Original Article
ISSN (Online): 2582-7472

ShodhKosh: Journal of Visual and Performing Arts
January-June 2023 4(1), 4713–4718

ROLE OF INDIAN GOVERNMENT POLICIES IN SUPPORTING SMES AGAINST EXCHANGE RATE RISKS

Harshita [1]

[1] Research Scholar, Department of Commerce, Kalinga University Raipur, Chhattisgarh, India

DOI
10.29121/shodhkosh.v4.i1.2023.6359

Funding: This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

ABSTRACT

The economy of India is driven by Small and Medium Enterprises (SMEs), which contribute almost 45 percent of the total imports and exports of the country, and provide significant employment opportunities. This essential role notwithstanding, SMEs are still very susceptible to external shocks, especially those that concern exchange rates. The volatility of the rupee against the major currencies, particularly the US dollar, can also negatively impact their profitability by increasing the cost of inputs of firms that are import-driven and decreasing the competitiveness of exports when the rupee appreciates. In response to these challenges, the Indian government, in consultation with the Reserve Bank of India (RBI), has enacted various policies and institutional arrangements to assist SMEs in dealing with currency risk. These are ease of access to hedging instruments like forward contracts and options, the credit insurance plans offered by the Export Credit Guarantee Corporation (ECGC), interest subsidies on the Interest Equalisation Scheme (IES), and preference sector lending. Also, export promotion programs such as the Merchandise Exports from India Scheme (MEIS) and its predecessor, RoDTEP, provide relief on taxes and competitiveness. Awareness and training also enhance the capacity of SMEs to address risk. Although certain advances have been achieved, there are still gaps in awareness, adoption, and access, and further reforms are needed.

Keywords: Small and Medium Enterprises (SMEs), Exchange Rate Risk, Rupee Volatility, Government Policies, Hedging Instruments, Export Promotion, Credit Support

1. INTRODUCTION

SMEs are crucial to the Indian economy, being the source of almost 45% of total exports and providing millions of jobs. Though important, SMEs are incredibly sensitive to external shocks, notably exchange rate volatility (Basu, 2016). Currencies have a substantial impact on their profitability since SMEs tend to trade at thin margins and have limited access to advanced risk-management tools (Gupta, 2019).The depreciation of the rupee increases the input prices of the businesses that rely on imports of raw materials and reduces the competitiveness of exports (Hussain, 2020). Highly developed hedging techniques and the services of financial consultants are accessible to large corporations, but SMEs are usually not aware of them and do not have the resources (Jain, 2018). This puts them at risk of extreme uncertainty in international markets. In acknowledgement of this weakness, the Indian government has crafted a number of policy options to protect SMEs against exchange rate risks.

To illustrate, the Reserve Bank of India (RBI) has been launching simpler hedging instruments, including forward contracts and swaps that business enterprises can purchase with fewer compliance requirements (Kumar, 2017). The schemes of Export Credit Guarantee Corporation (ECGC) and the Interest Equalisation Scheme (IES) also assure that the exporters will not face the risk of payment defaults and receive the benefits of reduced costs of borrowing (Iyer, 2015). The scheme of export promotion, such as MEIS and RoDTEP, also subsidizes exporters on embedded taxes to enhance price stability in the international markets (Joshi, 2020).Other aspects of capacity building being put forward by the government include training and awareness. The Ministry of MSME and export promotion councils conduct workshops to enhance the knowledge of SMEs on the practices of currency hedging and invoicing (Uppal, 2019). Such initiatives not only minimize financial vulnerability but also increase the competitiveness of SMEs on a global scale.To recap it all, the sensitivity of SMEs to the rupee volatility is still high, but policies and institutional frameworks of the Indian government have been instrumental in reducing risks. Nevertheless, there are still specific issues with awareness, adoption, and accessibility of hedging practices that need to be reformed continuously to enhance SME resilience in international trade.

