



ASIAN CENTRE FOR
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DEVELOPMENT AND EDUCATION
AN INDIA SME FORUM INITIATIVE

Cluster Approach for MSME Development

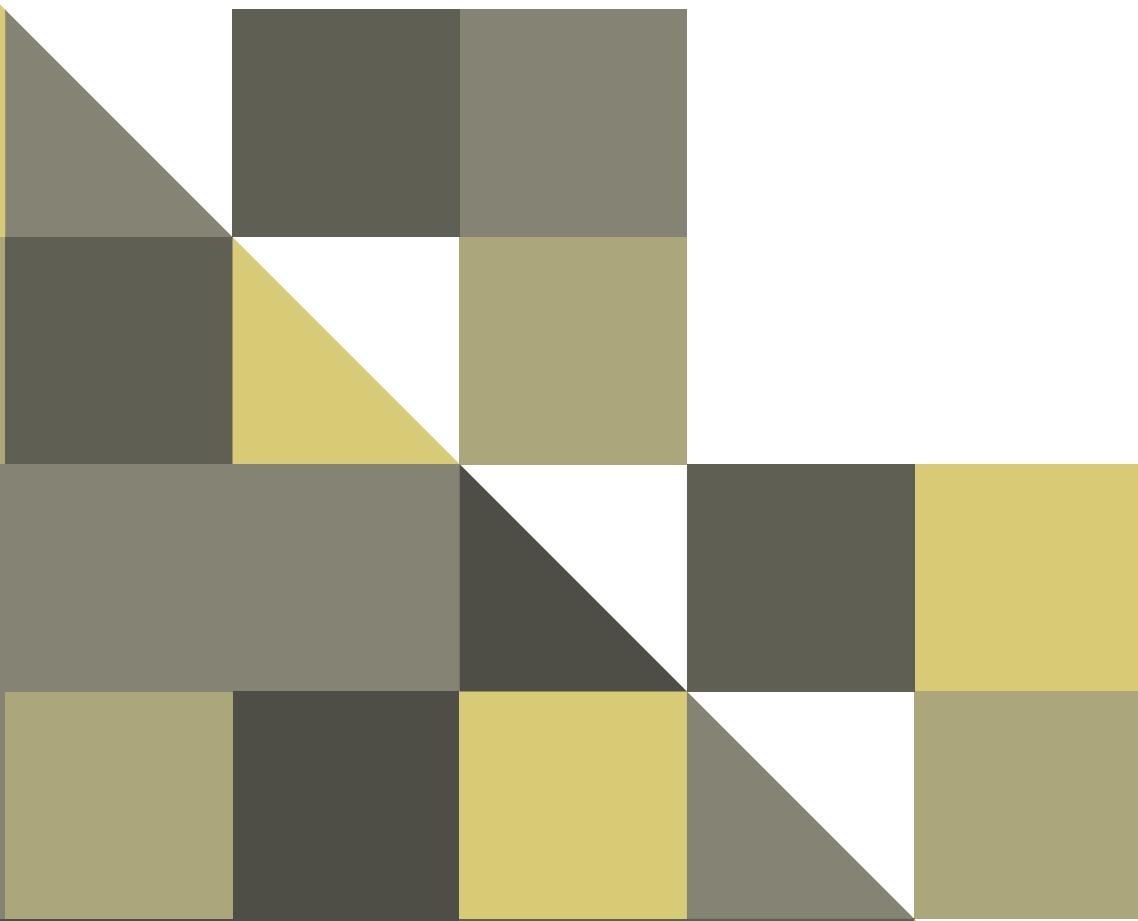
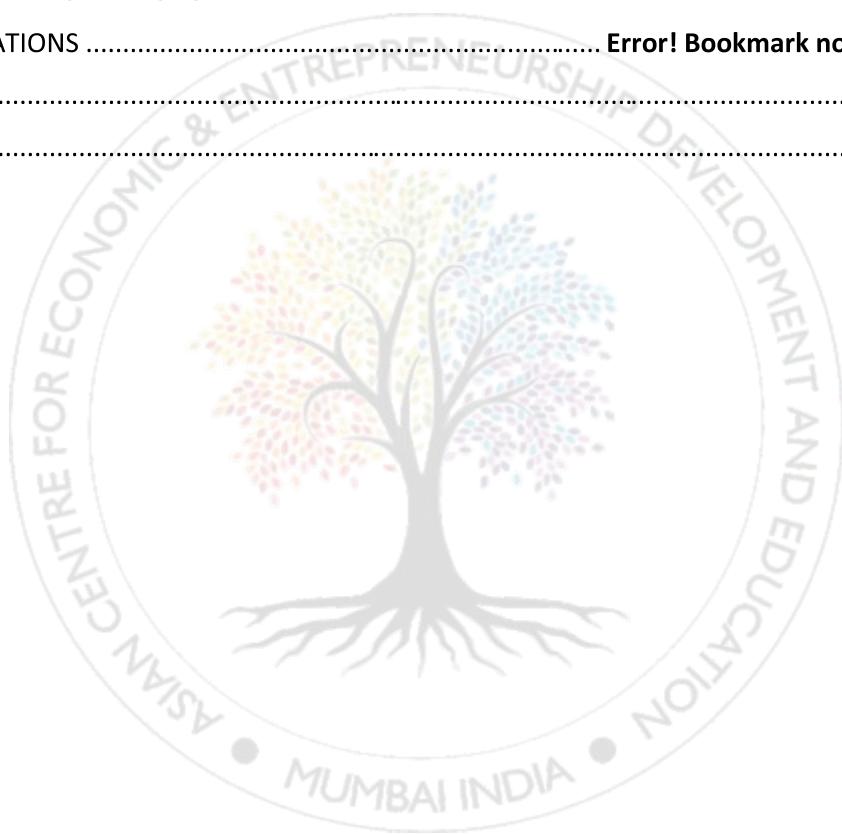


