

Speech

PERSPECTIVES ON THE ROLE OF SMALL SCALE INDUSTRIES IN INDIA'S ECONOMIC DEVELOPMENT*

A. Vasudevan

It gives me great pleasure to be here in the midst of experts deliberating on issues relating to credit to small scale industries, and to share with them some of my own views on the role of small scale industries in India's prospective development. The theme I have chosen is broader than the subject of discussions of the seminar but I believe that it would be germane to your deliberations today and tomorrow.

2. No society can work out its perspectives on development, based purely on the promotion and growth of large scale industries. Small firms are bound to exist side by side with larger firms. It is also true that good many small firms transform themselves over time, into larger firms, mainly through pursuit of active business strategies situated to suit the particular economic environment. Case studies of some of the firms which moved upward in terms of scale of operations show that the said mobility was surprisingly not impeded by regulations and controls of the administered regime. While this may be interpreted as the result of the wide prevalence of scarcity rents, it is important to note that scale mobility has been confined largely to those firms that have faced high 'dynamic' demand. The well-known adage that 'division of labour is limited by the extent of the market' stands vindicated.

3. Indeed it is the market demand that is at the heart of all decisions to invest and to produce. It is difficult to believe in the proposition of the classical economists that 'supply creates demand'. Nor can we any longer accept the proposition that societies are self-sufficient in all respects. Village self-sufficiency, a concept that was evolved during the period of India's Independence movement, can only be valid under some very strict conditions. The state of 'wantlessness', or 'minimisation of wants' which was echoed in the writings of Henry David Thoreau, Mahatma Gandhi and Professor J. K. Mehta, is the main pillar on which the edifice of village self-sufficiency has been built. But it is hardly a solution to Man's eternal striving for improving his economic well-being as well as his understanding of the principles that govern this universe. It is only the spiritually evolved beings who can perhaps limit their wants. Even here there could be exceptions or variants - Arabinde Ghosh's 'integral yoga' for instance, is an extraordinary exposition of integrating the material and spiritual parts of Man.

4. Let me come to terra firma and things more pertinent to occasion. Policy makers in Independent India have always recognised that small scale industries contribute to the material progress of the country. In the famous Mahalanobis model, widely discussed and debated in the mid-'fifties as a major contribution to planning for growth, village and small scale industries were given a special place, in that they formed one of the vital parts of the four sectors into which the economy was classified in the model. The discussions during that period of time, however, were somewhat emotionally charged on the specific role of small scale industries. For some, combining 'village' and small scale industries is essentially an appeasement of the nationalist-adherents of the Gandhian ideology. Some questioned the rationale behind the support to the 'ambar charkha' on technological and economic efficiency grounds. There were, on the other hand, many who considered that a number of small scale firms could well act as ancillaries to larger firms and be the needed medium for large scale industrialisation. Some felt that given the emphasis on heavy industries within the organised industry segment of the Mahalanobis model, there is no option but to ensure that consumer goods are produced not only by agriculture but also by village and small scale industries. For many, this argument meant that small firms are capable of producing a larger quantum of consumer goods than before to meet the possible increase in demand that would arise on account of the spurt in incomes, generated by fresh investments in heavy and basic industries. It is also taken for granted that small firms would, in the process, create additional employment opportunities. Implicit also is the assumption that small scale industries are less capital intensive and more labour absorbing. This is regarded as an important gain of promoting small scale industries, given the country's resource endowments, namely labour abundance and scarcity of capital. To some, small scale industries, being suppliers of inputs to larger industries, will dot the regions where large basic and heavy industries (such as, for example, steel plants) are set up.

5. The implications of such a strong policy support to village and small scale industries are many. In the first place, village industries have to survive, given the fact that native crafts were considered as the only means of livelihood of many generations and native crafts were regarded as reflective of the cultural and sociological dimensions of the country. According to this view, village industries will have to be given protection from the onslaught of competition from large as well as 'organised' segment of small scale industries. For many scholars, such a protective support was given as a matter of policy, albeit grudgingly, essentially as recognition of the nationalistic feelings engendered by 'khadi' and village industries, even though such support would not be in line with the need for attaining high economic efficiency.

6. The modern or organised small scale industries too needed protective support in terms of fiscal concessions, reservations of items to be produced, trade restrictions, provision of facilities such as water, electricity under the framework of industrial estates, and provision of inputs at predetermined prices. The rationale for such a policy determined support is similar to the one advanced in favour of village industries. Modern small scale industries, it was contended, have to be rendered viable and competitive.

7. In both the cases of village and modern small scale industries, it was initially believed that protective support would be only for a temporary period. The 'temporariness' is to be understood here as one that lasts till the sector gains enough vitality to be self- supporting.

8. It is necessary to recognise that the protective support is a form of State intervention - active and pre-announced intervention. And it is not that a protective support is provided only to village or to modern small scale industries but also to large scale ones, whether they are in the public sector or the private sector. Fiscal concessions, trade restrictions, barriers to entry, pricing of products and licensing of operations, to name a few, have been resorted to immunising, in the process, large scale industries from competition from outside. The extent or degree of support differed from time to time, but the fact is that competitiveness of the Indian industry, irrespective of the scale of operations, has not improved in any significant measure in the last 40 years in the international markets.

