CHAPTER I

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Small industries are an essential link in the chain of Indian economy. They serve the consumer and meet the needs of other business, both large and small. Small industries are important for social, economic and political reasons. It is often argued that Small Scale Industries (SSI) utilise scarce resources like capital more efficiently than large industries. They are also more employment oriented and perhaps also give more job satisfaction to the people who work in them. According to Malcom Harper (1) "They are nevertheless highly innovative and valuable for saving foreign exchange and generating local employment. They help in developing qualities of entrepreneurship". In many countries, small scale industries provide parts and sub-assemblies to large firms at a considerably lower unit cost than that at which the latter would produce them themselves.

In an economy in which ever larger multi-product firms are emerging, small firms provide competition, both actual and potential, and provide some check on

(1) Harper Malcom
"Small Business in the Third World"
(John Wiley & Sons, New York), 1984, Page 13

...2.
monopoly profits, and on the inefficiency which monopoly breeds. In this way they contribute to the efficient working of the economic system as a whole.

According to socio-political arguments small scale industries help in better distribution of wealth and reduce regional imbalances by dispersal of industrial structure. Besides, due to wide distribution of industrial structure it is less prone to enemy attack or internal disturbances. The employment oriented characteristic of SSI also helps in reduction of poverty in the country. Finally, the quality of community life is undoubtedly enhanced by the growth of SSI. These industries have a special role in the production of artistic goods where workman's skill is of importance.

In the wake of rapid industrial development of our country a large number of industrial units of different sizes, types and in different regions are coming up. A sizeable portion of the new units set up belongs to the small scale sector. There has been a phenomenal increase in the number of units established in the small scale sector. Taking into account the unregistered units, the total number of small scale units has risen from 7.34 lakhs to 12.75 lakhs during the period 1978-79 to 1984-85.\(^\text{(2)}\)

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The value of investment in the small scale sector is also considerable, it now amounting to Rs. 7360 crores. The value of production was about Rs. 50,520 crores (at current prices) in 1984-85 being 50 per cent of the country's total industrial production. The small scale sector provides employment to 90 lakhs persons. The data regarding the number of small scale units, their production, employment, exports, etc. are given in Table Nos. 1 to 4 in the Annexures.

In other countries also a significant part of manufacturing activity takes place in small and medium scale enterprises. (3) In Japan small and medium scale enterprises account for about 55 per cent of total industrial production, and they form 99.4 per cent of all industrial establishments in that country. (4) In USA also small enterprises account for approximately 50 per cent of the total businesses in the American economy and more than 95 per cent of the enterprises belong to the small scale sector. In USA there were about 94.00 lakh small scale enterprises. (4a) During the past few years, as the economies of the western industrialised countries have either stagnated or moved deeper into recession, it has

(4) National Alliance of Young Entrepreneurs, New Delhi "Small Industries - A study on credit facilities in India and other selected countries" - 1979, Page 72
(4a) Ibid - Page 72
become increasingly evident from a variety of studies, and from official government policy statements towards industrial and technological development, that small firms are more and more being seen as one of the favoured vehicles for economic regeneration. In particular small and medium enterprises are claimed to be more than averagely innovative, they are seen to be especially suitable as an instrument of regional development policy and perhaps above all, they are believed to be the most potential generators of new jobs. (5)

Fred R. Wittnabert has observed that contrary to popular opinion, big business is no longer much more profitable than small business, and since 1960 it has been fast losing its margin of superiority and has in fact already fallen behind small business in some respects. (6) The reasons for this trend are accelerating rate of change in the market place and in technological advance, rise of knowledge as an asset and other "equalising" influences like public hostility to big businesses, employee attitudes, new patterns of demands, foreign competition, Government policies etc.

