An Evaluation on How Recession and Inflation Has Affected MSME's & The Measures Taken by MSME's & The Government for Its Sustainability

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Abstract: ***MSMEs are one of the most progressive, vibrant and sensitive sectors of the Indian economy with a GDP contribution of around 8 percent and the largest after agriculture in employability. With the introduction of the reform measures in India since 1991, the Govt. has withdrawn many protective policies for the MSMEs and introduced several promotional policies to increase competitiveness of the sector. The current research is an attempt to critically analyze the effect of recession & inflation on MSMEs. This research has analyzed the present status of MSMEs as well as reviewed various governmental policies, challenges and factors that effected the growth of MSMEs. The study thus investigated the performance of the MSMEs sub-sector of the Indian economy during the ongoing period of recession and the ever increasing inflation, its problems and prospects and recommended measures to make the sub-sector virile and vibrant in order to play the crucial role it is expected to play.***

Keywords: MSMEs, SMEs, Recession, Inflation, Sustainability

1. Introduction

MSMEs are the most essential and important part of any financial system of an economy especially in ensuring evenhanded, comprehensive & employment friendly financial development. MSMEs are known to be the engine of financial development and for promoting fair growth. The MSMEs comprise of over 90% of total enterprises in most of the economies and are accredited with producing the maximum rates of employment growth and account for a major share of industrial production and exports. In India, the MSMEs act as an important function in the entire industrial economy of the country. MSMEs in India make up over 80% of the total number of industrial enterprises and generate over 9000 value-added products and services.

MSMEs are essential and are of supreme importance in the growth of any country especially in a developing country like India. MSMEs play an essential role and can be regarded a back bone of nationwide financial system (Peters and Waterman, 1982; Amini, 2004; Radam, 2008).

MSMEs in rising markets are dependent on more labor-intensive production processes than large enterprises, increasing employment and leading to more reasonable income distribution (Luetkenhorst, 2004). Moreover, it is obvious that development of SMEs in any country would have productive outcome on the income generation and employment in any market.

In India, SMEs has made significant contribution to the economy:

- Nearly 40% of the country's domestic production.
- Approximately 50% of India's total exports.
- Approximately 45% of India's industrial employment.
- Approximately 40-45% to the GDP and make up more than 90% of all industrial enterprises in India.

2. Objective of the Study

To evaluate the effect of recession and inflation on MSME's & the measures taken by both the MSME's & the Government for its sustainability.

3. The effect of recession and inflation on MSMEs

Since breaking its self-imposed isolation from world markets in 1991, the Indian economy has witnessed a period of sustained growth of greater than 6%. In 2003–04 and 2007–08, its annual growth rates reached an even higher orbit, marking the second highest growth momentum in the world with an average of 8.8%, next only to the People's Republic of China (Economic Survey 2008–09). Per capita GDP growth also doubled to 7.3% (from 3.7% in 1980–91) increasing per capita consumption and further fueling economic expansion (Arvind, 2008). Growth of this magnitude catapulted India to become the world's twelfth largest economy in current prices, with a GDP of over USD1 trillion, and the fourth largest economy when measured by Purchasing Power Parity (PPP) (Government of India, 2008).

MSMEs with over 26 million business units contributing 40% of the country's industrial production and 35% of its direct exports, has consistently outperformed average industrial growth by over two percentage points during the 2003–08 periods (Annual Report, 2008–09). The growth was fairly broad-based for this heterogeneous sector, which produces over 8,000 products. Sustained high economic growth has raised expectations of even higher growth.

However, the growth momentum started losing steam in 2007–08 and recorded a sharp decline after the onslaught of the global financial crisis in September 2008. On the external front, the growth period from 2003–04 to 2007–08 was characterized by a rapid expansion of trade (both exports and imports), a phenomenal rise in portfolio and FDI, a dramatic rise in exports of services, and an inflow of funds tapped by the private sector through private placements and ECBs. "The capital inflows were far in excess of the current account financing requirements" (Economic Survey, 2008–09)

On the domestic front, this excess liquidity fueled the growth of sectors such as housing and real estate, automobiles, communications, and household goods. It also led to capital expenditure for expansion in these sectors, as well as in export-intensive sectors: namely textiles, transport, automobiles and components, communication, and pharmaceuticals, including the acquisition by Indian companies of assets abroad.

