

# Diagnosing Definitional Issues of the Small Scale Sector in India

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## ABSTRACT

*Definitional ambiguities of the small scale sector in India are a consequence of the diverse agencies and sources responsible for defining and documenting these units. They pose a challenge in getting a uniform and non-overlapping national level picture. The paper focuses on the evolution of definitional criteria laid down by the concerned Ministry from the post-independence period till date and throws light upon the underlying ambiguities. Simultaneously, other agencies have used different documentary criteria which may have led to under/over estimation in the documentation of the performance of the sector. The authors posit the need for a uniform definition and standard documentation practice.*

**Keywords:** MSME, Small Enterprises, Registered Units,

## I. INTRODUCTION

The small scale sector constitutes an important segment of the Indian economy in terms of its contribution to the country's industrial production, exports, employment and creation of an entrepreneurial base. It is estimated that in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 per cent of the total exports of the country. The sector is estimated to employ about 59 million persons in over 26 million units throughout the country (MSME-Annual Report 2010-11). The issue that draws attention of policy makers and academicians is identifying single or primary and uniform criterion or characteristic by which this sector could be defined. Taking up the issue of defining the small scale sector raises the question of the necessity of defining the small. A comprehensive definition of the small scale sector is aimed at making sure that the factors that determine eligibility to be 'small' are aligned with current economic and industry indicators. Standardised definitions and concepts of small are also necessary to avoid divergent statistical figures at the national level for documentation purpose. With the diverse sources and agencies entrusted with the task of defining, identifying and documenting the small scale sector in India is it possible to get a uniform and non –overlapping picture at the national level?

## II. THE DILEMMA IN DEFINITION

It may be observed that small enterprises are not easily defined or described on the basis of the nature of the work that workers or employees in the sector are engaged in, because the sector has tribal forest workers on one hand, as well as home-based, info-tech and software workers on the other. It cannot be based on the number of employees in undertakings because it covers agricultural workers, craftsmen, home-based workers, self-employed workers, workers in weavers' cooperatives, as well as workers in small scale industries where the workforce can be counted on one's fingers. On the other hand, the definition of small business cannot be based on the level of organization because

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some of the enterprises may have very few workers, and even these may be working in a dispersed manner with hardly any organisational link or interaction with each other, sometimes because of the nature of the work, and sometimes because of the geographical or locational dispersal of the workers pursuing the same vocation. How then can we define the sector?

### III. DEFINITION OF 'SMALL' ENTERPRISES: THE WORLD OVER

The legal definition of "small" varies by country and by industry. In the [United States](#) the [Small Business Administration](#) establishes small business size standards on an industry-by-industry basis, but generally specifies a small business as having fewer than 500 employees for manufacturing businesses and less than \$7 million in annual receipts for most nonmanufacturing businesses.<sup>1</sup> The definition can vary by circumstance – for example, a small business having fewer than 25 full-time equivalent employees with average annual wages below \$50,000 qualifies for a tax credit under the healthcare reform bill [Patient Protection and Affordable Care Act](#).

In the [European Union](#), a small business generally has fewer than 50 employees. However, in [Australia](#), a small business is defined by the [Fair Work Act 2009](#) as one with fewer than 15 employees. By comparison, a medium sized business or mid-sized business has fewer than 500 employees in the US, 250 in the European Union and fewer than 200 in Australia.

In addition to number of employees, other methods used to classify small companies include annual [sales](#) (turnover), value of [assets](#) and [net profit](#) (balance sheet), alone or in a mixed definition. These criteria are followed by the European Union, for instance (headcount, [turnover](#) and balance sheet totals). In summary it may be inferred: small businesses are usually not dominant in their field of operation<sup>2</sup>.