Thomas A. Timberg has observed that small units are the most efficient ones in a given industry and for this reason continue to pre-dominate. He has mentioned that in

(5) Rothwell Roy and Zegvald Walter
"Innovation and the Small and Medium sized Firm"
(Frances Pinter Publishers, London) 1982, Page 244.
(6) Wittnabert Fred R
"Bigness Versus Profitability"
some cases decentralised small scale units have actually displaced large ones because of superior efficiency or at least superior profitability. (7) Comparative performance of the Small Scale Sector in India and Corporate Sector has been given in Table No. 5 in the Annexure. The Bolton Committee report put forth the following argument in favour of small firms. "Their output per person employed is on an average lower than that of large companies, but this is in part explained by the labour-intensive nature of the trades in which small firms dominate, and by differences in the composition of the labour force - the employment of more part time labour. It is also counter balanced by a better return on capital employed, so that there is no ground for asserting that as a group large firms are more efficient than small ones in their use of total resources, or the reserves". (8)

At one time it was believed in many countries that by establishing a few prestigious large industries rapid industrialisation of the country would take place automatically. However, small industries development is now being recognised as vital to the rapid economic

(7) Timberg Thomas A.  
"Small Industry - Cannibals and Missionaries"  


...6.
growth of developing countries. (9) This of course does not mean that one should be "against" large industry. Rather as pointed out by Eugene Staley and Richard Moree, the most productive industrial structure for any country will be a combination of large, medium and small manufacturing units. The best combination is that in which there is a reasonable approximation to the optimum unit size for each type of product, taking into account production and marketing requirements, size and geographical distribution of markets and resources, the level of transport costs and other factors. (10)

In India, various industrial policy resolutions of 1956, 1980 etc. reiterated the importance of the small scale sector and emphasised the continued need for its development as an essential step towards economic self-reliance. (11) As mentioned earlier the small scale industries in India have fared extremely well, maintaining high rate of growth and there has been a big leap in the number of small scale units, in the employment generated etc. However, of late, there have been some disturbing reports of growing sickness in numerous small scale industrial units. Industrial sickness has become a

(9) Vapa Ram K. "Productivity in Small Industries - Some Lessons from Japan" - (Asian Productivity Organisation), 1969 Page iii


growing phenomenon in our country causing much anxiety to
the lending agencies, the government and the entire
business community. Corporate collapse has always brought
fearful mental pain to entrepreneurs, managers and their
families. People will not accept failure explicitly as
they used to. (12) Some will go to any lengths to avoid it.
They organise sit-ins and protest marches and call the
Government for help. Every year huge resources of commercial
banks and other financing agencies are being locked up in
sick industrial units and there are no immediate signs of
a reversal of the trend in sickness. Since banks today are
financing business activities in wide areas and diverse
fields, it is difficult for them to obtain and scan relevant
information for each type of business unit and adopt adequate
preventive measures in time to safeguard their interest with­
out resorting to more drastic measures. Industrial failure
has always brought years or decades of legal wranglings in
its wake. It has ruined lives, destroyed the health of its
victims, and pushed them to the edge of suicide. Sick units
lock up funds of banks. Since banks can not recycle funds
locked up in sick industrial units, they inevitably suffer
a loss of opportunity and loss of income, affecting their
own profitability.

(12) Argenti John
"Corporate Collapse - the causes and symptoms"
(McGraw Hill Book Co. (UK) Ltd.)
1976, Page 2
I have been working as an Officer in one of the Nationalised banks in Pune and have observed a number of small scale units becoming sick due to one reason or the other. Though some units become sick due to external factors like change in Government policies, unfavourable market conditions, labour trouble etc. the main causes of sickness are internal such as faulty planning, wrong selection of product line, lack of proper study of the market, tough competition among SSI units due to their mushroom growth in one product line, lack of managerial abilities etc. I have also observed that delays in the preparatory work for starting production and consequent cost overruns are crucial factors responsible for rendering several units sick at the operational stage, if not at the trial production stage itself.

Since more than Rs. 321 crores of commercial banks' moneys were blocked in 22360 sick small scale units, as at the end of June 1981 (13), I thought that it is necessary that some one who is actually dealing with the problems of small scale units, should do research in this subject, which will be of some use to the lending agencies, Government, as well as the small scale entrepreneurs themselves. I therefore selected "Problems of Small Scale Industries, with special reference to selected units in Pune Metropolitan Area" as the subject of my research and started working on this project.

