



Causes of Industrial Sickness in Msme Sector : An Analysis

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ABSTRACT

The growing sickness in industrial sector of our country has created an alarming situation not only for entrepreneurs but also for the planners and authorities, particularly to the MSMEs sector of the country. In spite of the incentives and facilities offered by the government to promote large number of MSMEs units over the years, a substantial number of units have been confronted with a number of problems bringing in an inherent feature of incipient sickness, recipitating into situation of critical sickness or closure. This may be due to a most of major key factors. The more common are management failure, lack of finance, shortage of raw-materials, power cut, labour trouble, marketing problems, etc. Therefore, there is a need to identify sickness in the initial stages and to initiate the process of corrective measures and rehabilitation before the sickness assumes serious proportion.

KEYWORDS : MSMEs, UNIDO, SSI, converging, prospective, profound

INTRODUCTION:

The Micro, Small and Medium Enterprises (MSMEs) sector constitutes a significant segment of the Indian economy in terms of its contribution to the country's industrial production, exports, employment and creation of an entrepreneurial base. MSMEs have the advantages of generating gainful employment with low investment, diversifying the industrial base, reducing regional disparities through dispersal of industries into rural, semi-urban and backward areas. The government established the Ministry of Small Scale Industries and Agro and Rural Industries (SSI & ART) in October, 1999 as the nodal ministry for formulation of policies and programmes/schemes, their implementation and related coordination, to supplement the efforts of the states for promotion and development of this category of industries in India. The Ministry of SSI and ART was bifurcated into two separate ministries, namely, Ministry of Small Scale Industries and Ministry of Agro and Rural Industries, in September 2001. The role of the Ministry of Small Scale Industries is mainly to assist the states in their efforts to promote growth and development of the SSIs to enhance their competitiveness and to generate additional employment opportunities. In addition, the Ministry attempts to address issues of country-wide common concerns and also undertakes advocacy on behalf of the SSI. The output of the Small-Scale Industry Sector contributes almost 40 per cent to the gross industrial value-added and 45 per cent of the total exports from India and is the second largest employer of human resources after agriculture. As per the quick estimates of 4th All India Census of MSMEs, the number of enterprises is estimated to be about 26 million and these provide employment to an estimated 60 million persons of the 26 million MSMEs, only 1.5 million are in the registered segment while the remaining 24.5 million (94%) are in the unregistered segment.

Literature review :

According to the **Sick Industrial Companies Act (2006)**, the sick unit is defined as 'An industrial company which has at the end of any financial year accumulated losses equal to or exceeding its entire net-worth and has also suffered cash losses in such financial year immediately preceding such financial year.'

The **Reserve Bank of India**, the sick unit is defined as 'Incurred cash loss in the previous accounting year and is likely to continue to incur cash loss in the current accounting year, and has erosion on account of cumulative cash losses to extent of 50% of those of its net-worth.

According to **State Bank of India**, "A sick unit is that unit which fails to generate internal surplus on a continuing basis and depends for its survival on frequent infusion of external funds." Thus an industrial unit was defined as sick if it was registered. for at least seven years. It incurred cash losses for the current and the preceding year, and its net worth has eroded.

According to **ICICI**, 'A sick industry is one whose financial viability is threatened by adverse factors present and continuing. The adverse factors might relate to management, market fiscal burden, labor relation or any other. When the impact of factors reaches a point where a company begins to incur cash losses leading to erosion of its funds, there is threat to its financial stability.'

Performance of MSMEs :

The Table-1 shows that there is a consistency in growth rate of Total MSMEs, fixed investment, production, employment remained more or less constant and the growth rate of export is showing a fluctuating trend during the period 2004-05 to 2013-14.

