

## UNIT - 3

### Management of MSMEs and Sick Enterprises

#### **PROBLEMS FACING THE MSME SECTOR**

The MSME sector in India is highly heterogeneous in terms of the size of enterprises. The small and highly fragmented structure of MSME makes them vulnerable to the external business environment. The problems faced by MSME are quite unique to the nature of the sector. The common problems<sup>9</sup> that MSME face are high interest rates, the rising cost of raw materials, obsolescence of technology, restricted access to market, availability of skilled labour, and compliance with regulatory systems. Exports from the labour-intensive sector were also hit. The main problems faced by the MSME sector are briefly discussed below:

##### **Lack of availability of adequate and timely credit:**

Despite their dominant number, high growth potential, and importance in job creation, MSME face difficulty in obtaining adequate and timely equity capital on competitive terms. This is the most critical problem faced by this sector. The major reason for this problem is the high risk perception among the banks with regard to this sector and the high transaction costs for loan appraisal. The level of non-performing assets is also very high in this segment. Hence, banks are reluctant to provide credit to MSME. As MSME find it difficult to furnish collaterals, they have to pay higher interest rates. These companies face obstacles in raising funds for their expansion and meeting their working capital needs.

##### **Inadequate infrastructural facilities:**

MSME, along with the industry in general, suffer from an underdeveloped supply chain and the lack of logistical infrastructure in the country. MSME may be located in industrial estates, urban areas, or in an unorganized way in rural areas. The infrastructural facilities, including power, water, and roads, in such areas are often poor and unreliable, which can lead to problems like difficulties in reaching the target markets in an efficient and profitable manner. Poor physical infrastructure hurts the productivity and competitiveness of Indian MSME vis-à-vis imports. For example, the food processing industry in India has been facing non-availability of adequate critical infrastructural facilities like cold chains and packing and grading centres. Again, export-oriented segments such as garments, leather, and jewellery face a lack of connectivity to ports.

##### **Technological backwardness and lack of product innovation:**

In order to survive and to be competitive in the present global environment, it is critical to use the latest technology and invest in research and development (R&D) for product innovation. The knowledge gap of MSME will increase with the digital divide and rapid changes in technology. Due to their small scale of operation, MSME have limited access to R&D and cannot invest much in acquiring modern technologies. This is a major hindrance in scaling up their operations.

##### **Lack of access to market:**

MSME often do not have adequate resources to link to diverse markets beyond their immediate vicinity. The limited access to larger markets in terms of market linkages, transport, and information exchange seriously undermines the demand for their products. This is a limitation and a constraint to profitability and growth. Marketing efforts are required to increase demand for the products/services of MSME. Finding a differentiator for the product or service on offer, finding customers, and creating a brand are some challenges that MSME face. In the absence of large marketing budgets, most MSME cannot opt for television and media advertisements. They need to rely on innovative and cost-effective techniques to make their offerings popular.

### **Difficulty in finding and retaining human resources:**

Although India has the advantage of a large pool of human resources, MSME continue to face a deficit in manpower with the right skill set for specific areas like manufacturing, service, and marketing. The human resource problem is further exacerbated by the low retention rate as MSME are generally unable to match large enterprises in terms of work environment and remuneration. MSME usually do not attract many experienced and talented workers due to their various limitations. They are left to hire young professionals, with little or no work experience, and need to provide on-the-job training. These employees take a fair amount of time to become productive. Once trained, many of them leave for better opportunities in bigger enterprises. Therefore, MSME typically become a training ground and stop-gap arrangement for employees.

### **Impact of WTO compliance and regulatory systems:**

MSME are adversely impacted by complicated mechanisms of adapting to technical standards, approvals, and permits which imply additional costs. MSME are vulnerable to the impact of WTO regulations as they are now in direct competition with companies in Southeast Asian countries and China, which can manufacture goods at a lower cost. MSME will face greater competition from imports. Large companies in India have the option of procuring from overseas suppliers and this may put Indian MSME in a disadvantageous position. Tighter patent laws also put MSME at a disadvantage. Moreover, Indian MSME are unable to implement anti-dumping measures and counter other unfair practices such as moves by competitors to patent traditional Indian products. It has been observed that MSME in China, Malaysia, Thailand, Vietnam, and Korea dump several products in Indian markets.

