CHAPTER II
REVIEW OF LITERATURE

2.1 Introduction

Many studies have been done in the domain of entrepreneurial failures. Knowing the root causes for entrepreneurial failures has always been a current topic of interest since it throws light on the possible ways and means of overcoming entrepreneurial failures, thereby making efficient use of productive resources. The literature available on the reasons for the failure of entrepreneurial ventures are discussed below.

2.2 Managerial factor

Though there have been studies done by different experts in different parts of the world, a common thread that links the findings of most of the studies is that, despite many variables that influence the performance of an enterprise, it is the person behind the venture who is of prime significance. In other words, it is the managerial factor that outweighs all other factors. Other factors do have their effect. But, even if other factors are favourable, still a project can fail if it is not well managed. This points out the importance of managerial factor.

John Argenti\textsuperscript{1} attaches greater importance to managerial factor for the failure of business ventures. According to him, only under extraordinary conditions external factors may have their influence over failure. He gives an analogy for collapse of a company as under:

\textit{The collapse of a company is in some ways similar to the sinking of a ship. If a ship is in good condition and the captain is competent, it is almost impossible for it to be sunk by a wave or a succession of waves. Even if there is a storm, the competent captain will have heard the weather forecast and taken whatever measures are needed. Only a freak storm for which quite inadequate notice has been given will sink the ship.}

Sudarshan Lal\textsuperscript{2} who worked with Small Industries development Organization of the Government of India attaches highest importance to the management of the enterprise for its failure. In the words of Sudarshan Lal, \textit{the most important cause for the ailment of an industrial enterprise can be attached to its management. This is because it is the}
management that conceives a project, its location, infrastructural requirements, finance, machinery, equipment etc., and puts the same into operation. All the units in an industry have access to almost the same resources. The one thing that distinguishes a successful enterprise from an unsuccessful one would be the quality of management

S.L.N.Simha\(^3\) state that any of the difficulties are the result of in-experience, either because the entrepreneur is new or even an experienced has embarked upon a new manufacturing line which is fairly sophisticated and for which much experience may not be available in the country or the difficulties may arise because of failure to exercise proper judgment in such basic matters as location of the unit, capacity, process, product mix, availability of power, water and adequate transport facilities, demand for the product etc.,

Dr.P.K.Sahu\(^4\) discussing about industrial sickness attaches greater importance to the influence of bad management for making an industry sick. He quotes as under:

*Industrial sickness generally caused by several uncontrollable external reasons and a number of controllable internal factors. Some of the more important external reasons being labour unrest, shortage of energy and raw material supply which interfere with production and create variance in cost and various Government regulations relating to tax, industrial disputes and for pollution control and health improvements. Besides these factors, the following categories of aggregate economic behaviours of the country have direct bearing on industrial sickness:

a) Economic growth activity (as Real GNP)

b) Credit availability or money supply

c) Capital market activity or investors expectations

d) Business population characteristics &

e) Price level changes.

From among the various industrial causes, the *prime cause of industrial sickness* is bad management

Dr. P.K.Sahu highlights that the overwhelming causes of business failure are management deficiency, mismanagement and management dissensions.
S.R. Singh and V. Kumar explain the process of managerial efficiency that causes failure based on their experiences at the BIFR (Board for Industrial and Financial Recondition) as under:

Let us elaborate these in some detail based on our experience and study of the cases dealt with by BIFR. The promoters with no experience of industry but having earned large amounts in other areas like trade, agricultural etc., get attracted to industry hoping to make quick buck. Their lack of experience can be made good by assistance of professional managers. But, they try to manage industry as a proprietary concern, often remaining away from the unit. Having no knowledge of technical needs and requirements of plant and equipments and minimum capacities necessary for viable operations, they mess up the unit from inception. The lack of planning and control soon manifests itself in high costs; the sickness soon sets in which gets aggravated owing to insensitivity of management to vary the product mix according to market needs; by and large, management failures remain the main cause of sickness.

2.3 Financial ratios as predictors of Industrial sickness

A large number of literatures are available on the use of financial ratios for predicting industrial sickness. Despite a large volume of work having been done in this area, the studies, in general, have only analysed the causes of sickness after the units have already become sick or in the process of becoming sick. In other words, analysis of financial ratios is only akin to doing a post mortem. Since it is prevention that is always better than cure, it is always of interest to identify those factors that are behind failure of entrepreneurial units so that adequate precautionary measures can be taken to prevent them from falling sick. Once the causes responsible for failure are understood and remedial measures are taken, the financial ratios will automatically improve. Financial ratios, no doubt, reflect the health of an enterprise. But, it can not provide a cure. The cure to industrial sickness lies in predicting the causes that are responsible to make an enterprise sick and in taking relevant preventive measures.

Sudarshan Lal points out the unreliability of totally relying on financial ratios as under:
The financial ratios, in all cases, can not be treated as true indicators of the state of health of a firm. The firms, especially the sick prone ones, in order to put up a better image, do a lot of window dressing. It has been observed that with a steady erosion of profitability, unnoticed by the banker, the borrower’s liquidity declines and the first sign of difficulty is delayed payment to creditors’ leading ultimately to default.

An obvious reason that has a great influence of the health of an organization that is started with borrowed capital is the proportion of borrowed capital. Since borrowed capital is interest bearing, a lower proportion of borrowed capital will always help an organization to sail through safely. Dr. P.K.Sahu ranks capital gearing as the important factor next to management factor in influencing sickness. According to him, from among the various internal causes, the prime cause of industrial sickness is bad management and the next important internal factor responsible for industrial sickness is the high rate of capital gearing. P.K. Sahu is of the firm view that high gearing and an economic depression are sufficient enough to push a marginal firm into sickness.

