrepreneurs, etc).

As the cost of technology is very high for MSMEs, the government is looking at ways to facilitate, incentivise and support the technology transfer at individual as well as collective levels. Linkages with Research & Development Institutes, rewarding innovation and new technology, creation of Technology Development Fund, etc. are some of the suggestions being considered at present. The cluster approach to offset the higher cost of technology upgradation may be one of the visible options.

Challenges

The Indian defence forces need to completely overhaul their machinery and fire power to maintain their strategic position in the region. The 34% increase in the country's defence budget in 2009, a recession year, is a testament to the growing focus on this sector. Indian defence companies, especially OEMs not only need financial support but also require support in managing the growth and business scaling.

The efforts of SMEs to capitalise on the tremendous opportunities in the defence sector are challenged by on-the-ground realities in the form of the complex, and often contradictory policy regimes, namely the FDI policy, Industrial Licencing regime, the offset policy and the tax regime.

Manufacturing of defence equipment is subject to a 26% cap on FDI. The restriction on FDI has three implications: first, it discourages original equipment manufacturers from bringing in proprietary technology. Second, it limits foreign capital inflows into the sector. Finally, it increases the corresponding fund requirements of the Indian partners. This is particularly relevant in the present high interest rate environment in which risk-averse banks are reluctant to lend. So while there is a contrary view that the 26% cap should be retained as it provides Indian companies greater leverage in negotiations, this benefit is available only to a handful of large companies as they have more resources than the bulk of small companies that work in this sector.

An Industrial License (IL) is required for manufacturing defence equipment. However, there is no clear definition of defence equipment. The licencing policy requires the use of the National Industrial Classification

(NIC) code when applying for an IL. However, the NIC code has no specific entries for defence equipment. Consequently, prospective Indian and foreign investors need to request clarification from the government on whether a product is a defence product or not – a process that can take several months with arbitrary outcomes! The problem is particularly acute in the case of dual-use products that have both civil and defence applications.

The next issue pertains to the stage of development of the defense industry in India, which is fledgling, fragmented and dominated by the defence PSUs (DPSUs). The private sector comprises only a few large and some medium and small companies doing niche work for the DPSUs and DRDO. Achieving 70% indigenisation requires a strong private sector, comprising a large network of small and medium sized players – this is the situation in Europe and the US. While India has a diversified manufacturing base and companies in sectors like

auto component manufacturing are well positioned to make the transition to aerospace and defence, their problem is that they lack the training and certifications required in this sector. This is where the DPSUs and the government will have to play a proactive role through vendor development programmes that would include training and assistance in obtaining certifications and building capabilities. Implementing the Raksha Udyog Ratna policy would also be a welcome step in this regard.

A well defined offset policy is critical for giving direction to the nation’s defence industry. While the government has tried to liberalise the policy over the past four years, there is a widespread view, amongst both private Indian industry as well as foreign players, that there are large areas of ambiguity (e.g. which services are allowed for discharging an offset obligation, who is eligible as “private defence industry”) and inflexibility in the policy such as multipliers and transfer of

technology not being recognised. There are serious concerns that such policy issues coupled with delays and poor management of the offset approval process could well derail the offset programme, if not the main acquisition itself.

The Ministry of Defence (MoD), while approving an offset proposal, specifies a DPSU or OFB as the Production Agency. This is the single biggest roadblock in developing capabilities of the Indian private sector in defence manufacturing.

The domestic tax regime also does not favour domestic manufacturer by SMEs which face multiple Indian taxes: excise duty, State VAT /Central sales tax and service tax on input services. Some of these stick as costs. On the other hand, a foreign OEM executing a supply contract for the MoD from overseas enjoys various tax and duty exemptions. The following table illustrates the unequal burden faced by Indian manufacturers while executing a defence supply contract vis-à-vis foreign vendors directly exporting to the MoD.

Tax	Domestic manufacturer	Foreign vendor
Customs Duty	Conditional exemption available on case to case basis	Exemption is available for imports by MoD
Excise Duty	No specific exemption for supply to MoD. Only unit/ project/ item specific exemption is available.	Not applicable on imports
Central Sales Tax (CST)	Payable @ 2%. No exemption	Not applicable on imports
Value Added Tax (VAT)	Value Added Tax (VAT)	Value Added Tax (VAT)
Service Tax	Applicable @ 10.3% on input services like payment on technical knowhow/ engineering services. No exemption.	Input services availed by foreign vendor from India are exempt.

The tax differential between domestic and foreign supply can be as high as 30%. Thus the current tax and duty regime makes domestic manufacturing uncompetitive in a competitive bidding process and in fact provides incentives for only sub-system and component manufacturing in India with integration and final assembly being done offshore.

Thus the current tax and duty regime makes domestic manufacturing uncompetitive and in fact provides incentives for only sub-system and component manufacturing in India with integration and final assembly being done offshore. In order to give a boost to domestic manufacturing and catalyse growth amongst the SMEs, there is a need for rationalising the tax regime and providing focused incentives similar to those that have been extended to sectors like IT and ITES.



Indian Railways

Introduction

Indian Railways

Indian Railways, the largest rail network in Asia and the world's second largest, runs around 11,000 trains everyday of which 8,702 are passenger trains, transporting over 18 million passengers and more than 2 million tonnes of freight every day, covering around 7,000 stations over a total route length of over 63,000 kilometres. Rail freight in India has grown at 8% over the last five years. FDI inflow into railways has been over US\$ 75 million from 2000 to 2009.

Indian Railways is expected to invest US\$ 45.9 billion in the 11th Plan (2007-12), triple the amount envisaged in the 10th Plan (2002-07). The annual plan for 2009-10 alone, envisages an investment of US\$ 7.6 billion, for:

- Import of electric & diesel locomotives over the next three years
- New projects under public-private partnership scheme
- New corridors, new electric & diesel loco and coach factories
- Enhancing capacity of passenger trains by 22%

Opportunity for MSMEs in Indian Railways

Indian Railways, along with the Defense Department and the Communications Department, has traditionally been a bulk-buyer from the SME sector. For 2009, Indian Railways has fixed a target to buy materials and components worth Rs. 3,615 crore from small and medium enterprises².

Specifically, the potential for SME involvement is in areas of –

- quality metal fabrication of mild steel and mild stainless steel base, forging
- polymers, plastics products, rubber gasket
- specialty paints, floor cleaning chemicals and deodorants
- construction industries, products and services
- agro and food processing.

