

Policy Paper: A Roadmap for Industrialization and Employment creation in MP

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MSME: Incentivizing Transition from Micro to Small and Medium Scale

Growing in size should be aspiration of any organization over a period of time. This applies to any enterprise as well, whether in industry or in services. But this is not true of India's MSME sector. Units start as micro units and continue to languish as micro units with no intention to convert themselves into small and medium ones. MSMEs play an important role in creating value and generating employment in the economic sector in the state. So let us see how their contribution to economy has been performing today.

"MSME share in the national economy is, in fact declining. Their contribution to total manufacture in this country fell from 42% in 2006 to 37.3% in 2013 and is slated to go down even further. During this period, importantly, MSME's addition to total GDP dropped from 7.7% to 7%"., as reported in the newspaper, (Gupta, 2017). The same news report also quotes," In terms of the no of units, it is estimated that 18.7% more have been added to MSME sector between 2014-2015 and 2015-16. The number of employees in them too has shot up from 81 million to 117 million between 2007-07 and 2015-16. But, as unregistered micro units are roughly 13 times the number of registered ones, the average employment per enterprise is just about three persons." The same trends are being observed in the state. Above data shows micro enterprises are not moving into small and medium ones and preferring to stagnate at starting level and even proliferating without making significant contribution to the economy. Also, they are not moving from unregistered to registered ones either.

What are the reasons for this state despite a no of committees having been formed and have given their recommendations? One of the main reasons has been that size of these enterprises has not been regarded as an efficient goal to promote efficiency in the MSME sector. Rather contrarily, committees have been recommending such measures as bailing out sick units by way of overdrafts which tempts these units to remain small. Many committees have recommended technological up gradation. There are institutions solely dedicated to the up gradation of MSMEs. Despite all this, there is hardly any movement of the enterprises up the value chain in MSME ecosystem.

Policy also does not provide any incentive to micro units to exit. It is really important to incentivize these units to move up the value chain. The credit structure can be regulated by RBI so as to incentivize the graduation of micro and small units into medium ones. Capital subsidy and interest subvention can also facilitate these micro units to graduate to their small and medium avatars if these are structured accordingly to favor the later. Once these micro units start moving upwards, they create value in terms of efficiency and quality employment. Only then, these units shall start absorbing the state of art technology better and remove the technological obsolescence and inefficiency.

Contribution of MSME sector of other countries should be an eye opener for us. Dipankar Gupta in TOI, April 22, 2017 writes on this:

"Germany's MSMEs contribute 57% of gross value added, but when disaggregated we find that as much as 35% is from small and medium sectors. Employment wise too, the small and medium units do better than the micro ones. While 79.3% of the Germany's MSMEs are micro, they only employ 18.8% of the work force. On the other hand, small and medium units comprise only 13.5% of the total enterprises in the country, yet they employ over 47% of the total workforce, ways above what the micro units do."

What then are the reasons for this sorry situation in the state and the country? Various thresholds in our labor laws encourage our enterprises to stay micro and small. Take the provisions of IDA related to hiring and firing of labor. "The IDA allows management to fire workers at will if the unit has less than a hundred employees. Further, it need not pay compensation to those dismissed, if they have served for fewer than 240 days in a row", writes Dipankar Gupta (Dipankar Gupta, 2016). Such a provision in a major law of the country is a sure recipe for not only staying small but also working around these stipulations to manipulate and retrench workers on 239th day. Entrepreneurs love this arrangement to flip the labor and stay informal to take advantage of this provision. Hence this provision is a great incentive to the units to stay small and even manipulate the number of workers employed and the no of days for which these workers are employed for this end. Records need not be kept. Units don't need to take permission from government to fire the workers either.

The consequences of this provision are not only confined to keep these units at micro and small level. The other parallel side effects follow in the form of keeping the workers casual and hence vulnerable to job security. Quality of

employment suffers in the long run. So strong has been this incentive that formal enterprises have started converting their formal labor into informal daily wage ones. Both the government and the corporate sector employ a large number of contract workers these days. Contract labor accounts for 55 per cent of public

- 55%: Percentage of contract labor in public sector jobs
- 45%: Percentage of contract labor in private sector
- 2m: No. of contract labors currently in organized sector
- 480m: Total no. of workers in the

(Source: The Economic Times, 16 July, 2016)

sector jobs and 45 per cent of those in the private sector (Economic Times, 2016). This casualization of labor has been the cause of labor unrest in industry. Not long ago the factory manager in Maruti in Gurugram was killed in one of such incidents in the country.

Yet another threshold that acts as incentive for the units to stay micro and small is the provision in "The Payment of Bonus Act". This act applies to those who earn below Rs 21000 (Gupta, Make a Quick Black buck, 2016). You earn a Rupee more and you can waive this entitlement a goodbye. This provision requires the units perversely to work around these thresholds and make a killing says Dipankar Gupta in the same article.

What then should be the policy action to incentivize these units to move up the value chain? First and foremost, we need to demolish all these thresholds immediately by reforming our labor laws. Regardless of the number of workers employed or the duration (no of days for which the worker is employed), all workers should be entitled to bonus and other benefits. Regardless of numbers, the industry can be given the option of retrenchment but industry should be mandated to pay compensation and other severance benefits to all workers.

With the huge workforce now in contract, the Contract Labor (Regulation and abolition act) should be amended and abolition of casual labor be taken off the statute book. This act does not provide adequate legal protection to the casual labor and acts as an impediment against the formalization of labor in the industry. The central and state governments can consider giving nationwide and statewide licenses to labor supplying firms with stipulated conditions. This can be a win-win situation for industry and workers both, as industry will get the easy hiring of labor supply and workers will be entitled to better social protection. Thus the aforesaid

changes in labor laws will help create more jobs in the organized sector and incentivize the industry to move up the value chain.

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