

# MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs) IN INDIA: CHALLENGES AND ISSUES IN THE CURRENT SCENARIO

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## ABSTRACT

***There is growing worldwide appreciation of the fact that Micro, Small and Medium Enterprises (MSMEs) play a catalytic role in the development process of most economies. MSMEs form the backbone of the Indian economy and have become engine of economic growth in India. It is estimated that MSMEs account for almost 90% of industrial units in India and 40% of value addition in the manufacturing sector. Today, small and medium industry occupies a position of strategic importance in the Indian economic structure due to its significant contribution in terms of output, exports and employment. The small scale industry accounts for 40% of gross industrial value addition and 50% of total manufacturing exports. More than 13.2 million units are spread all over the country producing about 6000 items, from very basic to highly sophisticated products. The MSMEs are the biggest employment provider after agriculture, providing employment to nearly 32 million people. This paper closely analyses the growth and development of the Indian small scale sector since opening of the economy in 1991. It also looks into the present scenario of MSMEs and the challenges they face like lending, marketing, license raj issues in detail.***

## INTRODUCTION

The contribution of the Micro, Small and medium enterprises (MSME's) to the economic growth of a nation is well recognized. Leutkenhorst (2004) argue that the contribution of MSME's towards employment generation is significant because this sector use more labour intensive production processes thus boosting employment and leading to more equitable income distribution, provide livelihood opportunities through simple, value adding processing activities in agriculturally based economies; nurture entrepreneurship; and support the building up of systemic productive

capacities and the creation of resilient economic systems, through linkages between small and large enterprises

## DEFINITION OF MSME'S IN INDIAN CONTEXT

There is no universal definition of small and medium enterprises. MSME's are defined in different ways in different parts of the world. Some define them in terms of assets, while others use employment, shareholder funds or sales as criteria. Some others use a combination of revenue and employment as a hybrid criterion. The definition of MSME has been a contentious issue in India. In 2005, the

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definition of a Small enterprise was expanded to include a two category classifications- Enterprises engaged in production/Manufacturing of goods for any industry and Enterprises engaged in rendering/providing of services.

Type of Enterprise	Engaged in manufacture or production of Goods	Engaged in Providing or rendering of services
Micro Enterprise	Does not Exceed 25 Lakhs	Does not Exceed 10 Lakhs
Small Enterprise	More than 25 Lakhs but does not exceed 5 crore	More than 10 Lacks but does not exceed 2 crore
Medium Enterprise	More than 5 crore but does not exceed 10 crore	More than 2 crore but does not exceed 5 crore

**OVERVIEW OF THE MSME SECTOR**

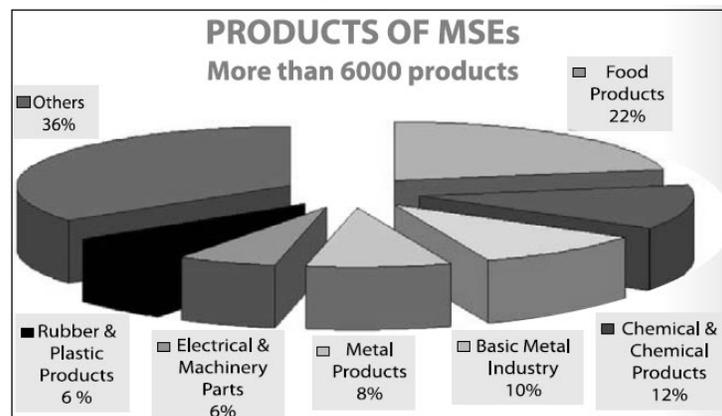
Small industry has been one of the major planks of India’s economic development strategy since Independence. With the advent of planned economy from 1951 and the subsequent industrial policy followed by Government of India, both planners and Government earmarked a special role for small-scale industries and medium scale industries in the Indian economy. A high priority was accorded to these enterprises from the very beginning and Government pursued support policies to make these enterprises viable and vibrant and over time, these have become major contributors to the GDP.