### **PREVENTING SICKNESS IN ENTERPRISE:**

Entrepreneurs face a number of problems in the promotion of units and during production, marketing, distribution, procurement of raw material, and availing of incentives offered by the government. Let us broadly study the general problems faced by entrepreneurs and the specific problems faced by their units.

The problems of entrepreneurs may be divided into two groups—external and internal. External problems are those that result from factors beyond the control of the entrepreneur, while internal problems are those that are under the control of the entrepreneur and not influenced by external factors.

Although the small-scale sector and the large and organized sector face similar problems, organized industries can face their problems more effectively as they are financially very strong and have large resources. Owing to their weak financial structure, the resources of small-scale sector enterprises are limited. While the large and organized sector can employ trained and experienced managers; in a small-scale sector enterprise, its proprietor or partners; or if the unit is a company, its director or directors themselves have to take care of all the problems. Some of the problems faced by the entrepreneur are given below:

**1. Political instability:** This does not encourage an investor to invest in the economy. Even if he has already invested, he might decide to fold up due to the prevailing hostile economic climate.

**2. Presence of inflation:** Inflation is an economic condition characterized by a general and continuous rise in the price level coupled with a fall in the value of money. Inflation is economically harmful to suppliers as it leads to unstable quoted market prices.

**3. Inadequacy of information:** The collation and analysis of relatively dependable, reliable, and authentic data may facilitate and enhance forecasting and planning. It is pertinent to point out that the entrepreneur may not be conscious of the existing forces of the law of demand and supply that directly or indirectly affects consumers' behaviour.

**4. Capital:** The entrepreneur may not find the required initial capital for the take-off of the business.

**5. Inadequate infrastructural facilities:** This may hamper or hinder the development of entrepreneurial activities.

**6. Inadequate government support or motivation:** Lack of government support or motivation may hinder a business through lack of free consultancy services and soft loans.

**7. Type of business to establish:** At the onset, it may be a Herculean task for new entrepreneurs to choose a type of business to establish, as they may lack experience in setting and managing the enterprise.

## **SPECIFIC MANAGEMENT PROBLEMS**

Besides the internal and external problems of entrepreneurs, some specific problems faced by the entrepreneurs are discussed in this section.

### **Management Deficiency**

It is a well-known fact that management deficiency is one of the main reasons for the poor performance and sickness of small enterprises. New entrants in the field of small industries in general do not have any prior training or background in the management of their units. With growing sophistication and modernization of market requirements for their products, it is very important for entrepreneurs to employ modern methods of management. Entrepreneurial ability can be honed through application and training. Various colleges and universities in advanced countries offer courses in starting and managing small enterprises.

### **Finance**

Financial inadequacy is also reported to be one of the most important causes leading to sickness of small-scale units. The Fourth All-India Census of MSME reveals that 70 per cent of the units have considered finance as a stumbling block in setting up and diversification of industrial units.

Critical issues in financial management require to be constantly borne in mind to ensure that a business enterprise remains healthy. Planning for profits must be ensured at all times by resorting to periodical performance evaluation. The proper utilization of various assets is critical to profit maximization. Along with credibility, solvency, and liquidity are essential for enterprise growth. During emergencies, liability management can be helpful. But all this would be possible only if proper books of accounts are maintained. An accountant ensures the smooth functioning of financial planning and management and takes care of the timely provision of financial information. All aspects of financial management contribute in a small or big measure towards maintaining business survival and growth.

### **Manufacturing and Technical Problems**

Most units face production problems due to lack of raw material availability, skilled labour shortage, under-utilization of capacity, and time and cost overrun. Manufacturing and technical problems arise right at the stages of project planning and feasibility report preparation. Problem areas are product pricing; selection of right equipment, plant and machinery; selection of personnel and their training; technical know-how; technology transfer; industrial engineering; production engineering; use of standard quality control, and use of high-tech equipment.

## **Product Planning**

The selection of a product depends on technical know-how, the infrastructural facilities available, and the technical and managerial abilities of entrepreneurs to complete a project successfully. Product planning is the ongoing process of identifying market requirements that define a product's feature set, promotion, distribution, and price. Most small-scale business enterprises don't do any product planning.

