CHAPTER-I

STATEMENT OF PROBLEM

I. INTRODUCTION:

"Collapsed, failed, bankrupt, broke and bust. None of these are pleasant words, and this is not a pleasant subject, but in real life companies do fail, do go bust. And yet how often does one see these words in books or articles on management?" So opines, John Argenti \(^1\) in his valuable book on corporate failure. It is often seen that failures in business have not attracted the kind of attention, success has received. Infact, it is our hunch that the studies on failure can lead to conclusions that would be useful in avoiding the same at least in future.

Needless to say, an attempt has been made in this study to develop relevant research findings based on studies concerning failure of business with a view to assist those who may have to pull themselves out, not only from a failure situation, but also put their enterprise on the path of progress.

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Increasingly, all over the world, the small industry is being adapted as a developmental tool. India is a vast country with its varied problems. Widespread unemployment in the context of large population, concentration of wealth in a few hands and concentration of industries in and around the four metropolitan cities and 65 big towns, have been part of this problem. The development of small industry has been chosen as a strategy to solve these problems at least partially. To realize this basic objective a number of organizations have been set up, both by the Central and State Governments, throughout the length and breadth of the country. They are, (i) State Industrial Development Organizations to provide the infrastructure facilities; (ii) State Financial Corporation to provide the needed finances; (iii) The small industry Extension and Training Institute to provide the necessary training of entrepreneurs; (iv) small industry service institutes for preparation of project report and feasibility studies etc. As a supportive measure the Central Government has reserved over 873 items for exclusive production in the small sector.\textsuperscript{2} It is also reported that Central

Government is actively thinking of reserving personal computers for exclusive production in the small sector.  

Needless to emphasize, the small scale industry occupies an important place in the national economy of India. Despite the significant development of large scale industry, the small scale industry has a stature of its own and holds out a promise of bright prospect. Economically, this sector aptly fits in to the country's resource endowments. As per the All India Census of small scale industry, the share of industrial production of this sector is about 45 per cent and if the contribution of handloom, handicraft Khadi and village industries, silk and coir based units are included, then the share of the small sector in industrial production would be around 55 per cent. Second, this sector has been playing a very important role in the development of industrially backward region in the country. In addition to these, the following are the advantages, when considered in the context of backward economy of India.

1. High Employment Generation Capacity:

The small scale sector has greater capacity to create more jobs per unit of investment. In actual fact the investment

needed in small industry is much less on account of simple technology, and high human labour utilisation. According to an estimate, 50 million jobs need to be created outside the agricultural sector in the next twenty years and this magnitude of job creation is impossible in the framework of conventional industrial growth. A project in the small sector with an investment of Rs. 1 million can provide employment to nearly 173 persons while the same number of employees in the large sector would require an investment of Rs. 5.31 million.

(ii) Low Capital Requirement

Needless to say, almost all developing countries are short of capital, and try to economize wherever possible. According to Annual Survey of Industries, the fixed capital per employee in small sector is Rs. 2,018 as against Rs. 17,753 in the large scale sector. The studies undertaken by ICICI and other institutions also support the above fact.

One can also measure the capital requirement in terms of

5. Ibid., p. 4
6. Industrial Credit and Investment Corporation of India, Bombay.
productivity per unit of investment. For example, the study published by Ram K. Vepa reveals that productivity per unit of investment in small scale industry is approximately three times higher than that in large scale sector. Thus in a capital scarce and labour abundant economy, the small scale sector has an important role to play in accelerating both employment and output, because of the high ratio of output and employment per unit of investment.