The micro, small and medium enterprises (MSME) sector contributes significantly to the manufacturing output, employment and exports of the country

and thus it occupies a strategic position in the Indian economic structure. It is estimated that in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 percent of the total exports of the country. The sector is estimated to employ about 42 million persons in over 13 million units throughout the country which makes it the second largest manpower employer after agriculture. Further, this sector has consistently registered a higher growth rate than the rest of the industrial sector.

There are over 6000 products ranging from traditional to high-tech items, which are being manufactured by the MSMEs in India. It is well known that the MSMEs provide the maximum opportunities for both self employment and jobs after agriculture.

**Figure No. 1**



**Source: Annual Report 2008-09, Ministry of MSMEs, Government of India**



The MSME's alone contribute to nearly 6% of India's GDP. As per the latest All India Census of Small Scale industries, the MSME's have increased from about 80,000 units in the 1940's to about 13.37 million units in 2008.. In the sports goods and garments sector their contribution to exports is as high as 90% to 100%. They constitute 90% of the industrial units in the country and also contribute to about 35% of India's exports. (Pandey, 2007)

In the recent past, small companies have performed better than their larger counterpart. Between 2001-06, small companies with net turnover of Rs. 1 crore – 50 crore had a higher growth rate of 701 per cent as compared to 169 per cent for large companies with turnover of over Rs. 1,000 crore (Business World Jan. 2007). The total SSI production, which had reached the all time high of Rs. 1,89,200 crores in 1989-90 dropped dramatically in the next 10 years and only in 2001-02 the level of production were surpassed. But after 2002, the production has risen at a faster rate. Since 2000, there is a continuous growth in number of units, production, employment and exports. The average annual growth in the number of units was around 4.1% and since its

inception, it continued to maintain more than 8% growth rate.

The contribution of MSMEs to the economy is despite the sector being exposed to intensified competition since liberalisation of Indian economy in 1991. Small industry in India has been confronted with an increasingly competitive environment due to: (1) liberalisation of the economy in the 1990s, favouring foreign direct investment (FDI); (2) the formation of the World Trade Organisation (WTO) in 1995, forcing its member-countries (including India) to drastically scale down quantitative and non-quantitative restrictions on imports, and (3) Economic reforms in the country. The cumulative impact of all these developments is a remarkable transformation of the economic environment in which small industries operate, signifying that the sector has no choice but to compete with its global counterparts.

#### PERFORMANCE OF MSMEs

The time series data in respect of the MSME Sector on various economic parameters is incorporated in the following table: -

**Table 1**  
**Performance of Micro, Small and Medium Enterprises**

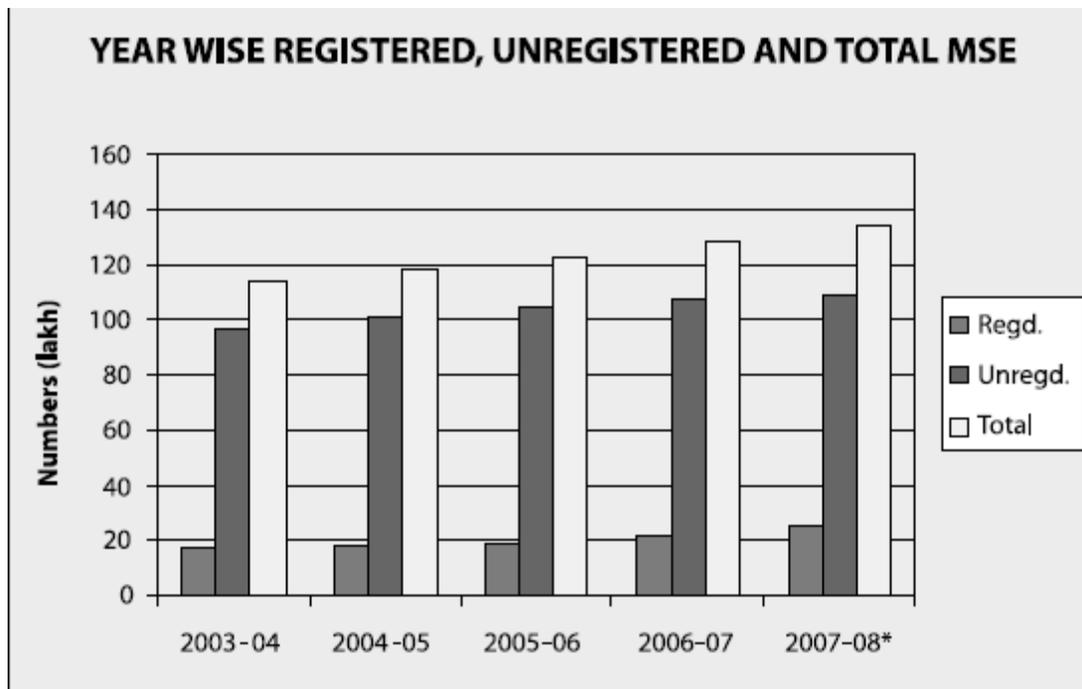
Year	Total SSI units(lakh numbers)	Fixed Invest-ment (Rs crore)	Production (Rs crore)		Employ-ment (lakh Persons)	Exports Rs crore)
			Current Prices (1993-94)	Constant Prices		
1990-91	67.87	93555	78802	84728	158.34	9664
1991-92	70.63	100351	80615	87355	165.99	13883
1992-93	73.51	109623	84413	92246	174.84	17784
1993-94	76.49	115795	98796	98796	182.64	25307
1994-95	79.60	123790	122154	108774	191.40	29068

