

Opportunities and Constraints for Indian MSMEs

Mr. Abhijeet Biswas

Research Scholar Faculty of Management Studies, Banaras Hindu University

Varanasi (U.P) Pin code: 221005

E-mail: abhijeetniftblr@yahoo.com

ABSTRACT

The MSMEs constitute over 90% of total enterprises in most of the economies and are responsible for generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, the role of MSMEs is crucial in the overall industrial growth. In the last few years, the MSME sector has reflected a higher growth compared to the overall industrial sector. The importance of MSME sector can be judged by the fact that around 50% of MSMEs in India are owned by underprivileged groups. MSMEs have played a commendable role in transition of India's economy from agrarian economy to an industrialized one. The MSME sector in India is the second largest employment generator just after agriculture. They are widely dispersed across the country and produce a diverse range of products and services to meet the needs of the local markets, the global market and the national and international value chains. Government has provided various schemes and programs to develop this sector and make it more competitive. Though, this sector has been contributing a major share in India's economy but there are various constraints that make the functioning of this sector extremely difficult. The present paper attempts to identify various opportunities and constraints for Indian MSMEs. The researcher tries to highlight the various government schemes drafted for promoting MSME Sector in India. This paper is based on extensive review of literature on Micro, Small and Medium Enterprises. The review showed that government is trying its best to support MSMEs through various schemes and still there are various constraints and hurdles for this sector that needs to be worked upon.

Keywords:

MSME; Constraints; Opportunities; Finance; Credit; Entrepreneurship

INTRODUCTION

The MSME sector is the nursery of entrepreneurship and has been recognised as the engine of growth. The MSME sector is responsible for about 40 per cent of the exports and 45 per cent of the total manufacturing output of the country (MSME Annual Report, 2012). It also contributes 8% of the country's GDP. Both entrepreneurship development and MSMEs have been globally acknowledged as instruments for achieving economic growth and development as well as employment creation (Rebecca, 2009). The MSMEs constitute over 90% of total enterprises in most of the economies and are responsible for generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, the role of MSMEs is crucial in the overall industrial growth. In the last few years, the MSME sector has reflected a higher growth compared to the overall industrial sector. The importance of MSME sector can be judged by the fact that around 50% of MSMEs in India are owned by underprivileged groups. MSMEs have played a commendable role in transition of India's economy from agrarian economy to an industrialized one. The MSME sector in India is the second largest employment generator just after agriculture. They are widely dispersed across the country and produce a diverse range of products and services to meet the needs of the local markets, the global market and the national and international value chains.

One of the significant characteristics of a flourishing and growing economy is a vibrant and blooming MSME sector. MSMEs play a pivotal role in the development of a nation. They contribute to socioeconomic development in various ways; namely, by creating employment for a rural and urban growing labour force and providing desirable sustainability and innovation in the economy as a whole. Most of the current multi-million dollar enterprises have their origin in MSMEs. Nevertheless, MSMEs in developed and developing countries are still facing a number of difficulties and obstacles that are impeding and complicating their operations and growth.

Despite the significant contributions of the MSME sector, the sector continues to face certain constraints like availability of adequate and timely credit, high cost of credit, collateral requirements, access to equity capital and rehabilitation of sick enterprises, etc. It thus emerges that adequate, timely and affordable credit is one of the bigger issues for the MSME sector. There are several factors which constrain financial institutions to get involved with the MSMEs. One of the major reasons, why banks shy away from granting loans to MSME sector is because they are opaque. Opaqueness basically means that it is relatively difficult to know about the pay back capability of the firm. Whether the firm has feasible and profitable projects with them and whether they have the interest to pay back the money to banks.

Micro, Small and Medium Enterprises (MSMEs) in India have evolved considerably since independence. From being referred to merely as the Small Scale Industries (SSI) sector in the 60s and 70s, the MSME sector has progressed in scale and in the scope of business activities over the years. Today, MSMEs are present across sectors in India, thereby constituting a formidable component of the country's outstanding economic growth. While a key achievement of MSMEs over time has

been their talent in utilising available domestic resources to deliver quality products and services, these firms have made their presence felt across India's key sectors as well as in prominent export markets.