2. OBJECTIVES OF THE STUDY

1) To analyze the role of Indian government policies in supporting SMEs against exchange rate risks.
2) To examine the effectiveness of hedging instruments and financial support schemes (such as forward contracts, ECGC, IES, and priority lending) in helping SMEs manage currency volatility.
3) To evaluate the impact of export promotion measures (MEIS, RoDTEP, SEZ incentives) on the competitiveness of SMEs in global markets.
4) To study the significance of training programs and awareness initiatives in improving SME risk-management capabilities.
5) To recommend policy improvements that can further strengthen SME resilience in the face of rupee volatility.

3. GOVERNMENT POLICIES SUPPORTING SMES

3.1. ACCESS TO HEDGING INSTRUMENTS

The Indian government has implemented several measures that have helped SMEs to overcome currency volatility. RBI has simplified the regulations and given SMEs the option to use forward contracts, options, and swaps without heavy compliance requirements, making Hedging Access stronger and promoting small exporters to hedge against exchange rate fluctuations (Bhatia, 2021). Besides this, Credit Support schemes like the Export Credit Guarantee Corporation (ECGC) and the Interest Equalisation Scheme (IES) offer low-cost finance and insurance options to lower the cost of borrowing and minimise the risks of payment to the SME (Goyal, 2020). Export Incentives such as the Merchandise Exports from India Scheme (MEIS), RoDTEP, and SEZ benefits assist firms in eliminating embedded taxes, enabling the firms to retain the pricing power despite fluctuation in the rupee (Haque, 2019). Outside of the financial instruments, the government prioritises Skill Training with the help of MSME ministry workshops and programmes initiated by the RBI that enhance the knowledge base on invoicing practice and hedging strategies, thus improving the decision-making process of SMEs (Jadhav, 2021). Moreover, an adequate Policy Framework is ensured by the active surveillance of the foreign exchange market by the RBI and the promotion of export diversification by the government to eliminate reliance on the US dollar too much (Kannan, 2021). Lastly, the goal of Risk Awareness campaigns is to enhance financial literacy and embrace practices such as hedging by SMEs, which make them resistant to external shocks (Irfan, 2020). A combination of these measures indicates that even though SMEs are still vulnerable to exchange rate fluctuations, due to the concerted government efforts in the financial, policy, and training sectors, they have become a lot more equipped to deal with the risks associated with exchange rate fluctuations.

3.2. CREDIT AND FINANCIAL SUPPORT

The provision of credit and financial assistance to the Indian SMEs forms a large portion of the government policy to alleviate the effects of exchange rate changes. Due to the financial nature of SMEs, they are very vulnerable to non-payment, default by overseas buyers, and high interest rates that are even more difficult to bear when the currency is fluctuating. The application of credit insurance programmes through the Export Credit Guarantee Corporation (ECGC) is therefore important in this respect since the organisation offers credit insurance cover to exporters against all the business and political risks. This not only builds confidence amongst SMEs when they are transacting with international customers but also boosts their credibility with the banks. Another scheme was the Interest Equalisation Scheme (IES) introduced by the Government of India, which subsidises interest on the pre- and post-shipment credit, particularly the credit used by the labour-intensive and small-scale industries (Banerjee, 2019). The scheme cuts the cost of effective borrowing by two or three percentage points, allowing firms to stay competitive globally even when currency fluctuations would otherwise push relatively small profit margins down (Ghosh, 2020).

In addition, the Reserve Bank of India has also introduced priority sector lending (PSL), which involves commercial banks dedicating a part of their lending portfolio to the SMEs and further to other vulnerable sectors. This ensures that there is a stable supply of cheap formal credit and also reduces dependence on more costly informal sources of borrowing (Iyer, 2021). This financing is particularly urgently required when the rupee is losing value, when the import-driven SMEs are facing the risk of higher input prices and when higher working capital is required. Together, ECGC insurance, the IES subsidies and PSL targets enable the financial risks undertaken by SMEs to be mitigated significantly. They provide insurance to exporters against nonpayment, they lower the cost of borrowing, and they even make sure that when the going gets tough, credit is there. However, they are not aware of such schemes, or the processes are too complex to be taken into account by most small companies, which impairs the overall performance. These programmes can be more welcoming and more helpful to the overall SME sector by increasing the scope and simplifying the process.