1995-96	82.84	125750	147712	121175	197.93	36470
1996-97	86.21	130560	167805	134892	205.86	39248
1997-98	89.71	133242	187217	146262.9	213.16	44442
1998-99	93.36	135482	210454	157525.1	220.55	48979
1999-00	97.15	139982	233760	170379.2	229.10	54200
2000-01	101.1	146845	261297	184401.4	238.73	69797
2001-02	105.21	154349	282270	195613	249.33	71244
<b>At 2001-02 prices</b>						
2002-03	109.49	162317	314850	306771	260.21	86013
2003-04	113.95	170219	364547	336344	271.42	97644
2004-05	118.59	178699	429796	372938	282.57	124417
2005-06	123.42	188113	497886	418884	299.85	150242
2006-07	128.44	213219	585112	471663	312.52	177600
2007-08*	133.68	238975	695126	532979	322.28	NA

**Source: Annual Reports of Ministry of MSME, Various years**

\* Projected

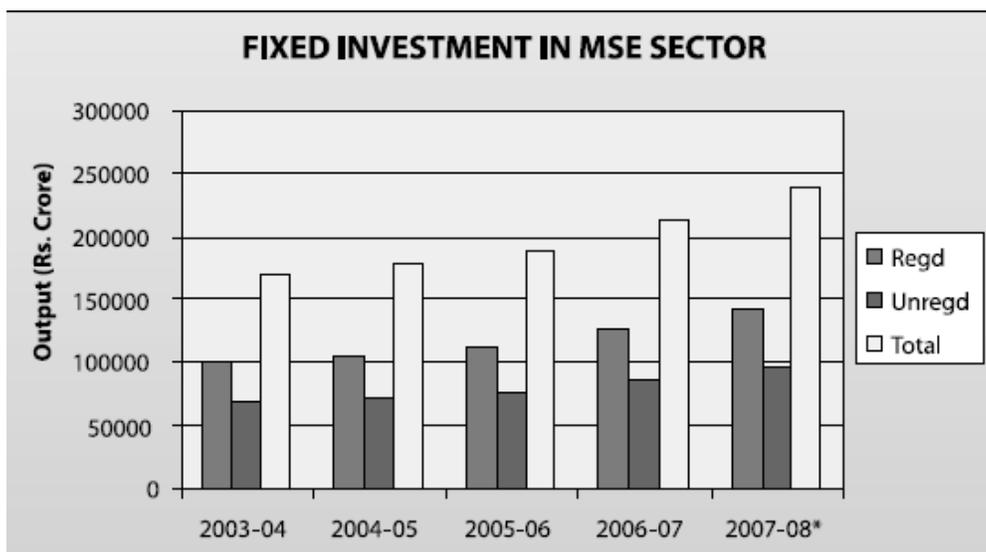
Figure No. 2



\* Estimated

**Source: Annual Report 2008-09, Ministry of MSMEs, Government of India**

Figure No. 3



\* Estimated

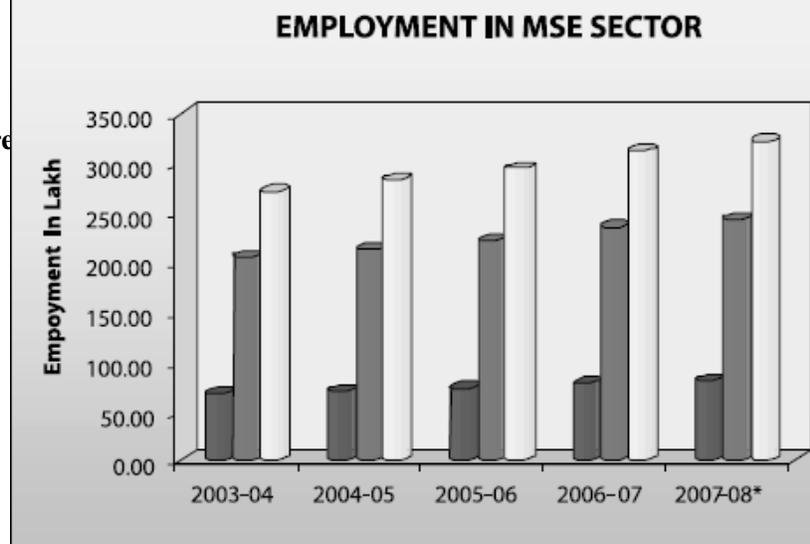
Source: Annual Report 2008-09, Ministry of MSMEs, Government of India

**EMPLOYMENT IN MSMES SECTOR**

The total employment from the MSME sector (*including SSSBEs*) in the country as per the Third All India Census of MSMEs with reference Year 2001-02 was 249.33 lakh numbers. The units operating with fixed premises are treated as MSMEs.

