SME SECTOR PERSPECTVIE – INDIA

1. RELEVANCE OF THE SMEs

Growth of all segments of manufacturing and services enterprises – be they micro, small, medium or large – is critical for economic development and creation of jobs. India has nearly three million small and medium enterprises, which constitute more than 80 percent of the total number of industrial enterprises in the country. They contribute nearly 35 percent in direct export and 45 percent in the overall export from the country. SMEs are one of the biggest employments – providing sectors (over 30 million jobs).

The concept of cluster development emerged about 15 years ago and offers a new insight into the potential of SMEs in enhancing their access to new technology. A cluster is a geographic concentration of firms and their various service providers and is defined by: (a) a product / product range, and (b) a place (name of a city, town, and village) with forward linkages (selling agents, direct customers) and backwards linkages (raw materials, suppliers, machinery suppliers) linked to production activities. It is estimated that there are 600 modern SME clusters and 2,000 rural and artisan – based clusters in India. To make their products globally competitive, Indian SMEs need to upgrade their technology.

The problems faced by the SMEs, particularly in accessing technology and maintaining competitiveness, are formidable. In recent years, the Government of India (GOI) has launched a number of initiatives to help small industries. Many of the SMEs are reeling under the current phase of economic slowdown, which is threatening their survival. In fact, many of these units are looking towards innovative and out – of – the – box ways to improvise their operations.

2. SCOPE OF ENERGY CONSERVATION

Numerous sectors – specific studies have confirmed that energy intensity in industry can be reduced with the widespread adoption of commercially available technologies to improve energy efficiency, producing significant aggregate impacts and global benefits from reduced emissions of greenhouse gases. It is consistent with several GOI sector priorities and national plans – specifically, the National Mission for Enhanced Energy Efficiency in Industry under the National Action Plan for Climate Change released by GOI on June 30, 2008 has emphasized the need for improving energy efficiency in the manufacturing sector.

Despite recent Indian reductions in overall energy intensity, the SME sector has fallen behind larger Indian industry benchmarks in terms of productivity, technology upgrading, and energy efficiency. In this context, the Bureau of Energy Efficiency is laying adequate emphasis on the SME sector as presented in the Working Group on Power for 11^{th} Five – Year Plan (2007-2012) – sub – Group 5. SMEs are facing high – and rising – energy costs, unlike certain other sectors of the economy such as agriculture, that benefit from subsidized energy prices. As SMEs are also exposed to global competition, price and cost pressures are areas of high and increasing importance. SMEs, especially those for whom energy costs represent a large portion of total production costs, can reap especially high direct economic benefits from improving efficiency of energy conversion and reduction of energy losses, yet numerous barriers and market failures have prevented widespread adoption. Key impediments include the following:

- Lack of awareness and capacity on the part of SMEs to take up energy conservation and to perceive effective programs.

- Lack of scientific approach, measured data on the energy performance status. This is also related to the skill of key personal employed by them and reticence to improve the reporting system due the tax – oriented approach followed by the SMEs.
- Low credibility of the service providers such as energy auditors / ESCOs, and dearth of champions and strategic partners.
- Limited access to affordable financing / incentives to induce SMEs to come one board.
- Low priority – energy efficiency is one of several priorities and usually ranks low in sectors where incidence of energy cost is less than 10 percent of the manufacturing cost.
- Lack of coordination among the Government and private sector agencies involved in energy efficiency related activities.