3.3. EXPORT PROMOTION SCHEMES

One of the strengths of the India strategy to protect Small and Medium Enterprises (SMEs) against the adverse effects of currency volatility has been export promotion policies. Since SMEs contribute a large proportion of India's exports but have very low profit margins, changes in the exchange rates even slightly may jeopardise their competitiveness in the global arena. In order to offset these risks, the government has put in place schemes of various types, all of which either directly or indirectly lessen the financial burden on exporters.Among the most prominent of these tools has been the Merchandise Exports from India Scheme (MEIS), where exporters obtained duty credit in the form of a scrip to offset the embedded taxes and infrastructural inefficiencies. MEIS allowed SMEs to stay competitive in the international markets in relation to the fluctuations in the rupee by partially offsetting these expenses. Despite the elimination of MEIS through compliance with the World Trade Organisation (WTO) requirements, it was replaced by the Remission of Duties and Taxes on Exported Products (RoDTEP) scheme, which still promotes the idea of compensating the exporter for the hidden fees, which are not refunded within the framework of the Goods and Services Tax (GST). This has been vital to the SMEs, as it has helped them hedge against cost increases that mostly coincide with bouts of exchange rate instability (Chopra, 2021).

Besides these remission schemes, India also encourages Export-Oriented Units (EOUs) and Special Economic Zones (SEZs). Companies based in SEZs enjoy exemption from taxes, eased customs and other infrastructural facilities, both of which mitigate transaction costs and act as a hedge against the strengthening or weakening of the rupee (Narayan, 2020). In the case of SMEs, the incentives not only make it possible to sustain profitability but also provide an opportunity to scale up exports through reduced overheads. Additionally, EOUs and SEZs are structured to absorb small-scale exporters into the global value chains so that they can access markets and decrease reliance on one currency, the US dollar.In aggregate, these export promotion schemes have the effect of increasing the resilience of SMEs by subsidising the indirect cost of trade, decreasing the unpredictability of profit margins, and encouraging international involvement. However, there are still gaps in scheme awareness, administrative lag time and disparate access, especially to tiny firms not based in major industrial centres. These challenges can be overcome by improving digital platforms and specific outreach to increase the effectiveness and reach of these export incentives.

3.4. SKILL DEVELOPMENT AND AWARENESS

In addition to financial and structural rewards, the Indian government has identified that one of the most significant gaps facing Small and Medium Enterprises (SMEs) is knowledge and ability to deal with Exchange rate risks effectively. Most SMEs do not have the knowledge to appreciate the technicalities of hedging instruments or the business strategy of currency invoicing decisions. In an effort to fill this gap, both the Ministry of Micro, Small and Medium Enterprises (MSME) and the Reserve Bank of India (RBI) have been promoting skill development and awareness programmes.The Ministry of MSME organises workshops, training camps and digital learning programmes through which entrepreneurs are taught about forward contracts, options, futures and how these can be used to address the issue of rupee volatility. Not only are these done in partnership with commercial banks, but also industry bodies and export promotion councils, and provide a platform of learning opportunities to otherwise locked-out companies as well (Patel, 2020). Another stakeholder that has contributed to ensuring that the role of managing currencies is affordable by large companies through the simplified instructions being given by the central bank to SMEs on hedging and promotion of awareness campaigns to demystify the myths surrounding the complex financial products is the RBI (Kaur, 2021).

Another support comes in the form of export promotion councils that advise SMEs on the selection of invoice currency, trade documentation, and financial planning. To a large number of small exporters, deciding whether to invoice in U.S. dollars or other foreign currencies may spell the difference between them being exposed to exchange rate risk or not. Councils may assist companies in adopting strategies that are consistent with their risk profile and their market orientation by educating them on these matters (Rao, 2019).Additionally, these initiatives lead to financial literacy in general because most SMEs still make decisions based on their intuition instead of financial planning. However, the process of awareness building will also involve the introduction of risk-management tools as well as an event to introduce a notion of changing their mentality towards their active engagement in the worldwide competition (Mehta, 2021). Notably, skill development activities are complementary to financial policies, as they allow SMEs to make appropriate use of policies like export credit insurance or interest subsidies. Even the most well-developed policies would not reach their target beneficiaries without a proper level of awareness.