2.4 Exogenous and endogenous factors

Any industry/business is under the influence of both internal and external factors. Internal factors have their influence because they are the factors that are built into the enterprise’s system and that have immediate repercussions on the functioning of the enterprise. Every industry/business functions within a macro environment that is external to the enterprise. However, no enterprise can function in isolation without any link with its macro environment. Though external in nature, Macro level factors have powerful influences on any enterprise.

Both internal and external factors have the following sub-factors. Many studies have underlined the presence of these factors that influence the performance of industrial units.

- Financial factors
- Production related factors
- Personnel related factors
- Market related factors
Any business is under the influence of both internal and external factors. Hence, the success or failure of any business venture may be due to internal, external or the combination of internal and external factors. Datt, R. and Sundharam, K.P.M.,\textsuperscript{8} brings out the influence of internal and external factors as under:

*Industrial sickness may be attributed to several factors working simultaneously which may be either internal disorders in the functional areas or external disruptions, popularly known as endogenous factors and exogenous factors. The endogenous factors may be function-related which are very much within the control of the management of the industrial enterprise. The exogenous factors relate to such factors as the Government policies pertaining to production, distribution and prices, changes in investment pattern following new priorities in the plans, shortage of power, transport, raw-materials and deteriorating industrial relations; such exogenous factors are likely to affect all the units in an industry.*

R.A.Sharma\textsuperscript{9} argues that an unfavourable investment climate and poor market conditions affect all categories of entrepreneurs.

Banarsi Misra\textsuperscript{10}, in his treatise on industrial sickness brings out the following internal and external causes as the factors responsible for the failure of industrial ventures.

*Internal causes*

- Unbalanced top managerial team
- Non-participating top management
- Lack of requisite personnel
- Insufficient knowledge of the industry
- Poor reporting of faults, breakdown, sales in the industry
- Poor cash flow planning
- Poor costing system
- Poor budgetary control
- Poor project implementation
• Poor market survey
• Reliance on only one customer
• Lack of market penetration
• Inefficient operation of plant and machinery
• Poor maintenance and replacement of components and parts
• Obsolete technology
• Under-utilization of technology
• Shortage of power
• Lack of production planning and control
• High material waste
• Labour unrest
• Unfavourable financial gearing
• Overtrading
• Deliberate diversion of funds
• Poor management of working capital

External causes

• Financial constraints due to credit policy of Government / institutions
• Unfavourable investment climate
• Shortage of infrastructural inputs like raw-materials, power, fuel etc.,
• Environmental constraints
• Inaccurate demand forecasting
• Imposition of excessive taxes by the Government
• Changes in international markets
• Availability of substitutes at lower price
- Difficulty in getting skilled man-power
- Lower productivity
- Deterioration in quality
- Increase in wages
- Increase in overhead costs

Though Banarsi Misra had covered all the possible causes that may lead to failure of entrepreneurial ventures, there has been certain overlap while classifying the factors under the two major heads of internal causes and external causes.

Gadgil, P.G. and Gadgil, P.L., quotes as under:

Non-financial signals also forewarn impending sickness. Low morale, desperation among the top and middle management level, turnover of employees, poor maintenance of plant and equipments, consumer complaints, frequent stoppages are some of the indicators of poor health of an industrial unit.

The non-financial signals indicated by Gadgil, P.G., and Gadgil, P.L., point to the influence of the following factors other than finance related factors, to the failure of enterprises:

- Production related factors
- Personnel related factors
- Market related factors
- Managerial factors

Though Sudarshan Lal gives top priority to managerial factors, he also assigns the following factors as responsible for the failure of enterprises, in varying degrees.

- Production related causes:
  - Improper layout
  - Improper maintenance
  - Absence of modernization
- Faulty production programme
- Low utilization of plant and equipment
- Lack of product diversification

- Poor materials management:
  - Excess/short purchase of raw materials
  - Wrong choice of suppliers
  - Redundant inventories

- Marketing causes:
  - Entering a buyer’s market
  - Producing a new product that has not yet gained customer acceptance
  - Pricing the product with thin margin
  - Absence of product mix

- Finance related causes:
  - Withdrawal/diversion/siphoning of funds
  - Losses arising out of bad debts
  - Lack of financial planning and control

- Personnel related causes:
  - Poor industrial relations
  - Absenteeism/labour turnover
  - Overstaffing

According to H.K.Bedbak, the achieved causes are those causes that are the result of poor operating performance that are internal to an organization. He observes as under:

*The internal causes from which sickness is achieved by the units are bad management due to inexperienced and inefficient management personnel, unplanned expansion, stock mismanagement due to bigger inventories, more credit purchases, more expenditure due to*
unproductive fixed assets and function, inadequate collection of receivables, defective buying of poor quality assets and raw materials, more replacement due to poor maintenance, lack of scheme of modernizing technology and absence of industrial relations etc. These causes make the unit gradually sick and turn the concern nonviable

According to H.K. Bedbak, Thrust-upon causes are the external causes that are not within the control of the units. He includes causes like shortage of power and energy, disrupted supply of raw materials, artificial economic constraints, unrealistic and erratic pricing policy and inordinate delay by financial and governmental agencies in extending help and deficiency of demand in the market under this head.