3. PAST INTERVENTIONS

Energy efficiency in SMEs is not a new program in India. In the past, several governments – induced interventions have addressed this area. Often these programs have not succeeded in achieving large – scale replication. A few bilateral / multilateral programs under the aegis of United Nations Industrial Development Organization (UNIDO), Swedish Development Cooperation Agency (SIDA), Indo – German Energy Program, and USAID were seeded during the past few years. Several national agencies like the National Productivity Council (NPC), The Energy Research Institute, Petroleum Conservation Research Association (PCRA), National Small Scale Industries Corporation, Winrock International, National Institute for Secondary Steel Technologies, etc. have been working at the grassroots level. A recently completed World Bank Global Technical Assistance Project, "Developing Financial Intermediation Mechanisms in China, India and Brazil" (the 3 CEE Project) led to the launching of five pilot lending schemes for energy efficiency at SMEs by Indian banks. Financing institutions / banks such as the State Bank of India (SIA), Small Industries Bank of India, Indian Renewable Energy Development Agency, and the ICICI bank, among others, have been funding and supporting energy efficiency projects in SME units. The ministry of Micro, Small, and Medium Enterprises, Government of India, has to count on BEE, PCRA and SIDBI for massive efforts needed in this area.

4. GAP AREAS

Implementation of energy conservation measures in SMEs has been at a far slower rate than expected despite substantive efforts in the past 20 years. Imperfect information about energy efficiency among small and medium enterprises still persists, preventing increased adoption of efficient technologies.

A central barrier, which will be the primary target area of the proposed project, is the current gap in understanding between the energy auditors / EE practitioners who prepare technical proposals for the SME clients and the local banks who evaluate loan proposals, not technical studies. This is mainly due to lack of facilitation efforts in connecting reliable energy audits to loan applications. Several clusters do not have access to the local service providers. Often there is doubt about their credentials. Thus, the 3CEE Report has pointed out that end – users and bankers often find that certain claims of energy savings are overstated. The technical credibility gap is an area to be addressed by energy professionals and supporting organizations such as BEE and PCRA.

There also appears to be a need to systematically support development of a large number of EE investment proposals under a programmatic approach to aggregate demand for EE investments in SME industrial clusters and to create a sustainable mechanism for identifying, preparing, and financing these proposals at the local level. ESCOs / energy service providers would perhaps be more readily accepted by end – users if they were able to finance the energy efficiency projects and realize their contribution related to the energy savings. So far, the issue of financing ESCOs has not been taken seriously even by

major stakeholders like the State Bank of India, who have in the business of energy efficiency financing for the past 7 – 8 years.

Quoting from the proceedings of the ECO – III sponsored Workshop "Accelerating Implementation of Energy Efficiency Projects in SMEs" held on June 11, 2008, Project Management Cell, UNDP – GEF Project for Steel Re – rolling Mills Sector, traced the tardy progress in respect to the energy efficiency scheme operating from 2001 to June 2007 for their massive program with US$14 million budget equally shared between GOI (through the Ministry of Steel) and Global Environmental Facilities (GEF). The Program has several features, such as the removal of barriers to energy efficiency financing through capacity building, implementing ESCO projects and monitoring and evaluation programs in the Steel re – rolling sector. The industry showed lukewarm interest in implementing capital intensive measures, such as the replacement of inefficient re – rolling mill furnaces. The reasons cited were mismatches between the solutions attempted and the user industry specificities. In fact, several programs fail to trigger market response and active participation due to lack of foresight about current attitudes regarding solutions to EE. Often, the role to be played by the energy solution provider for developing trust among the key actors is not given adequate attention at the program design stage. Energy efficiency programs also need substantive efforts for periodic review and midterm corrections to ensure results. Often frequent changes in the Program implementing agencies also adversely affect the outcome.

In many instances, the Banks have announced special schemes to finance energy efficiency in SMEs but they generally suffered from inadequate preparedness to market and facilitate SME customer's interest and involvement. For that reason, nationalized banks – Union Bank of India, Canara Bank, Bank of India, and Bank of Baroda – had launched schemes similar to the State Bank of India's initiative. These schemes did not evoke enough response as per the 3 CEE Project Report. This can be attributed to the lack of adequate preparedness of these banks to ensure a good response from users. According to the 3CEE Report, the following impediments are often faced by the banks and SMEs while implementing energy efficiency projects:

1) Lack of available capital, especially for smaller enterprises
2) Inadequate information on appropriate equipment and technology
3) Under – emphasis on EE investment financing by domestic financial institutions