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INTRODUCTION

Micro Small and Medium Enterprises (MSME) play a major role in most economies, particularly in developing countries. MSMEs account for the majority of businesses in the world and are important contributors to job creation and global economic development. They represent about 90% of businesses and more than 50% of employment worldwide. Formal MSMEs contribute up to 40% of national income (GDP) in emerging economies. These numbers are significantly higher when informal MSMEs are included. In emerging markets, most formal jobs are generated by MSMEs, which create 7 out of 10 jobs. MSMEs are a source of employment, innovation and competition, they provide impetus to the entrepreneurial spirit and a way to proper utilization of skills, because they enjoy a vast geographical presence as compared to big companies, MSMEs also contribute to better income distribution.

The importance of MSMEs for an economy is so critical that most policymaker and development practitioner consider the health of the MSMEs sector as a priority factor for conducive environment to achieve that growth.

For a developing country and economy MSME development is the key component of wider economic development and a source to reduce poverty as the MSME sector is also seen as the major contributor of the employment and income.

There is also a widespread belief that a thriving SME sector fosters competitiveness and an entrepreneurial culture, both of which are beneficial to economic growth. Furthermore, since they cross the boundaries of commercial activity, MSMEs are frequently perceived as being more flexible and agile, as well as more inclined to innovate, than their bigger and more established colleagues.

Micro, Small and medium-sized enterprises (SMEs) provide crucial industrial linkages to set off a chain reaction of broad-based industrial development. Without SMEs as subcontractors and suppliers of intermediate inputs to multinational enterprises (MNEs) and domestic large-scale enterprises (LSEs), industrial growth in developing countries may not be able to sustain increasing domestic value, employment, productivity, and industrial linkages. Hence, growing competitiveness of SMEs becomes a critical issue.