Table-1
Performance of MSMEs in India

Sl No.	Years	Total MSMEs (lakh numbers)	Fixed Investment (Rs. Crore)	Production (Rs. Crore) Current Prices	Employment (lakh person)	Exports (Rs. Crore)
1	2004-05	101.1	146845	261297	238.73	69797
		(4.07)	(4.9)	(11.78)	(4.21)	(28.78)
2	2005-06	105.21	154349	282270	249.33	71244
		(4.07)	(5.11)	(8.03)	(4.44)	(2.07)
3	2006-07	109.49	162317	314850	260.21	86013
		(4.07)	(5.16)	(11.54)	(4.36)	(20.73)
4	2007-08	113.95	170219	364547	271.42	97644
		(4.07)	(4.87)	(15.78)	(4.31)	(13.52)
5	2008-09	118.59	178699	429796	282.57	124417
		(4.07)	(4.98)	(17.9)	(4.11)	(27.42)
6	2009-10	123.42	188113	497842	294.91	150242
		(4.07)	(5.27)	(15.83)	(4.37)	(20.76)
7	2010-11	261.01	500758	709398	594.61	182538
		(111.48)	(166.2)	(42.49)	(101.62)	(21.5)
8	2011-12	272.79	558190	790759	626.34	202017
		(4.51)	(11.47)	(11.47)	(5.34)	(10.67)
9	2012-13	285.16	621753	880805	659.35	N.A.
		(4.53)	(11.39)	(11.39)	(5.35)	
10	2013-14	298.08	693835	982919	695.38	N.A.
		(4.53)	(11.59)	(11.59)	(5-47)	

Source: S&D Division - Office of the DC (MSME)

Sickness in MSMEs :

The details of sickness relating to MSMEs sector in India are presented in Table-2.

Table- 2
Sickness in MSMEs Sector of India

Year	Total SSI Units in Lakh	Sick units in lakh	Percentage	Total Investment in Crores	Sick units investment in	Percentage
2004	89.71	2.21	2.46	133242	3857	2.89
2005	93.96	3.06	3.26	135482	4313.48	3.18
2006	97.15	3.04	3.13	139982	4608.43	3.29
2007	101.1	2.49	2.46	146845	4505.54	3.07
2008	105.21	1.77	1.68	154349	4818.95	3.12
2009	109.49	1.67	1.53	162317	5706.35	3.52
2010	113.95	1.43	1.25	170219	5772.64	3.39
2011	118.59	1.38	1.16	178699	5380.13	3.01
2012	123.42	1.26	1.02	188113	4981.13	3.64
2013	261.01	1.14	0.43	500758	5266.65	1.05
2014	272.79	0.85	0.31	558190	13849	2.48

Source: Government of India, Ministry of Micro, Small and Medium Enterprises, Annual

Report 2014-2015.

It may be noticed from the Table- 2 that there were 89.71 lakhs MSMEs units in 2004 and their number has steadily increased year by year to 272.79 lakh units in 2014. The percentage of sick units among the MSMEs was 2.46 per cent in 2004 and it gradually went up to 3.13 in 2006 and declined to a level of 0.31 per cent in 2014. The total investments in MSMEs units was reported at Rs. 1,33,242 crore in 2004, of which investment incurred on sick units has been worked out to 2.89 per cent. The percentage of investment of sick units was revolving in the range of 3.52 per cent to 0.248 percent. The maximum percentage of 3.52 per cent was observed during the year 2009. In absolute terms, the investment in sick units increased year after year as there was increase in investment in MSMEs units.

Causes of industrial sickness :

United Nations Industrial Development Organization (UNIDO) has found that the main reasons for the sickness in Industry are management deficiency, inaccurate market forecasting, inefficient use of working capital, labor unrest and cost escalation.

Nelson et. al (1999) have analyzed the causes of sickness in 20 European companies. Their study reveals that the major internal causes of sickness are:

- (1) Strategy of growing too fast through unrelated diversification, resulting in lack of synergy and cultural incompatibility,
- (2) Poor management of finances, resulting in high leverage, delays in collection, under-capitalization etc.
- (3) Wrong personnel policies resulting in over staffing, poor employee relations, lack of adequate training of employees and promotion and retention of incompetent managers.
- (4) Technological obsolescence,
- (5) Authoritarian and conservative attitude of top management,
- (6) Poor management of inventories,
- (7) Inadequate information system,
- (8) Conflicts among stake holders,

Among the external causes are changes in the particular industry, the

economy as a whole and in the general environment, authors however, observe that as these factors affect all the units, the explanation for one unit getting sick should be sought within that unit as to why there was a deterioration in its capability to adopt to the changes in the environment.