The major orders in 2009 are –

- In the East Zone, for its m/z the last year's spending on SMEs³.
- The Eastern Railways have earmarked Rs. 1,000 crore for procuring the parts and components of railways from SMEs.
- South Eastern Railways plan to purchase materials and components worth Rs. 600 crore
- Purchase orders worth Rs. 15 crore are expected from the Metro Railway, Kolkata.

Besides components procurement for locomotive manufacture, there are several other areas where SMEs / MSMEs can participate significantly, in case they have not started already. For example, Indian Railways plans to develop 50 stations as world class stations through Public Private Partnership mode – these projects would provide ample opportunities to the SME players. Similarly, there are plans for developing 375 stations as 'Adarsh Stations' that shall have basic facilities such as drinking water, etc. Construction of Multi Functional Complexes (MFCs) has also been announced for 50 railway stations in this year's Railway Budget – such complexes shall have facilities like shopping, food stalls, restaurants, book stalls, PCO / STD / ISD / Fax booths, medical stores, variety stores, budget hotels etc. All these projects will involve the SME players.

The Dedicated Freight Corridor Project on the Western and Eastern routes (renamed this year as "Diamond Rail Corridors" Project), extension of the Eastern Freight Corridor, development of Delhi Mumbai Industrial Corridor and a proposed Eastern Industrial Corridor are some of the large scale projects that would provide immense opportunities to the SME sector – mostly in terms of component supplies.

²As indicated by the Deputy Commercial Materials Manager, Eastern Railways, in a buyers-sellers meet organised jointly by the Bengal National Chamber of Commerce & Industry (BNCCI) and National Small Industries Corporation (NSIC) in July 2009

³As indicated by CLW's Deputy Manager of Materials in a buyers-sellers meet organised jointly by Bengal National Chamber of Commerce & Industry in July 2009

The following table lists down some other areas where the SMEs can provide their products and services to the Indian Railways.

Area	Opportunity for SMEs
Modernisation of Indian Railways	<p>Indian Railways is continuously focusing on the modernisation of its entire rail system. Of late, railway stations and trains are on priority, keeping in view the forthcoming Commonwealth Games, to be held in Delhi in 2010.</p> <p>The Centre for Railway Information Systems (CRIS) of Indian Railways plans to use Radio Frequency Identification (RFID) technology to improve the wagon management system of the Railways – such technology can be developed and supplied by SMEs</p>
Rolling stock	<p>Rolling stock is usually procured from MSMEs through open tender processes – the average per year numbers are:</p> <ul style="list-style-type: none"> • Locomotives : 500 • Coaches : 3,655 • EMU/ MEMU : 935 • Wagons : 18,000
Factories for new coaches, diesel and electric locomotives, high speed bogies – in West Bengal, Bihar and UP	All these factories are likely to focus on outsourcing – thus providing possible opportunities for MSMEs.
Locomotive engine components	CLW procures around 4,500 locomotive engine components from SMEs
Electrification & overhead line equipment	SMEs have a large role to play in electrification – the target during the XI Plan is 3,500 Route Kilometers (RKMs) with an outlay of Rs. 3,500 crore – 1,299 RKMs have already been electrified
Track & track side development	A target of 250 km has been fixed for the construction of new lines in 2009-2010 – majority of this work will be performed by the SME players
Maintenance & service equipment	In the first two years of the current plan period, 7,843 km of track renewals has been completed and a target of 3,500 km has been kept for 2009-10. Out of 66, 565 km of broad gauge track, 57,345 km has been brought under mechanised maintenance – most of which is being catered to by the SME sector
Safety & security systems	The Railways Budget 2009-10 proposes the provision of CCTVs and other surveillance equipment at important and vulnerable stations, modernisation of signals and the use of various safety equipment like digital ultrasonic flaw detecting machines and wheel impact load detectors (WILD) - this provides ample opportunity for SME manufacturers of safety equipments
Station equipment & passenger information system	<p>Indian Railways has proposed to introduce Train Information Systems with automatic announcements in Kolkata, Chennai and Delhi suburban sections – this is already in the process of being installed in Mumbai.</p> <p>Besides, there are plans for installation of Automatic Vending Machines at 200 large and medium sized stations. Most of the procurement requirements in this field can be met by SMEs</p>
Railway hospitals upgradation	SMEs can supply various components for the proposed upgradation of the Metro Railway Hospital at Tollygunge (West Bengal) to a 75-bed hospital
Logistics	<p>Railways are in the process of bringing together state governments and major logistics players to set up logistics parks co-habited by multiple players through participative funding.</p> <p>Mega logistics hubs are being planned alongside the proposed Eastern and Western Dedicated Freight Corridors.</p>

Automotive

The Indian automotive industry is one of the fastest growing industries in the world today – paralleled only by China. Although the total output in the industry declined marginally in 2008-09 as compared to 2007-08, volumes have surged again in H2 of 2009-10 and prospects for the industry look bright again. According to a latest Fitch report, the Indian auto sector sales are expected to grow by 10% to 12% in 2010, with every possibility that India will be one of the largest producers of automobiles in the world in the next five years.

The Indian automotive industry (OEMs and components) is concentrated in certain regions of the country – the traditional hub has been the National Capital Region (NCR), comprising Delhi, Gurgaon, Noida, etc. Recently, there has been a shift towards relocating the automotive production in Pune (Maharashtra), Chennai (Tamil Nadu) and Gujarat, as these states offer better incentives to the industry and also serve as better shipment hubs for export purposes.

Gujarat has been witnessing increasing investment both from Indian and foreign companies in recent times on account of its pro-business policies and this has augmented well for the engineering industry in Gujarat, which contributes to about 10% of the country's total engineering output. The automotive sector in Gujarat is still at a relatively

nascent stage, and contributes to about 5% of the country's total automotive output.

Significant achievements for the state in recent times include:

1. Establishment of General Motor's plant in Halol, which has a capacity of 85,000 units per year and will commence production of LCVs in 2011
2. Relocation of the Tata Nano plant from Singur, West Bengal to Sanand, Gujarat in record time, netting an investment of Rs. 2,000 crores for the state in mid 2008.

Other important players in the region include Asia Motor Works, Atul Auto, Munjal Auto India Ltd. and Electrotherm. Rajkot district is the largest cluster for the production of auto components and diesel engines in the state.