3.5. INSTITUTIONAL AND POLICY FRAMEWORKS

One dimension of the government support of Small and Medium Enterprises (SMEs) is the institutional and policy frameworks that stabilise the external environment within which exporters act. These frameworks are macroeconomic, unlike financial schemes or training programmes, which directly focus on firms and aim at reducing volatility and establishing a stable trading environment. The two significant aspects of this strategy include the role played by the Reserve Bank of India (RBI) in the management of currency volatility and the diversification of the export market by the government.The RBI is involved in stabilising the market by closely observing the movements of the foreign exchange market. Though India has officially transitioned to an exchange rate system that is market-determined, the RBI may intervene in the circumstances of acute volatility to make sure that speculative flows are limited and the value of the rupee does not fall or rise suddenly (Sharma, 2020). In the case of SMEs, these interventions offer some form of certainty and also allow fewer unexpected shocks to disrupt export contracts. RBI also prevents abrupt fluctuations in currencies to ensure that less hedged small companies are not unfairly affected by unexpected currency changes (Banerji, 2021).

In concert with monetary interventions, government trade policies also encourage market diversification in export markets. The high concentration of exports in one market or currency, primarily the U.S. dollar, increases the vulnerability of SMEs to changes in currency. To reduce this risk, India's foreign trade policy has promoted the growth of SMEs into other markets like the European Union, ASEAN countries and Africa. Export promotion councils and trade agreements enable such diversification to provide guidance, incentives, and infrastructure support (Khurana, 2019). This makes them less vulnerable to a single currency zone, diversifying risk between numerous markets and stabilising income to SMEs.This institutional support is broadly based and strengthens these policy actions, including bilateral currency arrangements, frameworks and regional trade arrangements that reduce reliance on leading currencies. An example is to reduce the exposure of the BRICS or other South Asian economies to dollar shocks by attempting to develop trade settlements in local currencies (Iqbal, 2021). Although these strategies are not explicitly designed to address the needs of SMEs, they provide a more secure operating environment to small exporters.

Table 1 Policy–Objective–Impact

Objective	Policy/Measure	Expected Impact on SMEs
Reduce exposure to currency risk.	RBI's hedging instruments (forwards, options, swaps)	Greater protection from rupee volatility; improved pricing stability
Ensure financial stability	ECGC, IES, Priority sector lending	Affordable credit, reduced loan burden, protection from default risks
Boost export competitiveness	MEIS, RoDTEP, SEZ incentives	Higher profitability, ability to offset losses from exchange rate changes
Improve awareness and skills.	MSME training, RBI awareness programs, and export promotion councils	Better risk-management decisions, increased adoption of hedging practices
Strengthen long-term resilience	RBI monitoring, diversification policies	Reduced dependence on the US dollar, less vulnerability to sudden shocks

4. ANALYSIS AND CONCLUSION

Small and Medium Enterprises (SMEs) continue to be quite vulnerable to exchange rate volatility as they are often less financially savvy and larger than larger corporations. Big companies will enroll in advanced hedging communities and hire professional risk managers, but financial barriers, low financial literacy, and risk aversion will limit most SMEs.

The government policies that serve to reduce these structural disadvantages include subsidised export credits, relief of interests, via the Interest Equalisation Scheme, and easy access to forward contracts (Rao, 2021). However, adoption has been patchy, and numerous SMEs are reluctant to hedge because of their lack of awareness or lack of confidence in financial tools. This explains why financial schemes should be coupled with specific training and awareness efforts provided by the Ministry of MSME, RBI, and export promotion councils (Mehta, 2020).