Balan (1996) in his book managing industrial sickness mentioned that Some of the case studies relating to the state public sector unit already rehabilitated with positive results have revealed that (1) non utilization of capacity (2) single product without flexibility (3) lack of accountability and reporting system (4) low morale of employees and (5) poor marketing and financial systems are the common causes of sickness in industries.

Private studies conducted on another industrial unit have revealed that (1) obsolete technology (2) inadequate enterprise and infrastructure (3) unsuitable product mix (4) low capacity utilization (5) low individual output (6) absence of performance evaluation and feedback (7) inadequate management reporting systems (8) absence of planning and targeting both for production and sales (9) lack of team spirit (10) indiscipline within the organizational set up are important causes of industrial sickness.

Srivastav and Yadav (1986) through his book "Managing and Monitoring of Industrial Sickness," identified the following internal factors responsible for sickness:

- (1) Unexpected adverse market conditions for a prolonged period
- (2) Changes in Government policies in respect of excise duty, import/export substitutions and subsidies.
- (3) Disequilibrium between demand and supply
- (4) Recessionary trends
- (5) Rise in cost of production not compensated by corresponding increase in prices because of Government control and
- (6) Scarcity of critical resources like raw materials, power and skilled labor.

The authors further identify and elucidate upon the external factors as follows:

- (1) Poor financial management
- (2) Poor capacity utilization
- (3) Poor operation or equipment
- (4) Out dated production technology.

The authors have opined that the sickness is normally caused by internal factors which are mostly related with mismanagement in various areas of operations i.e. technical, financial, operational, marketing etc.

According to **RBI study**, based on the data furnished by the commercial banks (quoted by Agarwal, Mehta, Nair, Ramaswami, Sander-sara and Sharma) out of the 378 industrial undertakings enjoying credit limits of over Rs. 1 crore each from the banking system as on December 31,1979, 197 units or 52% of the reported units, had fallen sick due to mismanagement/ management deficiencies (including diversion of funds, infighting, lack of marketing strategy) further 86 units (23%) had fallen sick due to market recession, 52 units (14%) due to faulty initial planning and other technical drawbacks, 34 units (9%) due to power cut, shortage of raw materials and other necessary inputs in time and 9 units (2%) due to labor trouble. Thus the study revealed that the most vital cause of sickness was mismanagement of units, which along contributed 52% or more.

Faulty initial planning and other technical drawbacks, which contributed 14% of the sick units, were also related to mismanagement or incompetent management. Even the market recession that contributed 32% of the cases may be due to lack of proper planning and forecast-

ing on the part of the management.

According to **Ramesh**, the main factors adversely affecting the health of small scale industries are Promoters limited capacity to raise equity, Problems in raising institutional funds, delayed and insufficient working capital loans by banks, competition from multinationals and large scale industries, wide fluctuation in prices of raw materials, sub optimal capacity utilization, fall in finished goods prices, severe labor turnover, scarcity of skilled work force, poor maintenance management, lack of cooperation and understanding by revenue collecting authorities, untimely and sudden seizures and closure of units by financial institutions.

According to **Rai and Brahmanandam** (1984) while the internal causes are concerned with the choice of location, underestimation of cost of capital, overestimation of demand, mismanagement, failure to introduce proper control techniques and tools, poor maintenance of machines and equipments and poor public relations etc.. The external causes relate to changes in govt. policies, shortage of raw materials, power, transport etc., absence of industrial peace and mounting inflation.

Meena (1989) enlists the various causes of sickness in industrial units identified by banks, including the RBI, as:

- (1) Environmental (scarcity and uneconomic price of quality of raw materials, disturbed industrial relations etc.)
- (2) Managerial (lack of technical and managerial expertise etc.)
- (3) Operational (lack of market penetration etc.)
- (4) Financial (lack of proper financial planning and control).

According to **Joshi** (1983) industrial sickness is largely a phenomenon of dwindling financial viability in such a way that the structure can neither stand on its own feet nor can it be made to stand by help from outside agencies. Besides enlisting the various external and internal causes of industrial sickness, he mentions about certain causes of sickness in the small scale sector, as pinpointed by the RBI, like lack of managerial and technical competence, decline in demand for their products from the medium and large scale industries and the overall demand recession, delay in payment of bill by govt. departments and large units, lack of quality consciousness, poor marketing strategy etc.