MSMEs are a fundamental part of the economic fabric in developing countries, and they play a crucial role in furthering growth, innovation and prosperity. Unfortunately, they are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of MSMEs in developing countries rating access to finance as a major constraint. They might not be able to access finance from local banks at all, or face strongly unfavourable lending conditions, even more so following the recent financial crisis. Banks in developing countries are in turn hampered by the lack of lender information and regulatory support to engage in MSME lending. The overall result is absence of a well-functioning MSME lending market, and MSMEs are impeded in their growth, with negative consequences for innovation, economic growth and macro-economic resilience in developing countries.

Access to external finance to MSMEs has become more costly and troublesome while their accessibility has sharply declined. MSMEs' financing constraints limit their investment opportunities and stagnant growth. Access to finance is widely perceived to be an essential factor for firms, and especially MSMEs, to maintain their daily business operation as well as to achieve long-term investment opportunities and development targets.

REVIEW OF LITERATURE

Stiglitz & Weiss (1981) stated that the exclusion of SMEs from credit markets in the region is chiefly due to three sets of factors. First, their inherent lack of transparency, absence of suitable collateral and poor track record exacerbate information asymmetries, resulting in acute credit rationing.

Gibb and Lyapunov (1996) suggested that an entrepreneurial culture needs to be nurtured to support MSMEs in areas such as values, beliefs, attitudes and behavioural norms. Gibb also argues that a personal network based on social value constitutes an important variable that influences transactions between firms and customers, marketing channels, suppliers, employees, family, regulatory authorities, banks, accountants, and competitors.

Hossain (1998) stated that the inability to access credit is one of the major bottlenecks of MSMEs, as most of the developing economies have poorly developed banking sectors. For most developing and transition economies, the common challenges for SMEs typically include financing, overcoming institutional, legal and administrative barriers and accessing network support.

Hallberg (2001) argued that financing for the SME sector has emerged popularly in the recent few years and it has become a debatable topic for the economists as well as policymakers. This has become immensely important because SMEs account for the majority of units of a country and play a key role in employment generation.

Schiffer & Weder (2001) stated that financing is a greater obstacle for SMEs than it is for large firms, particularly in the developing world, and that access to finance adversely affects the growth of the SME sector more than that of large companies. A crucial element in the development of the SME sector is access to finance, particularly to bank financing, given the relative importance of the banking sector in serving this segment. According to a report of World Bank, access to finance is perceived as one of the main obstacles in doing business.

Batra and Mahmood (2003) highlighted that MSMEs in developing countries in East Asia receive support from local governments in the form of micro finance, interventions to increase private sector

training, technology development, and market information.

Dallago & McIntyre (2003) stated that SMEs are not themselves sufficient for growth without the proper development of institutions and support structures.

Ha and Swierczek (2003) found that the performance of MSMEs in Vietnam was positively related to entrepreneurial culture. This means that the owners of MSMEs are not willing to take risky business decisions and the presence of a risk avoidance attitude is prominent among entrepreneurs.

Gentry and Hubbard (2004) highlighted that entrepreneurs comprise just fewer than 9% of households in the U.S., but they hold 38% of household assets and 39% of the total net worth. Not only are entrepreneurs wealthier, but also the wealthy are more likely to become entrepreneurs.

Bari, Ali & Haque (2005) examined the key constraints faced by the SME sector in Pakistan, including lack of access to credit, excessive government regulation, an arbitrary and exploitative tax administration system, a weak technological base, and the lack of business support services. They also provided a set of concrete strategic recommendations to address such constraints in order to promote SME growth for greater income generation and employment creation.