As per the estimates compiled for the year 2007-08, the employment was 322.28 lakh persons in the sector. The share of MSEs in the total employment among units

Figure



\* Estimated

Source: Annual Report 2008-09, Ministry of MSMEs, Government of India

### CONTRIBUTION OF MSMEs IN THE INDUSTRIAL PRODUCTION AND GROSS DOMESTIC PRODUCT (GDP)

Over a period of last few years the contribution of MSMEs in the overall

industrial production and GDP has remain stable. In the total industrial production the contribution of this sector has been around 39% whereas in GDP its contribution is nearly 6% as evident from the table given below:

**Table-2**  
**Contribution of MSME in Industrial Production and GDP**

Year	Contribution of MSME(%) at 1999- 2000 prices in	
	Total industrial Production	Gross Domestic Product(GDP)
1999-2000	39.74	5.86
2000-2001	39.71	6.04
2001-2002	39.12	5.77
2002-2003	38.89	5.91
2003-2004	38.80	5.79
2004-2005	38.62	5.84
2005-2006	38.56	5.83
2006-2007	38.57	5.94

**Source: Annual Reports of Ministry of MSME, Various years**



### MSMEs AND OVERALL INDUSTRIAL GROWTH

The small scale sector has maintained a higher rate of growth vis-à-vis the overall

