The McGraw·Hill Companies

When the Going Gets Tough
Strategic Responses to Business Crises

Updated Edition of
Seven Business Crises

About the Author

Dr. Vihari G. Patel, a well-known economist with a doctorate from the University of Wisconsin, USA, has worked for more than 35 years in promoting and developing entrepreneurs in the country and most of Asian and African nations. He is considered a pioneer in entrepreneurship development through training, education and institution building.

He had been the founder Director of the Entrepreneurship Development Institute of India [EDI], India's first and foremost education, training, research and capacity building organization in the field of theory and practice of entrepreneurship.

As Economic Adviser to Gujarat's leading industrial development corporations, he helped evolve several path breaking policies, programmes and institutions in the State and later in the country. He also worked with the World Bank, ILO, UNIDO, Commonwealth Secretariat, Asian Development Bank and other leading international organisations as an expert, adviser and mission leader on Enterprise Creation Strategies and indigenous entrepreneurship promotion. He has been a member of several national committees for programmes and policies on industrial and enterprise development, noted among them being the Abid Hussein Committee on Small Scale Industries, the National Entrepreneurship Development Board, the National Science and Technology Entrepreneurship Development Board.

He was awarded the prestigious Aga Khan Award in 1993 for this pioneering and innovative work on entrepreneurship.

At present he lectures on Seven Business Crises, Growth Strategies and the Theory and Practice of Entrepreneurship and advises family owned companies on growth crises, succession planning and strategies to cope with the new global business environment.

He shares in this book his rich and deep insight based on hundreds of new and established entrepreneurs as well as family businesses with whom he had directly interacted within and outside the country.

The McGraw·Hill Companies

When the Going Gets Tough
Strategic Responses to Business Crises

Updated Edition of
Seven Business Crises

V G Patel

Founder and Former Vice President & Director
Entrepreneurship Development Institute of India
Ahmedabad

Tata McGraw-Hill Publishing Company Limited
NEW DELHI

McGraw-Hill Offices
New Delhi New York St Louis San Francisco Auckland Bogotá Caracas
Kuala Lumpur Lisbon London Madrid Mexico City Milan Montreal
San Juan Santiago Singapore Sydney Tokyo Toronto

Tata McGraw-Hill

Published by Tata McGraw-Hill Publishing Company Limited,
7 West Patel Nagar, New Delhi 110 008.

ISBN 0-07-062093-8

Head—Professional and Healthcare: *Roystan La'Porte*
Publishing Manager: *R Chandra Sekhar*
Editorial Executive: *Souvik Mukherjee*
Senior Copy Editor: *Sandhya Iyer*

Asst. General Manager—Production: *B L Dogra*
Junior Manager—Production: *Sohan Gaur*

Typeset at The Composers, 260, C.A. Apt., Paschim Vihar, New Delhi 110 063
and printed at Sai Printo Pack Pvt. Ltd., A-102/4 Okhla Industrial Area, Phase II,
New Delhi 110 020

Cover Design: Kapil Gupta, Delhi

Cover printed at: Rashtriya Printer

RZLYCRDYRCXDQ

Contents

Preface to the Second Edition *ix*
Preface to the First Edition *xiii*
Acknowledgements *xvii*

1. How is the Health of Your Business? **1**
1.1 Evaluating Performance: Ladder of Seven Crises *1*
1.2 Financial Analysis: Strengths and Limitations *2*
Seven Crises *5*

2. Starting Crisis **6**
2.1 Lack of a Thorough Study of Market Potential for Product *7*
2.2 Lack of All-round Managerial Ability *7*
2.3 Inadequate Arrangements for Keeping Accounts *11*
2.4 Underestimation of Capital Required *14*
2.5 Ignorance about Tax Liability *17*
Starting Crisis *19*

3. How to Steer Clear of Starting Crisis **20**
3.1 Listen to All Available Counsel *20*
3.2 Organise Up-to-Date Business Data *22*
3.3 Encourage Participation of Investors *22*
3.4 Meet Your Tax Consultant or Officer Often *23*
3.5 Estimate the Capital Investment Realistically *23*
3.6 Selecting Machinery: Do You See the Big Picture? *24*
Steering Clear of Starting Crisis *25*

4. Cash Crisis **26**
Cash Crisis *32*

5. How to Steer Clear of Cash Crisis **33**
5.1 Short and Long-Term Capital *35*
5.2 Dos and Don’ts of Cash Management *36*
Steering Clear of Cash Crisis *41*
Appendix A *42*
Appendix B *44*
Appendix C *45*

6. Third Crisis: Delegation Crisis **46**

6.1 Attitude Problem *46*
6.2 Neglect of Organisational Prerequisites *47*
Delegation Crisis *50*

7. How to Cope with the Third Crisis: Parting with Responsibilities **51**

7.1 Induct a Really Competent and Effective Person *51*
7.2 Amalgamate with Another Company *54*
Avoiding Delegation Crisis *56*

8. Fourth Crisis: Leadership Crisis **57**

8.1 Delegating More Powers to Other People *57*
8.2 Becoming an Effective Leader Instead of a Do-it-Yourself Man *58*
8.3 Managing through Effective Written Communication *59*
Leadership Crisis *65*

9. How to Overcome Leadership Crisis **66**

9.1 Be a More Effective Leader *67*
9.2 Be a Good Communicator *72*
9.3 Obtain Training in Management *73*
9.4 Learn to be Flexible *74*
9.5 Make a Periodic Audit of Your Time Management *74*
9.6 Develop a Team of Managers *75*
Facing Leadership Crisis *78*

10. Financial Crisis **79**

10.1 Finance from Promoters *80*
10.2 From Public Through Shares and Deposits *83*
10.3 From Financial Institutions *88*
10.4 From Commercial Banks *89*
10.5 From Suppliers *89*
10.6 From Leasing Companies *90*
Financial Crisis *91*

11. How to Avoid Financial Crisis **92**

11.1 All Authority in Your Hands? No! *92*
11.2 Exercising Caution in Time *92*
11.3 How to Obtain Funds *92*
Preparing for Financial Crisis *94*

12. Prosperity Crisis **95**
12.1 Complacency *95*
12.2 The Great Leap Forward *100*
Prosperity Crisis *105*

13. How to Avoid Prosperity Crisis **106**
13.1 Problem of Complacency *106*
13.2 The Giant Leap Forward *108*
Dealing with Prosperity Crisis *112*

14. Management-Succession Crisis **113**
14.1 Three Problems *113*
14.2 Some Counter Arguments *114*
14.3 Tax and Legal Issues *116*
14.4 Problems of Control *116*
14.5 Problems Relating to Valuation *117*
14.6 Partnership and Ownership Rights *119*
Management-Succession Crisis *120*

15. How to Avoid Management-Succession Crisis **121**
15.1 Succession Must be Planned *121*
15.2 Successor has to be Identified and Groomed *121*
15.3 Develop a Team *123*
15.4 Groom a Person Having General Management Skills *124*
15.5 Always be Ready to Receive Expert Advice *124*
15.6 Prepare Written Plans for the Company and Succession *125*
15.7 Take Expert Advice on Transfer of Voting Rights *126*
Planning for Management-Succession *127*

16. Planning for Survival and Growth **128**
16.1 Good Planning Ensures Success *128*
16.2 Different Approaches to Business-Planning *131*
16.3 Nine Processes and Principles for Business Planning *141*
16.4 Can the Long-Range (or Strategic) Plans of Small Firms Succeed? *145*
Planning for Survival and Growth *149*
A Form for Planning in Industry *150*

Index **155**

The McGraw-Hill Companies

Preface to the Second Edition

It has been over a decade since the first edition of this book was published. Much has changed during this period in the external environment facing the Indian as well as Asian entrepreneurs.

Withdrawal of special concessions and protection to new small enterprises from internal competition of medium and large ones; disappearance of market protection to large enterprises from global competition, combined with new rules of international trade (GATT and WTO), technological pressures (TRIPS), and financial inflows (TRIMS) has begun to shake up Indian entrepreneurship from its foundation. The process has already begun with a number of small, medium and large businesses closing down, merging or giving up the fight by sell-off (e.g. Ramesh Chauhan of Pure Beverages). Survival of the fittest is the new rule of the market game.

The profile of new players is also going through major changes. Entrepreneurial movement from trade to manufacturing is taking a new route as capital owners with commercial knowledge give way to technocrats and professionals with insight into technology and management. Ability to locate, absorb and analyse information and respond to change will determine business success and growth in the emerging knowledge society. The educated and techno-managerially equipped will prevail among the new starters.

On the technology front a serious threat is expected from the new rules of international trade and the patent regime as markets become global; capital, products and technology flow from west to east and north to south; 'process' gives way to 'product' patents and restricting opportunities. Imitation, a favourite of the entrepreneurs so far will have to give way to innovation.

Size of enterprises will change—large will become larger. Small enterprises, which have been the backbone of the Indian industrial base will have to learn to grow to remain efficient, find markets as suppliers to the large enterprises, serve niche markets and exploit the huge outsourcing opportunities. Indian entrepreneurs have not experienced the kind of huge investments, marketing resources and efficiency requirements that go with them. They experience three outcomes: (1) unprepared and overwhelmed by the onslaught of the intense competition, give up (2) if you cannot beat them, join them, start collaboration and partnerships (3) use the long industrial and entrepreneurial experience and find own strategies for survival and success.

The crises are even more relevant now: It is the third outcome of succeeding and growing in the new global business environment that makes the seven business crises relevant. More so now than ever. For, nothing much has changed in the last ten years as far as the causes, symptoms and cures of the seven crises are concerned. This is because their roots lie deeply in the mindset, behaviour and old habits of the entrepreneurs, the key promoters, the top bosses who will have to prepare the enterprise and make timely strategic adjustments to play the game under the new rules.

For example, for all new entrants at the start-up stage, even if their educational and occupational background have changed, the 'starting crisis' will still hurt them if any one or more of the five errors are committed, whether in choosing the project or product capacity, arranging sufficient finance or keeping proper accounts.

With more than 90% businesses still family-owned and managed, these are the ones that are expected to come under severe threat with the disappearance of oligopolistic markets. The new competitive scenario would bring out (as it already has begun to) inadequacies of traditional business knowledge, styles and structures. A large number may be wiped out in the medium and large sector. New products, technology, capital sources and markets would call for new knowledge, personnel and different management practices. A markedly new role for the entrepreneur, the one of owner-leader rather than remaining an owner-manager is unavoidable. This makes the discussion on 'delegation' and 'leadership' crises of this book very important.

The automatic or unplanned transition of business ownership in family businesses is exposing how unprepared and ungroomed the new generation has been to perform in the new environment, as we highlight in the management succession crisis. Breaking up of large and well-known business houses, their legal squabbles in dividing the assets after the founder entrepreneur has departed without leaving behind a management succession plan are making headlines for all the wrong reasons. The DCM's Rams, the Bajajs and even the Ambanis, are all victims of the 'succession crisis' in one form or the other.

Crises Approach is Unique: The 'seven crises' approach to business strategy is somewhat unconventional for it deals with business planning, management and growth in a manner quite different from the typical functional management concepts and education. There are no stereotyped references to the knowledge of production management, financial management, personnel management or marketing management. This is because knowledge alone is not enough for which one can always employ or hire a specialist; what is far more important is the attitude, the behaviour, and therefore, the entrepreneurial traits (in action) of the owner-promoter. The origin of the seven major crises lies in the entrepreneur. (At one stage in the book I have even advised some entrepreneurs not to grow if they cannot change their old habits, style and behaviour.) This book, therefore, goes much beyond typical management knowledge.

Similarly, I have referred to the major errors or lapses committed by the entrepreneur as 'crises' because they go beyond the typical problems that business firms face in our country. This book offers a strategy—for avoiding, facing and surviving the seven major crises. If, after reading the book, the entrepreneur acts on its advice, a wide variety of short- and long-term problems can certainly be avoided or sorted out. This claim has stood the scrutiny of a number of entrepreneurs who have benefited from its content and advice.

