Synthetic Model for Evaluation of Micro, Small and Medium Enterprises in India

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Abstract—The Micro, Small and Medium Enterprise (i.e. MSME) sector is a significant contributor to the Indian economy. Based on official figures from the Ministry of MSME, November 2008, this sector contributes 8% of National GDP, comprises 50% of India’s total manufactured exports, 45% of India’s total industrial employment and 95% of all industrial units. The MSME sector in India, however, has been changing over time, mostly through changes in government policy. Today there are around 130 lakhs micro and small firms in India. Number of firms in the MSME sector comprises a staggering 95% of all industrial units in India. Together they employ more than 8% of the total Indian labor force of 509 million individuals. This amounts to a significant 41 million people who are currently employed in this sector. The MSME sector is a significant contributor to India’s exports amounting to 40% of the total share. It also comprises a lion’s share (45%) of the total manufacturing output of the country. This calls us to enquire into a process to evaluate the performance of MSME of the country. But upon extensive literature search we found no evaluation model to be available at the disposal of researchers and policy makers. They have been largely dependent on fragmented studies. The paper attempts to bridge this research gap by developing a Synthetic Model which is largely qualitative in nature so that it can be used for empirical work in the future after testing its robustness. In the process basic principles of social science research have strictly followed and the geographical boundary is set in India.

Keywords— MSME, Evaluation, Synthetic, Qualitative.

I. INTRODUCTION

The entrepreneurial evolution of India under the British Regime during the second half of the Nineteenth Century had taken a very asymmetrical shape, concentrating entrepreneurial development mainly in the coastal regions. The industrial structure that we inherited from Britishers at the time of independence was purposely restricted to a few selected industries like textiles, sugar and steel including some limited development of engineering in railway workshops and assembly plants. Nair; 2004; Clingingsmith and Williamson (2008) commented that the pace and pattern of industrialization exhibited a distorted scenario owing to mainly articulated bias of colonial rules to expansion of raw material production, smallness of the domestic market, lack of investment climate, absence of entrepreneurship, lack of banking institutions and inadequacy of transport infrastructure.

A drive for diversification of economy through rapid industrialization was, therefore, considered necessary to ameliorate the basic conditions of providing employment to growing population, raising the standard of living of the people, improving the balance of payment situations and attaining self-sufficiency in the economy, besides reducing inter-regional disparities and creating employment opportunities to the surplus workforce over-burdening the agriculture sector. It has been observed that countries are trying very hard to industrialize as far as possible. As Industrialisation via development of Micro, Small and Medium sized industries is the only solution to economic backwardness. However this indiscriminate struggle has resulted into unsteadiness and lopsided regional economic growth.

II. MSME SIGNIFICANT CONTRIBUTOR

The Micro, Small and Medium Enterprise (i.e. MSME) sector is a significant contributor to the Indian economy. Based on official figures from the Ministry of MSME, November 2008, this sector contributes 8% of National GDP, comprises 50% of India’s total manufactured exports, 45% of India’s total industrial employment and 95% of all industrial units. The MSME sector in India, however, has been changing over time, mostly through changes in government policy. Today there are around 130 lakhs micro and small firms in India. Number of firms in the MSME sector comprises a staggering 95% of all industrial units in India. Together they employ more than 8% of the total Indian labor force of 509 million individuals. This amounts to a significant 41 million people who are currently employed in this sector. The MSME sector is a significant contributor to India’s exports amounting to 40% of the total share. It also comprises a lion’s share (45%) of the total manufacturing output of the country. On looking at the decomposition between registered and unregistered units. Of the total, a dominant 86% belong to the unregistered sector. When we take a closer look at the reasons for non-registration of units, we find that 54 percent of all units that were surveyed in the All India Census of SSIs in 2002 cited “not aware of such a provision” as a reason. The next most common reason is “not interested” while a smaller proportion yet cited “complicated procedures” as a reason for non-registration. This highlights the primary reason for including measures to simplify registration process in the MSME Act of 2006. Registration is voluntary in the SSI sector. Looking at the disaggregated data for registered and unregistered firms, we find that although registered units comprise only 13 percent of the sector but in terms of investment, their share is 59 percent and they contribute close to 56 percent of the total production in the sector.
Compared to the Second Census data which was collected in 1988, in the Third Census (2002), we find that per unit employment has gone down in registered units from 6.29 to 4.48. The per unit fixed investment has on the other hand gone up multifold from Rs.1.60 lakhs to Rs.6.68 lakhs. To understand the true complexity behind the sector, we have to look beyond simple classification of units along registered and unregistered categories. Based on the duration of operation, firms can be further classified across perennial (92 percent), seasonal (5.5 percent) and casual (2.39 percent). Based on the type of organization, all registered units can be further classified as proprietary (90 percent), partnership (7.2 percent), cooperative (2.42) or private company (1.5 percent). Based on their location, the units can be classified as rural (55 percent) or urban (45 percent).