2.5 Shortage of working capital, a crucial cause

Many experts have opined that shortage of working capital has been found to be the main cause for the failure of industrial units, especially the units that are newly set up. This has happened so in India, especially due to the structural deficiency in the financial system, where there are two sets of institutions viz., financial institutions and commercial banks catering to two different financial requirements of the same enterprise. While financial institutions extend term loans, commercial banks prefer extending working capital facilities. If there is no coordination between the two institutions, the ultimate sufferer will be the borrower, either due to delayed sanction of working capital assistance or inadequate working capital facilities extended. The difference in lending pattern between financial institutions and banks is getting narrowed down with banks also opting to extend term loan and financial institutions opting to offer some form of working capital assistance. However, because of the nature of their resources, there is bound to be some difference in their lending pattern. Since a greater proportion of the funds mobilized by financial institutions are in the form of long term borrowings, they are on a better footing to extend long term loans. As the liabilities of commercial banks are mostly in the form of short-term deposits, they are in a better position to extend working capital assistance, which is of short-term nature. The ideal situation of a single institution taking care of all the financial requirements of an enterprise can be possible only if the there is no asset-liability mismatch in terms of maturity period.
Tony Morden\textsuperscript{14} in his book on Strategic Management observes as under:

*Where the working capital base is inadequate, the enterprise runs the risk of becoming over-reliant on short term financing from banks and trade creditors. An increasing reliance upon such funds may eventually lead to a situation in which there is significant excess of current liabilities over current assets and the threat of withdrawal of bank and creditor support."

C.L. Pass and R.H. Pike\textsuperscript{15} in their article on working capital management and corporate financing observes as under:

*Experience shows that inadequate planning and control of working capital is one of the more common causes of business failure.*

2.6 **Project formulation factors**

A work well begun is half done. If a project is conceived correctly and executed properly, it eliminates the probability of the venture turning out to be failure, considerably. Hence, other reasons apart, proper planning at the project formulation stage also plays a vital role in the success/failure of enterprises. Project formulation is a crucial step. At this stage, the entrepreneur has not yet committed his funds; he has all the time in the world to examine the project from all aspects, to analyse the pros and cons of different options and to decide upon the best-suited formulation. Any error committed in haste at the project formulation stage will land the project in trouble. A project that is wrongly conceived will have inherent weakness that will ultimately land the project in failure. The entrepreneur needs to do sufficient groundwork to study the project from all aspects to ensure that the project is correctly formulated.

The literature available on project formulation factors throw light on the importance of correct formulation to avoid the possibility of projects becoming sick at the incipient stage itself. Sudarshan Lal\textsuperscript{16} points out that a wrongly formulated project exposes managerial inefficiency. He puts forth his views as below:

*Deficiency in managerial skills is evident from the manner in which the project has been formulated or implemented. The entire exercise would lack decisiveness and would be accompanied with frequent delays. Indifference, casualness and lack of*
dynamism would be evident everywhere. This shows inability of the management to man and run the enterprise successfully, even if the project is implemented.

Banarsi Misra\textsuperscript{17} also brings out the importance of proper formulation and implementation of projects in making the project a success as under:

Improper project planning by entrepreneurs, particularly by those going in for SSI units, by showing a low, unrealistic project costs for matching with the available equity has also been found to be generally responsible for industrial sickness. It is generally done for qualifying as a small-scale industry to avail of the benefits of interest concessions and other relieves available to this sector. Similarly, the project costs may be inflated deliberately and the funds are either diverted to other concerns or lavishly spent on buildings, furniture and other non-productive assets. This, in turn, increases the fixed cost and enlarges the break-even level. Another aspect is the over-optimistic or exaggerated project reports submitted by the entrepreneurs wherein generally a higher surplus generation from the unit’s operations is shown which becomes the basis for fixing the installments for the repayment of loans. Subsequently, when the repayment programme is not adhered to on account of meager surplus generation, it may lead to industrial sickness.

A project that is correctly conceived and implemented will in all probability be a successful one. At the project formulation stage there is ample scope available for carrying out a detailed analysis about the project cost with a view to keeping the project cost to the minimum. G.Jayabal and K.Nagarajan\textsuperscript{18} point out that a zero-based approach shall be followed for arriving at the project cost. According to them, unless serious thought is given to reduce the project cost by considering its components one by one and applying the zero-based principle, the project cost will only shoot up and the entrepreneurs will get trapped. Such systematic zero-based approach to project formulation not only reduces the initial investment considerably, but also improves the financial profitability of the project.

In their article on \textit{Root Cause of Entrepreneurial Failure}, Nicholas A. Bibby\textsuperscript{19} observes as under:

\textit{The two widely acknowledged causes of small business failure are 1) lack of knowledge about the business, and 2) insufficient capital to sustain the venture through}
break-even and profitability. A far more powerful and important root cause of failure that I now accept after a lifetime of study and observation is poor fit. Therefore, for me, traditional explanations for business failure are too elementary and not equal to the magnitude of the problem. Insisting that businesses fail due to knowledge and capital is tantamount to insisting that wind and rain cause roofs to leak.

Nicholas A. Bibby argues that most entrepreneurs can learn the basics of running a given business through traditional schools, books, training programmes, consultants, franchisors etc., According to him, the matter of insufficient capital can be overcome by intelligent and careful planning. He puts in place two things, which if absent will lead the business venture to failure; they are, ‘passion for the work involved’ and ‘personal fit’ for the venture.

Bibby’s argument that knowledge can be acquired and capital can be adequately tied up with a little bit of planning can carry weight only if all the entrepreneurs who opt to start their own ventures undertake these exercises. Since may entrepreneurs realize only at a later stage that they had committed the mistake of not studying their project in depth before setting up their projects, it still means that some failures do take place due to lack of knowledge. Similar is the case for the argument of Bibby that with intelligent and careful planning, the required capital for the project can be forecasted and mobilized. Many projects still fail due to delayed take-off, due to partial abandonment and due to incurring cost over-run etc., All these point to the fact that venturing upon projects with inadequate capital still leads to failures. However, Bibby is right when he says that ‘passion for the work involved’ and ‘personal fit’ are the two requirements to avoid failures. These attributes relate to the entrepreneurial traits of the individuals and they play a vital role in the success/failure of entrepreneurial ventures.