There has been positive feedback from a large number of entrepreneurs with whom I have discussed these crises, as a member of several Company Boards, in training programmes or performance workshops.

The updated edition of this book comes out at a time when financial institutions, industrial promotion agencies and policy-makers are concerned about a large number of industrial failures and the growing burden of NPAs. Despite viable projects and adequate finance, many enterprises have been still failing. These increasing failures are being attributed more to the failure of the entrepreneur, the promoter, the owner-manager than to any other factor. What, then, makes a competent entrepreneur? What entrepreneurial and managerial capabilities should one look for in the project promoter? What should the project revival and survival efforts focus on? If we are going to develop new entrepreneurs, what inputs should be provided? The 'seven crises' analysis offers a few key answers. The crises result from the manner in which the entrepreneur conceives, implements and runs his or her project. If the external environment is hostile, it is all the more important for the entrepreneur to be aware of these crises, to prepare for them, avoid them and survive them.

Therefore, all those who have already set up industrial enterprises and those who are about to start a business should also find this book useful. On the other hand, students of business management or potential entrepreneurs among the educated youth should also find it of interest; so should trainers, consultants advising new and existing entrepreneurs, financial institutions, banks and investors. This is because all of them need to evaluate and diagnose industrial firms to promote them and assist them. This book has the potential, I believe, to act not only as a source of information but also as a manual on how to evaluate projects of new entrepreneurs and the performance of operating enterprises.

Successful and seasoned industrialists, too, can benefit from this book. It would encourage them to review their thinking and business style, for business management is a multi-dimensional, constantly-changing field and, therefore, even experts will benefit from systematic and frequent review of their knowledge and beliefs.

The book is relevant for all sizes of firms. Its content is relevant not only to manufacturing firms but also to those involved in construction, transport and services. Even non-business organisations—government or non-government, educational or developmental—face delegation, leadership and succession planning issues. I have cited several examples from them.

So far the problem of Indian entrepreneurs has been the rather narrow and limited horizons within which they have confined their vision. It is now time for a progressive and broader outlook without which success in industry or business will not be ensured. With this in mind I have cited examples not only from within the country but also from outside. These examples are real and not imaginary and this book is, therefore, a record of actual experiences. It will become, I hope, a behaviour as well as a strategy guide for industrialists, businessmen and organisations in general.

V G Patel

Preface to the First Edition

The 'seven crises' approach to business strategy is somewhat unconventional—for it deals with business planning, management and growth in a manner quite different from the typical functional management concepts and education. There are no stereotyped references to the knowledge of production management, financial management, personnel management or marketing management. This is because knowledge alone is not enough, for which one can always employ or hire a specialist. What is far more important is the attitude, the behaviour, and, therefore, the entrepreneurial traits (in action) of the owner-promoter. The origin of the seven major crises lies in the entrepreneur. (At one stage in the book I have even advised some entrepreneurs not to grow if they cannot change their old habits, style and behaviour.) This book, therefore, goes much beyond the typical management knowledge.

Similarly, I have referred to the major errors or lapses committed by the entrepreneur as 'crises' because they go beyond the typical problems that small and medium firms face in our country. This book offers a strategy for avoiding, facing and surviving the seven major crises. If, after reading the book, the entrepreneur acts on its advice, a wide variety of short and long-term problems can certainly be avoided or sorted out. This claim, of course, must stand the scrutiny of those who utilise its content and advice.

There has been positive feedback from a large number of entrepreneurs with whom I have discussed these crises, either in training programmes or performance workshops, as well as from those who have read the Gujarati version of this book several years ago.

The book comes out at a time when financial institutions, industrial promotion agencies and policy-makers are concerned about a large number of industrial failures. Despite viable projects and adequate finance, a large number of small and medium enterprises have been failing. These increasing failures are being attributed more to the failure of the entrepreneur, the promoter, the owner-manager than to any other factor. What, then, makes a competent entrepreneur? What entrepreneurial and managerial capabilities should one look for in the project promoter? What should the project revival and survival efforts focus on? If we are going to develop new entrepreneurs, what inputs should be provided? The 'seven crises' analysis offers some key answers. The crises referred to result from the manner in which the entrepreneur conceives, implements and runs his or her project. If the external environment is hostile, it is all the more important for the entrepreneur to be aware of these crises, to prepare for them, avoid them, and survive them.

Therefore, all those who have already set up industrial enterprises and those who are about to start the business should find this book useful. On the other hand, students of business management or potential entrepreneurs among the educated youth should find it of interest; so should trainers, consultants advising new and existing entrepreneurs, financial institutions, banks and investors. This is because all of them need to evaluate and diagnose industrial firms to promote them and to assist them. This book has the potential, I believe, to act not only as a source of information but also as a manual on how to evaluate projects of new entrepreneurs and the performance of existing enterprises.

Successful and seasoned industrialists, too, can benefit from this book. It would encourage them to review their old thinking and business style, for business management is a multi-dimensional, constantly changing field and, therefore, even experts will benefit from systematic and frequent review of their knowledge and beliefs.

The book is relevant to small and medium-scale firms, employing, say, 5 to 300 workers. Its content is relevant not only to manufacturing firms but also to those involved in construction, transport and services. This is a time when India is entering the decade of entrepreneurs. New industrial and economic policies aim at liberating industrial business from the shackles of restrictive policies, procedures, clearances and protected markets. This, in turn, would lead to a situation of survival of the fittest and the death of many. In the past, a large number of Indian entrepreneurs could survive or even grow despite inadequate managerial capabilities simply because they could hide their inefficiency and high cost behind large profit margins or high prices resulting from lack of competition. Not any more.

So far the problem of Indian entrepreneurs has been the rather narrow and limited horizons within which they have confined their vision. It is now time for a progressive and broader outlook without which success in industry or business will not be ensured. With this in mind I have cited examples not only from within the country but also from outside. These examples are real and not imaginary. This book is, therefore, a record of actual experiences that will become, I hope, a behaviour as well as strategy guide for industrialists and businessmen.

V G Patel

Acknowledgements

It was somewhere around 1975 that I met Prof. Robert Bhuchele at an international conference on Development of Entrepreneurship. His paper based on American experiences of the growth problems of small businesses impressed me, particularly the 'crisis approach' to problems of start-up, survival, growth and prosperity. I have adopted this approach for looking at Indian enterprises in the small and medium-scale sector. I place on record my appreciation of his refreshing concepts.

The sustained, time-bound hardwork of Shri P P Dixit in helping me prepare the first English manuscript, as well as in suggesting additional points of counseling based on his rich industrial consultancy experience, must also be acknowledged with many thanks.

It was Prof. B G Shah, former Senior Professor at IIM, Ahmedabad, an expert in finance and management and a friend as well as a colleague in several EDI activities, who went through the whole manuscript carefully and comprehensively. He tightened the draft, suggested valuable changes to bring it up-to-date, sought fresh and recent examples and, based on his own experience enriched the presentation. I am extremely grateful to him for his total involvement in this work, his valuable professional advice, direct contributions and encouraging support.

It was obvious that we needed a lot more examples, some well-known and recent, to explain each crisis effectively. This is where Shri S S Modi, Senior Consultant of GITCO (where I worked earlier) came to my rescue. Together with Prof. Shah, new examples were compiled to strengthen the explanation of the crises and remedies. I am grateful to Shailesh Modi for his valuable assistance.

One chapter in which the maximum modifications and additions are carried out in this [2nd] edition is the one on Financial Crisis (Chapter 10). In the last few years, several new sources and instruments of financing a business have emerged, some of them international. Updating them and explaining the pros and cons of each mode of funding was a technical task which was ably and thoroughly carried at my request by my former and dependable colleague, Dr H C Raval of EDI. I thank him and acknowledge his insightful contributions.

I also wish to place on record the valuable and timely support extended by Shri Nikhilesh Desai of EDI in pursuing the second reprint and now the new edition. The Institute has extended unconditional assistance in handling all the activities connected with the publishers and the publication. It has made me feel proud and happy.

I must also mention that comments received from the publishers played an important role in strengthening the final draft. They have respected my style and approach while making useful suggestions at crucial places. There are many more examples and lists of dos and don'ts, thanks to their comments. I am thankful to them.

V G Patel

1

How is the Health of Your Business?

A number of large companies have been in trouble in the recent past. Share prices of one of them plunged from a peak of Rs 450 to Rs 95, while another showed a massive, unheard-of loss in its annual balance sheet. Even big companies face crushing defeats at times. Yet, the incidence of such failures is much more frequent in the case of small and medium-scale enterprises.

We would like to explore in this book the genesis of growth and decline of business enterprises, the how and why of this phenomenon and to propose remedies based on our real-life experiences and observations, which could help enterprises remain on a profit-oriented growth path. We have paid particular attention to the small-scale industries, and conceptualised seven crises that enterprises should keep checking and avoiding as they climb the various stages of their growth path from small to medium and even to large-scale operations.

1.1 EVALUATING PERFORMANCE: LADDER OF SEVEN CRISES

If you wish to diagnose the health of your business, you should apply the touchstone of the seven main crises described later in this book. We have studied a number of small-scale business units and have observed time and again that:

1. If you are watchful enough, you can actually see these seven crises invading a business enterprise in a definite manner. Moreover, it is not a one-time attack; these crises may afflict an enterprise repeatedly.
2. They descend on the business units at such delicate stages of their life that it either sinks into oblivion or just about remains afloat in a dazed state. In fact, if overlooked, these crises almost determine the coming decline of the business as surely as night follows day.

We certainly do not imply here that each industrial or business unit succumbs to all these seven crises in a specific and predetermined sequence or in exactly the same manner as described by us. Some units may escape from one or more of these crises while others may have to face more than two or three simultaneously. We also do not suggest that the seven crises described in this book form an exhaustive list of all types of crises that you may ever face in your business. For instance, the product that you choose for your project, or the game-plan that you adopt to beat competition in the market-place could be equally important causes for success or failure in your venture. We shall have a bird's eye view of such factors in the final chapter. In fact, this book is an attempt to conceptualise an easy-to-use framework for keeping watch on crucial aspects of the business so as to keep it healthy and growing.

We shall analyse each of these seven crises in three stages. First, we shall describe and explain the broad parameters of each crisis. Then, we shall give instances of units that have been enveloped by a particular crisis. Finally, we shall suggest measures to prevent the crisis from occurring and if, unfortunately, it does, the means to cope with it.

It is quite obvious that any entrepreneur would want to be up-to-date with the details of the strong and vulnerable points at a given time as well as the shape of things to come that would directly affect his business one way or the other. But how many entrepreneurs really succeed in getting an accurate picture of their businesses? Very few, indeed. In fact, in smaller units, you rarely come across owners who have assessed the strengths and weaknesses of their units systematically and appraised the business environment carefully to determine their future course of action. Yet it is not at all difficult for an entrepreneur to plan the direction his business should take if he studies his present situation carefully. In this book, we offer concrete advice to the small-scale entrepreneur so that he can, on his own, study the status of his business and, with the help of the framework offered by the 'seven crises' approach, actually probe and gain insight into what is in store for his business in the days and months ahead.

1.2 FINANCIAL ANALYSIS: STRENGTHS AND LIMITATIONS

Normally, we assess a company's present performance and its future well-being through an analysis of its financial results. We do this regardless of whether the company belongs to a big business house or is a tiny industrial unit. The analysis has an advantage in that we can rapidly survey the figures of sales turnover and return on investment, and also check whether the company is making a profit or loss. Besides, it is quite natural for a busy entrepreneur to gauge the financial and operating results of his business performance and reckon the future of his business through such an analysis. In any case, he does not have enough time to bother about other 'trivial' details of his company.

The other advantage is that it is quite easy to work out the financial analysis of a unit, provided the business information is available in a usable form with sufficient details. The third advantage relates to a lender of funds to the company who wants to make sure the company has enough liquid assets to meet its maturing obligations and whether it is a profitable venture. Therefore, financial analysis is the main instrument that may be used by the small-scale entrepreneur while interacting with his banker. He can also compare his financial position and operating performance with that of his competitors and identify areas where he needs to improve both. (You should, however, use inter-firm comparison with care as accounting policies, age and product-technologies of firms differ significantly).

