
ROLE OF INSURANCE IN THE DEVELOPMENT OF INDIA'S MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs)

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Abstract — This paper investigates the role of Insurance in the development of Micro, Small and Medium Enterprises (MSMEs) in India. MSMEs have been accepted as a crucial component of an economy irrespective of the phase of development it is in. It is estimated that more than 95% of the enterprises across the world are MSMEs, employing around 60% people in the private sector. The MSMEs are considered key elements in the development of every nation. In India, MSME sector contributed 28.77% in GDP in 2016-17 with 63 million enterprises and employment of 110 million people. Despite its size, MSMEs cumulatively act as foundation of a stable economy and plays a significant role in the sustainable economic growth of a nation. However, the inherent features of MSMEs including limited financial and managerial capability cause them to face financial and strategic risks. Sustainability of the MSMEs can be supported by eliminating the credit gap and ensuring enhanced access to finance. The provision of financial support by financial intermediaries like banks can be augmented with proper risk management by the MSMEs with the help of Insurance Sector. The study concludes that insurance can play a significant role in the development of MSMEs by providing them adequate risk protection and thus enhancing their access to finance

Keywords - *MSMEs, Entrepreneurship, Risk Management, Insurance, and Sustainability*

I. Introduction

Micro, Small and Medium Enterprises (MSMEs) have become an inevitable and crucial factor in the economic development of any nation. The MSMEs are the best representatives of economic activities (Congregado 2010; Iversen, Jorgensen, and Malchow-Moller 2007). The importance of MSMEs in developed as well as developing and underdeveloped countries have grown up simultaneously. The MSMEs take up a major share in the domestic trade and simultaneously play a significant role in the international transactions directly or indirectly. It is estimated that more than 90% of the enterprises across the world are MSMEs, employing around 60% work force in the private sector. MSMEs are considered as an engine to enhance economic growth and equitable development. It's a bottom-up approach wherein the process of growth is initiated at root, so that the benefits are derived by the deprived segment which is unable to enjoy the fruits of large scale industrialisation.

MSMEs in India are acting as catalytic agents in the development process. Small businesses, retailers and enterprises are considered the key to India's economic growth and the cornerstone of entrepreneurship wave taking over India. The Large Scale enterprises have their own inherent large requirements that impede their growth and capacity expansion limiting the relevant support towards nation building by way of contribution to GDP, Employment and Trade. The MSMEs stand as saviours encouraging large scale participation by entrepreneurs at different levels through the establishment of Micro, Small and Medium enterprises. MSMEs are easy to start, utilise local resources, promote indigenous production, provide employment etc. and thus contribute to GDP resulting in Economic Development. In India, MSMEs have shown an impressive growth. The number of MSMEs (Small Scale Industries till 2006) has grown from 7 million in 1991 to 63 million in 2016. The number of employees in MSMEs has grown from 15 million in 1991 to 111 million in 2016. The contribution towards GDP has also grown from 5.86% in 2000 to 28.77% in 2016.

In India, the Micro, Small and Medium Enterprises Development (MSMED) Act was notified in 2006 to deal with issues impacting MSMEs as well as the coverage and investment ceiling of the sector. The Act was enacted to promote development of MSMEs and also to enhance their competitiveness.

On 9 May 2007, the Government of India (Allocation of Business) Rules, 1961 was amended accordingly. The Ministry of Small Scale Industries and the Ministry of Agro and Rural Industries were merged to form the Ministry of Micro, Small and Medium Enterprises (M/o MSME). The M/o MSME work with the vision - "Sustainable development of globally competitive Micro, Small and Medium Enterprises as an engine of growth for the India Economy". The Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 categorised the MSMEs in two types:

(a) Manufacturing Enterprises: - The enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule of the industries (Development and regulation) Act, 1951. The Manufacturing Enterprises are defined in terms of investment in Plant & Machinery.

(b) Service Enterprises: The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment.