MSMEs hold much promise for spread of economic activity across space generating income and employment. The ability to respond effectively to fast changing global market signals through remarkable resilience has been noted as a potential attribute in achieving MSMEs, mostly in the industrialised nations of Europe. It has also been recognised that firms in a cluster tend to benefit not only from economies of agglomeration (scale and scope) and social embeddedness but have shown promptness to be innovative at the unit level itself. This positive aspect of industrial clusters in inducing technological dynamism in MSMEs has also resulted in the unit's gaining confidence in participating in the global market, often facing tough competition from established large domestic firms or MNEs. This interaction in the global arena in both technological and trade spheres, seen as a crucial characteristic of internationalisation, has important implications for MSMEs in Asia, particularly, in the late industrialising and chronically lagging regions. It is now widely observed that cluster level intervention could be the most effective step towards encouraging and strengthening elements of competitiveness in the local MSMEs. Promoting industrial clusters is seen as an important strategy of development intervention, especially, in developing nations; there has been a remarkable surge of efforts by both global institutions like UNIDO, ILO, UNCTAD, World Bank and national/ state governments.

WHAT IS A MSME CLUSTER?

“Clusters promote both competition and cooperation. Rivals compete intensely to win and retain customers. Without vigorous competition, a cluster will fail. Yet there is also cooperation, much of it vertical, involving companies in related industries and local institutions. Competition can coexist with cooperation because they occur on different dimensions and among different players.”

Michael Porter (1998)

A Cluster is a geographically proximate group of interconnected companies and associated institutions in a particular field, that share common markets, technologies, worker skill needs, and which are often linked by buyer-seller relationships. Industrial clusters are increasing recognized as an effective

means of industrial development and promotion of small and medium-sized enterprises. In fact, the Ministry of Micro, Small and Medium enterprises (MSME) adopted the cluster approach as a key strategy for enhancing the productivity and competitiveness as well as capacity building of small enterprises. The issue of effective Cluster management has gained immense popularity amongst policy makers as a very important tool of intervention. Recognizing this, Clustering and Aggregation is one of the identified areas for focus in the National Manufacturing Plan (NMP). Even though clusters and networks vary, however, both are observable and connected. Networks are the alliances belonging to group of companies that function together to achieve an economic objective and cooperate based on joint development projects while complementing one another and specializing to solve common challenges and reaching a collective efficient goal while conquering markets that would have been too difficult to reach on their own. These can be set among clustering firms and those that are present outside of these clusters. These networks can function vertically or horizontally.

MSME Clusters share many common features such as :

1. Same supplier of Raw materials & other inputs
2. Catering to the same markets and clients even when producing different goods
3. Share the same territory, infrastructure, services.
4. Face Common Obstacles & Challenges.

MSMEs are often unable to realise their true economic potential and achieve economies of scale. Due to this they find it difficult to take the benefit of market opportunities available to them. They lose mostly due to limited bargaining power in input purchase, inability to arrange for specialized support services & have no influence on support policies and services.

Through a support of cluster MSMEs can achieve high level of growth through their steady quality improvement and adding value, while adhering to the social, environmental and labour standards. The growth of a cluster is a result of collective efforts of the cluster enterprises like joint bulk input purchase, joint advertising & shared use of equipment between enterprises and their support institutions like provision of technical assistance by business associations or investments in infrastructure by the public sector.

A cluster will not ensure that entrepreneurship will flourish or that enterprises will generate sustained return. Even in Cluster MSMEs face difficulty for growth. But in isolation MSMEs are at a huge disadvantage. The Non-Performing clusters have some common things among them which lead to their poor performance like unhealthy competition based on lowering wages, disregarding workers welfare, minimizing investment in technology and depleting natural resource.

There are other factors that lead to non-performance which are poor coordination and cooperation between enterprises, which were mainly due to transaction costs, coordination costs & adverse business culture.