As per the 4th Census of MSMEs, there are close to 26 million such units in India, which provide employment to over 60 million people. The global financial crisis emerged around August 2007 from the structured investment instruments of subprime mortgage lending in the USA. Immediately after the first signs of the crisis, the inflows to emerging economies increased substantially, leading to theories of "decoupling." However, the portfolio inflows then reversed, leading to the crash of stock markets in many emerging economies, including India.

The mid-September 2008 collapse of Lehman Brothers, one of the largest investment banks in the world, led to a full-blown meltdown of global financial markets. It marked the watershed and led to the loss of confidence in global financial markets. The direct impact of the crisis on the Indian financial sector was noticed through exposure to toxic financial assets and money, as well as in foreign exchange markets.

But as the global crisis deepened, deleveraging and risk aversion led to the slowing of the Indian economy. Repatriation of investments by FIIs and a drying up of external financial sources for the Indian corporate sector, especially securities abroad (ECBs) resulted in a fall of more than 45%, from USD33 billion in 2007–08 to USD17.5 billion the following year. The paralysis of financial markets and an eventual worldwide collapse of commodity prices precipitated a fall in exports, which impacted the real economy.

Thus, the impact in India was visible in two spheres: finance and demand. As a result, industries faced a financial crunch due to:

- A severe liquidity shortage at banks as the corporate sector sought funds due to foreign sources suddenly drying up. The situation was compounded by the prevailing tight liquidity policy of the RBI prior to the crisis. The latter had also severely constrained the financing of NBFCs.
- In the aftermath of the crisis, MSMEs faced huge hardships in simply carrying out day-to-day functions. Payments for MSME accounts receivable were delayed by large buyers who were short on cash themselves. Banks became extremely averse to risk and chose to cut back lending. As a large number of industries, both small and large, were in the midst of expansion plans, servicing loans became a casualty and in many cases, the possibility of default began to loom large.

The economy had manifested a demand-driven recession for the following reasons:

- As global demand plunged, merchandise exports started falling and the growth in value terms declined from a positive 29% in April–August 2007–08 to minus 20% in 2009–10. Imports declined from the high growth rate of 24.5% to a negative 23.6%.
- Change from excess liquidity and cheap finance to that of a liquidity crunch and high interest rates, demand disappeared in sectors that had been riding on excess liquidity, such as housing and real estate, automobiles, and household goods. It sent shock waves down the entire supply chain and impacted a very large segment of the Indian economy. Immediately after the financial crisis, industrial growth dropped to minus 0.4% in October 2008 compared to 12.2% in the same period the previous year.
- Production (IIP) fell to 1.2% in October after peaking at 13.8% the previous year. The average growth rate in October–November 2008 turned negative for the first time in 13 years: minus 1.83%
- In view of the prevailing financial conditions, private capital expenditures by small and large firms came to a grinding halt. Projects driven by the private sector, including infrastructure, were adversely affected. The growth in consumption expenditures, both private and government, fell to 3.3% in the first half of 2008–09, half that of the corresponding period in the previous year. In the second half of 2008–09, private consumption fell further to 2.5%, dragging GDP growth down to 5.8%.

3.1 Impact of Recession

The impact of recession was mixed and characterized by:

- Inventory pile-up. (especially woolens)
- Payment delays.
- Impact on profitability.
- Impact on labor.
- Slowdown in investments.

3.2 Government's Policy for MSME in Response to the Crisis

India's central government has been quite nimble. It responded to the crisis in a swift manner, with initiatives to address problems faced by MSMEs and other vulnerable sectors of the economy. It reassured people on the stability of the system, by infusing substantial liquidity. It also initiated a number of countercyclical measures.

On the monetary front, the RBI pumped sufficient liquidity through substantial reductions in the Cash Reserve Ratio and

Statutory Liquidity Ratio, signaled an easing of the interest rates through repo- and reverse-repo rates, and improved access to External Commercial Borrowings (ECBs).