There are further classifications based on the main source of power used in the firm such as electricity (47 percent), no power needed (40 percent), oil (5.6 percent), coal (4 percent) etc. Another interesting fact is that about 11 percent of all small scale units are women managed enterprises. In the sector as a whole, about half of all units are engaged in services (49 percent). The significance of the services segment in the SSI sector has been steadily increasing over the last two decades. When we look at the decomposition of units across registered and unregistered units, we notice a majority of registered firms are in the manufacturing, assembling and processing space (62 percent). Another point to note is that there is enormous variation across states within India when we look at the MSME sector data. When we consider all registered units, we find that six states have 62 percent of all working units. These states are Tamil Nadu, Uttar Pradesh, Kerala, Gujarat, Karnataka and Madhya Pradesh. The maximum number of unregistered units (17 percent) was located in one state, Uttar Pradesh.

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III. PROBLEM
The issue and challenges are noticeable but to conduct any research at national or regional level an evaluation model is needed.

IV. METHODOLOGY
As no earlier studies have been conducted to evaluate MSME, a qualitative research is needed to develop a synthetic model which can further be tested in an experimental framework. For the purpose of development of such a synthetic model existing literature on the area and periphery have been reviewed. Total 100 relevant literature in form of published research papers in journals and chapters of books were found and out which 80 were reviewed and a conceptual synthetic model was developed.

V. SYNTHETIC REVIEW
The influence of education on performance lies in the fact that knowledge gained enhances the managerial capacity to develop a superior business in general organ industry-specific strategy (Honig 1998; Kim et al.2006; West and Noel 2009). Consequently, resources can be acquired more efficiently, costs are reduced, and revenues are increased. In short, performance improves. According to human capital theory, education may foster either specific or general skills (Joshi 2008; Reuber and Fischer 1999). Thus, we divided education into two types: (1) industry specific knowledge and (2) general business knowledge. Industry-specific knowledge is associated with the particular skills, insights and proficiency applicable to a sector, industry or product market. General business knowledge is aimed at preparing individuals to manage a firm or undertake a business project. In the context of a CEO-owner, our focus shifts to the question of whether the two forms of education differ in their influence on venture performance. Soriano, Castrogiovanni (2010) investigated the effects of entrepreneurial human capital on SME performance using data on 2,713 SMEs within the European Union. Performance was measured in two ways: profitability as ROA and productivity as revenue per employee. Results indicate that both profitability and productivity are positively related to industry-specific knowledge possessed by the CEO-owner prior to starting up the firm and the general business knowledge acquired once the firm is up and running. Experience as a result of having previously worked in a firm in the same industry before starting a business was related to productivity, but there is no relation with profitability. There is a link between performance and inclusion of other CEO-owners in the founder’s inner circle of advisors. This relationship is positive when the advisor’s venture has experienced failure and negative when the advisor’s venture has been successful. Kim (et al. 2006) clearly communicates that General business knowledge refers to the education received by individuals in universities or business schools. An indicator of general business knowledge acquired in universities would be courses taken toward undergraduate or graduate degrees in business administration. General business knowledge developed through formal education in business is expected to influence the knowledge, skills and motivation of an entrepreneur in ways that can contribute to the efficiency of the new venture. Formal business education can build knowledge with respect to opportunities, resources and efficient application, specifically with respect to the general administration of a business. In addition to knowledge, it is expected that such general education would also support the development of general skills such as communication, teamwork and critical analysis, and problem solving. Finally, it has been suggested that the extent to which an entrepreneur obtains formal educational qualifications is also an indicator of his or her determination and drive, energy, motivation and commitment to the business enterprise. Such general business knowledge might play a pivotal role in the success of an entrepreneurial venture.
Briga, Yvonne and Naomi (2010) in their effort to study the need of education to MSME and its impact on its growth found that proper education and good pedagogical delivery provides good managers and thus helps building successful enterprises. They proposed a practice-based entrepreneurship education programme which enhances collaboration between educational institutions and the small business community as a means of producing a well rounded and skilled graduate. Furthermore, it creates a more meaningful relationship between education and industry. They clearly commented upon the positive role that education plays in the growth and development of MSME in region.