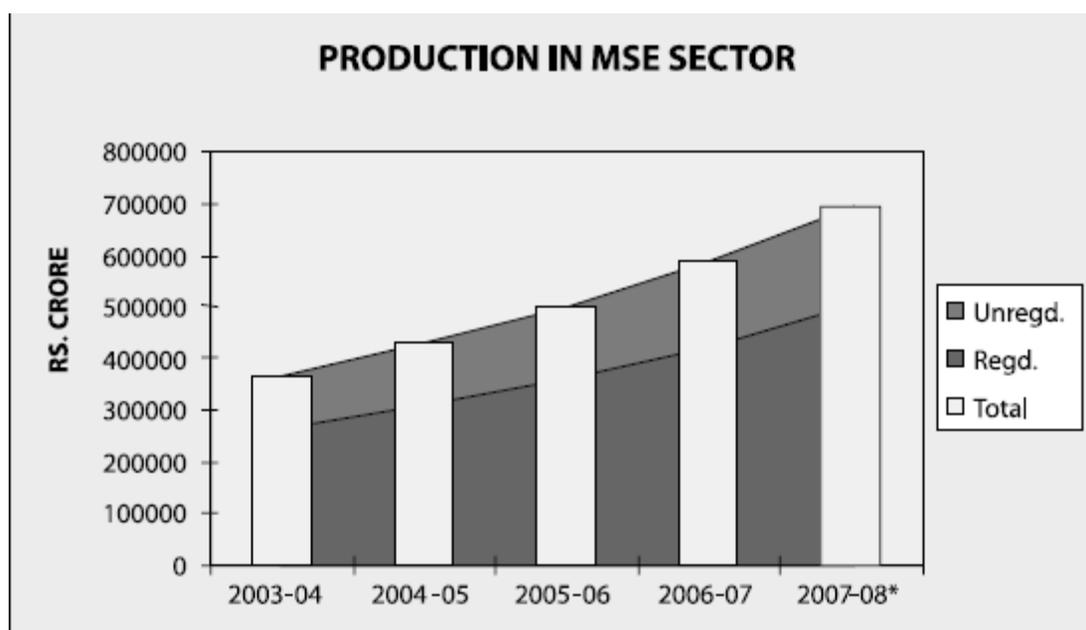
industrial sector. The comparative growth rates of production for both the sector during following years are given below:

**Table-3**  
**Growth rates of production**

Year	Growth Rate in MSMEs (%)	Overall industrial Sector (%)
2002-03	8.68	5.70
2003-04	9.64	6.90
2004-05	10.88	8.40
2005-06	12.32	8.10
2006-07	12.60	11.5
2007-08*	13.00	8.00

**Source: Annual Reports of Ministry of MSME, Various years \* projected**

Figure No. 5



\* Estimated

**Source: Annual Report 2008-09, Ministry of MSMEs, Government of India**

#### MAJOR OBSTACLES FOR MSMEs IN INDIA AND THEIR SOLUTIONS

Despite its importance, the MSMEs sector has long faceted extreme obstacles in accessing finance and markets. Some of these obstacles include inability to access finance and working capital loans from banks, inability to access capital from other sources, mistreatment by large procurement companies, difficult bureaucratic procedures for registration, and lack of management skills, etc. The increasing availability of cheap foreign imports has further hindered the development of Indian micro, small and medium enterprises. These obstacles have compelled the MSMEs lobbies and the Government of India to develop government intervention to ensure the continued growth and success of MSMEs.

A survey conducted by the All India Management Association has also identified 'lack of finance' as one of the

most crucial hurdles in the growth of MSMEs. The survey revealed that 60 per cent of the units fail due to lack of demand for products, 36 per cent due to marketing failure and 46 per cent due to lack of adequate finance. Significantly, as per a survey of ICSI, more than 60 per cent of the SSI units are sick and being pushed to closure due to non-availability of timely and adequate finance, whereas some Associations even feel that as many as 80 per cent of MSMEs are afflicted with financial problems. Some of the major obstacles being faced by MSMEs in our country are highlighted in the following sections.

#### Barriers in Inclusive Financing for MSMEs in India

Though MSMEs have been the engine for growth in various developed and developing economies, they have always faced problems in accessing finance. Without proper finance, MSMEs can

neither expand to compete globally nor can they acquire technology or meet their fixed and working capital requirements. The prominent barriers of MSME access to financing are: SMEs are regarded as high-risk borrowers due to their weak financial strength, asymmetric information provided by MSMEs about business plans, accounting statements and projects gives little help to investors and banks in assessing their credit worthiness. Unlike higher corporate loans, MSMEs take small loans which increase the transaction costs, administrative costs and other costs involved in information collection, inability to provide collaterals demanded by the lenders, high interest rates charged by lenders due to higher risk involved in MSMEs. However, now the MSME sector is coming under 'priority sector lending' and the banks are to lend 40 per cent of their loan able funds to the priority sector, which is inclusive of the MSME sector.