Sonia and Kansai Rajeev (2009) analyzed how far the globalization has had an impact on the MSMEs. They considered the period of study from 1973-74 to 2008-09. They analyzed the scenario before the liberalization era and as well as after the liberalization era. They analyzed the MSMEs on the basis of growth in the number of units, total production, employment generated by this sector and total contribution in exports. Their study concluded that the MSME sector has shown a better growth rate in all these

parameters in the pre liberalization era as compared to post liberalization era.

Bhavani T.A. (2010) studied about the quality employment opportunities generated by the MSME sector. He stressed on the point of quality employment and not short term employment. The author highlighted that MSMEs may contribute a high percentage towards employment generation but that is more quantitative in nature, rather than being qualitative. He also stressed on the use of technology for the MSMEs and argued in favour of technology upgradation, which in turn would improve remuneration, create quality employment opportunities and improve skills. Use of technology may reduce the rate of growth of employment in short run but it would ensure sustainable employment opportunities in the long run for the MSME sector.

Rao & Ganesh (2011) found that reluctance by banks to extend credit to women, inability to provide adequate security and margin money, tight repayment schedule are the main problems being faced by the MSME sector.

Jimenez, Ongena, Peydro & Saurina (2012) found for their sample of Spanish firms that bank balance-sheet strength determines loan approval in crisis times. Firm balance-sheet strength determines loan granting in good as well as in crisis times but matters more during the latter.

Shiralashetti (2012) stressed that absence of adequate and timely supply of bank finance, limited capital and knowledge, lack of power, low quality inputs, low return, non availability of suitable technology, low production capacity, ineffective marketing strategies are the main problems of MSMEs in India.

Singh et al. (2012) analyzed the performance of Small scale industry in India and focused on policy changes which have opened new opportunities for this sector. Their study concluded that SSI

sector has made good progress in terms of number of SSI units, production & employment levels. The study recommended the emergence of technology development and strengthening of financial infrastructure to boost SSI and to achieve growth target.

OBJECTIVES

- To highlight the various opportunities provided to MSMEs in India.
- To identify the major constraints for MSMEs in India

METHODOLOGY

The study is primarily based on qualitative literature survey method. It facilitates in depth analysis of the issues related to MSMEs, opportunities for MSMEs and the various barriers for MSMEs. Extensive review of the literature provided useful insight about the various opportunities and constraints for Indian MSMEs. The present study is exclusively based on secondary data which has been collected from the various issues of Annual Reports on MSMEs, Handbook of Statistics on the Indian Economy published by Ministry of MSMEs and SIDBI Annual Report.

Opportunities for MSMEs in India

1. Less Capital Intensive

MSMEs don't require much capital to start with. Micro, Small and Medium Enterprises are labour intensive and are primarily dependent on labour force. It can be started with a low capital and can be managed well.

2. Employment Generating Sector

There was a time when our economy was primarily based on agricultural activities. Agricultural activities contributed almost 80% to the employment. But, gradually things have changed and the share of MSMEs in employment generation has risen significantly. Now MSMEs have

become the second largest employment provider in our country and are responsible for transformation of our economy from an agrarian to an industrialized one.

3. *Balanced Regional Development*

There is denying in the fact that MSMEs play a very vital role in Indian Economy. Another aspect of MSMEs that needs to be highlighted is their contribution in overall balanced regional development. They tend to use local resources and this provides employment opportunities to local people of that region. This leads to the balanced regional development of that particular area.

4. *Support from the Government*

Government realized the importance of MSME sector in our economy and has started supporting MSMEs with various schemes specifically crafted for them.

5. *Globalization has opened up gates for MSMEs*

Post liberalization, whole world has become a market. Now Imports and Exports not require much of the legal formalities. MSMEs are contributing almost 40% of the overall exports from our country. If given much more attention than, this share can rise further in the coming years.

6. *Quality Management Standards*

The scheme aims at improving the quality of the product in the MSME sector and inculcating quality consciousness among units of the sector as per global standards.

