

SMES – THE REAL BACKBONE

Countries such as China, Israel and South Korea, which recognised the potential of SMEs in upgrading domestic Defence R&D and manufacturing base and encouraged their incubation through conducive policy and financial support, have successfully transformed themselves as net arms exporters today.

Make in India' vision cannot really succeed without uplifting the SME sector. An economy obsessed with big numbers, big investments and bigger stories often tends to overlook the ground realities and humble enterprises which go into making these aspirations possible. We are talking about small and medium enterprises here – the SME sector, the unsung and real backbone of Indian economy!

The SMEs contribution to India's GDP and India's growth story is phenomenal – to say the least. India's approximately 30 million manufacturing SME units contribute nearly 45 per cent of the industrial output; 40 per cent of the country's total exports; employ over 60 million people ie more than 66 per cent of the 80 million workforce is employed within the Indian manufacturing sector. Industry or manufacturing sector employs about 22 per cent of country's total workforce size estimated between 430-470 million; create more than 1.3 million jobs every year and produce more than 8,000 quality products for the domestic and international markets. Does this sound impressive?

Plagued By Uncertainties

But as always, numbers do not tell the whole story! Because, SMEs continue to be plagued with a host of obstacles ranging from high sickness to debt traps to shutdowns which themselves have been the result

of legacy structural problems such as low access to cheap capital, low bargaining power *vis-à-vis* larger firms; delayed payments for its supplies, slow technology upgradation and product innovation etc – in sum this sector perpetually lives in an environment of uncertainties. Nonetheless, if we are serious about higher GDP, job growth and 'Make in India', then we will have to provide a serious boost to the SMEs.

Employment Generators

For all practical purposes, 'Make in India' vision is really about addressing the challenges of an economy in transition. We are witnessing high urban migration and a shift in our demographic profile whereby we have the largest pool of young people, with most of them below the age of 30 years. But to turn this demographic phenomenon into demographic dividend, we need to convert youthful energy into gainful employment for enhanced productivity. So, which sector can provide such avenues? Agriculture is saturated and overburdened. It provides employment to approximately 50 per cent of our workforce but contributes only about 17 per cent of GDP. The services sector can never be a mass employment generator unless industrial sector picks up.

So, as a logical corollary – it is the only industry which has the ability to provide mass employment as well as the potential to really uplift the Indian economy.





OF INDIAN ECONOMY



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Countries which transitioned from low income to middle or high income economies also recognised this fact and took appropriate measures. China, for example, where not long ago agriculture bore the brunt of employment and GDP contribution, corrected its historical and unfair burden on agriculture and now, all its three sectors contribute and employ roughly about 30 per cent of workforce with a slight skew towards industry. Contrast this to India where agriculture continues to be the main workforce absorber while contributing lowest to GDP. Thus, 'Make in India' vision is also about mitigating historical burdens. And within the industry sector, SMEs are the largest employment generator and have the biggest potential to absorb the new workforce.

Defence Natural Magnet

So, where does Defence fit into 'Make in India' scheme? The Defence sector is among those niche breed of industrial and R&D activities where net gain in terms of value addition as well as employee rewards are much higher compared to SME units in other sectors. And in India, as is the case world over, SMEs have been the mainstay of Defence sector. This fact has been acknowledged by the Dhirendra Singh Committee of 2015. The Committee's voluminous report highlights that almost 80 per cent of components, aggregates and assemblies of complex weapons systems and aircraft are made by SMEs. It points out that there are nearly 6,000 SMEs across the country employing over 11 lakh people that supply components and sub-assemblies to Defence PSUs, Ordnance Factories, DRDO and private companies.

A focus on SMEs will not be unique to India. The global Defence industry which is primarily dominated by a limited number of Original Equipment Manufacturers (OEMs), works in close co-ordination with SME units. There are many reasons for this – innovative capabilities in niche manufacturing, greater operational flexibility, lower overhead costs and a demonstrated ability to learn and absorb new technologies – all important attributes for success in a fast paced sector characterised by regular innovations and continuous manufacturing up-scaling. More so now that the trend among OEMs is to increasingly become R&D hubs and systems integrators and to leave actual manufacturing to others.