The Government of India has encouraged this sector through various policy initiatives. In order to meet the credit flow requirements of the sector, the Centre Government and RBI have from time to time appointed various high-powered committees<sup>1</sup>. All these committees have voiced their concerns over the MSME sector suffering due to the non-release of adequate and timely finance and have made recommendations for easy access to credit and its flow to the SSI/MSME sector.

The mind set of banks towards MSMEs have also changed in the recent past. With the entry of private banks, increased competition has led to a rush for lending to prime customers. The lending to the MSME sector grew by 69% between 2000-01 and 2005-06. But there exists a stark disparity amongst small players and big players within the MSMEs sector.

Loans to bigger companies are growing at a faster pace than loans to the MSMEs sector. By the end of 2006, the proportion of SSI loans to total loans has remained small at 6.4 per cent. Today, most of the lendings are concentrated on priority sectors like auto ancillaries, pharmaceuticals and IT sector where India had a proven record of competitive advantage.

The establishment of Small Industries Development Bank of India (SIDBI) in 1990 as an apex institution for the promotion, financing, and development of small scale industry is also a revolutionary step towards improving financial access of MSMEs.

Apart from this the Government of India has initiated many steps to overcome the problems faced by MSMEs in this regard viz. increase in the loan limit of composite loan scheme for MSMEs upto Rs.5 million, providing loans to MSMEs within the interest rate band of 2 percent above and below the respective bank's PLR, setting up of Technology Bureau for Small Enterprises to address the technology related needs of MSMEs and proposal to convert TBSE into a full fledged Technology Bank, opening of specialised MSMEs branches throughout the country (presently numbering 417), introduction of Laghu Udyami Credit Card for SME borrowers, identification of 60 clusters for focused development by including their credit requirements in the respective State Credit Plans, setting up of a Credit Guarantee Fund Trust for Small Industries, establishment of Small Enterprises Financial Centres (SEFC) for strategic alliance between branches of banks and SIDBI located in 388 clusters identified by ministry of MSME and Credit Linked Capital Subsidy Scheme for Technological Up gradation.

### Marketing Problems

All types of business enterprises face marketing problems, but these problems are more severe in case of small scale units because of lack of knowledge, adequate funds and lack of experience. Some of the marketing problems commonly faced by the small scale entrepreneurs in India are:

- a. **Competition from large scale sector:** Because of scarcity of resources, small entrepreneurs usually use inferior technology. As a result their products are not standardized. The obsolete technology used by them gets translated into inferior quality of products.
- b. **Lack of marketing knowledge:** Most of the small scale entrepreneurs are not highly educated or professionally qualified to have knowledge of marketing concept and strategy. Their lack of expertise further inhibits their understanding of the prevailing trends in the market.
- c. **Lack of sales promotion:** Small units lack the resources and knowledge for effective sales promotion. Large scale units mostly have well-known branded names. They also have huge amount of resources to spend on advertisement and other sales promotion tools. Small scale units, on the other hand, have to pay a heavy commission to dealers for their selling efforts, which reduce profits margins.
- d. **Weak bargaining power:** At the time of purchase of inputs, large scale entrepreneurs manage to get huge discounts and credit. Such facilities are not available to small units.
- e. **Product quality:** It is costly and difficult for a small unit to have quality testing and evaluating equipment.
- f. **Credit sales:** The small scale enterprise is invariably called upon to sell on

credit. However, when it comes to purchasing inputs, they are denied liberal credit facilities. As a result, they have to borrow excessive working capital than actually needed. This increases the general cost of production and prices, making it non-competitive.

Marketing, therefore, is of utmost importance for a small-scale unit. It enables them to improve the quality of goods or services, generates employment, and improves the standard of living and so on. Lack of brand image, lack of sales force, product quality, credit sales, and local and limited market are the common problems faced by small scale entrepreneurs. Consequently, they are at a disadvantage with their large-scale counterparts. Recognizing the vital role of small-scale industries in India's economic development, the government has reserved a number of items exclusively for the small scale sector to overcome the marketing problems of small-scale industries. The number of reserved items for exclusive purchase from small-scale industries has been continuously on increase. There are many other initiatives taken by the Government to promote marketing of products/services of small units but no concrete action plan has been chalked out or targets made. Some of the important marketing strategies initiatives taken by the government in this regard are as follows:

#### (i) Small Industry Cluster Development Program

The scheme applies to any cluster of industries where there is a commonality in the method of production, quality control and testing, energy conservation, pollution control etc. among the units of the cluster. The scheme aims to take care of the modernisation and the technological needs of the cluster. It covers a comprehensive range of issues related to

technology upgradation, improvement of productivity, energy conservation, pollution control, product diversification and their marketing, training needs etc.