VI. CLUSTERISATION

Das (2007) in his research on Cluster Development in India informs that with the launching of the cluster development programme in India by the UNIDO in 1997, promoting clusters is a strategy to enhance the competitiveness and to participate in the global value chain. It has been almost a celebrated strategy countrywide. The surge of various cluster schemes can be observed since 2000 onwards. Numerous Government and quails-government documents have acknowledged cluster development as the most important initiative to improve the performance of the MSMEs in the country. 11th Five Year Plan document states that “A cluster approach can help increase viability by providing these units with infrastructure, information, credit and support services of better quality at lower costs, while also promoting their capacity for effective management of their own collectives (emphasis ours)” (Planning Commission, 2006: 35).

VII. OWNER SHIP STRUCTURE

The ownership structure of a firm can be investigated from a number of alternative dimensions. Most commonly, ownership structure refers to the ownership by different groups of shareholders or ownership concentration. According to Demsetz (1983), the ownership structure of a firm reflects the influence of shareholders. However, the results on the relationship between ownership concentration and firm performance are mixed. It can also be argued that ownership concentration among the top management of the firm can lead to risk aversion and lack of willingness to engage in strategic changes. Firms with inefficient ownership structures will fail to survive in the long run. As a result, there should be no relationship between ownership structure and firm performance. Yet, there are conflicting results on the relationship between ownership concentration and performance.