Gujarat is now offering several incentives to Suzuki Motors to set up an export-oriented unit for production and export of its popular models including the A-Star. The state would assist the company in setting up railway links from its production unit to Mundra Port.

From the above illustrations, it is clear that Gujarat is leaving no stone unturned in expediting and encouraging the flow of investment into the region and it is almost certain that the contribution of the state to the country's automotive output will increase in the years to come.

Government initiatives

- The Government of Gujarat has been aggressively supporting the growth of this sector through development of the industrial cluster and industry-focused investment regions.
- Introduction of reforms and flexible labour laws
- Promotion and development of small and medium enterprises (SMEs) through various innovation initiatives
- Introduction of cluster development measures to support and strengthen the growth of the sector
- Promotion of institutions such as Space Application Centre, Indo-German Tool Room, Electronics & Quality Development Centre, etc. to provide support to the engineering sector

The opportunities ahead

Metallurgy

- Blast furnaces, sinter plants
- Steel melting shop equipment

Heavy electrical industry

- Boilers
- Switchgear and control gear
- Turbines, transformers and generators

Dairy machinery

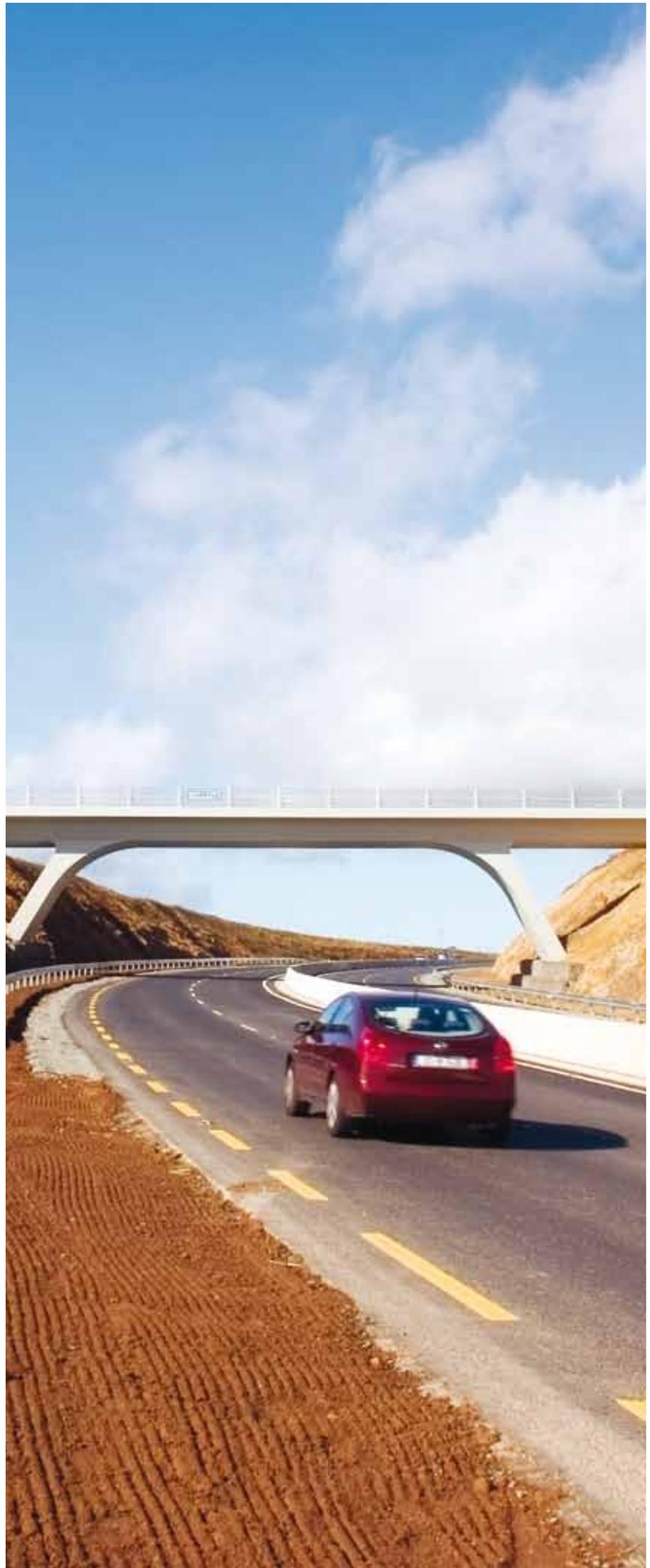
- Evaporators
- Milk and cream deodorizers
- Milk refrigerators and storage tanks
- Spray dryers and heat exchanges

Industrial machinery and machine tools

- Modern cement and textile machinery
- Material handling equipment
- Oil field equipment and services, mining machinery
- Precision machine tools and renewable energy equipments

Auto and auto ancillary

- Auto ancillary SEZ/parks
- Assembling and manufacture of automobiles
- CNG kits for automobiles, industrial automotive bearings
- Manufacture of auto components for all types of vehicles
- Automobile design centre



Foundry

India has about 5000 foundries and is the fourth largest producer of castings in the world, with an annual output of over 7.5 million tons. Indian foundries regularly meet the demands and expectations of the global market and currently export about 300,000 tons annually. Many Indian foundries have adopted the state-of-the-art technology, in all areas of manufacturing.

India has a stable domestic demand, which has helped the foundries survive the recent global economic downturn. India remains a high growth

region for small cars, tractors and two wheelers. The annual production of cars and SUVs is already above one million mark. The industrial growth has been impressive at 5-6 %, in spite of the recessionary trends.

Of the many foundry centres in India, Gujarat has two leading clusters – Ahmedabad and Rajkot, each producing more than 40,000 tons/year. Ahmedabad has a number of small and medium size foundries, producing a variety of castings in Grey Iron, S.G. Iron, Steel and also Aluminum alloys.

Rajkot engineering cluster produces a range of products such as castings, pump-sets, automobile components, diesel engine generating sets, bearings, machine tools and so on. In addition, a number of miscellaneous engineering items such as agricultural implements, hydraulic jacks, air compressors, fasteners and so on are also manufactured in the cluster.