The MSMED Act classifies the Micro, Small and Medium Enterprises (MSMEs) as follows:

| Enterprise (Type) | Investment in Plant & Machinery (Manufacturing) | Investment in Equipment (Service) |
|-------------------|---|-----------------------------------|
| Micro | Up to 25 lakh | Up to 10 lakh |
| Small | Above 25 lakh upto 5 crore | Above 10 lakh upto 2 crore |
| Medium | Above 5 crore upto 10 crore | Above 2 crore upto 5 crore |

II. MSMEs Economic Growth

MSMEs have a significant role to play in the economic development of a nation. SMEs perform a significant role in employment generation facilitating the growth of the economy (Taymaz, 2005; Van der Nest, 2004; Gregory, Harvive & Lee 2002) as well as sustainable development (Ariyo, 2005). MSMEs present an effective means of promoting entrepreneurship at rural and semi-urban areas, proper utilisation of local resources using indigenous technology, help employment generation at a low capital involvement (Sule, 1986; World Bank 1995). This greatly helps in developing rural and semi-urban areas as economy growth centres preventing rural-urban migration.

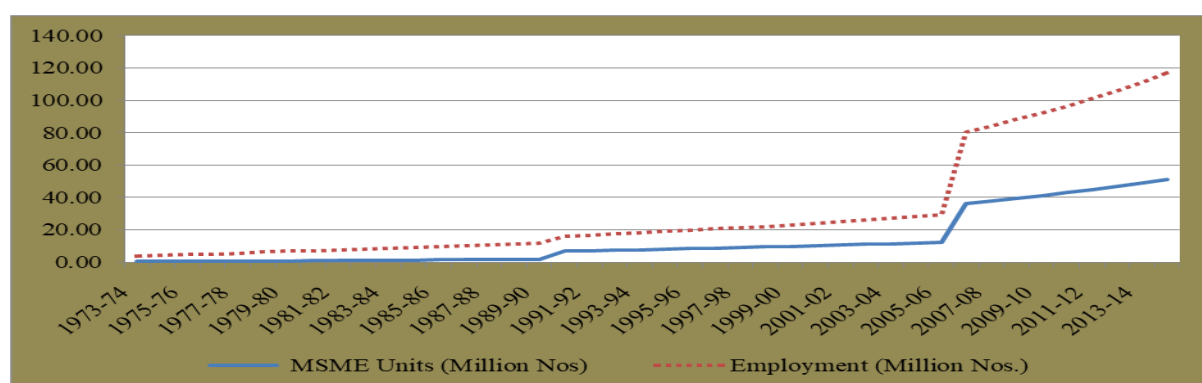


Chart 1: Growth of MSMEs and Employment Generation

The above chart shows the growth of employment vis-a-vis growth of the MSME units for a period of 40 years. In 1973-74, with 42,000 units MSMEs (then SSIs) employed 39 lakhs of people which has grown to 11 crores of employment with 63 million units in 2016-17.

MSMEs are now coming up as a feeder to the large scale industries as the stiff competition across the globe has compelled the big industries to resort to outsourcing in order to be cost effective.

On the other way, the enhancement of global business connections has enabled domestic MSMEs to connect to global players and get involved in the production or supply chain and thus adding to exports, and simultaneously contributing to economic growth. Since 1970s, the increased attention of the developing nations towards support and promotion of SMEs is due to their increased participation in the production process of Large Scale Industries which strengthened the industrial linkage (Ekpenyong and Nyong, 1992). The potential contribution of MSMEs towards development of an economy comes through:

- Production of goods and services, adding to GDP
- Utilisation of local resources and upholding indigenous technology
- Creation of employment opportunities at relatively low capital investment
- Reduction of income inequality
- Improving quality of human resource by enhancing the skill level of local manpower which will be ready to support any industrial expansion in future.
- Helps lowering rate of migration from rural to urban areas.