But let us now look at four limitations of financial analysis.

Firstly, it is a somewhat *slow process.* Often, the blunders committed and the bottlenecks faced by a company can be traced much more quickly through means other than financial analysis. Indeed, financial analysis may not give timely clues on non-financial factors affecting the business adversely.

Secondly, financial analysis lays *emphasis entirely* on *past happenings* rather than on problems likely to arise in the future. No doubt the financial snapshot of a company may give some hints about its future, yet it is better to adopt probes inclined more towards the future of the enterprise than its past. More so when the past is no longer valid for the future operations of the enterprise. This concept of utilising probes to assess the future of an enterprise is one of the vital components of the 'seven crises' framework that we are going to describe soon.

Thirdly, financial analysis helps us identify and understand *only the symptoms* of the disease affecting an enterprise and not its underlying causes. There might be a number of errors or even blunders in managing a business that could result in a financial crisis. Quite often, one comes across a businessman who, typically, underscores the financial side of his difficulties and proclaims, "Just give me rupees one lac (or five lacs or twenty lacs) and watch how easily I tide over this crisis to become truly competitive in my line of business". But the sorry fact is that, most of the time, it is not the lack of finance that is the root of the problem. The financial bottleneck is the end result of a series of management and administration blunders made months or years ago by the entrepreneur. Try giving more money to an entrepreneur who has not been careful in the past with his financial management and you can be sure that history will repeat itself, this time as a bigger tragedy.

The fourth disadvantage of financial analysis is that you cannot really decide on the basic *factors with which* to *assess the health of a small-scale unit.* What might appear to be a relatively trivial incident could upset the whole applecart of a small business and adversely affect the profitability in a big way. Therefore, since the health of small-scale unit is sensitive to a number of diverse factors, profit and loss figures based on past performance are not very helpful in controlling or guiding its future direction.

To sum up, we would say that financial analysis does have many positive aspects, but it also suffers from so many limitations and grave lacunae that we cannot rely on it as a principal or sole approach to probing the health and viewing the future of a small business enterprise.

Of course, other methods are in vogue to check and assess the efficacy of the main functions of an enterprise and the working of its various departments, as well as to audit the administrative and management processes. For small industries, though, I do not consider them to be practical. In fact, the very leanness and agility of a small enterprise are qualities that enable it to lock horns with the mighty Goliaths of the business world.

So, from all angles, the 'seven-crises' approach seems to be an effective and practical one for analysing the small-scale sector units. Since such a probe is based on hard facts and the obvious flow of events, it is easy to grasp and apply. More importantly, the owner-manager of a business who consistently uses this approach to assess his business avoids many blunders that could spell disaster for his business, and thus ensures the success of his venture throughout.

Seven Crises

• ***Starting crisis*** • ***Cash crisis***	***First three years***
• ***Delegation crisis*** • ***Leadership crisis***	***Three to seven years***
• ***Financial crisis*** • ***Prosperity crisis***	***Seven to ten years***
• ***Management-succession crisis***	***Ten years onwards***

2

Starting Crisis

Every year, thousands of entrepreneurs of new ventures commit certain mistakes. These mistakes result in virtual closure or stagnation of their enterprises. Their businesses thus live on borrowed time. We call this crisis the starting crisis, since it is the outcome of the initial (starting stage) errors of these entrepreneurs. Actually, it deserves to be called so on two counts:

- It comes first in order of sequence amongst all the other crises, and
- It is the root-cause of failure of a very large number of business ventures; it is the worst killer.

Some ventures do survive for a few years after the onset of this crisis, but surely, it is an existence on the brink and you can see all the signs of an impending mishap. A new entrepreneur who has no clear idea as to the costing of his product may not have any difficulty initially if his product is in heavy demand and enjoys a high profit margin in the market. Later, however, when competition in his line of business comes up, not knowing what is the cost of his product, he may commit blunders when quoting to a customer or bidding for a tender.

During our study of new ventures that failed within a brief span of time after commencing operations, we realised that such ventures are especially prone to commit the following five mistakes.

1. The entrepreneur rushes into the business in response to what is really a temporary spurt in demand or because he sees 'others' in the business making money.
2. The key person—the entrepreneur—does not have adequate and all-round insight or experience into the managerial aspects of the line he has chosen.
3. Accounts are not maintained properly and hence there is no reliable database for decisions on product mix, pricing and profitability.
4. The estimates of the capital required for the business have gone haywire and, consequently, the investment in the project is estimated below the required level.

5. There is a pervasive ignorance about the incidence of various taxes on the enterprise.

Let us now look at these five causes in detail.

2.1 LACK OF A THOROUGH STUDY OF MARKET POTENTIAL FOR PRODUCT

A major cause of business failures, particularly of new entrants, is the lack of thorough study of market potential and absence of a comprehensive marketing plan. Some units are set up because 'others' in the same line of business are seen to be making large profits, while others come up in response to a temporary spurt in demand regardless of the long-term demand potential for the product.

Take the case of a well-known business house that set up a rifle production unit at Ahmedabad, attracted by a temporary spurt in demand far rifles from the civil defence segment in the wake of the Indo-Pak war in the mid-60's. During the ten years of its operations, capacity utilisation did not exceed 5 per cent. Before launching the project the promoters did not make an assessment of even the medium-term market potential for the product.

Consider the cases of many mini-paper, mini-cement, mini-steel, plastic-woven sacks and texturising units that were set up as they were seen to be money-spinners by those who were not in these lines of businesses. The result was a widespread sickness among these units with most of them suffering from low capacity utilisation and operating losses.

Take again the case of a large manufacturer who set up a plant for manufacturing button-cells in collaboration with a well-known Japanese firm. The unit could not sell these to the original manufacturers, who imported them as part of completely knocked-down kits or preferred to set up in-house facilities for their manufacture. The demand for button-cells in the replacement market, too, did not materialise as expected because of the availability of cheaper, imported button-cells smuggled into the country. The button-cells produced by the unit were priced out of the market because of heavy import duties on the inputs used in their manufacture.

2.2 LACK OF ALL-ROUND MANAGERIAL ABILITY

Let us note two important issues about efficient management of business.

First, small business ventures at start-up stage cannot afford to employ experts to manage different functional areas. So the task of the owner-manager at the helm of the venture is a multi-faceted one, covering all the functions.

Secondly, if there is an error in even one of the managerial decisions, it could wipe out the entire profit of the unit. At times, the consequences could be more serious than this. It is like slipping from just one rung of the ladder when that rung happens to be the top one. When we discuss business failure due to the lack of all-round experience in managing the business, we emphasise the word *'rounded'* or *'all-round'*. By such all-round experience, we mean a comprehensive knowledge, a jack-of-all trades, in such diverse functional areas as selling the finished goods, purchase of materials, production management, dealing with labour, pricing the product, deciding the product mix, managing working capital, etc.

Take the example of an industrious salesman who had been with a firm for many years, looking after the sales function efficiently. One morning, it occurred to him that he has carried the burden of the entire firm on his shoulders. His monologue went something like this:

> "The key to success in any business is the sale of its products. The beginning and end of the business cycle is nothing but sale and 'other' people working in the factory to manufacture goods are mere cogs in the business machine set in motion by me. So, why carry this burden and get only a tiny share of the prosperity of the firm? Instead of others enjoying the fruits of my labour, why should I not start my own business?"
>
> So, he started a new business venture and, as it usually happens, invited a person with manufacturing experience to join him as a partner. Ultimately, the salesman-turned-entrepreneur failed as he took some imprudent financial decisions (over-investment in raw materials), did not keep or understand proper accounts of the funds and ended up booking orders below the cost of production.

In recent times, there has been a tremendous progress in technology. This has encouraged various engineers and scientists to set up their own ventures. However, they get enmeshed in the starting crisis and their ventures succumb to failure. Just as the salesman in the above example thought about the overriding importance of the selling function in business, the engineers and scientists believe that the present age is the age of science and technology. Innovating new equipment and processes and new designs is considered by them as the *nirvana* of the business. Besides, generally, engineers and scientists may have a bit of vanity in them, making them feel superior to other ordinary *babus* (administrators and managers). They believe that whatever is needed by way of management and administrative inputs for the unit, which they refer to derisively as 'bookkeeping skill', can be learnt in a matter of hours. Even the young businessman who sets up his own new venture may behave like the egocentric salesman. Typically, he has two to three years of routine experience in running an enterprise. When he embarks on his own independent business, he has some experience in the various functional areas of the enterprise but mainly as a 'boss'. He lacks deep familiarity with any of the functions and, thus, does not have a mature, well-rounded insight into any of them.

Let us have a look at a real-life case.

> Two sons of business tycoons acquired MBA degrees from a prestigious Indian business school. One of them had a brief experience in his father's factory in the production department while the other had some experience in sales. Now, by sheer chance, they came across a person who had developed an innovative product that seemed to have a ready market. The young businessmen set up a venture to manufacture the product, but it seemed to take longer than the projected schedule. So the sons approached their fathers for more capital to invest in their venture. By the time the first year got over, additional funds were needed. The second year, too, saw scarcity of funds and need for more money. The young businessmen got fed up with the venture and their fathers, too, were eager to come out of the 'mess'. Ultimately, the venture was sold to a person who did not have even high school education but had a lot of business experience. Within a matter of months, he revived the venture and it has now blossomed into a blue-chip company.

When we say that a lack of all-round management experience is a primary cause of failure in business, you should pay close attention to that word, *'management'*. What we mean by this is the ability that gets developed through actually working in a real business environment and enables a person to take good short-term and long-term business decisions. Instances galore when a veteran of a particular business line having worked in different functional areas of the business for 12 to 15 years or even more, sets up his own venture and comes to grief almost immediately. If you analyse the causes of his business failures, you generally find that he has not been exposed to taking long-term decisions, like deciding on capital investment, choosing a location or selecting the product for a new project, etc.

Besides, he should have had experience in or understanding of the specific line of business in which he embarked. There are instances when a seasoned entrepreneur lacks experience in the specific business line of the new venture, though he has long years of experience in some other line. It is all a case of the grass being greener on the other side. We have come across the case of a manager who ventured into a line of business in which he found his 'half-wit' brother-in-law making a lot of money. This gentleman therefore invested his life's savings in the new venture and lost. The poor man did not know that administration of any specific business line has its own special maze to cross through. Successful entrepreneurs are those who know all the twists and turns inside this maze of their business line. The moral: do not compete in business with your (allegedly!) half-wit brother-in-law unless you have adequate insight into that particular line. We had many living examples of such business lines like diesel-engine manufacture, TV sets production, automobile repair shops, etc.

Management pundits believe that the ability to manage is a kind of universal spare part; it will fit, whatever may be the equipment (or business situation). A popular example to support this view is that of the Army Chiefs who, after retirement, get appointed in large enterprises and usually succeed in their new tasks. This is so mainly because under the Chiefs, there is an army of experts in various functional areas and their role is to provide "strategic and leadership" inputs—a role that eminently suits them. On the other hand, if the business is small, the man in the driver's seat should have enough expertise in the line or he will invariably get entangled in the twists and turns of business.

You may have met a number of persons who are constantly on the lookout for 'good project ideas'. We would rather discourage such project-idea hunting because it implies that the person can handle any project, be it electrical, chemical, pharmaceutical or engineering, provided the products made in the project have a good market. This is, in our view, a plain myth.

Take the example of the plastic industry where the market has been large and growing for most products. Yet many traders, merchants and even technicians who entered this industry attracted by the huge demand, either in the manufacture of woven sacks or plastic films for packaging, have failed. Anyone can handle a plastic project, they must have thought, for the production is automated, the process is simple, the machinery suppliers few and well-known; location requirements are not stringent, and ready project reports are provided by suppliers and consultants. However, almost half of them have closed down. For, many of them did not possess the skill, experience or insight pertaining to raw material purchases, working funds management and cost control in a competitive, low-margin industry.