7. *Credit Guarantee Fund Scheme*

Bank extends loan facilities for the budding entrepreneurs. But usually one has to face the problems of Collateral or third party guarantee in order to avail credit from banks. Realizing this constraint, Government of India and SIDBI started with a trust known as Credit Guarantee Fund Trust in year 2000. This trust runs a scheme known as Credit Guarantee Fund Trust for Micro Small Enterprises. Under this scheme, loans are

provided to the budding entrepreneurs without the hassles of collateral or third party guarantee. The purpose of this scheme is to strengthen the credit flow to the MSME sector and encourage the entrepreneurs to achieve their dreams. The main objective is that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. The Credit Guarantee scheme assures the lender (Bank) that, in case the MSE unit which has availed collateral free credit from the lender fails to pay back the amount, the trust will make up for the losses to the bank. The trust will compensate up to 75 % to 85% of the losses depending upon the gender of the entrepreneur who availed the credit and the region to which he/she belongs. A maximum credit cap of Rs 100 lakhs (Rupees Hundred lakhs only) are eligible to be covered under this scheme.

Table- 1 highlights the trend of the CGS scheme over the last decade. The table depicts how the scheme has shown tremendous improvement over the years and benefited thousands of budding entrepreneurs.

8. *Microfinance Programme*

Under the scheme, the government of India provides funds to SIDBI under a „portfolio risk fund (PRF), which is utilized for security deposit requirement of the loan amount the MFIs/NGOs.

9. *FDI Policy*

With the promulgation of the MSMED act 2006 the restrictive 24% ceiling prescribed for equity holding by industrial undertaking, whether domestic or foreign, in the MSME has been done away with and MSME are defined solely on the basis of investment in the plant and machinery and equipment. Thus, the present policy on FDI in MSME permit FDI subject only to the sectoral equity caps, entry routes and other relevant sectoral regulation.

10. *Entrepreneurship Development Programme*

Entrepreneurship development programs are being organized regularly to nurture the talent of youth by enlightening them on various aspects of industrial activity required for setting up MSMEs. These programs are generally conducted in DICs where they are motivated towards self-employment. The course contents of such programs are designed to provide useful information on product process design, manufacturing practices involved, testing and quality control, selection and usage of appropriate machinery and equipments, project profile preparation, marketing and pricing techniques.

11. Management Development Programme

The objective of imparting training on management practice system is to improve the decision making capabilities of existing and potential entrepreneurs resulting in higher productivity and profitability.

12. Technology Up gradation Programme

In general, MSMEs lack access to technology due to poor consultancy support/service for technological information, non availability of skilled man power, lack of awareness among entrepreneurs about emphasis on production and production cost, lack of managerial skill and poor adoptability to change trade trends. For technology up gradation DIC provide capital subsidy and other assistance to strengthen MSME Sector.

13. Cluster Development Programme

The ministry of MSME, government of India has adopted the cluster development program for following purposes; **i.** To support the sustainability and growth of MSMEs by addressing common issues such as improvement of technology skill and quality, **ii.** To build capacity of MSMEs for common supportive action through formation of SHGs, **iii.** To establish or upgrade infrastructural facilities in the new and existing industrial

clusters of MSMEs, **iv.** To setup common facility centres.

14. Marketing Assistance Programme

Marketing is a key strategy to the success of any enterprise and it is more relevant about MSMEs. The sector is characterized by absence of strong brand presence in the market and largely unorganized marketing networks, unlike large enterprises. The objective of the marketing assistance programs are following; **i.** To enhance export from MSME units, **ii.** To encourage MSMEs in their efforts at tapping and developing overseas markets, **iii.** To increase participation of representatives of small or micro manufacturing enterprises under MSME India stall at international trade fairs and exhibitions.

15. Exhibitions for MSMEs

It is the one of the program implemented by the government of India for the promotion of MSME units. It is very help to the MSMEs to expand the reach of their market. The government of India conducted this program through DICs.