Some of the major causes of sickness, as revealed by several studies/surveys, have been summarized by **Reddy** (1990) as under:

- (1) Delay in the implementation of the project due to various sanctions/ approvals required by different govt. agencies,
- (2) Long delays and inadequate financing by the financial institutions,
- (3) Obtaining term loan for creating fixed assets and under utilization thereof,
- (4) Problems relating to shortage of working capital funds, raw materials & power supply and lack of marketing efforts/skills/channels.

Reddy is of the view that there is definitely a case for a detailed study into the role of banks or finance corporations to bring about more efficient performance of these institutions. He further observes that "the major two areas of weakness in the small industrial sectors are management of marketing and financing functions".

Various Indian studies have revealed that lack of managerial effectiveness on the part of the entrepreneurs in one or more of the functional areas, has been the major cause of industrial sickness especially in the small scale sector.

The vital role of managerial acumen in the performance of a unit is well recognized in the western literature too. **Penrose** identified three basic constraints to the growth of firms, viz. "managerial ability, product or factor markets, and uncertainty and risk". All considered,

he concluded that the fundamental limit to the productive opportunity of the firm cannot be found in external supply and demand conditions, we must look within the firm itself. Likewise, **Morris** considered the growth of a firm as a managerial objective. **Bosewell** analyses the rise and decline of the 64 small firms in U.K. (all employing less than 50C persons) out of which 28 or 44% were found to be in decline. Among the main causes of decline like market and technological factors and limitation of inheritor management etc., the management factor appeared to be more important.

The studies made by the **RBI** (quoted by Sandersara. Mehta) like the analysis of causes of sickness in 341 sick industrial units and the case studies by RBI of 18 and 15 units, cited in the **Tiwari Committee Report** (1984) confirmed/concluded that mismanagement was the most wide spread, cause of industrial sickness. The RBI study revealed that out of the 341 sick units, 222 or 65% of the units had fallen sick due to management deficiency, mismanagement of management dissensions. According to Tiwari Committee (appointed by RBI as a follow up of its aforesaid studies) "mismanagement may take the form of poor production management, poor labor management, poor resource management, lack of professionalism, dissensions within the management, or even dishonest management". Further, according to the committee, "the management deficiency may be classified broadly in two distinct stages of a project:

- (1) Sickness arising at the time of planning and during implementation; and
- (2) Sickness arising after implementation.

Bulsara and Bhatt (2010) studied the factors responsible for industrial sickness. The objective of the study was to analyze the factors responsible for industrial sickness in nearby Surat area. They have identified the following factors responsible for sickness:

- (1) Adverse govt. rules and regulations.
- (2) Mismanagement
- (3) Economic conditions
- (4) Tough competition
- (5) Shortage of manpower
- (6) High cost of production
- (7) Poor quality control
- (8) Excessive high wage structure
- (9) Lack of trained skilled labor or technically competent personnel
- (10) Transport bottlenecks
- (11) Delay in getting financial assistance
- (12) Increase in cost due to delay in implementation of project
- (13) Bad industrial relations
- (14) Inadequate working capital
- (15) Changes in technology
- (16) Changes in consumer Behaviour
- (17) Diversion of funds

CONCLUSION :

The extensive literature review reveals the divergent views regarding causes of sickness. The reasons vary across the two ends of the spectrum. The studies conducted in western as well as Indian countries that "mismanagement is the major reason of sickness which may take the form of poor production management, poor labor management, poor resource management, lack of professionalism, dissensions with-

in the management, or even dishonest management etc. Some of the authors also opined that changes in government policies, lack of managerial and technical expertise, shortage of raw material are the main causes of sickness. However, the authors seem to agree on the following aspects of sickness.

1. Poor management of finance, resulting in high leverage, delays in collection, under-capitalization etc.
2. Technological obsolescence,
3. Poor management of inventories,
4. Non utilization of capacity,
4. Low morale of employees,
5. Poor marketing System,
6. Absence of planning and targeting both for production and sales,
7. Indiscipline within the organizational set up,
8. Decline in demand for the products of the medium and large scale industries and the overall demand recession.

Even as the various researches on sickness seem to be converging on the above-mentioned aspects, there is a need to carry out extensive and profound investigation taking into account a wider number of research findings cutting across a diverse range of industries. Prospective researchers can work on this area of future research.

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