(iii) High Value Added:

This is another significant advantage incorporated in the small industry concept. According to Ram K. Vepa, the value added per unit of investment is 0.96 as against 0.46 in large industry. This is also corroborated by the statistics published by "Annual Survey of Industries, 1965". Moreover the small industry, by virtue of its size, has greater flexibility. This enables it to evolve a strategy from time to time to take advantage of prevailing business environment by introducing appropriate products in appropriate markets. The success of smaller Japanese companies as against giant American companies in the context of high priced petroleum products is a testimony to this fact. According to Peter F. Drucker a small industry can carve a niche for itself in a

8. Ibid.
limited market with skilled choice of products and markets based on analysis of its inherent strengths, weaknesses, opportunities and threats.\textsuperscript{9}

(iv) Simple Technology:

This is a highly significant feature of the small sector. The scale of production being low, it enables the entrepreneur to use simple technology. Even the marginally trained worker can handle the machinery in this sector because of low level skill required which in turn account for, low labour cost per unit of output.

For example, in one unit in Khadi and village industry sector, the conventional spinning machine used in the mill sector, has been converted into a number of manually operated units. This spinning unit which requires rotating action can be operated by any unskilled labour, who can use his hands to rotate the machine, and thereby earn satisfactory income on hourly basis. Such an arrangement in large cotton spinning unit is totally unthinkable, because these machines have a high speed and require skilled and well trained labour. In addition, the high speed of the equipments generates fluff, which is said to cause respiratory diseases.

Moreover chances of accidents leading to loss of fingers etc are common, whereas no such possibility exists in the case of manually operated small units.

(v) **No Pollution Problems:**

Today, environmental pollution has reached high dimensions. There is a struggle to maintain harmony with the nature. Under these circumstances, the large scale industries are under severe attack by the environmentalists all the worldover, but the scale of operations of small business and simple technology considerably reduce the hazards of pollution.

(vi) **No Social or Housing Problems:**

According to available statistics on small industry for the year 1984-85\(^\text{10}\) the average number of persons employed by small firms was 9. With such a low level of employment the firm is not likely to make a serious impact of undesirable nature either on the housing situation or on the society. This is because the small firm usually utilizes the local resources; the men and women working in small industry usually have their own housing arrangements in the local area. This is not the case with the large industry which attracts migratory labour and thereby give rise to housing problems.

\(^{10}\) Development Commissioner, Small Scale Industries, Ministry of Industry, Government of India.
(vii) **Low Import Component:**

It has been stated earlier that the small sector accounts for approximately 55 per cent of industrial production, but it uses only 9 per cent of imported materials. In other words, the import component per unit of output produced by the small sector vis-a-vis the large scale sector is very low. This also implies that this sector uses high percentage of indigenous raw material per unit of output.

After having reviewed the advantages of small sector, it is now in order to present the status of the small scale industry in India. As of today, there is a well developed small sector with over 1.35 m small units. These units provide employment to nearly 96 m persons and account for over 40 per cent of the total industrial employment. The turnover of these units amount to Rs. 61,000 crores with a capital investment of Rs. 8,380 crores. Reflecting its wide capabilities, small sector produces now over 5,000 diverse products ranging from ordinary nuts and bolts to highly sophisticated medical electronic products.

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In addition to this, of the total exports of Rs. 11,555 crores the share of this sector was 20.3 per cent of the total at Rs. 2,350 crores. In respect of some of the items the small firms have shown incredible performance for instance, in woollen garments, sports goods, this sector enjoys 100 per cent share while it enjoys 90 per cent share in garments, processed foods and marine products.\textsuperscript{13}

While above facts and figures speak of the brighter side of the picture, the incidence of sickness which has afflicted this sector, gives a gloomy picture. In June 1984, there were over 81,647 small sick units out of the total of 83,597 sick units in the country.\textsuperscript{14} While the latest figures put them at 1,17,783 units showing a staggering 408 per cent increase in 1987 over meagre 23,149 units in 1980.\textsuperscript{15} This alarming level of sickness is not without its phenomenal impact for instance, the sickness has resulted in unemployment of 10,60,000 persons while a turnover of Rs. 4,602 crores has been lost. An amount of Rs. 907 crores has been

\textsuperscript{13} D.Nagaiya, \textit{Small Scale Industry in India, a handbook of Statistics, NSIET, Hyderabad.}

\textsuperscript{14} S.C.Narker, \textit{'Industri al Sickness Managers need to be cured'; Commerce Annual number 1985 on Industrial Sickness, Vol. 151, No. 3893, p.5.}

blocked as dead capital\textsuperscript{16} and Rs. 1,282 crores is the outstanding credit from banks and financial institutions.\textsuperscript{17}

Taking into consideration the fact that a total of Rs. 8,000 crores is lent to small sector by all the nationalised banks put together\textsuperscript{18} the likely impact of sickness appears to be immense. Viewed in the context of the fact that, there are a number of units in this sector, which are in the process of becoming sick, but are not yet identified as sick, the problem assumes greater dimensions.