16. Technology Business Incubation

It is one of the most recent services that NSIC has initiated. TBI enables technical entrepreneurs to conduct their R&D programmes in a professional, friendly and supportive environment, while receiving the guidance and hand holding they need in the initial phase. This facility is being offered in Information Technology, Product Design, Energy and Environment auditing, Bio-Technology Electronics and Communications.

17. Industrial Infrastructure Up-gradation Scheme

It was launched in 2003 with a view to enhance competitiveness of industry by providing quality infrastructure through public-private partnership in selected functional clusters. The scheme has been suitably modified in 2009 mainly to cut delays in the implementation of the projects and streamline the process. Under

the Scheme, central grant is provided to upgrade the infrastructure of the existing clusters. The infrastructure includes physical infrastructure, R & D infrastructure, Common Facilities centre etc. The central grant is restricted to 75% of the project cost subject to a ceiling of INR 60 crore. The remaining 25% is financed by other stakeholders with a minimum industry contribution of 15% of the project cost, which must be in form of cash and not in kind like the cost of land or exiting building

18. Infrastructural Development Scheme

It was launched in 1994. The scheme covers districts which are not covered under the Growth Centres scheme. The aim of the IID scheme is to provide developed sites with infrastructural facilities like power distribution network, water, telecommunication, drainage and pollution control facilities, roads, banks, raw materials, storage and marketing outlets, common service facilities and technological back up services etc. The scheme covers rural as well as urban areas with a provision of 50% reservation for rural areas and 50% industrial plots to be reserved for tiny sector. The scheme also provides for up-gradation/ strengthening of the infrastructural facilities in the existing old industrial estates. IID scheme has been subsumed in the MSE-CDP, with all its existing features. However, pending finalisation of guidelines, the proposals for IID centres are being dealt under the existing scheme.

Constraints for MSMEs in India

1. Absence of Timely Credit

This perhaps is the biggest hurdle in front of MSMEs. Availability of adequate and timely credit is a very difficult task for the MSMEs. Banks and Financial Institutions usually are a bit reluctant in granting credit to MSMEs because of their non transparent nature.

2. Limited Capital

Usually MSMEs lack capital. The owners don't have much of a capital to setup a large facility with heavy machineries. This in turn affects the production process.

3. Lower Level of Technology

MSMEs tend to use outdated technological methods which lower their efficiency and effectiveness. There is a lack of technical know-how, since in most of the cases the owners of the units are not very well qualified.

4. Low Production Capacity

MSMEs are small units with fewer numbers of machineries and labours. Thus the production capacity of MSMEs is also less as compared to the large enterprises and because of this, MSMEs face a major competition when it comes to the aspect of quantity of production.

5. High Cost of Credit

MSMEs usually don't maintain a proper balance sheet and their mode of operation is opaque. It is difficult for a lender like banks or financial institutions to judge the credit worthiness of MSMEs. Since it is difficult to ascertain the pay back capability of MSMEs, the banks charge an extra premium for the inherent risk in lending to MSME sector.

6. Ineffective Marketing Strategy

MSMEs do not make effective use of marketing intermediaries. They lack use of strong strategy. The whole process is based on pushing the product instead of knowing the preferences of the customer.

7. Lack of Skilled Manpower

MSME Sector is a labour intensive industry and is heavily dependent on the skill of workers. In most of the cases the workers are either non skilled or semi skilled. This affects the quality of the product being manufactured. MSMEs also don't have a fixed process for manufacturing the product with precision. It varies according to the skill of the worker.

8. Constraints on Modernization

MSMEs operate with limited capital and limited profit. They face several other challenges in day to day working. Considering all these factors, they are not left with enough cash to go for modernization or expansion of the units.

9. Inadequate Infrastructure Facilities

MSMEs don't have access to uninterrupted power supply. In fact, in most of the cases they get power supply only for half a day and need to manage for the remaining day on their own. Even the road connectivity connecting the units is not good. Water Supply in most of the cases is not as per the requirement.