The presence of Rajkot Engineering cluster in different engineering segments

Foundry	Diesel engine	Machine tools	Automobile parts	Pump-sets	Bearings	Others
<ul style="list-style-type: none"> • Pump and motor bodies • Diesel engine components • Automobile components • Cylinder lines • Other casting products 	<ul style="list-style-type: none"> • Lister engine • Peter engine • Comet engine • Diesel engine spares 	<ul style="list-style-type: none"> • Conventional machine • Metal cutting e.g. lathe (ii) Metal forming e.g. power press, shearing press • CNC machines • Machine tools spares 	<ul style="list-style-type: none"> • Connecting rods • Pistons • Crankshafts • Camshafts • Liners • Sleeves • Air cooled block • Spares 	<ul style="list-style-type: none"> • Submersible pump sets • Centrifugal pump sets • Mud pumps 	<ul style="list-style-type: none"> • Ball bearing • Taper roller bearing • Cylindrical roller bearing • Needle roller bearing • Spherical roller bearing 	<ul style="list-style-type: none"> • Forgings • Agricultural implements • Hydraulic jack • Air compressors • Fans • Dust collectors • Packaging & plastic items

Foundry industry in India

India is one of the largest producers of castings in the world and accounts for about 8% of the world's castings production. In the year, 2007-08 India's casting production was estimated to be nearly 7.8 Million metric tons. India is the second largest producer of grey iron castings behind China and the third largest producer of steel castings in the world. Indian foundry industry produces various grades of value-added castings as per various international standards. The major casting producing countries and their share in production is depicted below in the table.

The major casting producing countries and their share in world casting production

Country	% share of world casting production
China	34
USA	12
Russia	8
India	8
Japan	7
Germany	6
Brazil	3
Italy	3
France	3
Korea	2
Others	14

The various types of castings produced can be categorised into the following types: ferrous, non-ferrous, aluminum alloy, graded cast iron, ductile iron and steel. Castings are mainly used in automobiles, railways,

pumps, compressors and valves, diesel engines, cement industry, electrical industry, textile machinery, sanitary pipes and fittings, power generation, construction and many other specialised applications. Grey iron castings account for the major share of total castings produced are of grey iron.

The Indian scenario

In India, there are approximately 4,500 foundry units out of which 80% can be classified as small-sale units, 15% as medium-scale units and just 5% as large-sale units. Approximately, 20% of the foundry units have ISO international quality accreditation.

There are several foundry clusters in India. Some of the major clusters are Ahmedabad, Batala, Jalandhar, Ludhiana, Belgaum, Chennai, Kolhapur, Rajkot, Coimbatore, Howrah, Agra, Pune and Vijayawada. Most of the clusters are known to cater to a particular type of end-use industry. For example, while the foundries in Ahmedabad make castings for the local textile and pump manufacturing industry, Batala, Jalandhar and Ludhiana mainly produce castings for local machine tools, tractors and agriculture industry. Coimbatore foundries are known for the pumps, motors and valve castings. Howrah predominantly produces sanitary castings and manhole covers. Belgaum and Kolhapur belt mainly produce

automobile castings. The foundry industry in Rajkot predominantly caters to the local diesel engine, pump and engineering industry.

Exports

The exports of castings had been showing a healthy growth rate of 25-30% per annum till 2006-07. However, the year 2007-08 saw a dip in the exports, and it grew by approximately 15% vis-à-vis the previous year. The slowdown in export was mainly due to the steep hike in raw material prices coupled with the weakening of the US dollar during the period. In financial terms the export of castings was around Rs.4, 500 crores or US\$ 1.125 billion (1 US\$= Rs.40.06 as on 1 April '08) in 2007-08.

Raw materials and energy

Between April '07 and August '08, there was an unprecedented and frequent hike in all key inputs to the foundry sector such as pig iron, scrap, coke and ferroalloys which resulted in many foundries shutting down their operations. Prices of pig iron went up by 76%, steel scrap by 60%, coke by 165% and ferro alloys by 100% during this period. Almost all foundries were forced to cut down production and adopt cost cutting measures.

Since the beginning of 2009, the prices have started to stabilise. However, many foundries which had purchased raw materials at higher prices earlier are facing extreme hardships since they are forced to sell products at lower

prices, corresponding to the current raw material prices.

Energy prices in India are typically the highest amongst the leading foundry producing countries. Although, the industry has been taking several measures to use energy efficiently, a lot more needs to be done.

Product mix

The Indian foundry industry predominantly produces grey iron, although the production of steel, ductile iron and non ferrous castings is increasing. The break-up of total production of castings into different categories is given below in the table.

Category wise break-up of castings production in India

Material	% production
Cast iron	69
Malleable iron	10
Non ferrous castings	1
Ductile iron	12
Steel castings	8

The Indian foundry industry is trying to focus on higher value added castings such as ductile iron to improve profitability and beat competition. The demand for light weight castings is growing, especially in the automobile sector due to the increasing demand for fuel efficient cars.

Manpower

The Indian foundry industry is highly labour intensive. As per industry estimates, it provides direct employment to about half a million people. The government has realised the importance of vocational education and skill-upgradation of the existing workforce and has taken initiatives to upgrade nearly 1,390 Industrial Training Institutes (ITIs) in PPP (Public Private Partnership) mode.

Technology

In recent times, the government has been encouraging technology transfer through joint ventures and foreign direct investments. The government has cooperated with UNIDO in technology upgradation of certain foundry clusters like Hyderabad. In addition, the government has provided financial assistance to foundry clusters in Ahmedabad, Belgaum, Coimbatore and Howrah to strengthen the industrial infrastructure and set-up common facilities in the cluster under industrial infrastructure upgradation scheme. There will be more clusters coming up for upgradation in the 11th Five Year Plan. There are several other government schemes such as CLCSS (Credit Linked Capital Subsidy Scheme) which encourage SMEs to invest in technological upgradation.

Environment

The foundry industry is considered to be a polluting industry. Hence the industry has been under severe pressure from the pollution control boards to install pollution control devices. Although, the awareness to control pollution has increased among the industry, there is a need to develop and promote cost-effective pollution control systems for the industry. Closer partnerships between the industry and academic institutions would help in addressing the environmental challenges facing the foundry industry.

Fresh investments/expansions and future outlook

The foundry industry will continue to be a sunrise industry in developing countries like India and China for many years to come because of the growth in automobile and infrastructure sectors. In recent times, the industry has been facing severe challenges due to rising cost of inputs and shrinking exports on account of the global economic slowdown. The industry needs to focus on new manufacturing strategies and rationalise production processes, cut costs and introduce innovations. The future outlook for the industry is bright due to the growing demand for castings within India as well as internationally.