To supplement the monetary measures, a massive fiscal stimulus package was infused to pump-prime the economy, and a series of steps were taken to stop the fall in exports.

a) **Monetary Policy**: RBI's successive policy announcements helped to reduce reverse repo and repo rates to 6% and 3.5%, respectively, down from 9% and 5%. The RBI also announced a set of measures that included a further liberalization of its policy on ECBs, by raising ceilings and adding eligible sectors such as the housing sector, Non-Banking Finance Companies (NBFCs), and so forth.
b) **Fiscal Policy**: To provide a countercyclical stimulus via planned expenditure, the government decided on additional spending of up to USD4.5 billion in 2008, mainly for critical rural infrastructure and social security projects. Further, state governments were allowed to raise additional market loans to 0.5% of their gross state domestic product, which amounted to about USD6.5 billion, for capital expenditures.
c) **Trade Policy**: A credit line of USD1.2 billion was made available to the EXIM Bank as pre-shipment and post-shipment credit. Export credit for labor-intensive exports such as textiles (including handlooms, carpets, and handicrafts), leather, gems and jewelry, marine products, and the MSME sector provided an interest subvention of 2% until March 31, 2009, which was later extended for a year.
d) **Other Policies**: To facilitate the flow of credit to MSMEs, the RBI announced a refinance facility of USD1.5 billion for the SIDBI for incremental lending, either directly to MSMEs or indirectly via banks, non-bank financial companies, and SFCs. An additional allocation of USD35 million was made to the textile industry for the Technological Upgradation Scheme. Public Sector Banks were asked to offer need-based, ad hoc Working Capital Demand Loans for up to 20% of existing fund-based limits for units that had an overall fund-based credit facility of up to INR100 million.

4. Conclusion

MSMEs are one of the most effervescent and sensitive sectors in Indian economy. This research report has analyzed the problems and growth prospects of MSMEs. This research has analyzed the present status of MSMEs and the impact of recession and inflation on the growth of MSMEs. Though globalization has increased competitiveness in Indian MSMEs to certain extent, still MSMEs are not adequately prepared to compete to sustain themselves in highly competitive market.

Access to adequate finance with limited budgeting constrains refrain the MSMEs to create market access in one hand & on the other hand, the input costs become quiet high by inflation and exports also marginally decrease due to the degrading rupee. But with the successful measures taken by the central bank & central government, decline in exports was successfully arrested and remained stable since then.

In conclusion, MSMEs are the growth engine of the economy and help sustain other sectors such as services. This sector contributes a major amount in generating employment opportunities and also has provided employment to minorities, backward class people and also to women. Unless Indian government puts its policies strong and right, many MSMEs may not survive the impact of another recession and ever increasing inflation in this global competitive drive.

5. Recommendations

MSMEs are becoming one of the important contributors in the national wealth of the India and its importance is increasing day by day. Moreover, the significance of MSMEs is attributable to its capacity of employment generation, low capital and technology requirement, use of traditional or inherited skill, use of local resources, mobilization of resources and exportability of products.

Along with the effects of recession & inflation, MSMEs are also facing a number of problems like finance, poor technology base, issues in marketing, increasing domestic and global competition, etc. Therefore, in order to overcome these issues and compete with large and global enterprises, MSMEs need to adopt innovative approaches in their operations. Keep focus and lay emphasis on generation of revenues and not reducing costs. Moreover, the government should revise their plans or schemes in order to promote MSMEs and try to build business confidence with a positive outlook and good developmental intentions.

Thus, with regards to these various issues, following recommendations can be made in order to help MSME to survive in this highly competitive market:

- The government should create an environment that is full of opportunities and incentives which would sufficiently attract investors
- The government should extend the current reforms to Indian educational system to make it more functional, relevant and need-oriented and driven. For instance, the thrust and emphasis should be on modern technology, practical technological and entrepreneurial studies aimed at producing entrepreneurs
- Government and other non-governmental organization should regularly organize seminars for potential MSMEs where they should be educated on how to plan, organize, direct and control their businesses
- MSMEs should device effective marketing strategies. For example, low cost advertising, good management customer's relationship, etc.
- MSMEs should adopt IT-based solutions in terms of multi-tasking, expanding customer base, raising productivity, controlling cost, working remotely, fast and accurate decision-making and facilitating collaboration.

6. Future scope of the study

The research report has analyzed the present status of the affects of recession & inflation on MSMEs. MSMEs are one of the most sensitive sectors of the Indian economy that needs to be adequately prepared for inevitable situations like this in the future. With the recommendations made in this paper, MSMEs can be benefitted largely by understanding & getting prepared for such instances. The Government can also keep an eye on such preparedness by MSMEs and may also consider for the recommendations made. For scholars this paper can act as a road map where in they can check the status and can draw comparative analysis.

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