Demsetz and Lehn (1985) and Demsetz and Villalonga (2001) find no statistically significant relation between ownership structure and firm performance while several researchers, for example Agrawal and Knoeber (1996), Andersson and Reeb (2003), Barontini and Caprio (2006), Hermalin and Weissbach (1991), King and Santor (2008), Morck, Shleifer, and Vishny (1988) and Villalonga and Amit (2006), find a positive association between ownership structure and profitability. Insider ownership. Increased ownership by insiders or the presence of a large shareholder can lead to better performance (King and Santor 2008). First, greater insider ownership improves firm performance because it reduces agency problems between owners and managers (Jensen and Meckling 1976). Second, when controlling shareholders are not involved in management, they are more capable of monitoring and controlling managers. Third, the presence of a large shareholder may have a positive effect on firm performance because they have greater resources and incentives to acquire information and monitor managers (Shleifer and Vishny 1997). Fourth, firms owned by large shareholders such as families may make better investment decisions, since families have more specific knowledge on the firm and have longer investment horizons. Managerial ownership. One important form of insider ownership in small firms is managerial ownership. Managerial ownership can increase management’s motivation to work to raise the value of the firm’s stock (Hermalin and Weissbach (1991). Morck et al. (1988) find that insider ownership between 0-5 % increases firm performance, insider ownership between 5% and 25 % decreases performance, but that insider ownership above 25 % again increases performance. McConnell and Servaes (1990) indicate that management ownership tends to affect shareholder wealth positively at low levels of ownership and negatively at high levels of ownership. Hermalin and Weissbach (1991) argue that firm performs better at low levels of management holdings and stock returns improve with an increase in managerial ownership at low levels. Agrawal and Knoeber (1996) find a positive statistically significant relationship between firm profitability and insider ownership, while firm profitability and an increasing number of outsiders on the board are negatively associated. On the other hand, Ben-Amar and André(2006) and Lasfer (2006), report that outside ownership has a positive influence on abnormal returns. Research on venture capital suggests that this form of concentrated holdings may lead to increased performance (Kang and Sorensen 1999). Furthermore, Yermack (1996) reports that board stock ownership and firm value are positively associated. Family ownership. Another important type of insider ownership in small firms is that by families. In small firms, having owner-CEO or family-CEO eliminates the conflict between owners and managers. In the literature, the impact of family ownership, control and management on firm performance varies partly because of the differences in defining family ownership (e.g. Miller et al. (2007)). Large family holdings can have a negative impact on firm value and it may be even more negative if family members hold executive positions such as CEO in the firm (Ben-Amar and André 2006). When a family member serves as CEO it can be expected to have a negative impact if the CEO is not competent enough to run the business. Furthermore, a family-CEO will not have so much to lose as professional managers who have to ensure their reputation in the executive labour market (Ben-Amar and André 2006). Anderson and Reeb (2003) investigate the relationship between founding-family ownership and firm profitability with a data on large listed companies. They find family firms performing significantly better than non-family firms and firm performance is better when family members serve as CEO compared to the firms with outside CEOs. Also Barontini and Caprio (2006) suggest that family...
control is positive. Furthermore, King and Santor (2008) indicate that family-owned firms exhibit superior accounting performance, i.e. higher levels of control is positively associated with profitability, but they also report that family firms have higher leverage. Villalonga and Amit (2006) argue that family ownership creates value when the founder serves as CEO or as board chair with a hired CEO. According to agency theory, the separation of ownership and control is the most efficient governance structure. Furthermore, the role of the board is recognized as crucial in corporate governance. Board composition refers to the size and structure of the board, i.e., number of board members and type of board members (Zahra and Pearce 1989). Board composition can be seen as an alternative mechanism to solve agency problems. Therefore, the board is regarded as a key link between management and shareholders (Adjaoud et al. 2007; Brunninge et al. 2007). In closely held firms the role of the board is different because the risk of management’s opportunistic behaviour is lower (Brunninge et al. 2007). Board structure can also be seen as a potentially important predictor of firm financial performance (Zahra and Pearce 1989). Prevost et al. (2002) support the notion that board composition and inside equity ownership are substitute mechanisms in controlling agency problems. The greater the share of outside shareholders, the more effectively management behaviour should be monitored and disciplined (Demsetz and Villalonga 2001). Therefore, in firms with separate ownership and management, board’s role to monitor and control is important to safeguard shareholders investments (Brunninge et al. 2007). The connection between board composition and firm performance may not be as simple as is sometimes assumed. Previous research has provided evidence that board’s ability to perform their service, strategy and control role depends largely on the board composition (Pearce and Zahra 1992). Furthermore, board composition affects board members’ ability and power to provide strategic direction and performance. Dalton et al. (1998) and Hermelin and Weissbach (1991) find no relationship between board composition and firm performance. Lasfer (2006) suggests that managers choose a board that is unlikely to monitor and there is a negative relationship between board size and managerial ownership. Furthermore, managers are also likely to reduce the monitoring role of the board by CEO duality. Mak and Li (2001) report that firm ownership and board structures are related. They also find that the proportion of outsiders on the board is negatively associated both with managerial ownership and board size, and that separate leadership structure and block holder ownership are positively related. Board size refers to the number of board members. Board size has been suggested to have an impact on firm performance. Bozec (2005) reports that the size of the board is positively associated with firm size, i.e. larger firms have larger boards. It can also be argued that when board size increases too large, agency problems increase (Bozec 2005). Furthermore, it has been suggested that firms with large boards appear to use assets less efficiently. Yermack (1996) argues that smaller boards are more effective and firms with large boards appear to use assets less efficiently and earn lower profits. Boards with more than seven or eight members are less likely to function effectively and such boards are easier for the CEO to control (Jensen 1993). Furthermore, larger board size may lead to the deterioration of corporate governance. Pearce and Zahra (1992) find that board size and profitability are positively correlated, while Eisenberg et al. (1998) report a negative relationship between board size and firm profitability. CEO duality refers to a board leadership structure in which the same person undertakes both of the roles of chief executive officer and chairman of the board (Bozec 2005). In many SMEs, these roles overlap. Consequently, CEO duality is characteristic of SMEs. The preference for the separate board leadership structure is largely based on agency theory. According to agency theory, duality undermines board independence because the CEO will acquire a wider locus of control. Moreover, CEO duality undermines board independence and promotes CEO entrenchment (Bozec 2005). As a result, a negative relation is expected between the CEO duality and firm performance. As far as the impact of board leadership structure is concerned, Dalton et al. (1998) find no relationship between board leadership structure and firm performance. But, Bozec (2005) report that CEO duality and profitability are negatively associated, while Dehaene et al. (2001) suggest a positive relationship between CEO duality and profitability. In contrast, Ezzamel and Watson (1993) report on a positive association between separate leadership structure and profitability. Furthermore, Andersson and Reeb (2003) find that firm profitability is positively related to family CEOs. Outsiders on the board. Agency theory also suggests a need for board independence. Outside board members are believed to be independent from the management, and therefore, they can provide superior performance benefits to the firm (Fama 1980, Dalton et al. 1998). Outsiders on the board are often thought to play a monitoring role inside the board (Bozec 2005). Independent board members are regarded as good governance mechanisms because they represent the shareholders interests and bring added value to the firm (Ben-Amar and André 2006). Previous literature suggests that an effective board should be comprised of greater proportions of outside directors (Zahra and Pearce 1989; Dalton et al. 1998). Pearce and Zahra (1992) find that larger board size and higher proportions of outside directors on the board are positively associated with higher profitability. Yet, in many SMEs, owners, board and top management overlap. Previous studies on the impact of board characteristics on firm performance have shown mixed results. According to Agrawal and Knoeber (1996), firm profitability is negatively associated with presence of outsiders on the board, while Pearce and Zahra (1992), Dehaene et al. (2001) and Prevost et al. (2002) find a positive relationship between outsiders on the board and firm profitability. According to Kesner (1987), presence of insiders on the board is positively associated with firm profitability. In contrast, Wagner et al. (1998) suggest that presence of both insiders and outsiders are positively associated with profitability.