#### (ii) Sub-Contracting Exchanges

Sub-contracting Exchange is a novel concept announced under the liberalized policy package in 1991. The Exchange is an information centre where machine capacities of small scale industries are registered and enquiries from large industries for the manufacture of different components and sub-assemblies are passed on to the appropriate registered small scale units.

Such an Exchange is a Store House of Data with regard to the capacities of the small scale units in term of products manufactured services rendered on one hand while maintaining data with regard to the requirement of the buyers, which could be products /components/ subassemblies/ services on the other hand. The Exchange also stores data about the specifications and quantities etc. of the various facilities available with the sellers/required by the buyers in the above cases. The main objective of storing such a data is to arrange matchmaking through appropriate software between a buyer and a seller that may result in increased business opportunities.

The Exchange is, therefore, in a position to a great extent to provide sufficient information to vendees to have access to the details of facilities available with the Sub-Contractors who could meet their requirements. On the other hand it also helps to provide information to Sub-contractors/Vendors about the Vendees who are looking for outsourcing.

#### (iii) Tender Marketing

In this scheme National Small Industries Corporation participates in bulk global tender enquiries and local

tenders of Central and State Government and Public Sector Enterprises on behalf of small-scale units. It aims at assisting small units with ability to manufacture quality products but which lack brand equity and credibility or have limited financial capabilities.

#### (iv) Consortia Marketing

A small unit in its individual capacity faces problems to procure and execute large orders, which inhibits and restricts their growth. National Small Industries Corporation Limited (NSIC) accordingly adopted Consortia Approach and built groups/consortia of units manufacturing same products, thereby easing out marketing problem of SSI units. The Corporation explores market and secures orders for bulk quantities which are then farmed out to small units in tune with their production capacity. Testing facilities are also provided to enable units to improve and maintain the quality of their products conforming to the standard specifications.

#### Technological Up gradation

Modernisation, technological and quality up gradation have assumed great significance in the present day context. With the inflow of latest technology reducing the cost of production and the increasing competition from within and outside, the small scale sector will have to attach more importance and pay attention to the areas of technology up gradation and modernization. However, due to lack of information on the areas of technology up gradation, entrepreneurs who have plans for technical up gradation are not to go ahead. The Government has come out with various schemes to overcome this problem.

#### Problem of Industrial Sickness in the Sector

A host of developmental schemes launched by the Government for solving

the problems of small scale industries have yet to achieve their goals to arrest sickness in MSMEs. The plight of existing small scale industries is visible in many industrial complexes wherein the industrial sheds have been converted into allied activities like showrooms, banquet halls, restaurants, etc. There seems to be some lacuna in the implementation part of the developmental schemes.

#### **Existence of Inspector Regime and Complexity of Procedures**

One of the major grievances of the small scale sector is that the frequent inspections by multiple government agencies are a source of harassment. At present, 55 inspectors of different levels are visiting the small scale units, which is a cause of major concern to the small scale units. It is suggested that the government should stream line the inspection procedure. It should also include repeal of laws and regulations applicable to the sector that has become redundant.

#### **Organizational Problems**

MSMEs find it difficult to match the wage rate, job security and career development opportunities, available in larger organizations and therefore are not in a position to hire skilled and competent manpower. Often, as a result a bottleneck develops in the MSME organisation, it may result in just one or two people controlling the organisation, whether at the decision making level or at the operational level. Even in moderately large sized firms employing several hundred workers, these bottleneck points seem to exist. The decision makers at the bottleneck points are obviously busy people. They must handle many day-today problems that demand immediate attention, e.g., payroll, inventory, finances, personnel, suppliers, and customer demands. These problems

must be solved quickly, or the company will be unable to function. Clearly, there is little chance for them to think about making major changes or risk taking, which is essentially required for innovation process.