In the world of business, no project is so simple and no market so easy to exploit that just anybody can walk in and succeed. We prefer to identify the strengths (in terms of knowledge and skills) of such persons and then discuss appropriate projects with them that have good potential and scope in the industry.

2.3 INADEQUATE ARRANGEMENTS FOR KEEPING ACCOUNTS

The third of the five causes of failure of a new business venture is the lack of necessary financial accounting data. Some businessmen feel that they cannot afford to employ an accountant. There are also those who think that they have such a thorough knowledge of their business that in the initial phase, at least, account-keeping is only incidental. Let us wait, they say, for the business to pick up and grow and then we will think of employing qualified/experienced accountants. There are still others who are such greenhorns in business that they can hardly spell out the exact difference between total cost and gross profit margins or when the business breaks even. Worse still, they find it unnecessary to get accurate up-to-date information about such vital data of their business activity from time to time. Nor do they show adequate appreciation of the importance of financial data in the forms required for proper cash and working capital management. They run their businesses like a car driver who drives at night without head lights.

Let us listen to a highly successful Chief Executive of an institution that advances loans to small-scale units. He was asked, “What would be your best advice to entrepreneurs starting their first venture?”

“Invest some amount,” he said “to engage the services of a good accountant as soon as you start your venture. The accountant would help you obtain the necessary data and to set up the financial information system.” He continued, “Let us say you don’t have money to engage such an accountant. And you don’t know much about accounts yourself. Then, for heaven’s sake, don’t start the new venture. Believe me, if you don’t recognise and accept the need for an accountant, you have no insight into how to set up and run a new venture successfully”.

Let us look at another case.

> The owner of a one-year-old construction business invited an expert in accounting to carry out the audit of his business activity. The owner said, “I have started this venture about 12 months back.

I have obtained more contracts than the projections of business I made at the start. Moreover, all the contracts are working smoothly. I had called my accountant to prepare the profit and loss account and to derive the tax liability. To my surprise, he says that I have made a loss! Either he is a fool or a rogue or may be there is a cheat working *incognito* in my office. I am confident that I have made a hefty profit during the past year." The accounts expert studied the details given to him and concluded that the accountant was right, that the firm had indeed made a loss. The owner had not included depreciation of two items of construction tackle (a sizeable figure). Further, the owner had not considered (as expense) the salary of his wife (who was employed in a job earlier), even though she was now working in her husband's construction firm. Also, the estimate of worker-hours required for each project were underestimated and the owner had not taken into account the actual cost of labour (higher, due to overtime) in fulfilling the various contracts. The additional labour cost, which exceeded even the norm, was over 12 per cent. And no interest was calculated on the capital brought in by the owner!

The above situation is typical of many persons engaged in the business of taking contracts.

Here is another instance of an electrical contractor.

Three engineers left their lucrative jobs and started business as electrical contractors. None of them had any knowledge of accounts. They were entirely dependent on whatever their old book-keeper recorded.

The accounts were usually prepared late by one or two years. As a result, the credit collection was tardy. And the firm had to write off a large portion of its debt because after three years of the due date of payment, even a court of law cannot help you recover a debt. Finally, quarrels began and the firm had to be wound up.

You will rarely find people engaged in small job-work type of activity like the building contractors, toiling day and night like slaves and becoming prosperous at the end of it. One important reason is that they have virtually no idea of the costing of their activity. The cost of tools and tackles used in their work are not taken into account when calculating the cost of the work even when these tackles break or are subject to wear and tear. As a result, the worth of their business gets eroded gradually and, after some time, they wind up the business and take up jobs as employees of some company or the other.

The following is a case in point.

Krishnan, a graduate in mechanical engineering, worked as Assistant Engineer in ACC, the well-known cement manufacturer. His technical background and experience in the cement factory prompted him to start an enterprise on his own to manufacture cast-iron cylpebs, a product in great demand by cement manufacturers in the region. Lacking knowledge and experience in product-costing, the prices he charged for cylpebs did not cover their cost of production. When cylpebs manufacturing thus turned out to be unprofitable, he switched over to manufacturing ferrous ground castings. These castings can be produced by both the pit furnace and coupola processes, with the former being more cost efficient. But he charged the same price for both. The result was sub-optimal product-mix and faulty pricing. The same lack of knowledge in product-costing made him accept jobs at uneconomical prices. Even after five years of operations, the unit continued to make losses.

Another case is that of the hundreds of diesel-engine manufacturing units in Rajkot set up by erstwhile workers in diesel units so that they could raise their status from employees to that of the owners. The basis of their pricing for the jobs they undertook was what "others" charged, thus showing scant regard for proper job-costing and adequate provisions for tax liability, capital maintenance and replacement, and contingency during lean business times. Even after a decade in business they have not arrived at an item-wise break-up in the cost of jobs they undertake. The result: many of these units operate on illusory or narrow profit margins.

A hazy awareness of costing and profitability prevents entrepreneurs from seeking strategic (or even simple) solutions to the fundamental problems of their business. . Only when the fact that profitability is low or tenuous is brought into sharp focus does one look for ways to overcome fundamental problems. The solution may lie in adding value to your product, improving technology, reducing cost or tapping a new market segment. But so long as the fact of low profitability remains masked, you carry on routinely and are not motivated to seek creative, challenging solutions, so you remain one of the many vulnerable enterprises who fail to grow and prosper.

If you talk to a banker who has advanced funds to companies employing about 20-25 workers, the first thing he might tell you is that their owners (or sometimes even owners of relatively bigger enterprises) do not have a clear idea about the actual costs incurred in their business.

They have fancy whimsical notions about the selling prices of the products. In fact, they do not have any basic data at all for arriving at these figures.

Recently, 40 owners of small business establishments were asked about various aspects of their business activities. Except for two, the rest did not know how to arrive at the figure of the break-even level of their activity either by plotting a graph or by computation. The question therefore is: how can they ever know whether their business is making a loss or the level of activity at which it will become a profit-making venture or that which will maximise profit? And of the two who really knew about how to calculate the break-even level, one followed this unique practice of ringing a large bell in his factory and his workers almost always heard the 'break-even' bell.

Many entrepreneurs do not have adequate appreciation or basic understanding of the cost-volume relationship and its relevance to profit maximisation. For instance, if you are facing rough weather in the market and your products are not selling because of the comparatively high selling price, a good cost-accountant can help you in taking *rational* pricing (and product-mix) decisions. Such decisions, based on what is known as marginal costing, can help you combat successfully with your competitors during a recessionary phase of the market, and maximise your profits.

2.4 UNDERESTIMATION OF CAPITAL REQUIRED

The fourth cause of failure of a new venture lies in underestimating the capital investment actually needed for it. Put simply, the promoters do not have (or have no provision for) adequate funds for investing in the business.

To start a new venture, you need a great deal of enterprise as well as extraordinary efforts to accomplish the tasks ahead, particularly if you are a first-generation or a small-scale entrepreneur. So, the key-person (entrepreneur) who initiates the venture has to be a very optimistic person. And it is observed that such an optimist estimates the investment needed for the business and time required to set up the new venture optimistically and therefore quite unrealistically.

Thus the time required for the unit to reach its full capacity of production, the months required for the production process to stabilise and run efficiently, the schedule for creating (and increasing) market demand for the products—all these are estimated much below the realistic levels according to the dictum "Income will be high and early and expenditure will be low and late". This results in a severe shortage of funds for the project because a lot of things fall behind the original schedule—the unit reaches the planned capacity of production late, the sales income is also late in coming and ultimately the investment planned for the project becomes more than the original estimates. In reality, income turns out to be low and late and expenditure high and early. The entrepreneur runs out of funds to run the enterprise.

Thus, an important reason for failure of an industrial unit is low, erroneous and unrealistic estimates of capital investment and gestation time. It is a good principle to avoid both surfeit and shortage of funds in any business, but it is better to guard against shortage because it invites quick disaster. If the factory gets commissioned later than scheduled, the entrepreneur experiences shortage of funds almost immediately. He then has two options—either close down the business or borrow money at an uneconomic rate of interest. Apart from this, the vicious circle of other problems also comes into play. Productive time of the owner and employees is lost in troubleshooting and the entire plan of the project goes haywire.

During the gestation period, businessmen often fail to recognise ground-level realities. Delays in loan-sanction and disbursement, subsidies not coming through in time, late power connections and schedule-slippages by machinery suppliers are common; and once you begin production getting a foothold in the market takes longer than expected.

> There is this case of a saltwork at Bhavnagar. The entrepreneur got the loan sanctioned in two weeks. However, a collateral was compulsory. He was living in a loan-instalment (mortgaged) house, which was to be offered as a collateral. It took him six months to secure satisfactory title to the house and he could not draw the loan. He missed the first working season. There is also a tragic turn to this case of time overrun. For, before the beginning of the next season, a cyclone destroyed most of the saltwork's earthwork.
>
> Take another case of a vegetable dehydration unit. The entrepreneur, lacking technical exposure did not make adequate estimate for the price of auxiliaries—thermic fluid heating system, fluidline installation air conditioning, electrification, insulation/instrumentation, quality control instruments etc. The cost of the auxiliaries turned out to be over 30 per cent of the main plant. He had provided only for 10 per cent. The project cost overran. An obvious consequence was implementation-time overrun. The project accumulated a loss even before it could begin commercial production.

We would advise that over and above the realistic estimates of time and investment required to complete the project, there should also be alternate schedules of investment. That is, a clear picture of uncertain eventualities. Suppose the project is delayed by one month, what will be the need for additional funds? This is important because

1. There are fixed costs to be met during this period as well as the salaries of the employees, other pre-operative expenses etc.; and,
2. As a result of inflation, which is a hard fact of business life, price levels rise almost continually.

If the entrepreneur is equipped with such a schedule of investment, he would be up-to-date with information regarding requirement of additional funds. It would be useful if there is a delay in commissioning the unit. He can also plan in advance for arranging to procure this additional need for funds. Thereby, he avoids immediate failure once the venture is commissioned. Let us take an actual case in this context:

> Two partners had set up a unit to manufacture electronic goods. Both had sound backgrounds in the designing of electronic items during their service with a big firm. Each partner invested the entire savings of a lifetime in the new venture and also motivated his relatives and fellow-engineers to invest in it. Their strategy was to accept sub-contracts for certain routine electronic items so as to earn the "survival money" and, simultaneously, to slowly and steadily develop new products, which would become their 'cash cows'. But, as bad luck would have it, they found that they did not have enough capital to manufacture the routine items. One of the partners had to devote all his time during the initial nine months to raise the balance of the investment. The result was that they could not even begin production. Quarrels between the partners ensued. Ultimately, the entire unit was sold to a large company at one-tenth of its original price.

Of course, the above example illustrates poor management over and above the shortage of necessary funds. But if the partners had, right at the start, twice the investment they actually had, the senior partner could have devoted his time towards developing the new product and would not have needlessly wasted his time raising capital.

> On the other hand, Gopi Acharya handled this carefully and successfully.
>
> He was working for an engineering fabrication company. The company used to undertake jobs for large public and private sector companies. He decided to enter fabrication. However, he realised

that fabrication was a risky business. There are tenders and bids and one may or may not get a contract. So, he started marketing industrial equipment in a small way while he was still employed. It took a year for the marketing business to stabilise and generate a safe level of income. He was now ready to quit his job. But he was aware of delays in receiving advances, satisfactory work-completion certificates and, hence, payment in respect of large fabrication jobs. So he identified a financial partner and educated him thoroughly about the degree of risk, the partner's role, financial requirements and profit potential. The partnership and the project turned out to be extremely successful.

One of the areas where project costs are most frequently underestimated is the margin money required for working capital. This margin amount, which is the owner's investment in working capital, is a part of the total project cost. When the project is appraised by the State Finance Corporation (SFC) which advances loans for fixed assets, the margin for working capital is scrutinised on the basis of available information; since SFC does not have to sanction any finance for working capital, the margin, as proposed by the entrepreneur, is normally accepted. I believe that it would be a good practice for the entrepreneur to get the margin amount vetted (checked) by the bank that is ready to support the project *prior* to the sanction of term loan by the SFC.