10. Collateral Requirements

Bank extends loan facilities to the budding entrepreneurs but usually they ask for a collateral or a third party guarantee. This becomes a tough job for the budding entrepreneur. Arranging collateral to avail loan from a bank is a very difficult job for a budding entrepreneur and this becomes a hindrance in his path of setting a unit of his own.

11. Limited Access to Equity Capital

Micro, Small and Medium Enterprises have limited access to equity capital. Because of the size and capital limitations it's very hard for MSMEs to get listed on Stock Exchange. Investors find this sector as a very risky one to make investment.

12. Lack of Credit from Banks

The MSME'S are presently facing the problems of credit from the banks. The banks are not providing the adequate amount of loan to the MSME'S. The loan providing process of the banks is very long and formalistic. The owners of the MSME'S has to produce different types of documents to prove their worthiness. The banks are providing on an average 50% total capital employed in fixed assets. The cost of credit is also high.

13. Competition from Multinational Companies

In present era of globalization, the MSMEs are facing the great from the international manufacturing companies who are proving quality goods at cheapest price. Therefore, it is very difficult to compete with the multinational companies.

14. Unavailability of Raw Material and Other Inputs

For MSME'S required raw material, skilled work force and other inputs are not easily available in the market. Due to unavailability of these essentials, it is very difficult to produce the products at affordable prices.

15. Lack of Advanced Technology

The owners of MSME'S are not aware of advanced technologies of production. Their methodology of production is outdated. The owners are using older method in the field of fabricated metal and textile.

16. Lack of Distribution of Marketing Channels

The MSME'S are not adopting the innovative channels of marketing. Their advertisement and sales promotion are comparatively weaker than the multinational companies are. The ineffective advertisement and poor marketing channels leads to a very poor selling.

17. Indian SMEs are plagued due to lack of Information

Majority of the MSMEs are uninformed of the schemes started out by the government. This augments the overall challenges MSMEs face today as they are unable to reap the benefits of these special schemes.

CONCLUSION

MSME Sector has gradually evolved as one of the prominent sectors in our economy. Its contribution in Indian economy has been constantly increasing. Realizing the importance of this sector in our economy, government has drafted several schemes and policies for this sector. The Credit Guarantee Scheme has

emerged out as one of the most popular schemes for the MSME sector over the last decade. Almost all the banks today sanction loans through that scheme and the volumes keeps on increasing day by day. SIDBI is playing a very crucial role in the overall development of the MSME sector by providing various schemes especially designed for catering the needs of MSME sector. Ours is an industrializing economy which has been growing at a substantial rate over the last decade. MSME sector and small entrepreneurs are playing a very crucial role in the GDP of our country.

MSMEs have a major contribution in Indian Economy and government has come up with various programs to support this sector. MSMEs need a helping hand from government to perform. These programs have opened up various opportunities for the emerging MSME units. There is no denying in the fact that MSME sector is contributing a major share in economy of India but still there are several constraints and barriers that needs to be addressed so that the contribution of this sector may rise further. After a lot of effort from the government, this sector still needs a lot of support from banks and financial institutions to solve the major problem of timely and adequate amount of credit requirement.

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Table-1: CGS Operational Highlights

Period	Active MLIs	Number of Proposals Approved	Credit Amount Approved (Rs. in Crore)
FY 2000-01	9	951	6.06
FY 2001-02	16	2296	29.52
FY 2002-03	22	4955	58.67
FY 2003-04	29	6603	117.60
FY 2004-05	32	8451	267.46
FY 2005-06	36	16284	461.91
FY 2006-07	40	27457	704.53
FY 2007-08	47	30285	1055.84
FY 2008-09	57	53708	2199.40
FY 2009-10	82	113029	5110.09
FY 2010-11	93	137645	6234.67
FY 2011-12	115	178453	7865.87

Source: SIDBI Annual Report (2012)