08

SWOT analysis – Indian industry sector wise

1. Electronics industry



2. Textile industry



3. Leather industry



4. Automobile component industry



09

Investment opportunities for MSMEs

1. Textiles

- a. Manufacture of taffeta fabric (project cost – US\$ 1.17 million)
- b. Manufacture of crop shade fabric (project cost – US\$ 0.93 million)
- c. Conversion activity for Non-woven Healthcare Disposables (project cost – US\$ 0.71 million)
- d. Manufacture of webbings for seat belts (project cost – US\$0.71 million)

2. Food & agro processing

- a. Pack-house project of bananas (project cost – US\$ 1 million)
- b. Tomato processing at important crop pockets (project cost – US\$ 1 million)
- c. Baker's yeast (project cost – US\$ 1.33 million)
- d. Enzymes for food processing industry (project cost – US\$ 1.10 million)

3. Engineering

- a. Investment in casting project (project cost – US\$ 2.2 million)
- b. Auto components (OEM supply) (project cost – US\$ 2.2 million)
- c. Forged auto components (project cost – US\$ 0.88 million)
- d. Ready mix concrete for construction (project cost – US\$ 0.77 million)

4. Gems & jewellery

- a. Assaying & hallmarking centre (project cost – US\$ 0.44 million)
- b. Gold refinery (project cost – US\$ 0.66 million)

5. Chemicals

- a. Fine chemicals
- b. Specialty chemicals
- c. Polymer additives
- d. Nylon, Engineering plastics

6. Centres of excellence

- a. Research & development facilities
- b. Industry specific educational institutes and training centres

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Relevance of FIs & CRAs in promoting MSMEs

The different stakeholders with whom MSMEs are associated with are the local community, large buyers, FIs, B-schools, academic institutions, raw material suppliers, machinery providers, internal buyers, civil society organizations, regulatory bodies, etc. These stakeholders play an important role in the life and businesses of MSME owners. The interaction of the MSMEs with these stakeholders is frequent and direct. Although, the stakeholders serve their own mutual benefits, generally it develops into a healthy relationship. This relationship can play a vital role in transforming MSMEs into responsible businesses.

Financial Institutions:

- Through the products and services they provide, FIs are uniquely placed to influence the direction and pace of the country's economic development and by default, its long term sustainability.
- The SME owners who are the main drivers for all the issues concerning their enterprises have a very close financial and day-to-day need based relationship with these FIs.
- Indian banks, through their widely spread network; provide credit, loans and other services to thousands of Micro, Small and Medium Enterprises. Thus, bank managers and loan officers are the lifeline and the gatekeepers of capital for the SMEs.
- Indian banks serve the entire nation ranging from the top corporate to the smallest micro level enterprise and from the most sought areas to the remotest part of the country. They touch the maximum population of the nation in shaping their lives by providing them with their customised products and services.
- Despite many day-to-day problems faced by FIs, their mutual relationship with SMEs is strong. It is in this context that these FIs can significantly influence the economic growth and development of the SME sector and are better placed in bringing about the desired change.

RBI expected to announce financing package for MSME sector soon

The Reserve Bank of India (RBI) is expected to announce a financing package for the Micro, Small and Medium Enterprises (MSMEs), as the sector has been facing credit crunch due to delay in payments and unwillingness on the part of Banks towards offering loans in the backdrop of current global financial scenario, said Dinesh Rai, Secretary, Ministry of MSME, Government of India.

“Sending affirmative signals, the Government of India has also appointed a committee of secretaries to look at the problems being faced by the MSME sector, which include arenas of skills development, clusters approach, credit availability, technical and market considerations. Integrating the sector with global players is also of immense importance for the holistic development of India”, he further added. Towards the endeavors undertaken by the government are the enactments of MSME act 2006, Prime Minister's Employment Generation Program for generating 37 lakh jobs under the eleventh plan, setting up of National Commission for enterprises in organised sector, skills development planning commission amongst others.

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MSME in finance and credit policies

• Working capital shortages

- Inadequacy of working capital in any case has been a standing problem. The slow-down has exacerbated it. A large segment of MSMEs, particularly those that are part of supply chains, reported that they were facing problems due to unpaid bills.
- Most indicated that the problems were more acute at branch level with regards to requests for enhancement of working capital limits.
- In spite of willingness of a majority of MSMEs which are part of supply chains to utilise Factoring, it has not taken off due to legal and other tax related constraints.

• Over-arching concerns

- The overarching concerns of the MSME sector remain that of access to adequate credit.
- RBI is too occupied with the macro management of economy and has not had enough time for improvement of service quality for bank customers.

• Term loans and access to funds for new projects/start-ups

- Many progressive companies that went for expansion or started a new unit during the boom period (last 4-5 years) are now facing difficult to service periodic re-payment as market conditions have suddenly reversed. In the

current situation neither top-line nor bottom-line targets could be met by borrowers.

- Though Credit Guarantee for MSMEs have been made more user friendly, most of the banks still discourage borrowers from taking the guarantee cover and ask for the Collateral Security.

• Interest rates and service charges

- There is strong perception among the MSMEs (especially among the small segments) that they get a raw deal in interest rates. They are also made to pay higher charges for all types of chargeable services, especially non-fund based limits such as bank guarantees.
- The overwhelming view of the participants has been that while RBI has announced bold rate cuts and asked banks to reduce interest rates, nothing is passed on to the MSMEs. The interest is supposed to be charged based on the performance of the borrower.

• Third party credit rating

- Most MSMEs complained that third party credit rating requirement under BASEL II for loans portfolio above Rs. 10 crore had unnecessarily increased the cost burden on them. Most rating agencies apply the cut and dry corporate models on MSMEs. It is giving value to neither

the bankers nor the MSMEs. It has benefited only the rating agencies as they have secured their businesses.

• Losses due to exotic forex derivatives and forward contracts

- Exotic forex derivative instruments were sold by some banks to unsuspecting MSMEs to manage their forex risks. Losses worth more than Rs. 2000 crore are reported to be absorbed by MSMEs exporters alone. Recent RBI instructions have given a temporary respite to the affected MSMEs but the status quo remains.

• Commodity crash

- Many MSMEs that were contracted for import of raw material during 2008 suffered heavy losses as by the time the consignments arrived, the prices crashed, choking their working capital. As there was no precedence of such situations, most bankers failed to come to their rescue.

