

# Input Problems in SMEs: Policy Issues and Challenges

Ramesh Shrestha

---

**Abstract:** *The paper attempts to examine the input problems in SMEs and the policy issues and challenges thereof. SMEs in Nepal use both indigenous and imported raw materials for the production of output. Due to problems of unavailability, ambiguous and unfavourable public policies, involvement of agents and importers, higher prices of raw materials, many SMEs have been closed down and some are on the verge of closing, leaving many people unemployed. Therefore, conscious efforts must be made by all quarters to overcoming the problems, and at the same time the government should provide tax concessions and other incentives to those SMEs which particularly use local raw materials.*

---

## I. INTRODUCTION

The role of small and medium enterprises (SMEs) has always been acknowledged particularly in new jobs creation and in the economic growth. Therefore, all government, non-government, private and other sectors are giving much emphasis to the development of SMEs. Different policy framework, training centres, and agencies providing various kinds of support have been instituted for the development and promotion of these SMEs. Despite these all round endeavours, however, these SMEs are facing several problems and one of such problems are associated with the inputs used by these enterprises. This article seeks to examine the inputs problems in SMEs and the policy issues and challenges thereof.

## II. THE PROBLEM

Raw material is one of the basic inputs in the production operations of SMEs. The quality, cost, and regular availability of such raw materials in these enterprises greatly determine the smooth and continuous production and sales, and the prices of their products. Therefore, all SMEs have to carefully plan for

---

Dr. Shrestha is Associate Professor at Public Youth Campus, Tribhuvan University.  
Email: [arabns306@yahoo.com](mailto:arabns306@yahoo.com)

the procurement and holding of the raw materials they need. Such a plan has to include the identification of appropriate source and regularity of supply, the cost and holding and handling of such raw materials. There are many SMEs that use only local raw materials, while some also use either only imported raw materials, or both local and imported raw materials. For the SMEs producing traditional products, raw materials are locally available, but SMEs like electronics firms use only imported raw materials and other SMEs such as soap and confectionery use both locally available and imported raw materials as imported raw materials are sometimes better in quality and cheaper in price.

It is very much disheartening to note that supply situation of inputs for small scale units is not satisfactory. Recently, three sugar mills viz. Indra Sugar Mill, Lumbini sugar Mill and Bagmati Sugar Mill were closed due to lack of sugarcane in Nawalparasi. Annual productions of 45 lakh quintal of sugar are grown in Nawalparasi. This year only 18 lakh quintals of sugarcane were produced. The farmers were disappointed by the decision of mill owners like of not paying old dues, technical assistance no extended were the main reasons (Gorakhapatra 2010)

According to news reports published a few weeks back in the Kantipur Daily, the Nepalese paper mills were on the verge of closure because of the wrong government policy on the export of indigenous raw materials. The news reported that the District Forest Office in Okhaldhunga allowed to export raw materials like *Lokta* and *Orgello* even to the non-license holders without giving due priority to local paper mills. The mill owners, therefore, said that the decision of the District Forest Office, in the pretext of collecting more revenue, has violated the exports regulations, which led to the cutting of plant itself haphazardly by the exporters.

Hundreds of workers are employed in paper mills and the number of such mills fell down to two from 15, thus depriving the employment of several hundred youths.

### **III. METHODOLOGY AND DISCUSSION**

A survey method was used to collect the required data using a set of questionnaire and was administered to the entrepreneurs of several SMEs located in the cities of four development regions. The data were collected from 350 entrepreneurs of cottage, small and medium scale enterprises (SMEs) located at different cities like Biratnagar, Birgunj, Nepalgunj, Hetauda, Pokhara and Kathmandu.

#### *Source of Raw Materials*

SMEs manage raw materials from different sources. But following are the three major sources. They are – local market, national market and imports. Very few SMEs have access to imports otherwise almost all of them have to depend on big importers who supply them on regular basis at their cost. Those raw materials also include semi-manufactured and components of electronic goods as well.

Table 1: Source of Raw Materials

Source of Raw Materials	Total	Percent
Local Markets	194	61.59
Resources available in the country	77	24.44
Imports	44	13.97
<b>Total</b>	<b>315</b>	<b>100</b>

**Source:** Survey, 2011

Table 1 shows that 61.59 percentages of respondents procure the raw materials from the local market. In this, the share of the trained respondents is 35.56 percent and untrained 26.03. The percentage of respondents procuring the raw material from other places constitutes 24.44 percent and the percentage of respondents importing the raw materials is about 14 percent.

Aryal (1994) in his studies has revealed that the 22.75 percent of the firm receive their raw materials completely from the local market. About 63.62 percent firms were dependent on overall market and 13.63 percent from overseas countries.

Adhikari M. (1997), in her Master's thesis conducted survey of SMEs located at 3 different places, Birgunj, Biratnagar and Pokhara and came out with the findings that 47 percent of them got raw materials from foreign source, 23 percent from the indigenous source and another 23 percent of them obtained both the local as well as foreign raw materials; while the 7 percent of the respondent SMEs reported that they produced their own materials.