Clusters add value to the development of the economy by creating groups of networked businesses in specific sectors and improving business capabilities by offering tailored support. They improve competitiveness, seen in a dynamic and global context, i.e. closely associated with innovation and the adoption of 'best practice'. They enable economic specialization of a particular region, in a range of related activities. Clustering allows for a differentiated approach, targeted at a wide range of economic activities, which takes into account the variation in industrial structures and business needs. Clusters can contribute to an increase in economy-wide competitiveness by facilitating policy reform, fostering private-public dialogue and becoming a catalyst for wider private sector development initiatives.

BENEFITS OF CLUSTER DEVELOPMENT

AT THE LEVEL OF FIRM

Clusters at the company level assist businesses in seizing market possibilities that they could not achieve on their own. Clusters can lower cost and risk "pain barriers" by adapting international laws and standards to the local circumstances. Companies can no longer rely primarily on internal procedures and capabilities. Companies must change swiftly and generate suitable answers at a faster rate to keep up with innovation, technology progress, and increasing customer expectations. This is when pooling resources, combining efforts, and using synergies to gain a competitive edge while lowering the risks of launching new goods or entering new markets. Clusters help organisations increase their capacity by facilitating inter-company learning, experience sharing, and the sharing of know-how. Finally, there are advantages in terms of

corporate administration. For example, using shared sales channels complements each individual cluster member's sales networks; staff sharing (particularly in specialised areas like R&D) decreases costs and time to market.

REGIONAL AND SECTOR LEVEL

The capacity of a cluster to increase the profile of a certain sector in a specific place locally and globally is the source of regional and sector gains from clustering. This will boost the appeal of both for investment, since it is a sign of a 'business-friendly' climate in an area with enough governmental backing and governance.

CHALLENGES FACED IN CLUSTER DEVELOPMENT

There are certain challenges that cluster initiators and leaders are confronted with when attempting to construct a cluster. When attempting to construct a cluster, cluster initiators and leaders face a number of obstacles. One of the most evident is cultivating a cooperative atmosphere among cluster members and participants. Building trust is a difficult task, thus command and control methods, norms of engagement, and the "how we will operate together" should all be thoroughly considered and agreed upon from the start. It is necessary to implement and monitor a coordinated decision-making framework. • Agreement on the use of patents for newly created product and process innovations are two other common problems.

- Exposure of one's own expertise if competitors have access to it
- Profit distribution
- Partly longer process time as a result of comprehensive coordination efforts by the players involved
- Lack of time to deal with additional responsibilities required by a cluster (cluster tasks that could interfere with day-to-day work)

Clusters are complicated entities, and a wide range of activities can have an impact on their evolution. The problem is to choose and marshal the many policy tools available to get the best results. The technique that follows concentrates on activities that may be targeted directly at clusters, although it is anticipated that planners would examine the whole range of interventions that impact economic development in general, and hence clusters, when making policy.

Given the complexity of cluster operations, fragmented techniques addressing individual components are unlikely to yield optimal outcomes; instead, a systematic, integrated, and holistic approach is required and suggested.

MSMECLUSTER DEVELOPMENT STRATEGIES

The success of a MSME Cluster is largely due to people forming quality relationships and networking to achieve desired results. These linkages are mainly informal support through formal organisations. Clustering builds on the teamwork that is already in place and formalises it into a framework.

The main framework for successful clustering involves :

Cooperating towards common goals – Firms and others within a concentrated geographical region working together to increase their collective competitiveness by building links and working alliances. Clustering allows a group of closely situated businesses and organisations to become a high-performing system. This works at the system level rather than at the level of individual organisations. Firms and support organisations working together to achieve objectives that would not be attainable alone make form a dynamic local cluster.

Business networking - widespread informal and formal networking between enterprises – even rivals – throughout the cluster, as well as between firms and their supporting infrastructure – is a vital component of any high-performance cluster. Both 'soft' and 'hard' networks (strategic relationships between businesses) are critical. The growth of these networks is aided by a local culture that encourages both rivalry and collaboration. It entails far more than simply lobbying the government under a different guise. While clustering is an efficient way to acquire access to government entities and communicate local goals, the formation of a framework for broad changes in areas of common interest is more significant.