G.Jayabal and K. Nagarajan\(^{20}\) in their article ‘Entrepreneurial failures – the role of inadequate capital’ have brought out the mechanism that leads to failure, starting from inadequate equity capital. According to them, a lower equity capital base leads to failure following a sequence as indicated below.
Inadequate equity capital
↓
Inadequate debt capital
↓
Delay in tying up debt
↓
High cost of borrowings
↓
Delayed implementation
↓
Cost overrun
↓
Non-availability of working capital assistance
↓
Repayment of high-cost debt
↓
Accumulation of dues with banks/financial institutions
↓
Non-performing asset
↓
Non-availability of rehabilitation assistance from banks/financial institutions
↓
Dwindling of profits
↓
Recovery proceedings by banks/financial institutions

The authors quote inadequate equity capital as a cause for failure in a nut-shell as under:

*Though projects fail due to a number of reasons, one of the reasons that is come across frequently is the inclination on the part of the entrepreneurs to venture upon projects of bigger size, whose investment limits are beyond their means and reach.*
In other words, the tendency on the part of the entrepreneurs to stretch too far often lands projects in trouble.

Going in for projects with inadequate resources means delay in implementation which will have its bad consequences, leading to failure. On this account Sudarshan Lal\textsuperscript{21} cautions as below:

\textit{Delay in implementation would add to the project cost by way of interest for longer period of gestation, imposition of commitment charges, added costs towards contingency and supervision; If over-run in cost is to be met by raising supplementary finance from lending institutions, the over-run is likely to be still higher on account of delays in securing additional assistance; if the over-run in cost is such that it is not in a position to service the debt, the project is likely to become sick}

2.7 The importance of Market related causes

Next to managerial factors, most of the studies point to market related factors for the failure of projects. Market related factors gain importance because of their extraneous and continuously changing nature. Market related factors have often been found to be leading in its influence, mainly because of the fact that controlling market factors are not entirely in the hands of the entrepreneurs. The literature available on market related factors, especially those pertaining to Indian context, speak strongly in favour of market related factors, since in free market economy, the behaviour of market forces become not easily predictable.

The very purpose of existence of any business organization is to satisfy customer needs. If an organization has not oriented its objectives towards this goal of customer-satisfaction, the organization is bound to be ignored by the customers, which means that the organization will eventually face failure, however strong it may be in other aspects. Hence, market related causes play a vital role in deciding the success or failure of entrepreneurial ventures.

Siddharth Aguna\textsuperscript{22} brings out the importance of market research, customer orientation, assessing and facing the competitors, the importance of accurate sales-forecasting etc., in his work as under:
2.7.1 On Market research

Many small businesses concentrate on improving their methods of production. However, conducting research to make improvements in marketing your product may bring even greater benefits; many businesses offer good products; but unless the entrepreneur takes advantage of the market opportunities, few of these products will be sold. The purpose of market research is to gather information to use in marketing decisions. Many entrepreneurs make the mistake of business decisions on their own feelings and opinions. To be valid, however, your decisions should be based on the best information available. Market research will help you to identify new markets to enter and to find new customers in your existing market.

2.7.2 On Customer orientation

Your customers and potential customers have a choice and you need to make sure that there are good reasons for them to buy from you.

2.7.3 On Competitors

Combining your own good ideas with the best ideas of your competitors could give you an advantage. You can learn from your competitors’ successes and avoid their mistakes. A single mistake can be disastrous to your business. You must be aware of what your competitors are doing. Knowing your competitor helps you to understand the total business environment in which you operate. If you don’t know how your competitors will react to your plans for change, you are probably operating your business ineffectively.

2.7.4 On accurate sales-forecasting

The total sales forecasting process is one of refinement. It starts with the more general factors – the external, non-controllable environment and the internal business environment – quantifies them and finally establishes specific operational goals and targets. Marketing planning often suffers because management does not develop an effective sales-forecasting programme; since one of the basic components of effective marketing is sales-forecasting, it seems obvious that in the future an increasing amount of time and resources will be spent by companies in developing more adequate sales-forecasts.
2.8 Simultaneous presence of many causative factors

Though there are many different causes that influence failure of units, it rarely happens that a single factor is responsible for the failure of a particular unit. In effect, all units are under the influence of some or all of the factors. It is the combined influence of many causative factors that eventually make units fail. Studies also point to the simultaneous influence of many factors on the performance of enterprises.

Though studies by different experts have lead to the identification of many causes that are responsible for failure of entrepreneurial ventures, the cause / causes that are responsible for the failure of a particular venture differs / differ from one venture to another. External, internal and managerial causes may be present simultaneously. According to R.A.Sharma\textsuperscript{23}, \textit{every unit has its own problems and many a time, several problems are present simultaneously.}

The presence of more than one cause for failure is brought out by the article in the Business column of The Hindu\textsuperscript{24} as under:

\textit{The reasons for the failure of units are many. It is usual for banks to blame the entrepreneurs for the failure and the units to blame back the banks. What is lost sight of in the counter offensives is that the real cause of sickness is not identified in time and remedial measures are not initiated promptly. Sickness has become endemic in small industries owing to a combination of factors such as inadequate and delayed institutional finance, inefficient and non-professional management, shortage of inputs including power, labour unrest, technological obsolescence, market failure and competition.}

\textit{Economic reforms and globalisation have postulated competitive efficiency as the critical determinant factor in business. In order to re-emerge as organic parts of a globally competitive industrial economy, Indian small industries need adequate political and appropriate beauracratic support.}

John Vinturella\textsuperscript{25} in his article explaining the risks of entrepreneurship quotes his experience as under:

\textit{When small businesses fail, the reason is generally one, or a combination, of the following:}
• inadequate financing often due to overly optimistic sales projections
• management shortcomings such as inadequate financial controls, lax customer credit, inexperience, and neglect, and
• misreading the market

The above reasons attributed by John Vinturella fall under the three major heads, ‘Finance related factors’, ‘Management related factors’, and ‘Market related factors’.

