

Benefits and Challenges of Sustainability Practices of Indian SMEs

Case studies from National Capital Region

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Abstract

This paper explores the sustainability practices of some small and medium enterprises (SMEs) of National Capital region of India. The basic research questions put forward in the paper are mainly to understand the nature of sustainability practices, the challenges and opportunities faced by firms in terms of net benefits, and to come up with a plausible public policy framework. This is an exploratory study and seven case studies have been conducted based on semi-structured questionnaire for seven SMEs & open ended questions for industry experts. For the purpose of the study a purposive and convenient sampling technique was adopted and seven companies were selected from three manufacturing sectors, viz., Auto-component sector, Readymade Garment Industry and Electronics, to generalize the results across overall manufacturing practices. Two companies from auto-component sector, Four companies from Readymade Garments and one company from Electronics Sector were included in the study. Given the degree of environmental and social sustainability challenges posed by government policies and international market and buyers' demands for compliance, the paper has developed two propositions – 1. SMEs sustainability and CSR measures are reactive and depends on compliance and regulatory requirements of an industry; and 2. Perceived Net Benefits are almost zero and could be enhanced through cluster-level initiatives. For small-scale sector social initiatives undertaken are mostly for the welfare for their internal stakeholder-employees, however the medium-scale companies still try to explore beyond employees, but not in a constructive manner. Cost of implementation is a challenge for companies in garment industry, however all companies believe that real impact could be created by pooling funds to initiate a mega sustainability project at cluster level. The awareness of real benefits from sustainability practices by medium-scale companies is low, particularly lower in auto-component sector. Thus the paper suggests a mix of command and control and incentive based approach for SMEs meaningful contribution towards sustainable development.

Keywords: Sustainability practices, environmental and social compliance, net benefits, SMEs, public policy

Introduction

Sustainability concept essentially is centred on three major areas of a firm: economic performance, social and environmental performance of a firm. Today in terms of environment the entire world is facing a crisis, viz., global warming and climate change. Under such a circumstance many developed and developing countries have started undertaking a more cautious approach in regulation. In such a situation any firm in the globe faces three types of

risk: physical risk in terms of existence of a particular firm under extreme climatic condition, operational risk out of scarcity of resources and regulatory risks.

Most of the Indian Small and Medium Enterprises (SMEs) like textile, auto ancillaries and components, engineering, chemicals and electronics generate pollutants in their production process. Thus their regulatory risks are high. Following sustainable development measures an enterprise company can gain competitive edge in this market with a focus on sustainability. Moreover the issue of competitiveness in terms of increasing compliance costs has led to the question of how far it is feasible and possible for a firm to internalize such costs.

Sustainability practices in companies have now become increasingly significant for corporate sector after the introduction of the mandatory requirement of CSR in company law and sustainable development in government guidelines. Not only that, exports of Indian goods have to fulfil a set of sustainability norms as a requirement from importing countries. Though the sustainable development practices for SMEs are not mandated by the government of India, but mandate for large corporations and export requirements have made the SMEs follow sustainability practices in the value chain. In the process sustainable development strategies may prove to be a cost burden for these enterprises. Another interesting area to explore is whether there are any benefits in terms of competitive edge that these SMEs may derive by adopting the measures of sustainable development.

There is another argument in this context. Small and medium enterprises are said to be more pollution intensive due to the lack of adoption of advanced technology which need huge investment. In such case can these firms contribute to sustainable development strategies by working in terms of Triple bottom line approach? If that be the case then what is the public policy implication of making these firms work towards sustainability at low cost? In such cases does the medium enterprise or a small enterprise requires some tax incentives or subsidies to work towards this goal?

Here it is also interesting to study a case where SMEs are very old and had grown with the help of government reservation policies getting benefits of export promotion and subsidies and tax exemptions. In such a case whether a small or medium enterprise is working towards sustainable development goals and contributing towards economic, social and environmental sustainability? What should be the public policy framework in order that these firms deliver towards achieving sustainable development goals?

In this context the major research questions are as follows:

1. What has been the nature of sustainable development practices by SMEs?
2. Are SMEs advantageous in terms of net benefit while incorporating sustainability strategies?
3. What should be the public policy implication to promote sustainable development practices of SMEs?

Section two presents a brief survey of literature, section three describes the research methodology adopted, section four presents the study of cases in auto-component sector, section 5 presents the case study on garment sector, sector 6 talks about sustainability

practice of an electronic company and section 7 analyzes and consolidates all the findings and policy implications.