It is concluded that government policies cannot be ignored to cushion the rupee volatility shocks on SMEs. The buffers are provided by affordable credit facilities, the tax remission programme such as the RoDTEP, and the institutional measurement of currency movement. To unlock the potential of policies, however, one would need to continuously reform them so as to make access to them easier and thus promote financial literacy and stimulate active hedging. India can reduce financial and knowledge gaps to create a strong SME sector capable of supporting competitiveness in unstable international markets.

CONFLICT OF INTERESTS

None .

ACKNOWLEDGMENTS

None.

REFERENCES

Mall business performance in India. *Indian Journal of Economic Studies, 34*(1), 44–59.

Bhatia, P. (2021). Simplifying hedging for Indian exporters: The RBI framework for SMEs. *Global Finance Review, 19*(3), 245–262.

Chopra, K. (2021). The shift from MEIS to RoDTEP: Implications for Indian SMEs. *South Asia Trade and Development Review, 15*(2), 117–131.

Ghosh, A. (2020). Export credit policies and global competitiveness of Indian SMEs. *Journal of Emerging Market Finance, 9*(4), 301–318.

Goyal, R. (2020). Financial insurance mechanisms and SME resilience: The role of ECGC and IES. *Asian Economic Policy Review, 22*(1), 77–95.

Haque, S. (2019). Export incentives and price stability for SMEs in India. *International Trade Journal, 33*(2), 154–173.

Hussain, F. (2020). Rupee depreciation and its consequences for SMEs in India. *Economic and Political Weekly, 55*(7), 112–120.

Iqbal, Y. (2021). Local currency settlements in BRICS: Implications for SME exporters. *Journal of Global Financial Systems, 13*(1), 211–229.

Irfan, T. (2020). Enhancing risk awareness among SMEs: The Indian experience. *Journal of Financial Literacy and Inclusion, 6*(2), 98–115.

Iyer, A. (2015). The effectiveness of the Interest Equalisation Scheme in India. *Finance India, 29*(3), 765–781.

Iyer, A. (2021). Priority sector lending norms and SME financing in India. *Indian Banking Journal, 47*(2), 55–70.

Jadhav, M. (2021). Building SME resilience through training and financial literacy. *Journal of Small Business Development, 10*(1), 22–39.

Jain, S. (2018). Exchange rate risk management in Indian SMEs: Barriers and opportunities. *International Journal of Management and Applied Finance, 8*(2), 44–60.

Joshi, V. (2020). Export subsidies and competitiveness of Indian SMEs. *Trade and Development Quarterly, 18*(3), 233–249.

Kannan, R. (2021). RBI's foreign exchange management policies and SME stability. *Journal of Economic Policy and Research, 14*(4), 312–329.

Kaur, H. (2021). Awareness programs for hedging practices: Role of the RBI. *International Finance Perspectives, 11*(2), 130–147.

Khurana, M. (2019). Diversifying export markets to reduce currency risks for SMEs. *South Asian Economic Studies, 21*(2), 175–192.

Kumar, N. (2017). Simplified forward contracts and swaps for SMEs: An RBI initiative. *Reserve Bank Review, 63*(1), 22–35.

Mehta, S. (2021). Financial literacy and SME competitiveness in volatile markets. *Journal of Entrepreneurship and Business Studies, 16*(1), 99–118.

Narayan, R. (2020). SEZ incentives and SME growth in India. *Global Trade Review, 28*(3), 56–74.

Patel, V. (2020). Training programs for SMEs in India: A pathway to better risk management. *International Journal of SME Development, 14*(2), 65–83.

Rao, P. (2019). Export promotion councils and SME risk management strategies. *Indian Journal of Commerce and Trade, 27*(1), 77–89.

Rao, S. (2021). Subsidised export credits and SME competitiveness in India. *Finance and Development Journal, 11*(3), 141–159.

Sharma, D. (2020). RBI intervention and rupee stability: Implications for SMEs. *Journal of Emerging Economies, 12*(2), 211–228.

Uppal, R. (2019). Training and awareness initiatives for SMEs in India. *Journal of International Business and Policy, 4*(2), 156–172.