Business & Entrepreneurship information exchange for self-employed and business-oriented experts lists down the 21 Most-Common reasons for Business failure as below:

1. Failure to focus on a specific market because of poor research
2. Failure to control cash by carrying too much stock, paying suppliers too promptly and allowing customers too long to pay
3. Failure to control costs ruthlessly
4. Failure to adapt your product to meet customer needs
5. Failure to carry out decent market research
6. Failure to build a team that is compatible and has the skills to finance, produce sell and market
7. Failure to pay taxes (Insurances and VAT)
8. Failure of businesses to grow; businesses which did not try to grow didn’t survive.
9. Failure to gain new markets
10. Under-capitalization
11. Cash flow problems
12. Non-payment by customers
13. Poor sales & marketing
14. Fatal leasing agreements
15. Loss of financial backing
16. Tougher market conditions

17. Poor management

18. Directors aiming to find new markets, but not making a single sale

19. Companies diversifying into new, unknown areas without a clue about costs

20. Companies finding that staff set up as rivals and stealing the business

21. Company directors spending too much money on frivolous purposes thus using up all available capital

A glimpse at the list of reasons reveals that the reasons fall under the following broad categories:

- Financial factors
- Market related factors
- Management related factors &
- Production related factors

Waller Lansden, a business service organization helps businesses and individuals throughout the United States and abroad achieve financial and strategic goals in a wide range of transactional, regulatory and litigation matters. Bobby Guy²⁷, an attorney with Waller Lansden in Nashville, who practices Bankruptcy Law, quotes the following reasons for business failures out his rich and varied experiences.

1. Management in Complete Denial

2. Failure to Adapt to a Changing Market

3. Reliance on Critical Financing that Dries Up

4. Poorly Designed Business Model

5. Poor Internal Controls and Execution – customer service, accounting controls, theft, fraud

6. Addition of New Products or Divisions that Drag Down the Profitable Ones.
7. Failure to Prepare for Volatility of Uncontrollable Costs. For example, energy, materials, labor, or insurance.

8. Failure to Control the Controllable Costs. Businesses spend down the initial cash before it is flowing in at a positive rate.

9. Poor Capital Structure. Companies take on too much debt…. Enough said!

10. Over-expansion. The need to get there first or to demonstrate revenue growth to anxious investors leads businesses to grow too fast.

He quotes incompetent management as the top most reason leading to failures.

2.9 Findings of previous studies

a) Studies conducted by different experts in different parts of the world have pointed out many causes that are behind the failure of industrial ventures. Out of the various causes identified by different studies, ‘Managerial factor’ has come out as a strong factor that decides the fate of a venture, despite the fact that other causes also play their part.

A survey conducted in the United States on the major reasons for small business failures gives the following break-up details:

<table>
<thead>
<tr>
<th>Reasons for failure</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neglect of Business</td>
<td>3.00 %</td>
</tr>
<tr>
<td>Fraud</td>
<td>2.00 %</td>
</tr>
<tr>
<td>Disaster</td>
<td>1.00 %</td>
</tr>
<tr>
<td>Poor Management</td>
<td>92.00 %</td>
</tr>
<tr>
<td>Others</td>
<td>2.00 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00 %</strong></td>
</tr>
</tbody>
</table>
Further analysis of the causes for poor management gives the following break-up details:

<table>
<thead>
<tr>
<th>Management Causes</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incompetence in line</td>
<td>9.00 %</td>
</tr>
<tr>
<td>Inexperience in Management</td>
<td>18.00 %</td>
</tr>
<tr>
<td>Unbalanced experience</td>
<td>20.00 %</td>
</tr>
<tr>
<td>Incompetence</td>
<td>45.00 %</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00 %</strong></td>
</tr>
</tbody>
</table>

The highest score of 92 % obtained by ‘Poor management’ and the highest score of 45 % obtained by ‘Incompetence’ go to point out that it is the person behind the industrial venture who is primarily responsible for its success/failure.

b) A study team of the State bank of India in its report[^29] on the causes of failure of enterprises has stated that a large number of units studied by them lacked management expertise. This, according to the study team, is evident from the fact that **there was no planned approach to the activities in the key functional areas, such as finance, marketing and production; there was no financial discipline, particularly in the management of working capital and there was no effort to build up internal strength during good periods.**

c) Study conducted by R.P.Mahapatra[^30] on the reasons for sickness of industries financed by Orissa State Financing Corporation came out with the finding that **inefficient management is the single major cause for industrial sickness.** The study concludes saying as below:

*One of the interesting remark of the study is that the units run by entrepreneurs having no business background are inflicted to sickness. Although most of the entrepreneurs are educated, considerable number of units are becoming sick due to lack of professionalism and managerial talent. Hence, efforts may be made to arrange training facilities through various programmes like entrepreneurship development programme to check its further spread.*
d) R.A. Sharma\textsuperscript{31} who studied 242 manufacturing companies spread throughout the country to identify the reasons for good/dismal performance of enterprises, observes, interalia, as under:

*Entrepreneurial performance is a function of socio-cultural background of the entrepreneur, his motivations, knowledge, ability, financial strength and environment.*