2. *Brief Literature survey*

As far as the definition on sustainable development goes, one of the very common definitions has been forwarded by the Brundtland Commission report (1987) as “....development that meets the needs of the present without compromising the ability of future generations to meet their needs.” However Hart(1997) had indicated in his paper that sustainability is beyond pollution control. Elkington (2001) formulated the Triple bottom line approach of Economic, Social and Environmental aspects of organizational sustainability.

There are few studies on the sustainable development of SMEs at international level. A study by Vargas (2000) suggests that microenterprises success’ depends on community based sustainable development. Community integration is necessary to promote sustainable development. Olaru et al (2010) showed that as far as the European excellence model of quality management is concerned, SMEs in trade in Romania exhibit a poor score in integrating sustainable development. They are only concerned in meeting compliance requirements and therefore focus on continuous progress in integrated development is missing.

As per the European commission definition business responsibilities are mainly related to its immediate relevance on social and environmental impact. Large businesses do have such immediate concerns to address. However as far as small business operations are concerned these concerns may not be immediately relevant to their business (Nair and Sodhi, 2012). Also unlike large companies these companies do not fall under the purview of the Company law mandate on CSR in India. Thus SMEs in Indian economy had been involved in social responsibilities in a very informal manner (Nair & Sodhi, 2012).

Shen et al (2015)’ s rigorous work using Analytical Hierarchical framework (AHP) has identified some common barriers of CSR implementation among SMEs in textile industry. Among these barriers financial constraints have become the major barriers followed by barriers like lack of customer awareness, lack of standards and regulations. Role of Top Management and lack of social audit have been identified as some of the other barriers. This study was in line with few more studies on implementation issues of CSR in SMEs. The most notable among them are that of Sweeney (2007) and Arevalo and Aravind (2011) which also pointed out that lack of resources including financial resources is the major constraint. Cost of implementation of CSR in SMEs is the main challenge.

Shen et al(2015) had also given suggestions that Government of India can provide tax and subsidy incentives to the SMEs in garment sector. Also the paper highlights on ethical standards and suggested that such standards must be defined by the government and defined and practised by the management of SMEs.

3. *Research methodology*

An exploratory study was conducted as similar work is not very evident from literature particularly for India. Qualitative Case based research method is adopted. Semi-structured interviews with SME officials and various Industry Associations and experts in this field, with each interview lasting for 90 minutes, are conducted. Seven Case studies from different manufacturing sectors were undertaken in this study. Content analysis of these interviews were made to address the research questions.

Unit of Analysis:

A multi-stakeholder approach was adopted, collecting opinions of 7 experts at the cluster level (industry associations) and also conducting interviews with the company officials were conducted.

3.4 Sample selection and sampling technique

The sample frame is limited to the medium and small enterprises of NCR region. There are many SMEs across sectors like Auto components & ancillaries, textile & garments, IT, chemicals, electronics and engineering. Thus the sample selection is based on the respective industrial association that could be accessed in Gurgaon, Manesar, Faridabad and Okhla catering to Auto-components & ancillary and Textiles & garments. Due to poor responses from companies, a purposive and convenient sampling was adopted. 25 companies were contacted, however a total of seven companies responded to the study. For generalization purpose, these seven companies were mainly selected from three types of manufacturing sector. Two companies from automobile sector, four from garment sector and one from electronic sector, were finally included in the sample.

3.5 Criteria for Sector selection and Sample Description

The study included three manufacturing sectors: Auto-components, Garment and Electronic Industry. The criteria of selection is based on the presence of small and medium scale units in and their importance in overall GDP of the country. The second criteria are the sustainability challenges of these sectors. The sector and sample description are presented in sub sections for the three sectors:

3.5.1 Description of Auto-component Sector and Sample Companies

Auto component industry is one of the important industries in India's GDP growth. This sector is a major contributor to pollution. In drive transmission and steering parts, suspension and braking parts and other ancillary activities, low cost technology and small parts are produced, thus leading to presence of SMEs in these divisions. (Source: CRISIL RESEARCH, 2015). Overall the industry has environmental and social compliance challenges like air pollution, water sustainability, energy consumption, waste management & recycling and occupational health hazards.

Two companies were selected for case studies in this sector from NCR region: One company, A.S. Industries, does moulding and painting; and the other company Talbros Automotive components Ltd. produces auto-ancillary parts. A.S. Industries is a 23 year old company whereas Talbros is operating since 56 years. Both started as small scale units and over the years they became medium enterprise and very recently they have started operating at large scale (As per the definitions of Ministry of MSME)¹. Investment in A.S Industries is much higher than that of Talbros. 5000 employees work for A.S., whereas only 700 employees work for Talbros. Both Talbros and A.S are part of Auto Component Manufacturing Association (ACMA). A.S. Industries receive some tax concession benefits but Talbros receives none. Both the industries follow the environmental and work-environment related compliance standards and they are OHSAS 18001 and ISO14001 certified.