Upgrading To Exporters

Countries such as China, Israel and South Korea, which recognised the potential of SMEs in upgrading domestic Defence, R&D and manufacturing base and encouraged their incubation through conducive policy and financial support, have successfully transformed themselves as net arms exporters today. The impressive rise of Israeli SMEs such as Bedek (which later became Israel Aerospace Industries), ELOP, Elbit Systems, Tadiran and Elisra into the world's top Defence innovators is particularly commendable.

New DPP has excised the normally long gap between AoN and RFP



India, too, can reach the same heights as many of the right ingredients for success are already present. We have hundreds of SMEs closely collaborating with various Defence PSUs, Ordnance Factories, DRDO and private companies in areas such as aerospace subsystems and accessories, ground equipment and tooling; naval systems, subsystems and accessories; IT hardware and electronics; Maintenance, Repair and Overhaul (MRO); casting, forging and metal works and R&D. Within this mass there are quite a few companies (and I count Samtel Avionics as one such), which have consistently upgraded themselves in terms of R&D as well as technical capabilities while entering into strategic product development and preferred supplier relationships with global manufacturers.



So, how can Defence SMEs and therefore, the bulk of India's indigenous Defence sector be taken to the next level? The first steps have to come from SMEs themselves followed by government push. The SMEs need to understand that OEM expectations in terms of quality and supply commitments require them to invest in technology and manpower training in anticipation of a contract not post facto. This demonstrates confidence and a strong commitment to a long-term business relationship; vital ingredients for success in a sector where the stakes are so high.

Government on its part has spelled out some progressive initiatives to encourage SMEs growth in the latest Defence Procurement Policy announced by Defence Minister Manohar Parrikar recently. These include:

- **Recognition of SMEs role in Defence manufacturing:** The new DPP clearly recognises the critical role that SMEs play in our Defence ecosystem.
- **Promotion of design backed indigenous manufacturing:** The new top priority procurement category of 'Indigenous Design Development Manufacturing' (IDDM) will back domestic companies which have proven competencies in design and innovation, very much the forte of SMEs.
- **Stress on innovation:** The move to fund 90 per cent of the developmental cost in the 'Make-I' category, with a guaranteed return of the

remaining 10 per cent if a successful prototype does not receive orders will encourage local development and innovation and will alleviate to some degree the high cost of capital that Defence manufacturers have to deal with. Reserving projects in this category with development costs under ₹ 10 crore for SMEs is a bonus.

- **Assurance sans interference:** In the 'Make-II' category, industry will fund its own prototypes but government will refund the entire development cost if there are no orders within two years of successful prototype development. Since there will be no direct ministry oversight, manufacturers can work unimpeded. This augurs well for the entire industry including the larger established SMEs that have their own R&D.
- **Reservation for SMEs:** All Defence products that will have a development cost of less than ₹ 3 crore have been reserved for SMEs in the 'Make-III' category, which is a sensible move that will benefit the micro and small firms in this category.
- **Streamlining of arms acquisition process:** The new DPP also seeks to streamline the entire arms acquisition process by cutting down on the long delays that have become the norm. For instance, the concerned armed force will have to submit a draft 'Request for Proposal' (RFP) along with the 'Acceptance of Necessity' (AoN) thereby excising the normally long gap between AoN and RFP in one fell swoop.

However, increased offset threshold has been one big dampener which the government needs to reconsider. The new DPP seeks to increase the offset threshold from ₹ 300 crore to ₹ 2,000 crore for foreign vendors, ostensibly to reduce the final price of Defence equipment. Since the offset policy required 30 per cent of the contract value to be ploughed back into the indigenous industry, this will not only reduce foreign investments into

Indian firms but also reduce business opportunities for a large number of Indian firms, particularly SMEs.

The SMEs contribution to India's GDP and India's growth story is phenomenal

The Fallacy

And before I end, let me bust the common fallacy that growth story typically involves large enterprises vs SMEs whereby one makes way for the other. This is a fallacy! Take the example of Italy, one of the most industrialised economies of the world. It may come as a surprise to many that SMEs constitute the backbone of the Italian production system. On a total number of more than 6,000,000 enterprises, 99.9 per cent are SMEs. This sector contributes 81 per cent of the total employment and 72.4 per cent of the Italian GDP. Within EU, SMEs accounted for 66.5 per cent of all European jobs in 2013 and contributed over 3.4 trillion Euro to its economy. Are we listening? 