## **Selection of Equipment, Plant, and Machinery**

Most entrepreneurs ignore the importance of making a detailed scrutiny before selecting equipment, plant, and machinery. However, entrepreneurs should give importance to production capacity, process capability, accuracy requirements, and other supporting facilities before buying their equipment. They are required to look for alternative and appropriate high-tech equipment if it is techno-economically feasible as technically superior equipment will lead to higher quality, quantity, reliability, and productivity. Such things increase productivity and lower the cost of production.

## **Human Resource Development**

Selecting the right person for the right job would contribute to the smooth and efficient working of the enterprise. After selecting the right personnel on scientific lines, it is very essential to train them at appropriate organizations so that they have both theoretical and on-the-job training in improving the productivity of the enterprise. Entrepreneurs should know that it is not machines alone that work, but the people behind the machines who make it work. Organizations like the North India Technical Consultancy Organization Ltd (NITCON) and various training institutes are coming forward in a big way to help small business houses train their personnel.

## **Technical Know-how**

While there are numerous ways of doing a job, there is only one way of doing it in a manner that is most effective, efficient, and highly productive. Many entrepreneurs do not realise this and their trial-and-error method wastes time, money, energy, and other resources.

## **Preparation of Project Report**

A project report is usually not prepared on scientific lines. Very often project feasibility reports are prepared for availing loans. A project report, also referred to as pre-investment feasibility study, or business plan, is a detailed description of the business. It is the roadmap showing how and when the business will achieve its goals. It is an operating document—the description of a project indicating what products are to be manufactured or what services are to be offered and to whom.

It is essential that the promoter of a business venture have conceptual clarity on what business he is in. Details of the infrastructure required for the business; manpower, material, and the financial resources needed to reach the envisaged activity level; how such resources would be mobilized and managed and with what financial resources; how the business will achieve the stated goals; the time frame within which a project will be implemented; when it will produce the envisaged output; and when the business would reach optimal activity level and generate financial surplus would constitute a business plan.

## **INDUSTRIAL SICKNESS**

Companies become sick at some stage of their existence if they are not managed well. If early signs of impending sickness are ignored, the sickness grows over a period of time. A well-managed company picks up the signals at the appropriate time and becomes healthy. If a management team is unable to revive a sick unit, the stakeholder has limited choices: to bring in a new management team to revive the unit, to close down the unit and cut losses, or to sell it off if there is a buyer.

Sickness in industrial units is universal and not a new phenomenon in developing economies. An industrial unit may face a number of problems during the implementation and operation stage because of a number of factors in the macro and microenvironment. The problem of sickness in industries is very grave and adversely affects production and employment in the country besides producing other socioeconomic repercussions. The following are the ill effects of industrial sickness:

- Sick industries are unable to utilize the production capacity of goods and services. There is an under utilization of capital assets.
- It leads to substantial loss of government revenue and enhances public expenditure.
- Increase in industrial sickness discourages the development of entrepreneurship in the country.
- Industrial sickness results in large-scale unemployment and industrial unrest.
- It locks up necessary resources and funds in the sick unit. This also increases the non-performing assets of banks and financial institutions.
- The profitability of banks and financial institutions gets adversely affected as the return on investments on projects is reduced. Since their funds get blocked in sick units, it results in problems of project financing.
- The confidence of investors goes down. The rate of project financing also comes down. Therefore, the prevention of sickness and rehabilitation of sick units assumes greater importance.

## **CAUSES OF INDUSTRIAL SICKNESS**

The causes of industrial sickness in India may vary from one unit to another. In India, the Tiwari Committee report outlines the causes of industrial sickness and divides them into several factors.<sup>6</sup> These causes can be classified into two categories: internal causes and external causes.

### **Internal Causes**

These are the factors that are internal to the organization and over which the management has control. Sickness due to internal causes can be avoided if the management is proactive enough to identify the causes and eliminate them at the initial stage itself. The internal factors that cause industrial sickness are the following:

**Project formulation:** Some industries are born sick. Some industrial concerns are sick from the very inception. This is attributed to ill-conceived projects, poor planning, poor appraisal, uneconomic size of the project, outdated production process, and high input costs.