¹ Definitions in Manufacturing sector under Ministry of MSME, Govt. of India are: Microenterprises are those which have investments upto Rs 2.5 million, Small-scale enterprises are those which have investments in between Rs 2.5 million to Rs 20 million and medium enterprises investment limits are between Rs 20 million to Rs 50 million, beyond Rs 50 million are large-scale enterprises.

3.5.2 Description of Readymade Garment Sector and Sample Companies

Readymade garment is a more labour-intensive industry, mostly run by SMEs. They manufacture garments and supplies the products to large branded apparel houses. This sector depends on skill, creativity and innovation. 40% of the products are exported. Raw material costs are proportionately high and subject to volatility. Thus profit margins are low (Source: CRISIL RESEARCH, 2015). Economic Sustainability of small scale sector is weak. Foreign Trade Policy of 2015 has incorporated necessary export incentives to provide an economic boost to the sector. Environmental challenges are there with respect to water conservation, energy conservation and waste management.

Four case studies were undertaken out of which two were small units and two medium units. Two small units are Addagio Overseas and Neetee Clothings Pvt. Ltd. Both these small units have economic sustainability challenges. However to satisfy the environmental and labour compliance laws they have undertaken sustainability measures. The two medium units are Matrix Clothings Ltd and Afflatus International where both the companies have invested in a huge manner over and above medium industry investment norm of Rs 50 million but still operating at medium scale. Matrix Clothing has opened up a unit abroad. These companies are economically well settled. Except Addagio, all are 100% Export oriented units (EOUs).

3.5.3 Description of Electronic Sector and Sample Company

The third sector chosen for the study, Electronics sector, can be divided into six categories with varied demand and different business dynamics. The company, Deki Elcetronics, considered in the study produces plastic film capacitors and belongs to industrial electronics. Most of the domestic demand is catered by Industrial electronic segment. The costs of raw material is 70% of the total costs of the electronics industry as a whole. Operating margin is 7-10% (CRISIL Research). There are major regional trading arrangements and bilateral trading arrangements for electronic exports from India to other countries based on Environmental, Health and Safety standards of respective countries². This includes various countries' norms to be followed for quality measures for safety purposes of electrical and electronic goods, hazardous products, e-waste standards and packaging standards. Thus an export oriented unit needs to ensure these standards of importing countries and therefore sustainable development practices are usually followed in exportables.

This company is running for 32 years. It is a medium enterprise with 610 employees and a present investment of Rs 40.33 crores. Initially the company started as small scale unit with initial investment of Rs 56.2 lakhs. This shows that the company is highly capital intensive. It produces plastic film capacitors. It is not part of any industry cluster. They do not face any kind of challenge from the clients/customers. The company caters to compliance requirement by importers including RoHS (Restricted use of Hazardous Substances) and REACH compliance related to use and restrictions of chemicals.

4. Major Findings of sustainability practices in auto-component sector

- Water sustainability is a challenge in A.S. They have installed proper Effluent Treatment plant and Sewerage Treatment Plant. They use waste water for Gardening purpose. They also buy water to meet the industry requirement as

² A joint study by Federation of Indian Micro and Small & Medium Enterprises (FISME) and ELCINA Electronics Association of India (2009)

in Gurgaon there is strict NGT norm on using boring ground water within plant due to the issue of ground water depletion. The General Manager HR of the company comments as follows:

- Talbros has a challenge of sound pollution though they comply with the standard limit. As their production process demands more energy consumption they have taken a lot of steps to reduce energy consumption by energy conservation methods using low- consumption ACs and machines, changing lighting system into LEDs and installing solar units within their plants.
- As far as CSR policies are concerned both the companies focus is on training, skill development and women empowerment. AS industries have opened a tailoring school for women that makes aprons for their own workers.
- Both the companies do not see any real opportunity in CSR , but regard CSR as philanthropic activity as a corporate citizen. However, AG industries' CSR is more of strategic CSR involving its own employees and engaging community. But CSR is more of philanthropic donations to NGOs for Talbros.
- Both maintain a proper Safety, Health and Environmental Standards. The companies provide Personal Protective Equipments as a safety norm to the employees.
- It is concluded that sustainable development practices are costly affair for firms in auto-component sector without any real benefits being felt.