2.5 IGNORANCE ABOUT TAX LIABILITY

Lack of knowledge about tax matters is another reason for a large number of new ventures rolling down their shutters within a span of two to three years after inauguration. Most entrepreneurs worry about income tax (which is to be paid if and when one makes profit) but are ignorant about sales and excise tax which one has to pay even if the firm is losing money. It is essential for the owner-entrepreneur to be thoroughly familiar with the various types of taxes that can be levied on his venture before he starts his business. The consequences of neglecting tax-related matters can be disastrous as the following case proves.

An engineer started an electrical motor-rewinding business. Prior to this, he had been working in textile mills. So he had plenty of experience in the engineering and technical aspects of the line. However he was not at all familiar with sales tax. Therefore, he did not take any care about sales tax applicable to his products and its payment. He bought his raw materials without proper bills. Five to six years after the unit had begun functioning, the sales tax department cast its eye on this unit. He was liable to pay sales tax right from the day he started business up to the date the department contacted him. In addition to the liability, he had to pay the interest on the sales tax amount and a heavy penalty as per the law. The poor man had all his properties attached by the government and his business auctioned to realise the dues. A very heavy price for ignorance!

Starting Crisis

- ***Inadequate 'rounded' managerial experience/ understanding of the line chosen***
- ***Underestimation of the capital required for the project***
- ***Lack of understanding/arrangements of accounts***
- ***Wrong choice of equipments/technology/project capacity***
- ***Ignorance about taxation***

3

How to Steer Clear of Starting Crisis

There is neither any element of mystery nor secrecy in these starting slip-ups; they are quite easy to identify and avoid if you are careful enough. Yet, thousands of entrepreneurs go on merrily committing the same starting mistakes. Besides, many business units continue to reel under the aftermath of these oversights, suffering in the process even though they might continue to survive. Here are some suggestions to steer clear of these starting errors:

(a) listen to all available advice,
(b) organise up-to-date business data,
(c) encourage participation of investors,
(d) meet your tax consultant or tax officer often,
(e) estimate the capital investment realistically, and
(f) while selecting the machinery, take an overall view.

Let us explain each of these.

3.1 LISTEN TO ALL AVAILABLE COUNSEL

An entrepreneur who embarks on a new business after a few weeks or months of planning realises later on that either his projections of the unit's achievements were rather optimistic or he had let his imagination run wild about the success of the project. A similar situation occurs in the case of a group of people who, under inspiring leadership, get into a frenzy about a particular scheme or project. The group estimates the profit from the project a little too optimistically and dismisses the possible bottlenecks in the implementation and running of the project too easily.

We have observed that their optimism is mainly about the projected sales turnover of the unit. Entrepreneurs setting up new businesses do not think carefully enough about such aspects of their project as—who will buy their products, what would be its demand potential, why should a buyer procure items made by the new project in preference to the existing products offered by competitors or how long would it take to establish the product in the market in terms of market share, quality, etc. Often, great hopes are pinned on the lowered production costs. The new entrepreneur nurses the delusion that he would make the product of a superior quality and at a lower cost than the existing competitors, and sets up the venture based on this delusion. Sometimes, there is a similar optimism about the investment required to make his dream of a new factory come true.

To avoid these mistakes without spending anything extra, we suggest the following:

1. *Sleep over your scheme for a few months.* After the initial wave of enthusiasm ebbs somewhat, the project that takes shape out of a hard second look is likely to be more realistic. The interim period could be utilised for preparing a detailed budget and a market plan for the project that is more precise and based on sound assessment of key-variables affecting its viability. You should not base your projections on single estimates of implementation schedules, costs, profits, production levels, etc. Instead, it is prudent to assume a range of estimates (optimistic, pessimistic, and most likely) for the assumptions underlying the projections of key-variables in a project. Remember that you have all the time on hand before you start a project, but once you begin it, you do not have time to think or to decide differently.
2. When planning for investment required for the project, we suggest that you *become a bit old-fashioned and conservative*, going through every item with a fine tooth comb, fussing about small details and keeping a generous margin of society. Put differently, be cautious while estimating income and be realistic when projecting expenditure.
3. *Get your project scrutinised* by bankers, consultants to the small-scale industry, future suppliers of materials to your venture, directors whom you intend to appoint on the board of your company and other persons who are directly or indirectly interested in the success of your project. If you can motivate these people to help, you can quickly identify, with their counsel, a number of weak points in your proposal and ways to deal with them. Once, while discussing the viability of small-scale units with representatives of banks in a town, the bankers unanimously declared that the typical small-scale entrepreneur never met them until his unit began to face real problems. The entrepreneur never discussed the project plan with the bankers before arriving at various decisions. In fact,

the first time the bankers got a chance to meet the entrepreneur was when the entrepreneur wanted his initial over-draft, i.e. when he was already in trouble.

3.2 ORGANISE UP-TO-DATE BUSINESS DATA

Well before you commission your venture, set up sound financial and cost information systems that will help you know the product costs, income from sales, profit/loss and cash-flow in an authentic and reliable manner. The money that you spend for establishing such systems is to be regarded not as an expense but as an investment.

Without such systems, you will be groping in the dark about the outcome of your business decisions (on product mix or pricing or make or buy) that you want to take or have already taken. You should ensure that you get such information as a matter of routine, at appropriate intervals during the year, over and above the customary end-of-the year annual reports. To obtain such periodical reports, evolve suitable costing and financial information systems and appoint an accountant experienced in designing and implementing them.

3.3 ENCOURAGE PARTICIPATION OF INVESTORS

When you begin to search for additional capital, try to identify investors who will help obtain the funds you need from the right source in right time at right cost. One advantage of accessing investors like development banks (SIDC or SFC) or commercial banks is that they examine virtually all the aspects of your scheme thoroughly and objectively. Besides, when they see for themselves that the unit is doing well, they will come forward with additional investment on their own. Moreover, these development institutions do not panic when the venture faces a minor crisis: they continue with their financial support and also help with counsel and additional funds to tide over the crisis period as long as the project remains otherwise viable. Small-time investors, on the other hand, lacking vision and experience, may virtually throttle you to death on the basis of even a small adverse rumour against the business.

Many small entrepreneurs believe that they should keep full control of their units. As a result, they do not get the benefits of timely advice and funds from development agencies and thus court disaster. Or else, the growth of the unit gets arrested due to lack of finance and planning. You would find that it is much better to have a smaller share of capital in a successful venture than to be at the helm of a unit that is on its deathbed or is badly crippled. You should remember that institutional investors are not generally interested in controlling or managing your business.

3.4 MEET YOUR TAX CONSULTANT OR OFFICER OFTEN

Do not rely solely on your accountant or manager in matters of tax liability. Check out on the tax-liability of your venture independently, by yourself. Before you start, find out which tax-laws are applicable to your line of business, what benefits you can avail from the government by way of subsidies, tax and excise reliefs, and other reliefs and concessions that may be available. Make it a point to interact with the tax/government officers to discuss these and related issues.

Normally, an entrepreneur equates tax with income tax alone. So the account books are prepared keeping in view only the income tax liability. A key point to note here is that while income tax is payable on profit made by the firm, sales tax is imposed on sales. Therefore, no businessman should forget to minimise liability for sales tax on his business within the framework of sales tax laws. Central excise, octroi, etc. are further levies about which it is better to know as much as you possibly can.

3.5 ESTIMATE THE CAPITAL INVESTMENT REALISTICALLY

We have already mentioned earlier how estimates of project cost that are way below the realistic level cause the starting crisis. We have also indicated some specific pitfalls in this area. While estimates of investment in land and building can be checked easily (based on the process of manufacture and equipment layout, etc.), the estimates of investment in plant and equipment, working capital, pre-operative expenses, etc. are often made with less care than necessary. In particular, you should be realistic in estimating pre-operative expenses, and provide for price and physical contingency margins in working out capital costs. As a rule of thumb, provide 10% of investment cost for contingencies. As far as possible, base investment estimates on firm quotations valid for a reasonable period required to mobilise funds and obtain all clearances required for starting the project. It is also important that you make a correct choice of technology and plant and machinery. We give below some comments on this choice so that the entrepreneur can steer clear of the hazard of incorrect selection.

3.6 SELECTING MACHINERY: DO YOU SEE THE BIG PICTURE?

When you select machines for your project it is a decision that you live with life-long; it is an irreversible decision. And yet, I have seen entrepreneurs take this decision rather routinely and perfunctorily. They seem to think that, when it comes to choosing equipments for the project, what is good for competitors is also good for them.

The fact is that this decision calls for detailed and careful thinking. A few questions are suggested here (to be answered by the entrepreneur) for analysing the choice of the machines.

- Does the machine have specifications of performance that I need?
- Does the machine need specially-trained technicians and skilled labour? If yes, can I get technicians and skilled labour of the required category at an affordable cost?
- Are the specifications of the machine compatible with those of other equipments, processes and raw materials to be used in my unit?
- Does the process (built into the equipment) generate effluents? If yes, how do I treat the effluents and at what cost? What are the regulations governing this?
- Can I avoid buying this equipment altogether?
- Is the technology of the machine appropriate to my needs and environment?
- How effective is the after-sales service? What is its cost?
- Is the equipment energy-efficient?
- Have I carefully considered the economies of scale and time of the equipment?

Let me give you a typical instance of how an entrepreneur took decisions about equipment for his project and came to rue the day.

> In a ball-bearings manufacturing project, the entrepreneur decided to buy eight turning lathes for turning races (rings) of the ball-bearings. He took this decision because an earlier project for bearing manufacture also had eight turning lathes. He did not pay enough attention to the 'make-buy' aspect of that operation. After he commissioned the unit, he found that the cost of turning rings in-house was almost twice of what he would have paid if he had bought these items from small-scale industries next door. (The earlier project had these lathes because it was located in an area without any ancilliary units and further, it required manufacture of different bearings with higher accuracy). The result was that from day one, all the eight turning lathes of the entrepreneur sat idle.

Steering Clear of Starting Crisis

- ***Choose the project line you are most familiar with (experience, education, market contacts, special knowledge, etc.)***
- ***Make realistic, not over-ambitious plans***
- ***Allow the project report to 'thaw' and recheck optimistic assumptions***
- ***Be conservative about income (low and late) and liberal about expenditure (high and early) in making cash flow projection***
- ***Never start a project without ensuring sufficient funds—change it, curtail it or drop it***
- ***Use as much advice and information as possible from all possible sources***
- ***Invest in an accountant at the earliest (learn what important financial data are needed)***
- ***Visit sales tax and excise offices regularly***

4

Cash Crisis

Have you heard of entrepreneurs (may be you are one of them) who rush to expand activities or launch new projects when they see their accounts showing good profits? They mistake profits for cash. You must know that a profitable credit sale will add to income, but no cash is received at the time of sale. A credit purchase adds to cost of sale/inventory but involves no immediate cash outflow on that account. So many entrepreneurs are intrigued over the fact that they have "large earnings" but "inadequate cash" or "low earnings and ample cash". They must recognise that only cash can help meet the maturing financial obligations, not the totality of current assets. Soon, the inevitable follows. In spite of book profits they experience cash inadequacy, overstretched creditors, shrinking working capital and profit margins. They feel strangled by the liquidity-profitability squeeze.

The moral of this is that you must avoid making two common mistakes: one, do not mistake accounting profits for cash and two, do not neglect to work out carefully and realistically the cash requirements for expansion or starting a new project. These mistakes have proved fatal to many enterprises—whether small, medium or large.

Cash is, therefore, the life blood of business. In the day-to-day sense what matters for survival is the availability of adequate cash. For only cash can help the entrepreneur meet his maturing financial obligations. Failure to generate adequate cash can have serious consequences on continuing profitability and solvency of the enterprise; it can lower its credit-rating in the market and may enforce reduced prices, which are uneconomical to the entrepreneur or cut back on production. Eventually, the enterprise gets caught in the liquidity-profitability squeeze that often leads to insolvency. The lesson: manage your cash well to remain profitable and competitive. Remember, a business transaction is consummated only when it converts into cash!