**Project implementation:** Delayed implementation gives a project a difficult start. This will lead to time overrun and cost overrun, affecting the financial viability of the project. This may be due to inadequate mobilization of finance.

**Project management:** The problems of project management can be discussed under four broad headings—poor management of production, marketing, finance, and general and personnel administration.

**Constraints of production:** The problems may be due to wrong selection of site; inappropriate technology; lack of maintenance system; absence of research and development for innovation; and poor quality and productivity.

**Constraints of marketing:** The problems may be due to lack of market research, a poor and inadequate distribution system, absence of a costing and pricing system for the products, and the dependence on a limited number of customers.

**Constraints of finance:** Problems may be due to poor resource management, lack of financial planning and budgeting, weak equity base, and inadequate working capital.

**Problems due to general and personnel administration:** Poor industrial relations leading to labour unrest, lack of motivation and coordination, lack of manpower planning, poor talent management, lack of professionalism, lack of control systems, excessive expenditure, and incompetent and dishonest management.

### **External Causes**

External causes are those that are external to the organization and over which the management of the organization has no control. Sickness due to external causes can be minimized if the management plans suitable strategies and takes on the external factors to reduce their impact. The external factors that cause industrial sickness are the following:

**Infrastructural and technology management:** Irregular supply of raw material, non-availability of technology, shortage of power, water, and other resources, transport bottlenecks.

**Government policy:** Delays in disbursement of loans from financial institutions, delay in getting approvals from government authorities, import–export restrictions.

**Marketing constraints:** The sickness could be due to liberal licensing policies, restraint on purchase by bulk purchasers, changes in the global marketing scenario, excessive tax policies by the government, and market recession.

**Extraneous factors:** Natural calamities, political climate, non-availability of skilled labour, and required talent.

### **SYMPTOMS OF INDUSTRIAL SICKNESS**

It is essential to identify sickness in advance to prevent its widespread ill effects on society as a whole on the one hand and, on the other hand, to save the limited resources of banks, financial institutions, and investors for more productive use elsewhere. Thus, it becomes imperative to predict and monitor industrial sickness in advance so that the interests of all concerned could be safeguarded. An early warning signal of probable failure will enable both the management team and the investor to take preventive measures, make policy changes, reorganize the financial structure, upgrade infrastructure, and even undertake voluntary liquidation. This usually shortens the length of time for which losses are incurred and thereby improves both private and social resource allocation.

The symptoms of industrial sickness may be in the form of financial distress starting with short-term liquidity problems, revenue losses, operating losses, and moving in the direction of overuse of external credit until it reaches a stage where it is overburdened with debt and is not able to generate sufficient funds to meet its obligations. In case of large units whose shares are quoted in stock exchanges, a signal of sickness is sent when dividends are skipped and share price sharply declines. This measure, therefore, will have to be used very cautiously with other identifiable symptoms to judge whether skipping dividends indicates sickness or represents a temporary downward slide in financial performance.

The existence of symptoms and signals provides grounds for suspecting that the industrial unit concerned is prone to sickness. The symptoms of industrial sickness act as leading indicators of sickness, and if immediate remedial actions are not taken, the sickness will grow to the extent that the organization will face its natural death. Just as diseases are identified by certain symptoms, industrial sickness can be identified by the following symptoms:

- Continuous reduction in turnover.
- Continuous reduction of the net profit to sales ratio.
- Lack of movement of stocks and rising level of inventories.
- Default in payment of interest on borrowings and default in repayment of term loan instalments.
- Short-term borrowings at high interest rates.
- Continuous cash losses leading to erosion of tangible net worth.
- Approaching the banker for temporary overdraft at frequent intervals.
- The “sundry debtors” as well as the “sundry creditors” keep growing and reaching a disproportionately high level.
- High turnover of personnel.
- Change in accounting procedure with a view to window dressing.
- Delay in finalization of accounts.
- Poor current ratio. ; Low capacity utilization.
- Frequent return of cheques deposited/bills drawn by the party.
- Non-submission/delayed submission of stock statements/financial statements.