9. The consequence of the deliberate State intervention has been the inadequate appreciation of the need to have superior technical quality of the products for absorption abroad, although it is generally agreed that the quality of goods produced for the domestic market was much lower than that required for absorption abroad. The lack of adequate technological upgradation in the Indian industry has meant that it will be difficult to improve India's share in total world merchandise exports, however many price incentives that could be afforded. The policy implication of this situation is that besides promoting R&D domestically, technology may need to be either imported or emulated through technical collaborations, if the Indian economy has to be integrated with the rest of the global economy. This is possible only if there is an all-out national effort at improving the quality of Indian products, some of which would be absorbed in the domestic markets as well. There will have to be a 'vertical integration' of domestic and foreign markets so to say, and the entrepreneurs will need to bestow greater attention to matters such as consumer preferences and tastes, product standardisation, packaging, and marketing along with information for consumers embedded on the products meant for sale.

10. The vertical integration process will also influence the nature of relationships among different scales of operations within each industry and within each firm. Small scale industries cannot remain outside this process. Their role in fact becomes critical in areas where they provide inputs to larger units. In such cases, they have to attain technological standards that allow larger units to switch over to higher, and more sophisticated technologies. One would expect sub-contracting agreements to include exchange of information on technology needs between the contracting parties. But this by itself may not necessarily provide enough comfort for the small scale units, since, with sub-contracting arrangements, their financial position would get linked with the performance of larger units. The ultimate litmus test of success is the market demand for the product in question and if the said demand grows, the large unit as well as the sub-contractor party would reap financial benefits. Where there are uncertainties in demand either due to cyclical factors or due to shifts in preferences, a small unit that is wholly dependant on a larger firm will suffer losses, and in the extreme case, face closure. This point becomes particularly relevant where technologies are imported by larger units and smaller units are required to accordingly adopt consistent technologies. The costs of such adaptations by small units could be high and may not be realised within a short to medium term horizon. There has to be, therefore, a buffer from such incipient situations. Such a buffer has been in the nature of diversification of activities. Diversification, it is generally accepted, would give an opportunity for units to exploit scope economies.

11. It is not often adequately appreciated that scope economies are largely interlinked with scale economies. The principle of dynamic optimisation is best realised when both scale and scope economies operate, and as scope economies often require sufficient scaling support, small scale industries would be at a considerable disadvantage compared with larger ones. A mechanism may have to be, therefore, evolved to ensure that small scale units upgrade their technologies along with larger ones. A suggestion has been advanced in this context that small scale industry associations and ancillarisation arrangements would help gather technology information, and provide common facilities such as tool rooms and quality testing stations. While this could serve small units well, growth of small scale industries as a group may not be realised by exogenous inputting of what economists call 'technical progress' simply because of the large variable and some associated fixed costs that are involved in such adaptations in the context of uncertainties in demand. One needs to, therefore, work out a well defined technology policy wherein there is a pass-through of information and skills through endogenous efforts on the part of industries. This is in line with the recent literature on economic development which points out that the contribution of endogenously realised technical progress to economic growth is predominant. Now that there are opportunities for competitive forces to operate, and to be enhanced, the small scale and larger units would have to put in place institutional mechanisms for vertically supportive technologies.

12. The problems in setting such mechanisms cannot be easily resolved without some official assistance in the form of application-oriented research in the major scientific laboratories. For, the lead time required for undertaking serious R&D activities is in most cases large. Besides, the costs involved in setting up large scale research facilities that are oriented to addressing market preferences of goods and services could be substantial. But the industrial restructuring that is presently taking place in the organised large scale industrial sector segment offers hope that imported and replicated technologies could be supplemented by and oriented with indigenous research efforts. The present situation also offers best opportunities to establish definitive quality and ecological standards, taking into account the likely potential natural resources and the competence to be internationally competitive. To a large extent the initiative for giving a forward thrust to endogenisation of technical progress rests with large scale industrial units, which could ensure that the propagation effects of endogenisation processes is enabled through ancillarisation.

13. The emergence of electronic commerce as an important force in international transactions is a pointer to the urgency of adapting new technologies in export-oriented small scale units. The spread of e-commerce in the domestic arena in the years to come cannot be ruled out and small scale units will have to be prepared to face the challenges implicit in such a development.

14. Technological upgradation is not a one-shot affair: it is a continual process. Small scale industries will have to prepare themselves to incur the requisite costs thereof on a sustained basis, but over time these additional expenses would be covered by minimisation or lowering of costs in other areas of production. In the short to medium term, the small scale units will need to access the credit, term financing, and capital markets for funding their modernisation plans, both through conventional and innovative practices.

15. The defining moment for small scale industries has arrived in that they would have to be a part of the linkages between production units and the institutions that support them, including the Government, the large scale units and legal framework. They can hardly be insulated from the winds of change by resorting to the traditional way of policy support, and would have to work together, in a collective manner, to be competitive and strong, and may I add, echoing Schumacher's dream, 'beautiful'.

* Inaugural address by Dr. A.Vasudevan, Executive Director, Reserve Bank of India to the National Conference on the Flow of Credit to SSI Sector organised by the Institute of Small Enterprises and Development at Kochi, Kerala on August 27, 1998.