Small traditional enterprises, with poor support system and little exposure face difficulties in the new e-business environment. MSMEs usually are diffident about adopting IT or solutions based on IT which places these MSMEs in an unfavourable position, vis-à-vis their larger counterparts which are more e-commerce savvy.

Today organizations are knowledge based and their success and survival is dependent on creativity, innovation, discovery and inventiveness. An effective reaction to these demands lead to innovative change in the organization, to ensure their existence. The rate of changes is accelerating rapidly, as new knowledge idea generation and global diffusion are increasing. Creativity and innovation have a bigger role in this change process for survival.

#### **CURRENT OPPORTUNITIES AND CHALLENGES IN MSME SECTOR**

Today, some of the MSMEs are acquiring companies abroad as part of the globalisation process. Mostly, these units are ancillaries and are export oriented. The MSME sector have transformed to the need of large local manufacturers and suppliers to global manufacturers like Auto Industry. Today some MSMEs are investing in R&D in order to compete globally. Outsourcing from multi-national companies has played a vital role in the emergence of Indian MSMEs as world leaders in specified products. The advantages in labour-intensive manufacturing units, lower transport costs and loose labour policies of the small

scale sector have led to major outsourcing in manufacturing and services.

The concept of cluster development also offers new insights into the potential role of MSMEs, in enhancing their access to new technology. It is estimated that there are 400 modern MSME and 2000 rural and artisan based clusters exist in India. These contribute to 60 % of India's manufacturing exports. Some of the clusters are so big that they produce 70 to 80 % of the total volume of that particular product produced in India. For example, Panipat produces 75 % of the total woolen blankets produced in the country; Tirupur produces 80% of the country's cotton hosiery. Characteristics of a successful cluster are inter-firm cooperation, cooperation blended with competition, the importance of local value systems, flexibility and innovative capacity, geographic proximity, sectoral specialization, a local pool of skilled labour and the presence of a large number of firms. It also includes willingness to work together to resolve potential clashes of interest, widespread entrepreneurial spirit and ability, promotion of a social compromise.

With the elimination of Multi Fibre Agreement (MFA) in 2005, lots of new opportunities have also got opened for the Indian textile sector. Presently, MSMEs in this sector have shown an average growth rate of 32% for the past two years. The auto component sector grew at an average 35% over the past two years and expects to maintain this momentum. Besides this sector, food processing and construction have also been growing. The IT sector services are another success story of MSMEs. The retail business in India has become an area of immense opportunity. In the retail sector, the MSMEs will act as a supply source for the big retailers like Reliance Retail, Big Bazar, etc.

However MSMEs, which constitute more than 90% of total number of industrial enterprises, are now facing a tough competition from their global counterparts due to liberalization, changes in manufacturing strategies, technological changes, and turbulent and uncertain market scenario across the world.

Despite numerous protection and policy measures for the past so many years, MSMEs have remained mostly small, technologically backward and lacking in competitiveness. The opening of the Indian economy in 1991 added problems to the MSMEs. At the beginning, small scale enterprises found it difficult to survive. But in the last decade, the economic environment has tilted in favour of MSMEs. Presently, the MSMEs in India are at a crossroad and intense debate is centered around questions like what would be the future of the small enterprises? How these enterprises can survive in the international trade arena? What role can the government play in making these MSMEs more competitive? In this context, it is important to re-look into the basic issues of MSMEs.

## CONCLUSION

MSMEs, as a major contributor towards growth of domestic economy and employment generation, should get adequate support in terms of policy framework, incentives and other relevant aids. Steps like providing infrastructural facilities, developing various industrial parks and technology incubators under MSME cluster development programmes, creating networks of organisations that help provide training to skilled workforce to improve productivity, encourage entrepreneurship and competency in management, funding R&D investments, technology advancement may work for the betterment of the sector. Although, Indian MSMEs are finding it difficult to sell their

products in the domestic and international markets because of increasing competition. To make their products globally competitive, Indian MSMEs need to up-grade their technology and put more emphasis on innovation.

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