While R.A. Sharma lists down certain entrepreneurial attitudes that were found to contribute towards success/failure of entrepreneurial ventures, his study points out that the success of entrepreneurial ventures depends primarily upon the ability of the entrepreneurs who are behind the ventures.

e) The study by The Reserve Bank of India\textsuperscript{32} on the cause-wise factors for industrial sickness and had concluded that **mis-management accounted for 52\% of the units becoming sick**, faulty planning accounted for 14\%, market recession 23\%, shortage of power, raw materials, inputs etc., accounted for 9\% and labour trouble/unrest 2\%.

f) Yrle, Augusta.C., Hartman, Sandra.J., Yrle-Fyou and Augusta.R.,\textsuperscript{33} in their study on finding the reasons for the failure of business enterprises have arrived at the conclusion that **managerial shortcomings and macro economic factors play a major role** in this regard. They conclude saying that undoubtedly, **solid management permits many small businesses to survive in difficult economic periods** which leads to the inference that though macro level economic factors have their influence on the performance of business enterprises, if the person managing the affairs of the business is shrewd enough, he/she can carry the business forward, overcoming the hurdles posed by economic factors.

g) The Tiwari Committee\textsuperscript{34} (a committee set up by the Government of India in 1981 under the chairmanship of Shri T. Tiwari to suggest a comprehensive special legislation designed to deal with the problem of industrial sickness, laying down its basic objectives, parameters and remedies necessary for revival of sick units) studied the causes of sickness in 379 large industrial units reported sick by the end of 1979. The analysis showed that in 52\% of cases, **industrial sickness was on account of deficiencies in management.**
h) Financial ratios are widely relied upon for predicting the financial health of organizations. Financial ratios, though reflect the status of financial health of a company, they suffer from the following two major deficiencies.

I. Financial statements from which these ratios are derived are available after a long time after the malady has set in.

II. There is always a possibility that the figures given in the financial statements are dressed up.

i) R.A.Sharma in his study on identifying the reasons for good/dismal performance of enterprises, finds the irrelevance of ratios in pointing out the reasons for failure/sickness of a company. According to him, *Ratios can explain the health of a company and bring out symptoms of sickness, but not the ‘why’ of sickness.*

Thus, financial ratio analysis falls short in their prediction of identifying the likely cause underlying failure of entrepreneurial ventures.

j) Vijji D.S.R., in his study on industrial sickness concludes as under:

*Mostly small scale units fall prey of sickness due to external factors.* Instances are galore to find small units being victims of inadequate power supply, lack of credit facilities, non-availability of raw materials, labour problems, poor marketing etc.,

k) R.A.Sharma quotes that his study on entrepreneurial failures points out that shortage of working capital acts as a crucial cause for failure; he observes as below:

*During the course of our investigations, we gained an impression that working capital needs of entrepreneurs, especially the new ones, are not yet being met adequately. There may be of course numerous reasons for collapse of an enterprise, but a common complaint is the shortage of working capital.*

l) Fixing up the ‘Means of Finance’ of a project is a crucial and important aspect to be looked into at the stage of project formulation. Deciding upon the proportion of Debt & Equity to meet the project cost is to be done carefully, giving due consideration to all aspects related to the financial projection. *A higher debt component may make the project unviable.* L.C. Gupta, who studied about corporate sickness observes as under:
The results point to the existence of a definite association between incidence of sickness and inadequacy of equity base. Companies with inadequate equity base appear to have little ‘reserve strength’ to weather adversities and are therefore sickness prone; a strong equity base implies the existence of unused borrowing power, whereas a weak equity base implies that borrowing power has been exhausted; unused borrowing power represents reserve strength.

m) In his diagnostic study on the sickness in Small Scale Industries in India, H.K.Bedbak classifies the causes for failure of business ventures into the following three heads:

- Inherited causes
- Achieved causes &
- Thrust-upon causes.

According to H.K.Bedbak, the ‘Inherited causes’ for sickness are lack of experience and faulty planning of the project, lack of capital, distorted capital structure, cost escalation due to delay in project commissioning, lack of marketing study, wrong location with inadequate infrastructural service, deficient financial planning, excessive capital used in fixed assets, obsolete technology, absence of market and inadequate market analysis. Such inadequates will not extend reasonable survival prospect right from its existence. The above causes quoted by H.K.Bedbak pertain to inherent weakness in formulating a project. These aspects are those that are to be carefully looked into and analyses before giving shape to the project.

n) The study report by AIMA has come out that the major cause that is responsible for the failure of Small Scale Industrial units is market related causes. The report concludes as under:

The main reasons cited by the SSIs for the non-growth of the sector have been market related (70%), finance related (25%), Government policies and regulations (12.78%), worker inefficiencies (13.2%), power (14%) and technical (14.6%). The market barriers included low sales & less demand for products, competitive market, stagnancy and market fluctuations.
In the area of Market study, SSIs lack awareness, which acts as a major hurdle to their progress. The AIMA study further observes as below:

**SSIs are getting confused about the market they should serve**, there is the local regional unorganised player at one end selling cheap quality goods; imported Chinese and Taiwanese goods on the other hand and the MNCs infiltrating into their domain on the other. As an example is the biscuit industry; many of the local players had to shut down because of competition from small bakeries on one hand and large regional players like Priyagold on the other and still larger national players like Britannia and Parle all of which offer similar products at almost the same prices. The primary benefit offered by the local players is low price, which is being eroded by the larger regional players as well as the multinationals, which have penetrated the market with lower prices to match the regional players. This has been possible due to the economies of scale, which enable the players with larger capacities to lower their prices.