Teamwork is a critical component of a local innovation system ; innovation increasingly relies on close collaboration between the scientific community and the private sector, with the most effective communication of tacit information occurring when the cluster's various components are close to one another. Different technologies are being used in new goods, and technologies are increasingly based on many scientific fields. A important component of a high-

performance innovation system is the degree of connectedness among knowledge agents and between them and enterprises. Businesses, especially specialised SMEs, seldom have the means to innovate on their own. Firms will likely stay isolated from knowledge agents unless an effective incentive mechanism is in place to foster links.

Linking and aligning all aspects - A successful clustering strategy connects the many elements of an innovation system, aligns the private and public sectors, and promotes a 'whole-of-government' approach at the local level in support of local clusters. It's about public servants recognising that their job is to promote, encourage, and develop new ways to do things rather than monitoring and patrolling a set of bureaucratic rules and regulations.

To Develop a Successful cluster the implementation needs to be strategic and Govt. Plays a Important role

Create policies which support and encourage not prevent and discourage:

Effective clustering need top-down policies that permit and encourage it. Government is the body that formulates and decides national policy. Effective policy frameworks connect the many aspects of an innovation system and align the private and public sectors in a systematic and coordinated "whole-of-government" approach to entrepreneurship growth. This is what alignment entails: aligning policies, tactics, and people to work toward a common objective of economic progress and betterment for everyone.

Collaborate and cooperate in networks:

The government should strive to become an intrinsic component of networks and networking, giving support for systems as needed. Many clusters have their origins in the various efforts performed across the world to promote and support inter-firm collaboration through networks. Networks were thought to need cluster-based commercial associations. Networks should not be confused with networking, which is more process-oriented. The former is a formalised partnership of companies; the latter is a social phenomenon involving personal contacts that distributes and promotes ideas, knowledge, and best practises within a cluster and imports them from other places. Competitive clusters require the capacity to network broadly as well as selectively construct networks.

Re-organise Government services delivery structures

Many government services are fragmented; for example, training, education, financial, technological, and promotional aid are frequently handled by many ministries and organisations. By changing from a solution-based to a problem-oriented approach, from independent to interdependent demands, and from individual to group interests, these may be reformed as cluster oriented. By using intermediates or brokers to signpost to services, or by establishing one-stop-shop service centres for clusters, such reorganisations can be achieved with minimum disruption. The establishment of cross-agency teams with cluster expertise would be a more substantial shift in strategy. The most significant change would be the establishment of new agencies that correspond to major clusters. Staff must have direct industry knowledge and a thorough understanding of the industry in all circumstances.

Re-organise government information delivery services

A useful action at the disposal of government is re-organising the delivery of its own information and services. Clusters offer an opportunity to deliver information and services in an alternative manner by ensuring that these are cluster oriented rather than broad-based. Most countries organise and publish economic data by sector and economic region or labour market but not by cluster.

Data aggregation and publication for clusters designated by the state or commercial sector would be beneficial to regional and local development agencies, cluster organisations, and service providers. Clusters and agencies might use employment, company startup statistics, growth rates, and market estimates to plan and implement programmes. It is critical to provide more than just local information. Clusters are constrained to learning just inside their own boundaries and are cut off from sources of fresh information and technology that help them establish competitive positions when they lack access to external best practises and markets, as is often the case in transition economies. Although the Internet helps to alleviate some of this isolation, it cannot replace the benefits of first hand experience and larger human interactions. The Government can further support in

this area by providing support for trade missions, visits to international exhibitions and, particularly, focused study tours to relevant and appropriate

locations.

Create entrepreneurial support and learning networks

Entrepreneurs and young firms have a greater need for networking than existing companies because they have less experience and no established routines. They thrive on information, advice and knowledge. The most effective networks are based on some sort of existing relationships among entrepreneurs, such as incubators, economic development programmes, common sources of capital, associations, etc. Innovative companies can benefit greatly from networks forming, for example, around common problems or specific technologies.