5. Major findings in Garment Industry

- The sustainability practices of Garment industry are centred around carbon foot-printing, water foot-printing, energy conservation, waste management, occupational health and safety and employee welfare. The medium enterprises are able to invest in community services, but small scale sector is more interested in compliance norms. Thus they do not have the incentive to invest in community services
- Cluster level initiatives are remarkably good in promoting sustainable development practices
- Both small scale and medium scale companies emphasize on benefits of these practices that would lead to workers retention, productivity enhancement of workers, scope for innovative thinking. The two medium enterprises also believe that it would lead to image building in international market and cost competitiveness.
- However all the four firms find costs and resource constraints to be the major disadvantage to implement an impactful sustainable development programmes in the companies. Thus costs are more than benefits
- Cluster level initiatives are appreciable and thus implementing a Mega CSR project by pooling funds can actually be realized. So far the implementation for each company is participative and that would benefit each member organizations' employee welfare or carbon/water foot-printing measures. More initiatives like together contributing for Gurgaon Jail prisoners' livelihood enhancement are more required.

6. Major findings of Electronic Sector

- Deki being a capital intensive sector operates at medium scale and therefore has proper sustainability practices due to compliance standards required by

international customers to gain market access. However their initiatives are quite innovative in nature

- CSR activities are both centred around employee welfare as well as community services
- The only benefit perceived by Deki is promoting brand image in international market
- They do not perceive any cost challenges however they feel that implementing impactful CSR and sustainability practices have major cost implications. They also believe in cluster based mega projects and networking effect through cluster economics for effective implementation of sustainability practices.
- Just like auto-component sector benefits and costs are not perceived clearly owing to capital intensity of the sector. The perception and practices are more close to auto-component sector.

7. *Discussions and Policy implications*

All medium enterprises today which are aiming to produce at large scale and some of them becoming global, had all started as small scale units in 1980s or 1990s deriving all the government benefits. Irrespective of whether they are part of any cluster or not, certain benefits of government are still being enjoyed by the enterprises in terms of reimbursement schemes, duty drawback schemes or Lean implementation subsidy schemes. In that sense the deliverables in terms of “giving back to the society” by medium enterprises are supposed to be much more robust as compared to small scale enterprises.

This research tries to explore the degree of impact of the sustainability practices, based on seven case studies in three manufacturing sectors – auto-component, readymade garments and electronic sector which are quite diverse to each other having different environmental and business risks implications. The discussion is based on the three research questions envisaged in this study.

7.1 *Nature of Sustainability practices of SMEs*

The sustainability development practices can be divided into two:

- Environmental sustainability
- Social sustainability

The practices of environmental and social sustainability of all companies are undertaken by mandate and not voluntarily for all SMEs and large scale firms, except Deki Electronics which has tried to create an impactful CSR programme. With respect to Environmental sustainability all large and medium scale firms have major schemes in reducing carbon footprint, water footprint, energy conservation, waste management and occupational health and safety standards. The degree of implementation of the same schemes is of much lesser intensity in small scale enterprises. The table 7.1 presents the degree of intensity with respect to various environmental problems.

Company Name	Sector	Air pollution	Water pollution	Water conserve	Energy conserve	Waste elimination	Occupational Health and Safety
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		measure	measures				
AG industries	Medium Auto-comp	Normal	Normal	Normal	Normal	High	High
Talbros	Medium Auto-comp	Normal	Normal	Normal	High	High	High
Addagio	Small Garment	Low	Low	Low	Low	Low	Low
Matrix clothings	Medium Garment	High	High	High	High	Normal	High
Neetee clothings	Small Garment	Normal	Normal	High	Normal	Normal	High
Afflatus	Medium Garment	High	High	High	High	High	Normal
Deki Electronics	Medium Electronics	High	Nil	Normal	High	High	High

Note: Low refers to just complying with standards, Normal refers to low efforts above standards, and High refers to high efforts over and above standards

More or less industries follow medium to high efforts depending on the operational hazards, export market and regulatory compliance. Voluntary efforts to contribute to nations sustainability is missing. This is particularly true for auto-component. The role of top management is particularly important. The two companies where the role of top management is proactive, they are following high and innovative sustainability practices with respect to environmental sustainability.

The social sustainability is mostly centred around employee welfare with the objective of employee retention, followed by training skills and women empowerment. The CSR Agenda for community services are cluttered for medium enterprises which are following such practices with no clear cut and impactful agenda. The community services are being adopted by firms which are under the purview of Company Act mandate on CSR. Deki electronics stands out in exception in its efforts to create impactful CSR initiatives.