Present institutional structure in Gujrat

- **Small Industry Service Institute (SISI)**

SISI is an arm of the office of the Development Commissioner, Small Industry Development Organisation (SIDO), New Delhi, in Gujarat. SISI helps MSMEs meet various needs of planning, assessment and implementation by offering services in technical consultancy, industrial management, training and workshops.

- **Gujarat Institute of Development Research (GIDR)**

It is an autonomous body engaged in research related to development issues. GIDR, through its industry finance research, undertakes study on sectoral development. A large portion of studies undertaken by the institute have focused on the development of small scale industries.

- **Entrepreneurship Development Institute of India (EDI)**

It is an autonomous body supported by the Government of India and the Government of Gujarat and sponsored by other apex financial institutions. EDI offers education for excellence in entrepreneurship, training and research. The institute has a mandate to promote

the creation of Micro, Small & Medium Enterprises.

- **Center for Entrepreneurship Development (CED)**

It is an autonomous body jointly promoted by the Government of Gujarat, GIIC*, GIDC*, GSIC* and GSFC*. CED aims to cater to potential entrepreneurs by grooming their management skills. The institution offers a variety of learning platforms for Micro, Small and Medium Enterprise creation.

- **Small Industries Development Bank of India (SIDBI)**

SIDBI is a national support institution for small and medium enterprises for their financial requirements and upgradation. Its mandate is to work for technology upgradation in Micro, Small & Medium Enterprises clusters.

- **District Industries Centers (DIC)**

DICs, under the governance of Industries Commissionerate support the development and economic activities of MSMEs, at the district level.



13

Industrial Policy 2009 - Overview

In order to achieve the vision for Gujarat and the resultant objectives, sector intervention strategy at certain macro and micro level is required. The new Industrial Policy has been formulated with the aim of supplementing the existing growth pattern in the state and augmenting it by way of well thought out and sustainable policy measures. These policies aim at ensuring maximum utilisation of the existing natural resource base and maximising sector-specific facilitation. While aiming for Gujarat to be an internationally favoured investment destination under the new Industrial Policy, the GoG has been conscious of the need to ensure that the state's regional and global competitiveness is substantially enhanced. Accordingly, all the policy measures proposed are presented along the parameters used to measure global competitiveness, viz:

1. Promoting geographical strengths to ensure balanced regional development

One of the clear focuses of the new Industrial Policy would be to facilitate and ensure a sustainable and balanced development in Gujarat.

- Creation of opportunities for vigorous industrial and economic activities in the declared backward talukas
- Special Investment

Regions – convergence of industrial, social and urban infrastructure. Leverage DMIC and the influence area in Gujarat

- Facilitation to mega projects

2. Leveraging existing strengths and resources

For sustainable development, it is necessary to ensure that the existing and inherent advantages are identified and put to productive use. The new Industrial Policy seeks to promote industrial development in the state to optimally use the existing resource base. The strengths of the state in terms of physical advantages such as a long coast line, strong manufacturing base, excellent levels of support infrastructure, high base of entrepreneurial economy, policy-driven government, etc would all be used to promote industrial development in the state. The new policy has identified and developed a strategy which would promote industrial development in the state in a planned manner and to do so, a few focus sectors have also been identified. These sectors would benefit from special packages which would be extended to them by GoG for encouraging their growth and development further. The focus sectors that have been identified are that of textiles and apparels, gems and jewellery, innovative

projects, mega projects, informal sector, agri-business, fisheries, IT/ Knowledge-based industries, port and related industries and power sector (non-conventional energy). Important interventions which would be needed for each of these sectors have been listed in the new Industrial Policy. The interventions proposed are mentioned below:

- Promotion of cluster development in the state
- Promotion of textiles and apparels
- Promotion of gems and jewellery
- Promotion of agri-business
- Promotion of fisheries development
- Promotion of IT/ITeS industries
- Promotion of ports and related industries
- Promotion of non-conventional energy
- Promotion of women entrepreneurship

3. Increasing the efficiency of the institutional catalysing industrial development

The GoG recognises that investments would flow only into those regions which possess a strong, efficient and transparent institutional set up. Information and facilitation being an important aspect, it had been addressed in

the Gujarat Industrial Policy 2003 especially to provide information in all relevant fields to new as well as existing entrepreneurs. At the district level, District Industries Centres (DIC) has been modernised and information kiosks have been set up in each DIC, providing the latest information on industrial development and relevant aspects. The state government intends to continue to focus on its role as a facilitator and bring about competitiveness among districts in promoting industries in Gujarat:

- Investor facilitation
- Improving the efficiency of environmental compliance

4. Improving infrastructure available in the state

The new Industrial Policy seeks to create adequate provisions which aim at upgrading and improving the infrastructure in the state. Infrastructure which is critical for the efficient functioning of industries has been focused upon in the policy. As per the policy, the onus of industrial infrastructure improvisation largely lies with the GoG and the GIDC.

- Upgrading industrial infrastructure
- New industrial estates for focus sectors
- Promoting new industrial



estate development through PPP in the existing industrial areas

- Providing efficient logistic services for industrial growth
- Infrastructure development for IT industries
- Development of ports infrastructure
- Improvement in hinterland connectivity
- Augmenting the power requirements of the state

5. Enhancement of technical competence and manpower

The new Industrial Policy for Gujarat has laid adequate emphasis on encouraging expansion of the skilled and educated manpower base. The GoG intends to provide incentives for investments which are directed towards enhancing the skill levels of the manpower and ensuring that the talent pool available in the state is in line with the industry requirements.

Though the state has, over the years, attracted large volumes of investment, the availability of suitable manpower has been lagging. To address this issue, the state government intends to develop industry-responsive and readily employable manpower focusing on local resources. For this purpose,

the government has set up Gujarat Knowledge Society and has also planned to set up knowledge corridors for higher education. In response to the current market trends, a large demand for trained manpower is likely to emerge from the manufacturing and services sector.

The state government intends to introduce industry-responsive short term/ bridged modular courses in existing ITIs, Polytechnics and Engineering Colleges with active user-industry participation and involvement on a PPP basis. It has been proposed to set up Extension Training Centres in GIDCs, Industrial Parks, SEZs and industrial clusters. Anchor institutes would be selected for various industrial sectors to provide industry responsive curricula, need-based training and skill development for faculties. The state government will support the development of Specialised Skill Development Institutions. Support will also be provided to DTE and DET for sub – ITI / Polytechnic, short term (2 weeks) training programmes for spot employment.