### IV. DEFINITION BY MSME ACT OF INDIA, 2006

The small scale sector as defined by the Micro Small and Medium Enterprises Act 2006 uses investment limits in plant and machinery and equipments as the criteria for defining the small. This definition, as offered by the Government of India has evolved from initial investment limit which was: fixed assets of R 5 lakhs in 1950 to its present form as per the MSME Act, 2006. The era of reforms witnessed this limit swelling to a staggering R 30 million in 1997 (with corresponding rise in the investment limit for 'ancillary' units as well). The hiking of the investment limit to R 30 million was suggested by the Abid Hussain Committee Report (Government of India, 1997). But later, this figure had to be lowered to R10 million. In 1991, Export Oriented Units (EOUs) was introduced under the umbrella of small.

However the 'historical' value of the investment in plant and machinery as a criterion has been severely criticized mainly on two counts. One, often the valuation is based on unverifiable data; and, two, even when an already registered SSI unit has crossed far beyond the prescribed limit there is no need/intent to re-register it as a medium-or large-scale unit. Nevertheless, not only has the investment criterion continued, but there have been significant leaps in its upper limit, certainly since 1980. (Das, 2006)

In this context it may be relevant to bring into focus the registration process of the small units. Registration of small units is voluntary and not compulsory. The main purpose of registration is to throw up real numbers and maintain a roll of such units for the purposes of providing incentives and support services. So small units covered under the MSME Act may or may not

register with the District Industries Centre<sup>3</sup>. The documentation is conducted in this premise, of registered and non-registered units.

**TABLE I**

**Definitional traversal of the small scale sector (1950 to 2006)**

YEAR	CRITERIA: MAX CEILING IN INVESTMENT (R LAKHS)	ADDITIONAL CONDITION/CATEGORY (R LAKHS)
1950	5 (In Fixed Assets)	50/100 Persons Employed With/Without Power
1960	5 (In Fixed Assets)	No Condition
1966	7.5 (In Plant & Machinery)	No Condition
1971	7.5 (In Plant & Machinery)	No Condition
1977	10 (In Plant & Machinery)	Tiny Units( 1 In P&M)
1980	20 ( In Plant & Machinery)	Ancillary Units (25 In P & M) Tiny Units (2 In P & M)
1985	35 ( In Plant & Machinery)	Ancillary Units (45 In P & M) Tiny Units (2 In P & M) Service Units (2 In P & M)
1991	60 ( In Plant & Machinery)	Ancillary Units (75 In P & M) Tiny Units (5 In P & M) Service Units (5 In P & M)
1997	300 ( In Plant & Machinery)	Ancillary Units (300 In P & M) Tiny Units (25 In P & M) Service Units (5 In P & M)
1999	100 ( In Plant & Machinery)	Ancillary Units (100 In P & M) Tiny Units (25 In P & M) Service Units (5 In P & M)
2001	100 ( In Plant & Machinery)	Ancillary Units (100 In P & M) Tiny Units (25 In P & M) Service Units (10 In P & M)
2006	Manufacturing: Micro: 25 Small: 5 Crore Medium: 10 Crore	Service: Micro: 10 Small: 2 Crore Medium: 5 Crore

Sources: (1) (1950-1977) SIDBI Report on Small Scale Industries Sector 2000, Small Industries Development Bank of India. (2) (1980-1999): Report on Small-Scale Industries Sector 2000, Small Industries Development Bank of India (SIDBI), Lucknow. (3) (2006: Ministry of Micro, Small & Medium Enterprises, 2007

The documentation of small units in India has been done by four official Census surveys beginning in 1973-74. Following the current definition, the recently conducted Fourth All India MSME Census with reference year 2006-07 documented the registered and unregistered units in the small scale sector on the basis of the definition provided in the MSMED Act, 2006. By registered units this Census includes units registered with the [State Directorate or Commissioner of Industries](#) or District Industries Centres (DIC's). The unregistered units are those which fall within the purview of the MSMED Act but have not been registered. The first two censuses did not include the unregistered units. Unregistered units were brought under the coverage of the census from the Third SSI Census. The First and Second SSI Censuses had enumerated only the registered units.