However, all seven companies believe that impact can be created through Mega CSR project at cluster level through pooling of funds. Thus the study concludes that CSR and sustainability strategies are mostly framed keeping in view the compliance issues and regulatory framework. Thus the SMEs which are deriving benefits of government are not giving back to the society at desirable level. This leads to proposition 1 of the study

Proposition 1: SMEs sustainability and CSR measures are reactive and depends on compliance and regulatory requirements of an industry

7.2 Perception of Benefits over costs

This perception had varied highly across industries. The two companies of auto-component sector, one of which has footage in export market do not perceive any real benefits or opportunities to the company out of CSR and sustainability measures. They do not perceive any actual challenge in terms of costs or resource constraints in mitigating with implementation of the schemes. This perception could be due to the fact that the companies feel they have nothing to gain or lose through CSR activities and it is a matter of compliance mechanisms. Being highly capital intensive such efforts are very minor and therefore are not in priority of the company.

Medium enterprises in garment industry are highly conscious about brand image in international markets for market access and on the other hand they feel the pressure of implementation costs of such initiatives. Thus net benefits do not allow them to go beyond compliance standards despite their willingness to contribute towards nations' sustainable development goals. Small scale enterprises' main focus for benefits is employee retention and enhancing their productivity.

Deki Electronics has initiated high level of efforts in sustainability activities based on perceived benefits of brand image, but costs are not a constraint for Deki and therefore they have perceived net benefits. However their only concern is, to create impactful CSR and sustainability efforts, financial implications are large and that is one of the reasons why they have not been able to implement such mega projects. In this context it is clear that higher costs are required for creating impactful CSR activities and thus it is beyond the scope of even medium enterprises to invest in CSR at large scale. 2% profit may not be a large amount to spend for impactful mega initiatives. All the companies support the viewpoint that social and environmental mega projects could be initiated through clusters of SMEs pooling funds together. This leads to the second proposition derived from the study as follows:

Proposition 2: Perceived Net Benefits are almost zero and could be enhanced through cluster-level initiatives

7.3 Public Policy implications to promote sustainable development initiatives among SMEs

The major query addressed in this section is that whether a public policy framework can be developed to promote sustainable development initiatives without affecting profitability of SMEs. The command and control approach of regulation and public policy is working well among medium enterprises, which leads to reactive strategies and not proactive ones. The degree of awareness is much lesser than that of large corporations. That is one of the major hurdles why proactive measures are not coming forth. Moreover mega CSR and sustainability projects are not possible with small expenditure on these initiatives. Thus to promote sustainable development a combination of command and control based and incentive based public policy framework needs to be created.

Moreover, SMEs get many advantages from the government, thus sensitizing is required among the top management as well as employees of SMEs to scale up activities of community services and skilled development. In this context government can play a pioneering role by funding such initiatives. Incentive based approach for firm level motivation is much more efficient than command and control approach through a mandate. Mandate would be detrimental for the profitability of SMEs.

Government can create policies both incentive based in terms of awards and recognitions and as a mandate such that more participation is ensured at the cluster level initiatives. The cluster initiatives of Ministry of MSMEs are more focussed towards growth of MSMEs. This could also be substantiated with more focus on sustainable growth of MSMEs by making the clusters emphasize on these issues.

There are multiple existing central government as well as state government schemes to ensure sustainable development initiatives. However either the SMEs are not well versed with the schemes nor they may be interested to implement them. A strong monitoring mechanism needs to be in place to evaluate the impact of such schemes and replace the inefficient unsuccessful schemes with more incentive based schemes. For example the Lean implementation scheme of the textile and garment sector is receiving far better acceptance than expected just because the scheme is linked to subsidy from government. Similar schemes for sustainability practices could be devised by the government which could be implemented through clusters.

7.4 Limitations of this research study and future implications of research

This research is an exploratory research and therefore is limited in scope of research. The research is limited in sample frame only capturing Delhi NCR region. Due to poor response from the industry only seven case studies could be conducted. Three different manufacturing sectors have been taken for generalization purpose. However the study is limited to manufacturing sector only. The factors affecting sustainability practices and the barriers to implementation were not part of the study.

Thus the future implications of research are envisaged as follows:

- Case based study at Pan-India level on sustainability practices of SMEs can be conducted
- Quantitative analysis survey based research can be conducted at pan-India level to identify the major barriers of sustainability practices in SMEs.
- Validation of Proposition 1 can be checked through a survey research at Pan-India level
- Validation of Proposition 2 can be checked by a cluster-level study of sustainability initiatives

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