MSMEs are highly flexible in their operation and diversified in the sectors in which they work and thus have a great scope to grow up and contribute substantially to economy under a supportive environment. The interest in and importance of MSME development among policymakers stems out from its ability to work as a direct assistance to the elimination of poverty (Neck, 1977). The importance of MSMEs especially in the economic development of developing countries can be gauged from the followings:

1. **Interdependence of Business**
In a vast country like India with enormous requirement for products and services, the number of large scale industries are limited and they are actually dependent on the large number of small wholesalers, retailers, distributors and other middleman who helps the products and services in reaching out to the remotest part of the country. They also help in the repair, upkeep and maintenance of those products which are an essential requirement for the re- purchase decision (A.K.Das, 2006)
2. **Maintenance of Competition**
Competition can be the vehicle of change. Through innovation or improvement, the MSMEs keep on continuing healthy rivalry for consumer patronage. Modern competition appears in many forms: price, credit terms, service, product improvement, product marketing strategy etc. MSMEs are more innovative than the large scale Enterprises because in general people working on new ideas that relate to their own profit are motivated in a more direct way. (Baumback, 1988).
3. **Diversity**
Diversity is part of the definition of small business (Harmon, 1979). While big business may be valuable small business is vital. MSMEs are diverse in their business involvement and contribute to a large extent to fulfil the diverse requirements of large Enterprises. The MSMEs fill the gap in the supply chain or production function where large enterprises are unable to accommodate themselves.
4. **Contribution to Social Welfare**
It is the MSMEs running in an unorganised sector without any management structure that typically hire/ engage employees of marginal ability (unskilled labour). Fresh employment seekers may not find their place in large enterprises instead they are largely recruited by the MSMEs operating at local levels. The MSMEs thus prepare a batch of skilled labourers which can support extension of large scale enterprises in future.

III. MSME and the Road Blocks

Despite being in a position to potentially influence the economic growth in a positive and substantial manner, the MSMEs continue to face various challenges in their successful operation and many succumb to premature winding up. Although more than 80% of the enterprises in India fall in the category of MSMEs, they still are suffering from problems like operating at sub-optimal scale, marketing inefficiency, quality maintenance, technological obsolescence, stiff competition from large scale enterprises as well as global players, supply chain inefficiencies, paucity of funds, rapid technological changes, unpredictable market and so on.

The difficulties faced by MSMEs can be broadly categorised as Financial, Managerial and Environmental. It is widely acknowledged that SMEs suffer from disadvantage relative to large firms, principally in the areas of access to finance, information and technology (Harvie C. & Lee B C, 2005). Financial Difficulties arises with

acquisition of seed capital and adequate finance to carry on the day to day operation and sustain the market fluctuations. In some cases, the production pressure increases in a particular season due to availability of raw materials during that season only. But since the sales takes place throughout the year, there is a high need of funds to meet the extra production requirement, to store the products and to carry out selling activities on a continual basis. In today's global market place, simply producing quality goods do not fetch money, if the entrepreneur fails to market the product in an effective manner. To understand the effect of marketing, we can refer to the phenomenal growth of India's Patanjali Ayurved in recent years. As such, the MSMEs need to resort to effective marketing strategy to position their products and services in the market. This calls for a hefty capital expenditure on Advertisement and allied activities which will yield fruits in future and to keep in pace with the rapidly changing demands of customers and requirements of global clients, Research is an area to focus on, which also needs adequate funds to generate results. Unfortunately though, finance is the element of which the MSMEs are starved of. The low access to credit facilities are one of the major difficulties that is faced by the MSMEs and this sole finance bottleneck gives rise to many other associated problems, which the MSMEs, sometimes, fails to sustain and ultimately succumb to winding up.

Managerial difficulties are related to lack of managerial experience and skill, that result in Strategy Risks like failure in timely decision, marketing strategy, competitive edge, marketing research etc. MSMEs cannot afford to maintain costly managerial staff and instead depends entirely on internal management abilities. This sometimes results in inadequate preparation for changes in the market place, failure to expand beyond local market, capitalising market opportunity, increasing labour problem, technical breakdown hampering production, etc. causing either catastrophic loss or premature close down of the MSMEs.

Environmental difficulties come in the shape of global competition, or competition from large firms, regulatory changes, political instability etc. Some changes in the market place including regulatory and political are very uncertain and take place any time destabilising the running of MSMEs, if they are not adequately equipped to foresee and face such situations. The Demonetisation issue of Nov, 2016, has been a cause of closing down of few MSMEs as they were unable to manage the sudden shortage of liquid cash, which resulted in their inability to meet labour payments, pay supplier dues, acquire raw materials etc.