**TABLE II**

### Coverage of SSI/MSME Censuses

CENSUS	REF YEAR	CRITERIA
1st Ssi Census	1973-74	Registered Units
2nd Ssi Census	1987-88	Registered Units
3 <sup>rd</sup> Ssi Census	2001-02	Registered & Unregistered Units
4 <sup>th</sup> Msme Census	2006-07	Registered & Unregistered Units.

Therefore the data available from the four censuses suffer from the several limitations. The units, which satisfied the criteria laid down by the Central Government from time to time in terms of upper ceiling, in original value of plant & machinery (in case of SSIs and ancillary units) and in value of fixed assets (in case of SSSBEs) and chose to be registered at district level were included in the first and second census only. These upper ceiling limits were policy driven and were always made applicable prospectively to new units seeking registration. The new units might not necessarily be newly established units. Some of the already established units might also have sought registration whenever the upper ceiling was enhanced, as they were not eligible earlier. Hence, it is not possible to state that the list of registered SSI units as on any date in the past bore the same classification in terms of the upper ceilings mentioned above. This posed difficulties in documenting the registered as well as the unregistered SSI sector. Obviously, the definition changed with time. Hence, it may be felt that it has become necessary to fix a reference in terms of time and then prescribe a definition of unregistered SSI sector.

The Unregistered SSI sector was not surveyed earlier than the Third Census. The First and the Second Census of SSI units covered only the registered SSI units. The impact of these structural changes may be reflected in the lack of uniformity in comparative analysis of Fourth with the Third Census in terms of size, employment, exports and gross output. The inclusion of service enterprises has added more than 180 lakh new units employing 49 per cent of total labour in the sector. With the increase in investment limit, 70,038 units registered under section 2m (i) and 2m (ii) of the Factory Act, 1948, have been included in the data, suddenly increasing the number of registered enterprises. In case of exports, the previous census did not include enterprises exporting their product through export/merchant houses located in export zones like ports. To overcome this underestimation, the latest census has collected data from units exporting their goods/services directly/indirectly or both.

The Censuses however failed to capture the informal/ unorganised segment of the small scale sector which still remains out of the purview of MSMED Act.

## V. THE INFORMAL SECTOR

The question that this paper raises is that the Indian small scale enterprise sector figures that are thrown up by the Ministry of MSME do not cover the informal sector, because they are not regulated by the MSMED Act. All the unregistered units as per the MSMED Act do not belong to the informal sector.

According to NCEUS (2008)<sup>4</sup>, the informal sector consists of all unincorporated private enterprises owned by individuals and households engaged in the sale and production of goods and services operated on a proprietary or partnership basis and with less than ten total workers.

Informal sector refers to economic activities i.e., production and distribution of goods and services by the operating units of the households which essentially differ from the formal sector in terms of technology, economies of scale, use of labour intensive processes, and virtual absence of well-maintained accounts. The informal sector as per SNA, 1993 refers to productive institutional

units characterised by (a) low level of organisation, (b) little or no division between labour and capital, (c) labour relations based on casual employment and/or social relationships, as opposed to formal contracts. These units belong to the household sector and they cannot be associated with other units. In such units, the owner is totally responsible for all financial and non-financial obligations undertaken for the productive activity in question. The 1993 SNA endorses the resolution of the fifteenth International Conference of Labour Statisticians, January, 1993 in so far as informal sector concept is concerned. It embraces a widely dispersed multitude of operating units with high rates of birth and death and considerable mobility. It is informal in the sense that they are not regulated by government under any statute. Because of its labour intensive nature the informal sector provides employment to a sizable section of the population to whom the state is unable to provide adequate employment. The need for identifying this sector or bringing it under preview of legislation is required. Hence there is need to monitor the size and structure of this sector and its performance over time for framing appropriate policies.