S. Adhikari (2006) reported in his article that Hetauda Cloth Mill was established but have not been able to establish ancillary industry producing raw materials (threads) to support the industry. Even the attention was never paid towards producing threads from raw cotton for it. The result was disastrous leading to the closure of the mill. Therefore, only the industrial policy that promotes close nexus between agriculture, industry and trade will produce fruitful results in the long run.

#### *Use of Raw Materials*

It is a known fact that products from mixed (local + imported) materials and fully import raw material products enjoy large market because of qualitative products.

Table 2: Raw Materials Use

Types of Raw Materials	Total	Percent
Local	139	44.41
Imported	35	11.18
Both/Mixed	139	44.41
<b>Total</b>	<b>313</b>	<b>100</b>

**Source:** Survey, 2011

On the use of raw materials, as per Table 2, 44.41 percent of respondents replied that they were using the local resources and the same percentage of respondents also disclosed that they were using both (local and imported). Only 11.18 percent of respondents used the imported raw materials. This shows that the majority of the respondents are using the local raw materials.

### *Nature of Products*

The SMEs are engaged in manufacturing activities, services and others.

Table 3: Nature of Products

Types of Raw Materials	Total	Percent
Manufacturing	216	67.29
Services	87	27.10
Others	18	5.61
<b>Total</b>	<b>321</b>	<b>100</b>

**Source:** Survey, 2011

The respondents are engaged in various kinds of activities ranging from agro-based works to services. Table 3 reveals that 67.29 percent of respondents were engaged in manufacturing activities and the 27.10 percent in services. Other miscellaneous activities constituted only 5.61 percent. The data revealed that forest based activities were very low as compared to other activities.

### *Problem of Inputs*

It was very often raised and mentioned that SMEs have difficulty in getting raw materials and have to pay high cost than what is charged for the large firms. The large firms have their supplies direct from producers, while the supply to small units is through several layers.

Table 4: Problems of Inputs

Problems of Inputs	Total	Percent
The raw materials are not locally available	41	18.14
The importer charges very high price	56	24.78
Direct import is not possible	65	28.76
Heavy dependence on agents	63	27.88
Quality Problems	1	0.44
<b>Total</b>	<b>226</b>	<b>100</b>

**Source:** Survey, 2011

The cottage and small-scale units have to depend on the suppliers for the raw materials and they have to procure locally since they are not in a position to buy in bulk quantities. Table 4 shows that 28.76 percent of respondents said that direct import was not possible; another 27.88 percent of respondents said that they have to depend on agents of the suppliers or manufacturers. The next 24.78 percent of respondents said that the importer charges the very high price and the 18.14 percent said the raw materials were not locally available.

Similar research works of Khatri-Chhetri and Karmacharya (2003) reported that around 38 percent of enterprises reportedly had faced problems in acquiring raw materials for their enterprises. Among the problems faced, the acutest was the short supply of raw materials in the local markets, followed by the transportation problem and lengthy government process.

Zivetz (1992) noted that the problem of obtaining raw materials is the greatest headache for entrepreneurs, irrespective of the size of their undertaking. While industries dependent on external raw materials face major difficulties, even industries, which rely on domestic raw materials, encounter obstacles. This clearly shows that entrepreneurs are at the mercy of the agents for meeting their inputs requirements, and in a case when they cannot directly procure the inputs, their cost of inputs and, in turn, the cost of production are very much likely to go high.

#### **IV. THE POLICY ISSUES**

In Nepal, foreign exchange and licensing are highly controlled by the Nepalese Government and it determines who gets what and when. The criteria by which licenses for raw materials importation are allocated are neither clearly spelled out nor adhered to, while the procedures for granting licenses, even to the bonafide applicants, are lengthy, time consuming and vulnerable to change. Zivetz (1992) comments:

"...licenses tend to be allocated to those with the 'source and force' necessary to obtain them, and because the black market for raw materials in Nepal and India offers lucrative, quick and sure returns, those entrepreneurs with access to raw materials are in a position to profit handsomely. As a result, many industrialists (particularly those from the smaller concerns) are forced at some stage or other to pay higher prices for their raw materials on the black market".

Such practices have made it difficult for small-scale industries, which are short of working capital needed, to store raw materials inducing them to pay bribe to the relevant bureaucrats. Though Zivetz commented about the wrong policy of the government 20 years back but the situation as well as government policy has not changed much in favour of business institutions.

The supply of raw materials for small scale units is the problem of high prices at which raw materials are made available to small scale units. The small scale enterprises procure the supplies from the agents as agencies which add some overhead to the cost of raw materials.

The importance of small and medium industries has been duly recognized by all the policies and nine national plans formulated so far. But despite the high priorities offered, no matching programmes and definite plans have been formulated to develop the small and medium industries. On top of it, no attention has been given to coordinate between small and large industries. Moreover, various facilities offered to the small and medium industries so far under the policies have been reduced or withdrawn and the policies as such have not contributed to their development. In this context, the facilities promised

to the industries so far are limited to the paper only and the need of initiating definite programmes is greatly felt.