The viability of the existing units which is a redeeming feature is also poor. According to a study conducted by State Bank of India during 1984, only 10 per cent of the sick units were considered viable, of these viable units only 40 per cent of the units could be taken up under a nursing programme organised by the bank.\textsuperscript{19} This gives an impression that sickness in small sector is highly incurable.

\textsuperscript{16} Figures worked out on the basis of information furnished by Development Commissioner Small Scale Industries, Op.cit.
\textsuperscript{17} Dacca Herald, Op.cit.
1.2 Causes of Failure:

If the industrial sickness and failure is to be tackled effectively, there must be a detailed diagnosis of the problem, on which alone appropriate policies can be based. With this end in view, an attempt has been made to mention the main causes of the failure of small business in India.

In general one can mention that industrial sickness or failure may be due to a variety of reasons, such as improper project planning and appraisal, and/or causes arising out of disorder in the main functional areas of finance, production, marketing and personnel management. Financial causes may include inappropriate financial structure, underutilisation of assets, inefficient capital management, absence of costing and financial planning. Similarly, causes of failure on the production front may include wrong choice of equipment, inadequate control on quality of materials and maintenance of equipment. Marketing causes may include improper product mix, dependence on a few buyers, exploitation by middlemen, and inaccurate demand forecasting. On personnel front the main problem is inability of this sector to attract the needed technical and managerial talent for its lack of visible prospects.
However the more particular causes of small scale industry failure in the industrial area under the study are as mentioned below:

I. **Raw Material Shortage**:

Many of the raw materials required by small sector are not available at the right price, in the right quality and quantity. Many of the inadequacies of small sector in procuring the raw material result from its poor working capital. Constrained by lack of funds, a small firm cannot buy raw material in bulk, but unless bought in bulk good quality material will not be available. Needless to say all available good quality material is bought out in bulk by large firms, starving the small units. This they resort to in order to wipe out competition from small firms. 20 State Governments, which have put in great efforts in augmenting the small industry by starting various agencies which also include an agency to channalise raw material, have not been able to address themselves to the real problems faced by small firms.

II. **Inadequacy of Finance:**

It is said that new small units enter the field with meagre capital and face financial problems right from inception.\(^\text{21}\) Owing to the limitation of own resources, the small firms start with high proportion of borrowings. A resultant weak equity base and high interest cost makes small business vulnerable to the environmental pressures. Inspite of the fact that number of special schemes are being launched by nationalised banks and number of incentive schemes launched by the State and Central Government the shortage of capital continues to be a problem of the small business. Since every small business has a gestation period during which it has to survive, marginal effort in this direction is highly inadequate.\(^\text{22}\)

III. **Marketing Problems:**

Added to others, marketing has been a key problem facing small firms. Due to lower scale of operations, and lower availability of funds for the purpose, the marketing task is not taken up with as much vigour and energy, as really necessary. Even though, number of causes are advanced

to explain the marketing failure of small firms like exploitation by middlemen, lack of marketing information of the right kind etc. the main cause is the lack of orientation as far as the marketing task is concerned. In a few industries the problem has been realised and efforts have been made to organise a co-operative effort to market their product, the handlooms and domestic electrical appliances are outstanding examples in this regard. Realising these problems, the Government of India has reserved over 800 items to be procured exclusively from small scale sector under the Central Government stores purchase programme implemented by the Director General of Supplies and Disposals (DGSD). Looking to the range of products (5,000) this effort though it reduces the adverse impact to some extent cannot fully solve the problem.