(13) Reserve Bank of India
"Report on Trend & Progress of Banking in Indis 1981-82" - June 1982
The purpose and objectives of study

The threat of failure confronts many small business enterprises, particularly those that are new comers. (14) Avoidance of failure has always been as much a part of a manager's task as the achievement of success. When many small scale industrial units are started annually, it is difficult to say why some succeed and why others fail. In the big impersonal world of macroeconomics, the story is easy to identify and explain - it is called as economic Darwinism - i.e. survival of the fittest. (15) While everyone agrees that bad management is the prime cause of failure, no one explains what 'bad management' means, nor how it can be recognised except after the company has collapsed, when everyone agrees how badly managed it was. In recent years a variety of generalised factors and situations have been identified as contributing to the indifferent performance of industrial units. However in generalising certain factors it is likely that one may miss some of the root causes of failure. It is therefore necessary to make a systematic study of this problem.

Based on the various material/articles published in newspapers and journals it is felt that a general feeling exists among business circles today that shortage of working

(14) Broom H.N. and Longnecker J.G.  
"Small Business Management"  
(South-Western Publishing Co.) 1971, Page 80

(15) Delaney William A.  
"Why Small Business Fail" (Prentice-Hall Inc.)  
1984, Page 5
capital is the main underlying reason for most of the failures among small scale industries. However, this view is not accepted by the bankers who provide credit to small scale industries. After studying many cases of small scale industries during my 10 years experience in banking, I have formed an opinion that though shortage of working capital is a symptom of sickness present almost in all cases of sick units, it is not the basic cause of trouble. A.M. Woodruff and T.G. Alexander have rightly mentioned that blaming failure of a unit due to lack of funds is like blaming a patient's illness on the thermometer reading. (16)

I also feel that marketing problem is the main factor contributing to the sickness of the small scale units. The marketing concept is yet to be fully understood, accepted and given effect to by the Small Scale Sector in India. (17) Marketing management is perhaps today considered of less importance by the small scale sector, as compared to production management. Marketing problems therefore continue to trouble the small scale sector. With the rapid growth of the small scale sector, and the resultant tough competition, the market can no longer be taken for granted by the small entrepreneurs.

(16) Woodruff A.M. and Alexander T.G. "Success & Failure in Small Manufacturing" (University of Pittsburgh), 1958, Page 4
I have therefore developed the following hypothesis.

(1) Shortage of working capital is generally not the major cause of sickness, but is symptomatic of some other inadequacies like inefficient marketing, inefficient management etc.

(2) Marketing is the major problem faced by small scale entrepreneurs. In marketing area problems like organisational inadequacies, severe competition, recession, wrong choice of the product line are some of the major problem areas, which ultimately make a unit sick.

(3) Apart from the marketing problem, other problems like labour trouble, mismanagement also affect the viability of a unit. But, the percentage of units becoming sick due to these reasons is less, as compared to marketing problems.

With a view to testing the above hypothesis and also to finding out the real causes of failure/sickness and also to suggesting some remedies for avoiding sickness by taking due precautions and timely measures, I decided to study the working and financial position of a few small scale industrial units. The principal objective of the study was to collect data about the problems and difficulties faced by the entrepreneur during the inception as well as operational phases, to have some insight into the working of SSI units and to suggest some remedial measures. But then should we try to prevent or cure failure? In the capitalist system (like U.S.A.) the resources of society are transferred from
one application to another, deemed to be more useful, by
the decline and failure of companies that are not using
resources usefully, and by the rise and success of
companies that are. (18) If we tamper with this mechanism
by reducing the number of failures, are we not going to
damage the efficiency of the economy? This may be true in
a capitalist country. But in India, where we have a mixed
economy, which is planned, and where we have shortage of
resources we cannot allow such waste of scarce resources,
and we have to strive for reduction in the rate of failure
of industrial units. That was the real objective of my
study.

(18) Argenti John
"Corporate Collapse - the causes and symptoms"
(McGraw Hill Book Co. (UK) Ltd.)
1976, Page 170