We referred earlier to the problem of underestimating investment required for a project. Such an estimate based on unrealistic but pleasing assumptions often leads to a cash crisis. Even companies with satisfactory levels of profit and cash face this crisis if they invest heavily in fixed assets such as land, building, plant and machinery; more so if they rely (as they often do) on short-term or working funds for such fixed investments or if they fail to keep control over stocks and trade debtors (i.e. inventory/accounts receivables) or else if they do not plan carefully the funds needed to support the growth in business.

Let us illustrate the issues discussed with some real-life cases.

The first case is that of an electrical goods manufacturing company that was actually on the threshold of success when it succumbed to the second crisis.

> The owners struggled day and night to establish production levels of three new products in their factory. For themselves, they accepted money required only for subsistence and toiled for almost one year.
>
> They did achieve the desired production levels but the income from sales was below the planned level. A key customer, who had inspired the owners to venture into this business, failed to place an order for the goods from the beginning itself, because he had to install certain new equipment to be able to utilise the new products. Unfortunately, this customer did not have enough funds to procure the new equipment. A second potential customer had a surplus stock of the items with him and so he could not buy the products from the owners of the new venture. A third potential customer found, to his dismay, that if he bought the new items, he would be able to utilise them only for certain applications. For other applications by this customer, the owners of the new unit would have to make changes in their setup and these changes were not feasible without additional investment.
>
> Over a period of time, the new venture secured substantial orders for two products out of three. But, by that time, they simply did not have enough cash to pay for three months' wages to complete the production cycle, for purchase of raw materials and to meet other production expenses. They had mortgaged all of their fixed assets by this time. To buy the required raw materials, they mortgaged one remaining property. But as bad luck would have it, they faced an unforeseen difficulty and once again began to face shortage of cash.
>
> The owners of the unit then rushed to the original investors of the project; these lenders did not have any surplus funds at the time. Some of the lenders were worried and were not sure if the

original loans given by them would be paid back because, as per initial projections, the company should have started making profits by that time and the repayments against these loans should also have started.

The owners then went to their bank. They were confident that since they had firm orders on hand, the bankers would not hesitate to advance funds. The bankers, however, realised that the company was still in the red and all its assets were mortgaged. Moreover, they checked up with one of the clients of the firm and discovered that the client had a quarrel with the unit's owners about the basic specification of the material supplied by the unit. This reflected on the quality of the unit's products. All this discouraged the bankers and they, too, were unwilling to bale the unit out.

The moral: it is common experience for actual sales, investment or costs to deviate from what is predicted both in amount and timings. So it is prudent to provide for these contingencies while working out fund requirements, including those of cash.

Let us now take a look at the second case.

The founder-entrepreneur of this unit was an expert in production and sales but was not quite knowledgeable in financial matters. In fact, he spent his entire life developing a new process and innovative equipment for rolling out metal sheets. He died of a heart attack barely two months before the process got stabilised and the company had begun to receive large orders. Actually, the new process yielded metal sheets of superior quality with higher market value and the unit was certainly viable. Besides, the process and new equipment were such as could be useful for a number of local industries as well as for defence applications.

But the unit began facing trouble right from the start. The founder spent three years developing the new process instead of one-and-a half years as originally envisaged. Of course, a few small orders as also contracts from the department of defence were obtained during the period. But by this time the entire equity of the unit had eroded and the company had to issue new shares worth rupees three lacs to raise additional funds.

When the company was at this stage, another technocrat realised the promising future of the new process and decided to invest all his savings in the unit. He perceived some scope for improvement in the sales function as well as in the production process. But due to inadequate understanding of the financial implications of his ideas, he assumed that the company could be made viable with an infusion of rupees two lacs. Had he consulted a good accountant, he would have seen clearly that a minimum of rupees four lacs were needed to clear the overdue bills and to buy materials for execution of big orders received by the company. Besides, he spent the two lacs without giving careful thought to the probable steps that the company's creditors could take against the unit. The consequences were that he spent his entire time resolving the disputes with the creditors, arranging money to pay wages to the workers and suppliers and searching for new lenders who would advance loans to him. He did not get any time to spend productively on the unit. There was, of course, no question of his initiating selling efforts for the company's products.

Finally, within three months, the creditors of the company saw to it that the equipment of the unit was auctioned off to clear the debts.

The third case relates again to the cash crisis.

This case is of a company that virtually invited the second crisis by investing all its resources in fixed assets such as land, building, plant and machinery and did not keep any liquid cash on hand.

The company was established by entrepreneurs who were well-versed in the bakery business and the unit was set up to manufacture boxes needed for baking, trays and similar equipment used in the bakery industry.

The company had clientele from three states in India. The entrepreneurs acquired a small manufacturing unit at a cost of Rs 20 lacs. They purchased a high-quality plant and machinery for production of bakery implements, and two trucks. They arranged for finance from the bank during the initial two years of production. Slowly, the sales turnover climbed to Rs 50 lacs. At the end of the first year; the unit made good profit even after meeting the initial project-related expenses. At the end of the second year, they declared a dividend of 35 per cent of the equity capital.

During the third year, they increased the production of the bakery implements and the sales turnover reached an annual level of Rs 100 lacs. The bank however began to feel that it was not advisable to sink more funds in this unit. The partners of the company were not cautious in extending credit and in liquidating the accounts receivables.

By now, the partners had tasted success and hefty dividends. Therefore, they were unwilling to allow new investors to join the project. The result was that as the company began to experience shortage of working funds, profits began declining because of the fall in the productivity level. The warehouse was full of finished goods and to fulfil the promises made to customers, new materials were ordered by air. Raw materials were purchased in smaller lots more frequently and the production cycle got interrupted often due to shortage of raw materials. Many a time, instead of supplying the finished goods from the warehouse, the production of regular products was interrupted to execute urgent orders. Besides, heavy cash discounts were offered on the sale of finished goods to mitigate the cash shortage. As a result, profits began to decline even though sales increased. In the end, the company had to borrow working funds by mortgaging the land, building, plant, machinery and trucks at a huge margin.

Let us now consider the fourth case.

It is about a utensil manufacturing unit located in Chennai. The entrepreneur of this unit constantly experienced shortage of working capital. When experts studied the unit they were surprised to discover that the entrepreneur had invested three times the funds required in the stock of materials. The unit made about 129 items of large and small sizes of utensils. It was obvious that a unit having such a structure of products should devise its inventory policy very thoughtfully. Also, every week the owner should have obtained the reports on raw material and stock of each type of finished goods and he should have taken corrective action as needed. No control of this kind was exercised; yet the unit was making a profit only because it was enjoying a monopoly in the market for some time.

The fifth case is as follows.

It relates to a profitable, reputed composite textile mill. Seeing good profits, the management became ambitious. It acquired a large sick mill, and undertook a massive modernisation programme. The expansion was financed largely with short-term bank credit, public deposits and a drawing down of working capital as profits slumped due to bad monsoon and the Indo-Pak conflict (1965). In face of declining demand, it indulged in price-cutting and extended term credit to generate sales. The consequence: low profits and funds generation in face of increasing funds needed to support extended credit terms.

Its profitability was further squeezed by higher input costs and shortage of essential supplies due to overstretched trade creditors. It experienced large-scale withdrawal of maturing deposits. Finally its operating profits were not adequate even to service interest charges on its debts. The mill had to close and is in the infirmary of the National Textile Corporation to this day. The liquidity-profitability squeeze brought about its ruin.

Cash Crisis

- ***Excessive attention to profits and sales growth rather than cash-in-hand (over investment in raw material stock, rising outstanding amount, etc.)***
- ***Excessive investment in fixed assets by tying up funds***
- ***Unplanned expansion in time and stages***

5

How to Steer Clear of Cash Crisis

The most effective way to avoid the second crisis is to keep a close watch on the amount of cash on hand. You should keep a cash budget required by your business and we recommend that a six-monthly cash budget should be prepared religiously. Thereafter, the budget may be reviewed and analysed every month or once every three months by checking the estimated income figures with the figures of actual income during the period. Comparing the two—the planned and the actual—gives an insight into some elements that you might otherwise have overlooked and on how to correct such errors if they have occurred.

Readymade proformas for preparing cash budgets are available with financial consultants or chartered accountants. Some proformas are designed for retail sellers of goods and other forms are for use by industrial units engaged in manufacturing activities. Some proformas are designed for monthly budgets while others are designed for projects of longer periods. A table has been given in Appendix A of this chapter, which would be useful in analysing the past as well as the projected figures of budgets.

With such an analysis of cash inflow and outflow, the small-scale entrepreneur will realise the difference between profits and cash and between cash and assets. More important, he will clearly perceive ways and means to conserve cash on hand. Here are some devices to conserve cash:

1. Purchase goods on discount from the supplier during his slack season
2. Exercise more effective control on accounts receivables
3. Obtain fixed assets like land, building and equipments on lease instead of using cash to buy them
4. Obtain specific services like equipment overhaul/maintenance from other companies specialising in providing such services instead of equipping your own unit with such facilities and workers

5. Keep a sharp eye on the stock of raw materials and finished goods and ensure that the stocks do not accumulate without control
6. Do not tie up cash in large transactions in which there is no significant gain in the short-term profit of your company
7. Avoid products or orders in which the profit margins are low and which do not give sizeable contribution (surplus) to meet fixed costs
8. Keep tabs on the cash required for the expansion programmes of your unit well in advance. This would help avoid a last-minute rush for such cash and also continue existing activities (other than those related to expansion) without any disturbance.

An expert accountant can help the entrepreneur learn the rules in cash management and he would save, many times over, the expense incurred in good cash management system. We have already mentioned in Chapter 3 that bankers and lenders having a stake in the units are willing to extend such help to the entrepreneur. During discussions on this topic, one banker said that the biggest problem was that the small-scale entrepreneur went to them only when it was too late. He said that he would rather play the role of a physician for a small-scale and help it grow than be an undertaker of the unit to give it decent burial. Besides acting as a physician to your unit and offering advice on cash management, the banker can give you practical advice on how to obtain working funds against the finished goods in your stores or against actual orders received.

We would refrain from laying down strict rules and recommendations on the structure of financial reports and their periodicity or frequency. This is so because the structure and frequency of reports depend upon the type of goods produced and other parameters of the small-scale unit such as the market in which the unit is operating. Yet, generally speaking, you should keep firm tabs on accounts receivables (or debts), product-wise stock of materials and finished products and on cash income and expense. These are vital aspects because among all other difficulties experienced by the small-scale entrepreneur, the problem of acute shortage of cash is the most chronic one.

Normally, it is believed that the only way to overcome this problem is to infuse additional cash. But this is absolutely wrong. Actually, if the accounting system is geared to provide information that is useful and valid, there can be no doubt that the entrepreneur can get some ideas for action on the cash front well in time and for operating so as to make the best possible use of capital available. He would thus resolve cash problems by tackling issues internal to his unit rather than search for help from outside.

5.1 SHORT AND LONG-TERM CAPITAL

It is easier to understand cash if we divide it into two categories. Cash that we invest in fixed assets such as land, building, plant and machinery is the *long-term capital*. On the other hand, cash that we invest in raw materials, work in progress, finished goods and in debtors is the *short-term capital*, because you receive that cash as soon as the finished goods are sold and the sale amount realised.

Entrepreneurs of the small-scale industry almost invariably face paucity of short-term cash. They must keep a close eye on the four kinds of short-term investments indicated below.

If they do keep a close watch, they would rarely face cash crisis with respect to short-term cash. Let us discuss the short-term cash investment under four heads.

Raw Materials

Finalise the purchase of raw materials based on your minimum requirement of such materials. Some units get raw materials under a system of quota and it may be necessary to stock such materials. Discuss with the bank at the initial stage itself and arrange for the necessary working funds. It is not wise to stock raw materials on the vague hope that such stocks might be useful in the future. Working funds that are blocked in unnecessary stock of raw materials create a shortage of cash on hand.