- Skilled manpower development
- Training extension centres
- Anchor institutes
- Specialised skill development
- Incubation centre for youth

- Apparel & textile
- SME skill enhancement
- Institutional arrangement for market-driven curriculum

6. Creation of labour market efficiencies

The GoG has played a proactive role in ensuring that the sick industrial units of the state are provided with incentives which would facilitate their revival and reutilisation of the existing non-performing or under-utilised assets. The government has over the years announced several schemes which have primarily aimed at providing concessions to the sick industrial units in an effort to revive them. It intends to bring the focus back on these units and address them through the new Industrial Policy.

- Rehabilitation of sick units
- Assistance to bring the informal sector into mechanism

7. Rewarding adoption of new technologies, business sophistication and innovation

In order to create an environment conducive to the next stage of development and attracting investment and talent, the State Government

has accorded priority to research and development activity through promoting R&D institutions as well as encouraging contract research from private sector industries, institutions and industrial associations.

The State Government intends to make the SME Sector more comprehensive and vibrant. Government of Gujarat intends to provide necessary support by way of interest subsidy, venture capital assistance, quality certification, skill development, etc.

- Research & Development
- Enhance competitiveness of SMEs

8. Improving environmental infrastructure

One of the most important areas of developmental activity, also regarded as highly sensitive, pertains to the environment. Globally a very high degree of importance is attached to the fact that production and developmental processes should have minimal negative externality. This is a philosophy which is widely agreed upon by the Government of Gujarat. The growth and development which the government envisages for the state would necessarily be a sustainable one.

Industrial development and associated growth should

therefore be necessarily carried about in a process wherein no damage is done to the ecology and to the environment as a whole. The subject matter of environment safeguard also gathers greater momentum in the light of the fact that Gujarat is a predominantly industrial state. The state accounts for 28% of the national production in chemicals.

In addition, there is a wide range of industries in the state and thus it is more conscious about its responsibility in ensuring a clean and green environment. The new Industrial Policy intends to accord Environment the status of Infrastructure. In doing so, the GoG plans to provide a wide range of incentives for all the sectors to encourage greater compliance with the environmental norms and standards. It has taken initiatives to develop infrastructure for environment protection including setting up of common effluent treatment plants, development of hazardous waste disposal sites and disposal of treated effluents into sea. The environment protection measures would continue to get priority. Now the environment protection operations will be carried out by a third party responsible for monitoring and compliance and not by the polluters/ stake holders.

The state government aims to encourage environment management by rational use of resources, environment audit and taking measures to reduce pollution load, waste recovery, recycling and waste recharge, besides focusing on the adoption of clean process technology. The government aims to promote waste management as a standalone viable activity through professional independent technology-driven entities. It intends to gain carbon credits and reduce carbon foot prints in the industrial sectors. This will provide greater opportunity to the people willing to take the benefit of green business like carbon credit earning. Focus would be on green credits through compensatory or advance afforestation. The state government aims at zero discharge from specific industrial sectors over a period of 10 years.

As the use of clean green technology also requires large scale investment and is by and large an

expensive process, the state government recognises the need to introduce PPP methods for building environment infrastructure. A third party management to that extent would monitor and be responsible for ensuring that all the necessary environmental guidelines, rules and norms are strictly followed and adhered

to. The interventions which have been designed for the environmental sector under the new Industrial Policy are listed below:

- GoG will initiate PPP in the following areas:
 - Desalination plants and plants for recycling water
 - Common hazardous waste infrastructure projects
 - Common environmental infrastructure projects
 - Other projects that can improve environmental compliance
- For innovative non-PPP projects, GoG will provide financial support to the following:
 - Use of innovative technology for recovery of useful material from E-waste, electroplating waste and photography waste.
 - For ship-breaking facilities that adopt modern technologies
 - For implementing innovative technology that can help in the recovery of ODS from old equipments
 - For reduction in energy consumption
 - For common desalination plants via Reverse Osmosis (RO) technology for SMEs
- Technology upgradation of existing plants through clean innovative measures.
- For encouraging green practices, in SMEs, GoG will provide financial assistance for
 - Use of clean, efficient and innovative air pollution control equipment
 - Periodical environmental/energy audits
 - Setting up of environment management system
 - Purchase of new equipments/ systems related to occupational safety and health
 - Installation of solar energy system for energy saving
 - Grading and ranking industries according to their environment performance -gold/ silver/ bronze passes
 - Rain water harvesting
 - Reduction in water consumption
 - Provide financial assistance for substitution/ optimisation of raw material including catalysts
- Obtaining carbon credit and reduction of carbon footprint
 - Projects that will impact the entire cluster of units will be given priority for obtaining carbon credits.

- Support for carrying out life cycle analysis and related measures for reducing carbon footprint.

- For all projects in the area of environment and waste management, the government will reimburse the electricity duty for five years

9. Promoting holistic development

The GoG, in addition to facilitating economic and industrial growth, would also ensure that all round social development in the state is also carried on. The government has therefore realised the need to synergise social development activities of corporates with government initiatives to ensure better reach, impact, visibility, sustainability and outcome. In this context, the state government would lay emphasis on promoting such activities in PPP mode and make the corporates partners in various programmes. The concept of Corporate Social Responsibility would be actively encouraged and promoted in the state.

An indicative list of sectors will be outlined where the corporates and industry associations may like to get associated. These may include: promotion of sports

at rural level to make youths capable for participation at national/ international competitions, building play grounds, enhancement of technical competence including vocational training and providing uniforms to students, adopting PHCs/ CHCs and supporting nutritional programmes, Nirmal Gujarat Programmes etc.

The corporates and industry associations may decide to undertake specific activities or a combination of activities in villages/ cluster of villages/ talukas/ districts. The participating companies or associations adopting to take up such activities would need to appoint a designated officer as Director for CSR activities. A committee consisting of the Director (CSR of the company), officer from DRDA and officer nominated by

the District Collector (DC) will be constituted to decide on activities, allocation of fund from corporates and government and monitor the progress of these activities.

10. Responsiveness to changing domestic and global environment

The state government will ensure the implementation of the Industrial Policy 2009 to meet with the stipulated objectives of the industrial policy. Recognising the increasingly dynamic nature of the world economy in an era of close global linkages and the constant need for frequent and appropriate response, a course correction mechanism would be put in place. The policy envisages building a response system wherein continuous

feedback and quick response to the required policy changes are made possible.