The opening up of market compelled the MSMEs share same playing ground in the Global market with the global players and the sustainability and survival of the MSMEs in India were a matter of concern under those circumstances. But it was later realised with the passage of time that the falling trade barriers actually provided the MSMEs with a new world of opportunities allowing them to be a part of the global supply chain. This was a result of the battle of cost effectiveness where large scale enterprises preferred to outsource their part of jobs to low cost economies or because the rising demand of quality maintenance made the global players to employ the best skills from every corner of the globe.

IV. MSMEs, Risk and Insurance

Risk in business may be referred as the chance of occurrence of something that may adversely affect the objectives (Aernorld, 1998). Risk is an omnipresent element in any and every sort of business and its degree is high in context to MSMEs for many reasons of which one may be the financial concerns. This makes them unattractive to investors (Anic and Paus ,1998; Inang & Ukpong ,2002 ; and Aruwa , 2004), as investors feel comfortable in staking their money with the large scale enterprises against a strong security basis and past debt history. Financial and strategic class of risks are posing the biggest threat to MSMEs today (Azende Terungwa, 2012). Among financial risks, besides the challenge of arranging seed capital, working capital appears as a critical factor. It is very important for MSMEs to manage the cash inflow in an uninterrupted manner so that the key areas of the business like employee payments, supplier payments, supply chain requirements are not disrupted under any circumstances. Otherwise, situations like Demonetisation, GST implementation, Ecological concerns, changes in International trade relationships may pause the life cycle of MSMEs. Risk Management is an essential activity for MSMEs. It refers to the necessary steps that give protection to the business in times of uncertainty causing unavoidable losses. The possible adverse effects on the business from all potential threats are considered and taken care of through effective Risk Management. Risk Management, i.e., treating a potential risk can be generally considered in any of the following manner:

1. Risk Avoidance

If there is any alternative way to bypass the action that calls for risk, that alternative is adopted to avoid the risk at all. For Example: Changing route or mode of transportation to avoid risk of accidents in hilly terrains during rainy season.

2. Risk Reduction
If the risk cannot be avoided, it is reduced by adopting risk reduction measures. For example: installing fire extinguisher, fire alarms, mock drill on fire incidents.
3. Risk Retention
If the risk is common in nature and meagre in value, it is generally retained. For example: Risk of defective raw materials, when acquired in large lots.
4. Risk Transfer
When a risk cannot be avoided, nor retained, it is transferred to a third party, called Insurer, for a consideration called premium. The Insurer agrees to make good the loss happening on the occurrence of the insured event.

Of these, the Risk Transfer Mechanism of Risk Management is of utmost importance as majority of the risks need to be mitigated in this manner that calls for an expense of "Premium". Many entrepreneurs view insurance as an unnecessary expense, while others believe it to be important but perceive it as a luxury, may be because many of the MSMEs suffer from the inadequacy of fund. But, of late, the importance of insurance for protecting the MSMEs against catastrophic losses has been realised and MSMEs are giving priority to this protection need keeping in mind the long term sustainability of the business. The lack of experience and farsightedness of owners managing the MSMEs, results in their inability to sustain unexpected shocks in the running of the MSMEs. The MSMEs fail to recover from business falls or catastrophic losses due to absence of adequate insurance coverage to keep the business protected under adverse uncertain circumstances. In the absence of Insurance and its protection-against-uncertainties services, the MSMEs will be reluctant to undertake innovative steps and instead hang on existing business model to ensure certainty. This will subsequently lead to under-productivity of the business enterprises hampering economic growth (Baumol 1968, 1990, 2006).

The lack of adequate insurance makes them a risky venture in the eyes of investors, and they consequently become reluctant to advance financial assistance to the MSMEs. Most of the MSME owners keep themselves busy with the daily operations in such a way that there is little time left to think about identifying the risks and manage them well. It has now become imperative to prioritise risk management aspect so as to ensure the sustainability of the business. The first essential step in this regard is to undertake a thorough risk assessment exercise, either through credit rating agencies or professional service providers. The Insurance Companies also perform this risk assessment activity as a complimentary service before taking up the insurance deal.