Work-in-progress

Avoid long period of work-in-progress inventory of materials i.e. unfinished goods. Some entrepreneurs at times get orders for manufacture of special products, not in their normal line of production. They then stop their regular production and divert their attention and production capacity for making the new products. Avoid this temptation. Normally, it is preferable to first complete the manufacture of products in hand and only then consider taking up special unplanned jobs. There are any number of examples of industrialists who began to face a cash crisis because they stopped the processing of planned orders already on hand and began taking up unplanned, special jobs.

For instance, five machines are installed in a factory to manufacture a product. All these machines are useful in manufacturing only that particular product. Now, if the owner of the factory agrees to manufacture some other product, immediately he has to change the settings as well as the equipment installed. This not only gets time-consuming but also results in a piling up of the raw material required for the regular product. The shortage of finished goods for this regular product is another consequence. Normally, the entrepreneur would not be able to recover all these costs from the sale of the new, urgent by-placed order. Therefore, weigh the pros and cons of such urgent orders carefully before accepting them. If you do not carry out such an exercise, shortage of cash on hand is bound to follow.

Finished Goods

Carefully decide the stock-level of finished goods. Make every attempt to see that the stock of finished goods does not accumulate. If there is an interruption in the flow of orders for the regular product, the owner must himself inquire into the reasons for this interruption. It is unwise to depend exclusively on one's employees for these vital issues. Besides, if there are any downward fluctuations in the orders given by regular customers, check these yourself and take immediate corrective steps. A large stock of finished goods is a direct cause of the cash crisis.

Credit Collection

Check if the assistant chosen for the task of credit-collection visits the debtors and does his job effectively. Many a time, the assistant simply invents excuses and is not efficient at his somewhat unpleasant job. Exercise caution over this. Moreover, at times, a client places a huge order on your firm. Check personally on the reasons for this large order because such a customer is likely to be on the verge of winding up his business and so he acquires large stocks of goods from his suppliers. Therefore, in all such abnormally large orders, the owners must personally verify and only then dispatch the goods.

The best advice is to have a good accountant for close control on all the four areas of cash-blockage discussed above. Your accountant should give you the latest information on financial matters every week. If he is unable to do so, it is in your interest to change your accountant and find the one who can submit accounts on a weekly basis.

5.2 DOS AND DON'TS OF CASH MANAGEMENT

Let us summarise how you can plan, preserve and save cash. Here are some dos and don'ts.

1. Do not overtrade or be too greedy. Take an amount of business proportionate to your cash resource. Do not overstretch yourself. Rely on the 'cross-the-bridge-when-it-comes' philosophy.

   A pesticide manufacturer secured an order for Rs 10 million from a state government agency and believed that he would be able to somehow arrange for the cash required to execute the order. He failed to get the required working capital. He ended up paying a penalty and getting blacklisted.
2. Do not divert short-term capital for long-term capital purposes such as land, building, plant and machinery.

   A pharmaceutical company diverted a good deal of its working capital to invest in building and machinery. It ran out of cash for the required import of raw materials for which payment had to be made. It fell short of its target in sales. It became a sick unit.
3. Be careful while undertaking expansion, diversification or such other investment decisions. Make sure you have a genuine cash surplus to make such an investment as well as to meet the extra working capital needs that will arise on account of such an investment.
4. Internalise your peak cash needs and prepare to meet them. They might occur during certain months in a year, say, in the first week of every month when you pay out the salaries of your employees. Even if the salary amount is not too large, it is an important commitment and hence a sensitive period to be planned carefully.
5. Pay as much attention to your list of creditors as you pay to your list of debtors. Failure to make statutory payment (telephone, electricity, sales tax) will disrupt your business. Defaulting on payment to a raw material supplier who has a monopoly in the market will bring your business to a grinding halt.
6. Do not delay the task of disposal for too long. You produced defective goods which you are required to sell at a discount. You have worn-out machinery which you must sell. Do not wait interminably for a customer who will buy at a price ideally sought by you.

   A silk-weaving unit in Ahmedabad had been saddled for the last 18 months with 15000 metres of short-width cloth. The owner was spending most of his time in trying to get an extra Rs 5.00 lacs limit from the bank. The bank refused to oblige. The owner was not willing to sell the cloth (and generate cash) at Rs 60 per metre because he thought Rs 70 was a reasonable price!
7. Avoid large amounts of withdrawal from business for personal reasons. Suppose you were earlier withdrawing Rs 10,000 every month

and a lump sum of Rs 20,000 or so once in a year. Your business has improved marginally. If you now start withdrawing Rs 20,000 every month and Rs 50,000 once in a year, you may get into trouble. In other words, limit the change in your personal lifestyle to what you would be able to live on without starving your business of essential cash.

8. Do not neglect apparently avoidable matters of equipment maintenance or replacement because you do not have cash or are too busy. You will end up spending more.
9. Avoid excessive optimism in planning. There are entrepreneurs who expect that everything will go right—raw materials will come on time, workers will not abstain, power supply will not fail, bank-limits will come through, sales orders will flow in, and customers will pay on expiry of credit-term. They come to grief. Be a realist and provide for contingencies.
10. Resolve cash-blocking disputes quickly. It could be a dispute with a customer who claims goods to be damaged and so does not pay. It could be an excise-refund claim.

    A Baroda-based owner of an electrical goods company got into a dispute with the State Electricity Board. It meant a long-drawn-out litigation. The business wound up because it did not have the resilience to wait for the settlement of the claim for Rs 5 lacs.
11. Devise ways of investing short-term idle cash attractively. This is if you are in a business (say, machine-building) where you receive a large payment which you are to utilise over a period of time.
12. Do not deviate from what constitutes your focus. There are some entrepreneurs who invest so much effort and cash into new product developments that the current business suffers.

    A Mumbai-based manufacturer of conventional gas stoves preoccupied himself in the late 1970s with developing a stainless steel stove. It became an obsession. His regular business finally closed down.
13. Manage your bank limits competently. Build a relationship with your banker on the basis of trust. Prepare stock/financial statements regularly and efficiently. The banker's attitude often hardens not just because of what happens to your business but because you don't tell him the truth about it and in good time.
14. Avoid status symbols in business if you cannot genuinely afford them. Some businessmen set themselves up in plush offices in the belief that it might raise their image regarding credit-worthiness.

Credit-worthiness does not improve but cash-worthiness definitely dips.

Recently, a computer software company blew up a good deal of money collected through public issue on an extravagant office and other such frills. Its business never got off the ground.

15. Revise your business policies and practices as you grow so that the growth makes a positive impact on your cash position. This will call for a deliberate review. The raw material supplier required a month's notice to supply you when you initially set up the business. Now, you are an important customer and he delivers in a fortnight. You can cut down your raw material inventory levels. You can reduce credit periods. You can emphasise and promote cash sales. Rather than carry on routinely, reflect and revise. If you are not confident, try out new policies and practices in limited ways.

    A manufacturer of fire crackers expects his distributors to place orders two months ahead of the season. He has been following this policy since he first set up business. It means holding about six months of finished goods inventory. The other established manufacturers expect firm orders and advance payment four to six months before the season. Is it not time the manufacturer reviewed his policy?

16. Be sensitive to your market reputation. Defaulting on payment to a supplier and not being apologetic about it, failure to pay employees in time—all these take a toll. There are entrepreneurs who think that it is easy to switch from one supplier to another and that employees are dispensable. Worse, there are entrepreneurs who have no qualms about reneging on a commitment. Such entrepreneurs end up in the league of ill-reputed businessmen. They fail to receive credit or accommodation so essential to tide over temporary cash problems.

    A big-time exclusive producer of a drug meted out bad treatment to customers: 100% advance payment, refusal to meet or talk to customers wanting marginal accommodation, refusal to explain delay in delivery. He is no longer an exclusive supplier. The customers would rather pay a little extra to other producers than buy from him. Those who have hung on to him do not pay in time. There is a cash crisis. On the other hand, there is a small-time supplier to a drug company who behaved sensibly and decently while the drug company was struggling to take off. The drug company owner carries a most pleasant memory of the support he received. The drug company is 100 times larger now. There is a standing instruction to purchase the given items from the small-time supplier and no one else. The supplier can confidently expect the drug company to bail him out if there is a temporary cash problem.

17. Avoid arrogance while you are at the peak. While cash management is meant to be handled by hard-headed businessmen, they are not immune to giving or getting a 'treatment' as we saw in the preceding examples. You did someone a good turn. You are in trouble now and want relaxation by just one week for payment. There is hope that the other person might agree. You were rude to him in the past. It is almost certain that he will refuse. So, create goodwill.

    An automobile parts company was finding it difficult to recover money from a large two-wheelers producer. In a huff, the owner sent a telegram that they would charge interest at 24% per annum. The two-wheeler company sent a board-resolution agreeing to pay such interest and asking them not to bother about the payment!

18. Curb your speculative impulses.

    A producer of power supplies at Ahmedabad bought an office to gain from capital appreciation. The cash impact of this investment on his business was so severe that the office was sold at a loss within six months. There is a boiler company with an annual turnover of under Rs 3 crores that has bought office space in six cities for expected capital appreciation. The boiler business is suffering for want of working capital.

Steering Clear of Cash Crisis

- ***Understand the relationship between profit and cash and the difference between cash and assets***
- ***Constantly watch for ways of economising on cash***
- ***Consult good accountants, bankers and financial experts; invest in a good accountant at the first opportunity***
- ***Constantly assess cash position and prepare cash flow statements every three months in advance***
- ***Monitor raw material stock, semi-finished goods, inventory of finished goods and outstanding recoveries***

Appendix A

Budget of Estimated Cash Inflow and Outflow
Period: January to March

	January		February		March	
	Budget	Actual	Budget	Actual	Budget	Actual
Cash inflow						
1. Cash sale						
2. Credit sale collection						
3. Other income (scrap, by-product, interest, dividend, sale of assets, etc.)						
4. Other receipts (specify)						
Total inflow:						
Cash outflow						
1. Cash purchases						
2. Payment to suppliers who sold on credit						
3. Salaries and wages						
4. Utility bills (electricity, telephone, water, etc.)						
5. Statutory payments (income-tax, sales tax, excise, octroi, etc.)						
6. Other cash expenses (office, production, maintenance, sale, advertising)						
7. Loans and advances (employees, suppliers, others)						
8. Developmental/Promotional cash expenditure (e.g. export promotion tour)						
9. Capital expenditure (machinery, building, office equipment, etc.)						
10. Loan instalment						
11. Other payments (specify)						
Total outflow:						

Estimated opening balance			
Estimated amount of bank loan to be obtained during the month			
Estimated amount of payment against loan during the month			
Estimated balance at the close of month			

Note:
You can prepare a table of inflow and outflow for every three months on the above basis. From such a table the following information can be obtained:

1. You can plan for payments because you know how much is to be paid and when;
2. You can arrange for loans beforehand, if required;
3. Or else, you can withhold payments against some small accounts;
4. You can plan for spending a large amount of cash (for instance, if you want to buy a machine, you can plan for the investment);
5. You can plan for rescheduling of loan instalments, if necessary;
6. You can decide whether to give cash discount to the customers; and
7. Working with the bank becomes smooth.

Appendix B

Table Showing Accounts Receivables as on ______________

	Amount to be realised				
Name of the firm	Age: 2 weeks Rs	Age: 3 weeks Rs	Age: 4 weeks Rs	Age: 2 months Rs	Age: 3 months Rs

1st reminder sent on—		2nd reminder sent on—		3rd reminder sent on—		4th reminder sent on—	
Name of firm	Amount	Name of firm	Amount	Name of firm	Amount	Name of firm	Amount

Legal notice issued on	Name of the company	Amount

Appendix C

Stock Position

Table showing Stock as on Date ____________

Qty	Description of item	In our possession			Under bank hypothication			Total
		Raw material	In-process	Finished goods	Raw material	In process	Finished goods	Rs
		Rs	Rs	Rs	Rs	Rs	Rs	

6

Third Crisis: Delegation Crisis

Many successful small-scale firms, after some years, reach a level of operations when it becomes difficult to manage them as a one-man-show, i.e., for the owner-entrepreneur to manage them entirely by himself. Unfortunately, this could also happen at such a time when the owner cannot afford to have a full-fledged team of managers. When the firm reaches this stage, he has to locate someone who can be delegated certain responsibilities so that he can look after essential and more important matters.