Even though several studies use the term “informal sector”, (Akintoye, 2006; Naik, 2009) Central Statistical Organization (CSO) in India introduces this sector as “unorganized sector” in its report on National Accounts Statistics (Bairagya, 2011). An explicit definition of the informal sector in the Indian context distinguishing between unorganized and informal sector is provided by National Sample Survey Organization (2000).

According to it, the informal sector incorporates the unincorporated proprietorships or partnership enterprises not covered under Annual Survey of Industries (ASI)<sup>5</sup>. In the unorganized sector, in addition to the unincorporated proprietorships or partnership enterprises, enterprises run by cooperative societies, trusts, private and limited companies are also included. The informal sector can, therefore, be considered as a sub-set of the unorganized sector.

## **VI. UNORGANIZED SECTOR AND INFORMAL SECTOR**

The terms ‘unorganized’ and ‘informal’ sectors are often used interchangeably. In India the term ‘organized’ and ‘unorganized’ is used in National Accounts Statistics (NAS)<sup>6</sup> and other official statistics. The unorganized sector has a crucial role in our economy in terms of employment and its contribution to the National Domestic Product, savings and capital formation. To provide the small scale sector with proper policy support, the government needs to identify the sector as a whole including the organized and the unorganized segment.

In the Indian National Accounts Statistics (NAS), the unorganized segment of the economy (CSO, 1989, 2007) refers to all operating units whose activities are not regulated under any Statutory Act or legal provision and/or those which do not maintain any regular accounts. In practice, the non-availability of regular accounts has been the main criterion for classifying these units as unorganized.

The 2008 SNA (Kulshreshtha, 2011) makes the important point that good coverage of the informal sector is essential to ensure the “exhaustiveness” of GDP estimates and thus improve the scope and quality of the national accounts. The informal sector according to the 2008 SNA (Kulshreshtha, 2011) consists of productive institutional units characterized by (a) low level of organization, (b) little or no division between labour and capital, and (c) labour relations based on casual employment and/or social relationships, as opposed to formal contracts. For statistical purposes, the operational definition of the informal sector is a group of production units which form part of the household sector as unincorporated enterprises owned by households

(Kulshreshtha, 1998). The informal sector consists of: informal own account enterprises<sup>7</sup>; and enterprises of informal employers<sup>8</sup> (Kulshreshtha, 2011).

On the other hand, the unorganized segment of the small scale sector is covered through the regular survey program of the National Sample Survey Organisation (NSSO) and the follow-up survey rounds organized by the Central Statistical Organisation (CSO) after each Economic Census. Among the non-agricultural economic activities, the two major activities are manufacturing and trade. The NSSO unorganised sector surveys cover: Directory Establishments (DE), defined as non-public, unregistered enterprises employing more than five workers; Non Directory Establishments (NDE), which are like Directory Establishments but with less than five employees; and Own-Account Enterprises (OAE), which are enterprises that have no regular paid employees. These follow-up surveys thus provide estimates for the unorganized sector of the non-agricultural economy. Instead of the investment criteria followed by MSMED Act, the CSO and the NSSO use the employment criteria to identify the type of units in the unorganised small scale sector.

## VII. CONCLUSION

Diverse information on the small scale sector is available from MSME Census, Economic Census, Enterprise surveys conducted as follow up of Economic censuses, Annual Survey of Industries and unorganised sector surveys conducted by NSSO. Moreover this information is not on the same footing due to their differing criteria used in defining small. When combined together the information from these sources may lead to overlapping and incomparable information about the small scale sector. The authors argue that within India there is lack of standardisation of definition of 'small' units: following the investment in plant and machinery criteria of the MSME Act these are called 'medium', 'small' and 'micro'; again other units, which are undoubtedly small in scale are termed 'informal' units. Informal units are a subset of the 'unorganised' sector, which are included in SNA following the number of employees involved criterion in defining 'unorganised'.