In the light of the findings from the survey, some areas that are important for policy thrust have emerged. With the advent of liberalisation and multilateral free trade regimes the **SSIs are now subject to the dictum of the market forces**. No longer they will be able to get the preferential treatment, subsidy, support, protection from the Government as well as from the institutional mechanisms. So, if they want to survive and prosper in this New World order, they have to be competitive; Marketing related factors have been cited as the primary reason for the low performance of the SSI sector according to the survey. Some of the salient constraints faced by SSIs are the inability to find a target market for the products due to competition at either end of the quality spectrum.

 o) Most of the entrepreneurs go ahead with their project without adequate market research. The absence of proper market study has made many industrial units sick. On the principal cause of sickness as have been noted by BIFR in the course of examination of cases dealt by them S.R. Singh and V. Kumar\(^4\) quote as under:

*The preparation of detailed project reports involving in-depth techno-economic analysis of all the factors relevant to the success of a proposed project was not generally undertaken by entrepreneurs, nor such detailed project reports were insisted upon by the financial institutions appraising the projects. BIFR, in this connection have identified
mainly three deficiencies. First is the deficiency in the assessment of market demand. Detailed market studies are conspicuous by their absence.

p) The Industrial Potential Survey report- Chennai (2001-02) of the Office of the Development Commissioner (MSME), Ministry of Micro, Small and Medium Enterprises, Government of India, observes that the rate of industrial sickness is increasing year by year. The findings of the survey are as below:

Provision of finance has a direct impact on the performance and growth of small-scale sector. The main reason for intensification of the sickness is due to failure to detect the symptom of sickness in an early stage itself. Some units are facing working capital problems. The reasons found for sickness in industrial units are noted below:

1. Management without proper planning
2. Poor credit flow to small-scale industries from financial institutions, especially working capital.
3. Shift in demand for new product.
4. Obsolescence of technology.
5. Recession in domestic market and stiff resistance in the export market in the wake of South East Asian Crisis have caused enormous damage to the viability of many units.
6. Lack of modernisation
7. Poor management
8. Reduced demand for products
9. Shortage of credit availability

The study report by All India Management association (AIMA) also reveals that more than one cause prevails behind the failure of Small-scale industrial units. The report reads as under:

The vulnerable areas as experienced by the SSIs have been cited as low capital base, difficulties in accessing technology, credit constraint, low access to business services, constraint of quality of human resources, low market awareness, infrastructural constraints etc.
2.10 An Overview

An overview of the literatures available indicates that there is a general consensus that both internal and external factors play their roles in industrial failures. The existence of more than one cause and their interplay leading to failure of industrial ventures have been established. G.Jayabal and K.Nagarajan\textsuperscript{44} have categorized the factors responsible for industrial failures under three broad heads, viz., internal factors, external factor and managerial factors. Under internal and external factors, they have included financial, production-related, personnel-related and market-related causes. These categorization / classification of causes that are considered responsible for failure of industrial units covers all the causes identified by different studies and all the causes quoted by different experts. This classification lays down all the likely causes that are behind the failure of entrepreneurial units in organized groups under the functional divisions of financial, production related, personnel related, market related and managerial factors which was taken as reference for extracting responses from the respondents and for further analysis.

From the review of literature, the factors responsible for failure are broadly classified into three groups, viz.,

I. Internal Factors,

II. External Factors &

III. Managerial factor.

The sub-factors contained under Internal factors and External factors, the variables under each sub-factors of Internal and External factors and the variables contained in the Managerial factor taken as the basis for this study are given under:

I. Internal factors

These factors pertain purely to issues that are internal to an organization. The following factors are contained in Internal Factors.

- Internal Financial factor
- Internal Production related factor
- Internal Personnel related factor
- Internal Market related factor
The specific causes (or variables) identified that are contained in each Internal factor are as given in the Tables below:

**Table 2.1 Variables contained in Internal Financial factor**

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Higher component of Term loan</td>
</tr>
<tr>
<td>2</td>
<td>Higher interest cost</td>
</tr>
<tr>
<td>3</td>
<td>Higher project cost</td>
</tr>
<tr>
<td>4</td>
<td>Improper finance mix</td>
</tr>
<tr>
<td>5</td>
<td>Insufficient working capital</td>
</tr>
<tr>
<td>6</td>
<td>Diversion of funds</td>
</tr>
<tr>
<td>7</td>
<td>Absence of costing and pricing system</td>
</tr>
<tr>
<td>8</td>
<td>Absence of financial planning and budgeting</td>
</tr>
<tr>
<td>9</td>
<td>Delay in availing Term loan</td>
</tr>
<tr>
<td>10</td>
<td>Delay in availing Working Capital loan</td>
</tr>
<tr>
<td>11</td>
<td>Non-availability of Working Capital loan assistance</td>
</tr>
</tbody>
</table>

**Table 2.2 Variables contained in Internal Production related factor**

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Delayed implementation of project</td>
</tr>
<tr>
<td>2</td>
<td>Improper choice of machinery</td>
</tr>
<tr>
<td>3</td>
<td>Inadequate quality control</td>
</tr>
<tr>
<td>4</td>
<td>Poor maintenance of plants</td>
</tr>
<tr>
<td>5</td>
<td>Lack of production control techniques</td>
</tr>
<tr>
<td>6</td>
<td>Higher operating costs</td>
</tr>
<tr>
<td>7</td>
<td>Lack of research and development</td>
</tr>
<tr>
<td>8</td>
<td>Obsolescence of technology</td>
</tr>
<tr>
<td>9</td>
<td>Failure of technology</td>
</tr>
<tr>
<td>10</td>
<td>Lower level of productivity</td>
</tr>
</tbody>
</table>
Table 2.3 Variables contained in Internal Personnel related factor