The state government intends to constitute Development Councils for focussed industrial sectors as well as specific aspects like manpower development, environment protection, etc. in order to have continuous inputs and suggestions. The councils will include industries representatives and experts as members.

An inter-departmental committee headed by the Hon'ble Minister of State (Industries) will be constituted to enable realisation of the intended outcome of the policy. The committee will also review suggestions received from Development Councils and recommend midterm corrections to the government.



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Promotion of cluster development in the state

Cluster based approach is increasingly being recognised as sustainable, cost-effective and an inclusive strategy to ensure competitiveness and improvement of Micro, Small and Medium Enterprises (MSMEs).

The importance of MSMEs for the Indian economy in terms of their contribution to employment, exports and regional development is very significant. Considering the importance, Gujarat would lay special emphasis on cluster development approach in the new Industrial Policy by announcing a scheme for assistance to clusters. The scheme would not only lay importance on softer interventions such as capacity building of cluster enterprises through marketing initiatives, technology upgradation initiatives, quality

improvement and training/ skill upgradation initiatives; but also focus on harder interventions such as the creation of cluster-specific common infrastructure and facilities, incubation center, CFC, ITI extension centre and other need-based facilities.

This would enable the MSMEs to build their capacities in the clusters, take the advantage of emerging global opportunities, enhance the competitiveness of cluster by facilitating the creation of critical common support infrastructure, ensure creation of sustainable employment opportunities and augment the income levels of people working in/ dependant on MSMEs. It would also make the industry associations/ cluster stakeholders more responsive, participatory

and empower them to participate in Public-Private Partnership (PPP) initiatives to compete globally.

The financial assistance proposed in the new Industrial Policy is as follows:

1. The government would extend financial assistance (including assistance from GOI) to cluster development with a ceiling for the period of three to five years.
2. Cluster Advisory Institution (CAI) to be constituted for proper development of cluster.
3. Financial assistance to nodal institution/ hiring of experts.
4. They will also be provided partial financial assistance for Last Mile connectivity.

Incentives for MSMEs

• Interest subsidy

- Incentives to SMEs for setting up new projects, expansion, diversification or modernisation
- 5% interest subsidy up to Rs. five lakhs per year for five years period

• Technology upgradation

- Interest subsidy at 3% per annum, maximum Rs. three lakh on term loan towards capital equipment
- Technology acquisition fund
- Assistance for patent registration

• R&D Support

- Support to R&D institutions
- Sponsored research – Subsidy at 50% of the project maximum Rs. five lakh

• Quality certification

- Support for BIS certification, ISO 9000, ISO 14000, HACCP, WHO GMP and others
- Subsidy at 50% subject to a maximum of Rs. 0.2 million

• Marketing support

- Assistance for participation in international trade fairs upto maximum Rs. two lakhs
- Assistance to industries associations at 50% of total rent subject to a maximum Rs. five lakhs

Challenges faced by the MSME sector

The MSME sector is faced by a number of challenges.

- **Financial assistance:** MSMEs, particularly the tiny segment of the small enterprises have inadequate access to finance due to a lack of financial information and non-formal business practices. MSMEs also lack access to private equity, venture capital and have a very limited access to secondary market instruments. With deregulations of the financial sector, the ability of the banks to service the credit requirements of the MSME sector depends on the underlying transaction costs, efficient recovery processes and available security.
- **Credit issue:** The main constraint which the MSMEs still face is the availability and high rate of credit. This is likely to get exacerbated in the current context of the heat being felt by the Indian financial sector due to the recent global financial meltdown.
- **Market orientation:** MSMEs face fragmented markets in respect of their inputs as well as products and are vulnerable to market fluctuations.
- **Accessibility to markets & technology:** MSMEs lack easy access to inter-state and international markets. The access of MSMEs to technology and products innovations is limited. There is also a lack of awareness of global best practices among MSMEs.
- **Delays in compensation:** MSMEs face considerable delays in the settlement of dues/ payment of bills by the large scale buyers.
- **Operation costs:** Rising global cost of commodities continues to haunt the local manufacturers. In addition to rising inflation, the SME sector has, in many ways become a 'talent pool' from which skilled labour and professionals are often fished to fill higher paying jobs in large domestic and international companies. As a result, SMEs face higher recruitment and training costs while dealing with high employee attrition rates.
- **Risk capital:** As the SME sector emerged to become the nation's economic growth engine, raising finance to power, that growth remains as impediment to sustained expansion. Venture capital firms are generally wary of investing in relatively young or unproven technologies. Banks too are unable to provide debt financing. In addition, there is no formal mechanism for SMEs to raise investment from capital markets. As a result, SMEs either raise money through informal means, or scale back on their product and service offering.
- **Export-driven business model:** The past two years have seen a marked appreciation in the value of the Indian Rupee. Since SMEs derive significant revenues from exports, this shift in the exchange rate ratio has eroded into their profits. SMEs lack in-house expertise to analyse hedging options and forecast exchange rate fluctuations. That, coupled with competition from other south-east Asian countries has forced SMEs to re-architect their business models. The above mentioned challenges call for an effective addressable mechanism.

About Confederation of Indian Industry

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the growth of industry in India, partnering industry and government alike through advisory and consultative processes.

CII is a non-government, not-for-profit, industry led and industry managed organisation, playing a proactive role in India's development process. Founded over 114 years ago, it is India's premier business association, with a direct membership of over 7800 organisations from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 90,000 companies from around 385 national and regional sectoral associations.

CII catalyses change by working closely with government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sectoral consensus building and networking. Major emphasis is laid on projecting a positive image of business, assisting industry to identify and execute corporate citizenship programmes. Partnerships with over 120 NGOs across the country carry forward our initiatives in integrated and inclusive development, which include health, education, livelihood, diversity management, skill development and water, to name a few.

Complementing this vision, CII's theme for 2009-10 is 'India@75: Economy, Infrastructure and Governance.' Within the overarching agenda to facilitate India's transformation into an economically vital, technologically innovative, socially and ethically vibrant global leader by year 2022, CII's focus this year is on revival of the Economy, fast tracking Infrastructure and improved Governance.

With 64 offices in India, 9 overseas in Australia, Austria, China, France, Germany, Japan, Singapore, UK, and USA, and institutional partnerships with 213 counterpart organisations in 88 countries, CII serves as a reference point for Indian industry and the international business community.

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About PricewaterhouseCoopers

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