VIII. CORPORATE SOCIAL RESPONSIBILITY

Corporate Social Responsibility (CSR) has permeated management practice and theory up to a point where CSR can be referred to as the latest management fad (Guthey, Langer, & Morsing, 2006). However, so far CSR integration
into business processes has been very uneven. Hockerts (2008), for example, finds that most firms conceptualize CSR primarily as a tool to reduce risks and operational cost. Only a minority of firms is actually using CSR as a means to drive innovation. In their study of 150 German and British pharmaceutical companies Blum-Kusterer and Hussain (2001) similarly find that regulation and technological progress are the two main drivers for sustainability innovations. They observed that the lure of emerging market niches was no important motivator for the firms studied. This is unfortunate since bringing stakeholders into the innovation process offers important opportunities to increase both the social and financial performance of firms.

Corporate social responsibility has long been debated/ critiqued for its efficacy, interests, and target audiences in various global contexts (Cheney et al. 2007; Ganesh 2007; Munshi and Kurian 2005; Stohl et al. 2009; Utting 2005; Vogel 2005; Wettstein 2005). However, few scholars have considered how situated discourses of development in the “emerging economy” (for an overview of this term, see Char 2009; also Mitra et al. in press) may influence the social role of corporations and CSR. Corporate Social Responsibility (CSR) has permeated management practice and theory up to a point where CSR can be referred to as the latest management fad (Guthey, Langer, & Morsing, 2006). However, so far CSR integration into business processes has been very uneven. Hockerts (2008), for example, finds that most firms conceptualize CSR primarily as a tool to reduce risks and operational cost. Only a minority of firms is actually using CSR as a means to drive innovation. In their study of 150 German and British pharmaceutical companies Blum-Kusterer and Hussain (2001) similarly find that regulation and technological progress are the two main drivers for sustainability innovations. They observed that the lure of emerging market niches was no important motivator for the firms studied. This is unfortunate since bringing stakeholders into the innovation process offers important opportunities to increase both the social and financial performance of firms.

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IX. SYNTHETIC MODEL

A qualitative analysis of the situation by synthetic reviewing has brought us to the conclusion that MSME evaluation has not been done. Literature survey is pertaining to India as a whole creating a vacuum for policy makers, researchers and Industry people. The extensive review has shown us the door for proper evaluation in the era of fast changing local and global fundamentals. Today across the world entrepreneurial growth has become a challenge and with India in specific the challenge becomes larger as the literature and preliminary data show that the state is starved of industry. The literature review has shown us broad dimensions of evaluation which consolidated shall bring about robust results and a holistic view. The dimensions to be evaluated are (a) Knowledge of Key People and decision makers of a Firm which is MSME in nature. (b) Financial Performance (c) Policies, People and their Impact (d) Corporate Social Responsibility (i.e. CSR).

Fig. 1 The Dimensions To Be Evaluated

X. CONCLUSION

The developed model is product of a very systematic and difficult process of qualitative methodology. As the model is not quantitative, it needs to be tested. Today the policies formed by government in developing countries in general and Indian in specific are not very effective in case of MSME. This is because of the mere fact that there exists no evaluation process and hence results from studies are many
times direction less. Knowledge of Key People and decision makers of a Firm which is MSME in nature. (b) Financial Performance (c) Policies, People and their Impact (d) Corporate Social Responsibility (i.e. CSR) above have been identified as the key areas or elements on the basis of which any policy should be made.

BIBLIOGRAPHY