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Poor labour relations</td>
</tr>
<tr>
<td>2</td>
<td>Over staffing</td>
</tr>
<tr>
<td>3</td>
<td>Absence of man-power planning</td>
</tr>
<tr>
<td>4</td>
<td>Inappropriate wage and salary administration</td>
</tr>
<tr>
<td>5</td>
<td>Lack of behavioural approach</td>
</tr>
<tr>
<td>6</td>
<td>Employee turnover</td>
</tr>
<tr>
<td>7</td>
<td>Higher wages and salaries</td>
</tr>
</tbody>
</table>

Table 2.4 Variables contained in Internal market related factor

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Inaccurate demand forecasting</td>
</tr>
<tr>
<td>2</td>
<td>Improper product mix</td>
</tr>
<tr>
<td>3</td>
<td>Dependence on few buyers</td>
</tr>
<tr>
<td>4</td>
<td>Lack of market research</td>
</tr>
<tr>
<td>5</td>
<td>Inadequate advertisement</td>
</tr>
<tr>
<td>6</td>
<td>Inadequate after-sales service</td>
</tr>
</tbody>
</table>

II. External factors

These factors pertain to issues that are external to an organization. These are those issues over which an organization has little or no control. These are macro level issues that influence the performance of all sectors of the economy. The following factors are contained in External Factors.

- External Financial factor
- External Production related factor
- External Personnel related factor
- External Market related factor
- Other external factor
The specific causes (or variables) identified that are contained in each External factor are as given in the Tables below:

**Table 2.5 Variables contained in External Financial factor**

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Higher bad-debts</td>
</tr>
<tr>
<td>2</td>
<td>Unfavourable investment climate</td>
</tr>
<tr>
<td>3</td>
<td>Restraint on lending by banks and financial institutions</td>
</tr>
</tbody>
</table>

**Table 2.6 Variables contained in External Production related factor**

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Shortage of raw materials</td>
</tr>
<tr>
<td>2</td>
<td>Import restriction on raw material</td>
</tr>
<tr>
<td>3</td>
<td>Inadequacy of electric power</td>
</tr>
</tbody>
</table>

**Table 2.7 Variables contained in External Personnel related factor**

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>General labour unrest</td>
</tr>
<tr>
<td>2</td>
<td>Inter-union rivalry</td>
</tr>
<tr>
<td>3</td>
<td>Non-availability of skilled man-power</td>
</tr>
</tbody>
</table>

**Table 2.8 Variables contained in External Market related factor**

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cheaper import of finished goods</td>
</tr>
<tr>
<td>2</td>
<td>Changes in market conditions</td>
</tr>
<tr>
<td>3</td>
<td>New entrants</td>
</tr>
<tr>
<td>4</td>
<td>Strong competitors</td>
</tr>
<tr>
<td>5</td>
<td>Imposition of taxes/duties by the Government</td>
</tr>
<tr>
<td>6</td>
<td>Price control by the Government</td>
</tr>
</tbody>
</table>
### Table 2.9 Variables contained in Other External factor

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ban on production by the Government</td>
</tr>
<tr>
<td>2</td>
<td>Pollution control/environmental problems</td>
</tr>
<tr>
<td>3</td>
<td>Unfavourable movement of foreign currency</td>
</tr>
</tbody>
</table>

### III. Managerial factor

The causes (or variables) that fall under this factor pertain to the personal attributes of the entrepreneurs. Many seemingly good projects have been found to have met with failures due to lack of managerial abilities of the promoters. Also, it has been found that some projects that are found to have some inherent weaknesses have turned out to be successful ventures due to the efforts of prudent promoters who possessed the kind of attitudes necessary to run ventures successfully. **Though managerial factor is in a way internal to an organization, given the importance of managerial inputs in transforming an organization, this has been classified as a separate factor for the purpose of this study.**

In the course of pilot study done by the researcher, the entrepreneurs came out strongly in favour of the Managerial factor in the performance of an organization. Hence, given the importance, this has been classified as a separate factor.

The specific causes (or variables) identified under this head that lead to failure of entrepreneurial units are as given in Table 2.10 below:

### Table 2.10 Variables contained in Managerial factor

<table>
<thead>
<tr>
<th>Variable No.</th>
<th>Variable Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Dispute among partners/directors</td>
</tr>
<tr>
<td>2</td>
<td>Non-exposure to the trade</td>
</tr>
<tr>
<td>3</td>
<td>Improper corporate planning</td>
</tr>
<tr>
<td>4</td>
<td>Lack of integrity</td>
</tr>
<tr>
<td>5</td>
<td>Reliance on consultants</td>
</tr>
</tbody>
</table>
2.11 Research gap identified

Many studies that have been done in the domain of industrial failures have come out with different causes that are found to contribute to failure. Though simultaneous presence of more than one cause have been found to influence failure of entrepreneurial units, no study has so far been attempted to rank the different contributing causes in the order of their importance. This study makes an attempt to rank the contributing causes that are behind the failure of industrial units financed by TIIC.

Identifying sector-specific causes have also been not attempted by any study so far. Since TIIC extends financial assistance to Tiny, Small and Medium scale sectors, identifying sector-specific causes will help TIIC to take sector-specific precautionary measures while lending to the different sectors. This study attempts to identify sector-specific causes, thereby filling the research gap.

Further, industry-specific studies, in the domain of entrepreneurial failures have also not been widely reported. This study attempts to identify industry-specific causes responsible for entrepreneurial failures in respect of five major industries, viz., Textiles, Engineering, Food Processing, Paper & Paper products and Chemical. As these five industrial sectors form part of about 74% of the total loan portfolio of TIIC, identifying industry-specific causes for these five major industries has been attempted in this study as this will help TIIC by providing with vital inputs that will be of use while appraising the project proposals of industrial units belonging to these five major industrial sectors.
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