The government's policy in case of imports of raw materials is conservative and no scientific assessment of import duty from the viewpoint of cost competitiveness is ever pondered. Except for a few items of raw materials, the import of raw materials is from India. But the irony is that Indian finished goods are available at cheaper prices than Nepalese products. Removal of facility offered to import thread in convertible currency has deprived enterprises of raw materials, which is cheaper by 25 percent.

After the advent of democracy in Nepal in 1990, more liberal economic policies were adopted. Transparency of government's liberal policies and initiation of favourable environment for development of entrepreneurship in the country were given priorities for the rapid economic growth. Pyakuryal (2001) observes, "Though the new policies allow competitiveness in the resourcing and marketing, the domestic goods have to compete with imported goods as the supplies of the local SMEs are not given preferential treatment under the liberalized regime. Basically, such business environment needs to be assessed from the point of view of facilitating economic access to raw materials (inputs) and encouraging the supplies of SMEs".

The entrepreneurs often complained about the inconsistencies of the government policy and they often feel frustration while dealing with the government office. It changes with the changes of government ministers and political parties. Industrial entrepreneurs in Nepal often complain that a situation of constantly shifting policies makes it difficult for them to effect long term planning. They also point to lack of coordination between offices involved in licensing, loans, taxation and other crucial areas. This has led to what has been aptly termed the credibility gap separating the private and public sectors (DRCG, 1984). The discussion with the authorities at the district level revealed that sometimes it so happens that the government at the centre announces some relief packages, but the offices at the districts are unable to implement it since the centre has not officially notified them in time. Such a communication gap between government agencies always creates despair among the entrepreneurs.

Sometimes the government's rules are subject to dual interpretation and the district offices because of it do not properly adhere to the very spirits of the rule. Zivetz (1992) observes, "Policies which are initiated by one administration may be discarded, reinterpreted or reinvented by the next in what appears a never ending process of trial and error. The lack of continuity from one administration to the next confounds both the civil servant – who must implement a succession of new policies and the entrepreneur – who must constantly readjust his priorities and production plans". She further notes "There is also a labyrinthine bureaucracy whose rules and regulations shift according to the whims of individual bureaucrats and administrations".

## **V. CONCLUSION**

Micro and small businesses are greatly hampered by the non-availability of raw materials at proper prices and terms. Big industrial organizations pay just one percent

duty on the import of raw materials whereas the micro and small industries are unable to enjoy this facility since they buy from traders. There is no alternative left for them except depending on the middlemen and suppliers. Some micro and small industrial units have access to forest resources. So the local resource based industries should be promoted. The government should make available the required materials on a regular basis or make arrangements to give import license and foreign currency facilities on the basis of the submission of a report. The raw materials should be made available to industries in easy terms. Care must be taken that genuine industries do not starve for want of resources.

The government should encourage domestic products and help in standardizing the products. A long-term plan has to be formulated relating to the supply of raw materials and any sale or purchase arrangement made accordingly.

Raw materials from the forest, which may go waste if not used in time, should be made available directly from the national conservation sites to stop wastage. Efficient supervision and monitoring system should be strictly enforced to prevent the misuse of raw materials.

Providing tax concession and other possible incentives should encourage cottage and small industries to use local resources.

## REFERENCES

- Adhikari, Madalasa. (1997) *Women Entrepreneurship in Small Scale Industries in Nepal*, Master Degree thesis submitted to Tribhuvan University.
- Adhikari, Shiva (2006), "Audhyogik Niti Samshodhanko Auchitya", *Gorakhpatri*, December 26, Kathmandu.
- Aryal, Bhoj Raj (1994), *Entrepreneurship Development Programme in Nepal with Reference to the Small Business Promotion Project*, Unpublished Master's Thesis, Kirtipur Campus, Tribhuvan University, Kathmandu.
- Development Research and Communication Group (DRCG) (1984), *A Study of Non-Agricultural Enterprises in Nepal*, Kathmandu.
- Gorakhpatri Daily, March 11, 2010.
- Khatri-Chhetri, Janardan and Karmacharya Keshav (2003), *Micro and Small Enterprises Policy Review in Nepal, Survey of Micro and Small Enterprises' Owners/Managers*, Third Component Report, HMG, ILO, UNDP/MEDEP, Kathmandu.
- Pyakuryal, Bishwambher (2001), *Strategy for SME Development: Policy and Legal Reforms*, in Bishwa Keshar Maskay (ed.) in *Small and Medium Enterprises Development in Nepal*, Kathmandu, Centre for Development and Governance.
- Shrestha, Ramesh (2007), *Entrepreneurship Development in Nepal*, Unpublished Ph.D. Thesis. Faculty of management, Tribhuvan University, Kathmandu
- Small Business Promotion Project (1994), *A Report on Women Entrepreneurs' Regional Workshops* organized by the Association of Nepalese Cottage and Small Industries, Kathmandu.
- Zivetz, Laurie, (1992), *Private Enterprise and the State in Modern Nepal*, Oxford University Press, Madras.
- Dr. Shrestha is Associate Professor at Public Youth Campus, Tribhuvan University, Kathmandu.