IV. Technological Problem:

In the present age of rapid technological advancement, a firm has to keep pace with changes in technology by updating their technology from time to time. This requires adequate finances on one hand, and technological awareness on the other. Since the overwhelming objective of small entrepreneur is to keep the costs low, he is likely to choose a technology which is cost efficient. Here he may fail to optimize benefits resulting from modern improved technology. As against this,
a large industry with its wide parameters of investment can exercise greater flexibility in certain cases. In other words, the inability of the small sector to absorb technological progress explains why the small firms cannot withstand competition from large firms.

V. Unused Capacity:

Capacity utilization in small sector is as low as 40 - 55 per cent. This is largely due to inability of the small entrepreneur to exercise control over the demand pattern for his products. While the owner manager of the small firm has to work overtime occasionally to meet the high level of demand, he may have to put up with minimal demand at times. These factors affect the performance of small industry, resulting in low contribution to overheads.

VI. Managerial Deficiency:

In most of the cases small businesses have a one man rule where owner himself is the entrepreneur cum manager, who combines a number of roles as he cannot afford to hire staff specialised in different functions. He is required to formulate policy and run operations as well. This puts him under

considerable stress and strain. Coupled with the type of problems identified already, he is likely to flounder in the absence of managerial support at the shop floor, as well as long range policy formulation.

This fact is amply corroborated by a study conducted by Reserve Bank of India consisting of 379 units, which concluded that in 52 per cent of the cases it was managerial deficiency which was responsible for failure in small units. Yet another study of 11,000 small business failures, conducted by Business Economics Division of Dun and Brad Street, a prominent professional research organization in United States, has concluded that in 92 per cent of cases it was poor management of the firm that was responsible for the failure - here, by poor management, it was meant that the entrepreneur lacked experience in the line, (in 9 per cent cases) lacked managerial experience, (in 18 per cent cases), had an unbalanced experience (in 20 per cent cases) and was managerially incompetent (in 45 per cent cases). These facts point towards the conclusion that major causes of failure are internal in nature.


This substantially disproves the generally prevalent argument, particularly amongst small entrepreneur, that external factors are solely responsible for small business failures. The earlier findings are further supported by Peterson, Kozmetsky and Ridgway in a study says that in 66 per cent of cases, the causes of failure in small business are internal in nature.26 Starnyl W. Edmunds27 reflecting on these issues says that small firms generally lack managerial competence and this deficiency is coupled with inadequate financing is the major cause of the problems.

It needs to be emphasized that the decision making process plays an important role in management of any enterprise, irrespective of whether the firm is small or large. Needless to say, a manager of small firm makes a series of decisions for ensuring the organizational effectiveness of the enterprise. These decisions concern both policy and operational matters and as a result are of non-recurring as well as recurring type. While, the choice of location of the firms product or product mix, market or markets call for policy decision; the determination of capacity of the plant process


or technology used etc. call for operational decisions. Herbert Simon a noted management expert who has done pioneering work on the science of decision making has equated management with the process of decision making. In order to improve his managerial competence a small business manager has to improve his decision making skills.

Conclusions:

In this chapter an attempt has been made to focus the importance of small scale industry sector in the national economy of India and the various measures undertaken by State and Central Government authorities to encourage the development of this sector ever since the passing of the Industry Development Regulation Act of 1951. While emphasising the specific advantages small industry offers vis-a-vis large industry on the increasing incidence of failure or sickness in the small sector. It is the hunch of the researcher that a most important single cause of industrial sickness or failure of the small sectors is the absence of managerial inputs at all stages of management of the firm in question. In other words, the hypothesis to be tested in this study are:
I. Although decision making skills are important at all stages of management, the neglect or inadequate appreciation of this aspect in the management of the small firm, is the most important cause of the failure in the small industry sector.

AND

II. Those business firms which have established their identity and credibility in the respective areas of their business, are on the path of growth and success, mainly on account of more structured approach to the decision making process at all stages of management.