The MSMEs may consider some critical insurance coverage as follows:

1. Property Insurance
It gives protection against the losses and damages that may happen due to fire, flood, riot, cyclones and other allied perils. It covers property like building, machineries, other factory equipments, furniture, inventory, signage etc. But, this does not cover mass-destruction events like earthquake and terrorism, which can be opted by the MSMEs separately.
2. Business Interruption insurance
This covers the consequential loss that may arise due to loss of property caused by fire, flood, cyclone etc. While the Property Insurance makes good the losses of physical property, Business Interruption Insurance makes good the loss of business that occurs during the time gap required to restart the business activities.
3. Workmen Compensation Insurance
As per the Workmen's Compensation Act, this insurance will cover all on-duty employees of the medical expenses, disability and death benefits. In case of accidents leading to death of the on-duty employees, the benefits are passed on to his or her family.
4. Group medical cover & group personal accident cover
These are group insurance policies being offered to a group of homogenous people fulfilling certain criteria and come at very cheap rate. The Group Medical Policy may cover all the employees against medical expenses. The families of the employee may also be added to this cover. The Group Personal Accident Policy covers the employees of the death or disability due to accidents.
5. Group cyber cover for employees
It is becoming very popular with the increasing rate of Digitisation of the work place. The growing incidents of cyber-crime make it a requirement to protect the business and its employees against any cyber-attack that may lead to loss or misuse of vital, financial or sensitive data and other associated damage.

6. Vehicle insurance

The MSMEs owning vehicles may take this insurance as it will protect them from the liability that arises due to accidents caused by their vehicles leading to injury or death of someone.

Apart from the above mentioned cover policies, MSMEs may also consider taking up other coverages such as Key man Insurance, Burglary Insurance, fidelity insurance etc. which adds up to their level of protection against adverse events. Considering the increasing intensity of natural calamities with every passing year, a well-rounded and justified insurance protection is a must for every business concern having a long term vision. This will make the MSMEs shock-proof in risky environment and thus attract the bankers to be comfortable while sanctioning financial assistance. The Risk propensity of inappropriately insured business units may compel the banks to curtail the extent of lending, known as Credit Rationing- irrespective of the willingness of MSMEs to pay a fair cost of capital, i.e. Interest, which is risk-adjusted. Insurance can help resolve two severe challenges faced by the MSMEs -- the sustainability during catastrophic losses and access to easy finance to carry out normal business operation and for expansion.

V. Limitation

Availability of data is a serious problem in undertaking study relating to insurance and MSME. While data on MSMEs are available to a rational extent, specific data on insurance related to MSMEs are unavailable. This discourages empirical study in understanding the role of insurance in the promotion and development of MSMEs in India.

VI. Conclusion and Suggestion

The development of MSMEs to a great extent can be influenced by proper insurance Coverage of the firms. Insurance in one way ensure protection to the firms against uncertain adverse events, and on the other way, gauge the level of risks the MSMEs are in, making it easier for banks and other financial institutions to provide financial assistance which is a very crucial element for success of each and every MSME. The measurement of Risk propensity of the MSMEs by the Insurers may also allow the lenders (banks and other financial institution) to charge a borrower-friendly cost of capital excluding the extra adjustment rate for unaccounted risk.

This essentially calls for increasing awareness among the MSMEs owners regarding the importance of Insurance and its usefulness in securing financial assistance. The Insurance needs to be seen as an essential element required to protect and to promote the future dreams of each and every MSME. There are several government initiatives in force to pave the way for MSMEs towards easy finance by creating a supportive environment and insurance can help to a great extent in this initiative. The promotion of Insurance among MSMEs will remove the problem of Information Asymmetry encountered by the financial institutions, as the Insurers will do the job of Risk Assessment in an efficient and professional manner and consequently, the MSMEs can avail fair rate of interest on loans provided by financial institutions.

The study suggests that:

1. While issuing financial assistance, an Insurance Policy that suits the need of that particular MSME should be attached, as a pre-condition for advancing the assistance.
2. The existing un-insured MSMEs should be brought under the Insurance umbrella.
3. Customised and innovative Insurance Policy that meets the specific needs of each category of MSMEs should be introduced at affordable rate.
4. Awareness program should be organised targeting the MSMEs to help them understand the importance of Insurance coverage.

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