Promote the development of cluster skill-centres

Rather than expecting every technical and business college to meet the specific needs of all firms, regions could designate centres of excellence around clusters. Cluster skill centres, associated with an existing institution, could become the lead entities for surveying industry needs, developing new curricula, staying in touch with cluster councils, updating skill standards, benchmarking practices in other areas and generally collecting information about cluster occupations and programmes. The centre need not be bricks and mortar but can be a 'virtual' centre that might organize teams from various educational institutions to work on particular problems, conduct R&D, or develop curricula — and all products and information would be readily available throughout the country. Skills centres can help firms determine which training programmes have the most relevant teaching experience, technologies and track record with the industry. They can also provide on-site outreach and access to socially excluded populations.

Stimulate innovation and entrepreneurship

Innovation and entrepreneurship are the engines of cluster development and growth. Most clusters have been formed by entrepreneurial employees of existing employers in pursuit of expanding supply chains or new market potential or in response to a company downsizing or closing. Although both innovation and entrepreneurship are influenced heavily by a region's educational processes and cultural norms, they can be enhanced by deliberate supporting policies created and driven by Government.

Create enabling financing vehicles

New ideas and innovations, new business formation and expansion are amongst the most important strategies for cluster development. Embryonic clusters include many new and potential entrepreneurs. Cluster oriented investments needs range from seed-capital and product development funds, to venture capital for entrepreneurs, to working capital for more mature and expanding firms. Government support can be provided by setting up appropriate financing mechanisms and by ensuring minimum bureaucratic regulations and impediments to access these funds.

Promote the use of incubators

Incubators are now widely used instruments for supporting new and small business enterprises, the basic concept being provision of low-cost shared space and services, combined with technical assistance. Limiting tenants to potential cluster members justifies more highly specialised services and assistance, promotes inter-firm business within the incubator and encourages learning and technology transfer among firms.

Create technology centres Many developed economies have invested in technology centres as part of regional economic development policies. The centres are often associated with educational institutions but some are independent. A focus on local cluster technologies can successfully stimulate innovation and facilitate technology transfer.

Use clusters as a promotional tool

Countries around the world have used clusters to promote themselves as a desirable place to visit and do business. Scotland, New Zealand, Canada, Spain and Ireland have all effectively used clusters to market regions to investors and customers.

Support the development of export networks

Individual small and mid-sized companies lack resources and knowledge of other countries to effectively exploit global market opportunities. Government can support the formation of cluster-based export associations. The purpose is to pool individual enterprise knowledge and resources to create a critical mass which can be used to identify and exploit export opportunities. Often the

result is a forum for cooperative behaviour that stretches well beyond exporting

CONCLUSION

Over time, the MSME environment has evolved and progressed up the value chain. The MSME industry has progressed from conventional product production to considerably more hybrid goods and value-added services. The collaborative strategy taken by MSMEs has aided this shift significantly. Due to their modest size, MSME firms that previously struggled to achieve economies of scale, specialisation, and innovation are now rapidly benefiting from the introduction of industrial clusters. Small businesses can use clusters and associated networks to combine the benefits of running a small unit with the scale and specialisation given by large units. In India, approximately 600 industrial SMEs clusters and over 7,000 artisan/micro enterprise clusters are now operational.

Furthermore, the country has around 2,500 undeveloped rural industry clusters. Some of these clusters are so huge that they account for approximately 80% of the country's output of a certain commodity. MSMEs have been able to overcome constraints such as technical obsolescence, supply chain ineptitude, global rivalry, and investment limitations thanks to the networking method. Furthermore, clusters are classed as export-oriented or specialised domestic to capitalise on the benefits of a certain target client base. The textile and marine processing clusters in Tirupur and Vizag are mostly focused on exports. MSMEs in specialised domestic clusters like as Jamshedpur's engineering cluster and Pune's auto cluster, on the other hand, provide the needs of major domestic MSMEs and the Growing Role of Industrial businesses.

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