At the same time, the authors posit that while investigating the issue of definition and documenting small sector, overlapping terms like informal and unorganised are used. Various agencies throw up national level figures in terms of informal sector (as given by NSS 67th Round Enterprise Survey, July 2010 to June 2011); unorganised sector (as given by NAS, 2011) and sometimes informal and unorganised used interchangeably as in the latest document of February 2012 (Report of the Committee on Unorganized Sector Statistics, 2012).

The Fourth MSME Census gives information on the size, nature of activity, type of organization, type of management/ownership and employment generated among other things in the registered and unregistered segment of the small scale sector. However the Census data does not cover all activities falling in the criteria of the informal sector even though they might as well very easily be considered under the purview of small. MSME Census uses the investment limit criteria while enumerating the small. On the other hand, the Economic Census, ASI, follow up Surveys and unorganised sector surveys conducted by NSSO use the employment criteria to enumerate the small. Within the same time frame different surveys on the same sector conducted on different footing are bound to shoot up varying and incomparable data. Observing this fuzziness in definitions, the authors suggest that a single window definition may be advocated for different agencies which address variety of issues faced by the small enterprises, be it soft loans, tax rebates, IPR protection or employment conditions may well be benefitted if such a comprehensive definition is arrived at. The GOI may entrust the Ministry of Micro, Small and Medium Enterprises to arrive at an all-encompassing definition, which will absorb all other sub categories, like informal, unorganised, etc.

Thereafter the approved definition may be binding on all issues of the economy dealing with “small”.

## End Notes

1. Summary of Size Standards by Industry, SBA.GOV retrieved from [www.sba.gov/content/summary-size-standards-industry](http://www.sba.gov/content/summary-size-standards-industry)
2. Small business, From Wikipedia, the free encyclopedia, [http://en.wikipedia.org/wiki/Small\\_business](http://en.wikipedia.org/wiki/Small_business)
3. District Industries Centres (DICs) are the Nodal Offices towards development of Industries. Since the introduction in 1978, District Industries Centres are engaged for promotion of SSI to achieve the goal of providing more employment and rendering economic development.
4. The National Commission for Enterprises in the Unorganized Sector (NCEUS) was set up by the Government of India in 2004, to "review the status of unorganized/informal sector in India including the nature of enterprises, their size, spread and scope, and magnitude of employment".
5. The Annual Survey of Industries (ASI) conducted by the Central Statistical Organisation (CSO), Ministry of Statistics and Programme Implementation gathers information on “registered”, or formal sector firms that are covered by Sections 2m(i) and 2m(ii) of the 1948 Factories Act and firms registered in the 1966 Bidi and Cigar Workers Act—particularly (i) those firms that use electricity and hire more than 10 workers; and (ii) those that hire more than 10 workers but nevertheless employ 20 or more workers. It also covers certain utility industries such as power, water supply, cold storage, and the like. Units with 100 or more workers are categorized under the census sector and are completely enumerated, while the rest are categorized under the sample sector and are surveyed based on a predetermined sampling design.
6. The organized segment of the economy in the NAS broadly includes all large mining enterprises, manufacturing enterprises registered under the Factories Act 1948, and private and public corporations engaged in non-manufacturing activities. They are called organized because statistics on their activities are available regularly from budget documents, annual reports in the case of the public sector, and through the Annual Survey of Industries (ASI) in the case of registered manufacturing. All other operating units regardless of their kind of activity are in the unorganized segment.
7. Informal own account enterprises are owned and operated by own account workers. They may employ contributing family workers and they may also have paid employees but only on an occasional basis. Depending on national circumstances, either all own account enterprises may be defined as informal or only those which are not registered with the tax authorities, the statistical agency or other government body.
8. Enterprises of informal employers employ one or more employees on a continuous basis and depending on national circumstances they are defined as informal according to one or both of two criteria: number of employees and non-registration of the enterprise or its employees.

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