It is generally seen that such a situation occurs when the company's workforce attains a level of around 20 or more employees. Of course, depending upon the nature of the business, this figure of employees could be higher or lower. If the process of manufacture is fairly simple and does not require any ongoing research and development like that of plastic film and containers, garments, tablets, etc.; or if the number of products is small and only a few processes are used for their manufacture; the sales function is also relatively uncomplicated dealing with only a few big customers; and the entire production is sold out at a centralised location, then the single owner-manager can possibly control the entire operations effectively for a fairly long time. On the other hand, if the production process as well as sales function are of a complex nature, one individual may not be effective in controlling the operations even before the strength of the workers increases to 25.

6.1 ATTITUDE PROBLEM

You may ask, "How come there is a crisis just because a portion of the work needs to be delegated to someone else?" The problem arises because some entrepreneurs just cannot delegate. They resist this process of delegation through clever devices and rationalisations. Their frame of mind and attitudes prevent them from delegating tasks.

The word delegation is often misused. It is often confused with a mere parting of some responsibilities to others. But effective delegation implies not only a sharing of responsibilities but also, and more importantly, sharing of power and authority with others. Responsibility and authority must go together for it to become an effective delegation.

There are many reasons why people are reluctant to delegate. First of all, delegation of one's responsibility to another is viewed as a threat to one's career or power. The person delegating fears that he will no longer remain "indispensable" to the business. There is also the question of reposing trust in others. The owner-entrepreneur or the manager may feel that some of the delegatees will get to know all the tricks of the trade, or they may turn his competitors or they may get to know business secrets. Effective delegation is not, therefore, possible unless there is a climate of trust in the organisation. Another important constraint on delegation is the non-availability of people equipped and prepared to handle the delegated responsibilities. This arises from the lack of planning to prepare people to handle difficult tasks. Lastly, the person who is under pressure to delegate believes that no one can do the job as well as he can.

It is not only a small entrepreneur who suffers from this reluctance to delegate. Quite a few executives of larger organisations, too, are tardy when it comes to delegating responsibilities. The results are: delayed decisions, avoidable restraints on growth, over-dependence on a few individuals and increasing threat to the executives' or owners' health.

6.2 NEGLECT OF ORGANISATIONAL PREREQUISITES

For effective delegation of responsibilities certain organisational prerequisites must be followed. The first need is to train people for more difficult tasks by exposing them to different jobs in accordance with a carefully thought-out career plan and assessing their potential for handling such tasks. It is necessary to clearly define the nature and scope of the new responsibilities, the authority and power attendant on them and to install a system for monitoring the discharge of the new tasks. As we will see later, indiscriminate or unplanned delegation of responsibilities can also harm business.

> A technician-entrepreneur began to manufacture precision instruments after ten years of experience in different functions of the business. After five years of operations, he began to earn profits.
>
> He was the sole proprietor of the firm. On advice from his bankers he embarked on an expansion of the business and raised additional capital through public issue of equity. Increased investment in equipment required greater effort to oversee the expanded business.

His products now had to be sold not only to a few wholesale customers but also to small buyers at far-flung locations. The need to delegate responsibility for sales was becoming obvious. It was virtually impossible for the owner to look after both sales and production functions. Since production was his forte he could never think of anyone else handling it. Reluctantly, he appointed five sales managers over two years but either they were sacked or they resigned on their own due to his continuing interference in their work. All this resulted in the unit recording a loss for the first time in its history. The utilisation of the equipment was poor during the year and the seventh sales manager had put in his resignation the same year.

However, the company has grown remarkably during the last five years. The delegation of authority is an important feature underlying its working now. The managers are put in charge of specific functions and given powers to take appropriate decisions. The key owners focus on revising the parameters of such delegated authority from time to time. A manager was asked to participate in a bid for purchase of land. The counter bids exceeded the amount up to which the manager was authorised to bid. When auction for another piece of land came up, a guideline was issued. But as the manager was authorised to bid in excess of the limit indicated in the guideline, he considered it appropriate to do so in the interest of the business. It is, thus, operational freedom and trust that have contributed to the progress of the company.

To be effective, delegation must satisfy three tests: first, the responsibility that is delegated should be clearly defined and largely controllable by the delegatee; second, adequate authority should be vested in the delegatee to make decisions and he should be free to discharge that responsibility within the limits of his authority; third, the person who delegates should monitor to see that the responsibility is effectively and efficiently discharged by the delegatee. The last test means that an entrepreneur who delegates is not absolved from all responsibility: he is ultimately answerable for his delegatee's performance.

Let us look at examples where neglect of the prerequisites for effective delegation has brought owners to ruin.

Take the case of an owner of a company who was a good inventor. He had invented a new packaging medium for processed foods and had developed machinery to manufacture this item. The entrepreneur kept a close watch on all aspects of the company's functioning. The company continually made profits and, in its ninth year, earned a profit of Rs 20 lacs. There were 32 workers employed in the unit. Since the company was doing well and as the owner earned substantial royalties from his other inventions, he decided to pursue his first love, innovation, by dispensing with some of his routine activities in the company.

He happened to attend a talk by a local management expert who said that each company should develop managers for delegation of tasks and responsibilities. The owner decided there and then to groom such executives for his firm. Within two months, he created a management team in the company. He recruited four managers in one month and by the end of the second month, he delegated the company's affairs to these new managers. After five months, the company suffered a grievous blow. One of its important clients who manufactured processed foods incurred a huge loss when a bulk of his products were spoilt in floods. The owner emerged from the cloister of his research laboratory to ponder over a way out of this. He learnt that his management team had embarked upon a scheme that was highly ambitious but rather foolish and which involved a large amount of money. The scheme was to manufacture a new piece of equipment; the team claimed that the new machine would revolutionise the industry.

But, for the owner, this meant a cash crunch, perhaps for the first time in the company's history. On the one hand, he had lost a big customer and on the other, the new management team had blocked a huge pile of funds for developing the machine.

At the time of writing, the owner has sacked the team of four managers and has himself begun to retrace lost ground by attempting to bring financial stability back to the company.

Another example is that of a unit doing job-work where a problem arose because of lack of monitoring and control.

The owner of the unit had delegated too much responsibility to his accountant. The accountant lost Rs 400,000 of the company's money in speculation and surrendered to the police voluntarily. The court sentenced the accountant, but the owner of the unit had to make good the loss by borrowing heavily from money-lenders. As a result, the company incurred losses for three consecutive years.

Delegation Crisis

- ***Inability to delegate responsibilities and share the decision-making burden***
- ***Psychological problems ("only I can do better", lack of capability to guide and groom others, lack of trust in subordinates)***
- ***Business and responsibility grow but time does not, thus business suffers and 'success' ends in failure***

7

How to Cope with the Third Crisis: Parting with Responsibilities

Of course you have this option of cutting down the company's business activity to a level where only one person (that is, you!) handles the entire show. But that is certainly not a real solution—particularly if the business has to grow, as it must, over the years. Actually, there are two practical solutions to resolving the delegation crisis:

1. Appoint or induct a really capable and effective person in the company, or
2. Amalgamate the unit with a similar enterprise.

There are other solutions besides these, but they are more in the nature of 'band-aid' than genuine long term cures. Among such patchwork solutions are off-loading a portion of the work such as book-keeping work or design tasks to outside suppliers. The other temporary solution is to delegate a part of the responsibility to some of the existing employees. But the most suitable way to resolve the delegation crisis is to adopt one of the two alternatives listed above.

Let us study each of these alternatives.

7.1 INDUCT A REALLY COMPETENT AND EFFECTIVE PERSON

The difficulty in accepting and implementing this option is due to the mental conditioning of the owner-entrepreneur. In fact, the new recruit should preferably be strong in exactly those areas where the owner of the enterprise does not quite measure up. We acknowledge that it is somewhat difficult for the owner of a company to be aware of his own weaknesses. It is even more of a problem to accept that the new second-in-command is an expert in those very areas. Therefore, it is advisable that the entrepreneur approach a good executive search organisation (of which there are many in India now) to locate the new person. They will talk to you, appraise your company, understand your strengths (and weaknesses) and from this, arrive at the specifications of the new man. Not only that, they will also be able to locate such a person for you. Expert consultants can even counsel the entrepreneur and help him overcome the mental blocks that he has towards delegation and towards accepting the new person.

There are many other advantages of inducting a new man (or woman) in to the company. For one, he can share a great deal of the burden of the entrepreneur. He can be especially instrumental in rescuing the company's affairs from the current mess and create an ambience for the smooth functioning of a competent team of managers. If selected and trained properly, this new man can function like a second owner of the firm. He is inclined to action, can take up formidable tasks pending for quite a while and cut across all red tape in the organisation to achieve targeted results. Secondly, because the new man is strong in those functional and knowledge areas where the entrepreneur is weak, he can effectively guard against these weak flanks and thus help improve the company's operations. If you recall, we had mentioned in the first chapter that there is a strong need to have an all-round knowledge and experience in the management of the company, especially for a small unit. This second man therefore, helps to provide the missing links in the effective functioning of a unit. He thus helps to achieve the goal of having a holistic, healthy and dynamic management. The third justification for the new person is that he acts as a sort of insurance, should a calamity befall the entrepreneur.

Let us not assume that simply by appointing a good second person when resolving dilemmas of a growing unit it is smooth sailing all the way. The first problem that you face is that it takes a long time to locate 'Mr Right' for the unit. It taxes your patience and tests your prudence. Secondly, the new man and the entrepreneur are mature, grown-up persons with certain firm beliefs and attitudes. So, the extent to which they can work harmoniously together is a moot point. Third, if the new man is really knowledgeable and competent, he would expect a big salary; chances are, he would ask for a share in the ownership of the company. This could cause panic in the entrepreneur, who looks upon his enterprise as his own possession. Here it is wise to remember that it is much more rewarding to have an 80% share of ownership in a profitable company than to have a 100% share in a losing concern.

To give you an actual instance, a furniture manufacturing company operated in a town with a population of 1.5 lacs. Its operations consisted of retail selling and it earned handsome profits. Originally,

> the founder of the company had managed it and then his son began to look after the business.
>
> When the number of workers rose to 23 and the annual sales level reached the figure of Rs 12 lacs, the management of the firm grew beyond the capabilities of the family. Luckily, they could find a powerful young man who wielded good influence in the area and was a native of the same town. Within four years, this man took over the reins of business remarkably well and put the company on a sound footing. Then, he asked for a larger compensation than his regular salary. He was temporarily persuaded to continue on the promise that he would be made a partner in the firm. After one year, he put up his demands again for more money emphatically. He got, as a result, a large bonus plus the usual empty promises. At the end of the sixth year, he resigned from the firm and set up his own furniture manufacturing company.
>
> It is already ten years since the second furniture company has been established and both the original and the new companies are existing today and making good profits. But, it is worth noting that neither of these companies earn as much as the original company was earning when it was the only such unit in that area.

We recommend that before inducting this second-in-command, the owner keep a reasonable duration of wait-and-watch. During this phase, the company will hopefully overcome the embarrassing and troublesome pains of growing up from the small to the large sector. This is also the phase wherein it is simply not feasible to work without the new man, nor can the owner afford to pay him adequate compensation (or provide a share in business). Till such time that a trial run of working together with the new person has taken place and until it is seen how the owner and the new man click, it is difficult to take a final decision on inducting the man on a long-term relationship. On the other hand, this phase of experimentation should not be extended so long that the person gives up all hopes of joining the company as a part-owner the way it happened in the example. We should indicate to him clearly and explicitly what he can expect by way of compensation towards the end of say, two years if his association with the company is worthwhile.

Often it happens that the new person not only has the required managerial skills and knowledge but also the money to invest in the business. In such cases, the man meets the basic requirements of association at the highest level of enterprise and brings in additional capital which is an extra benefit. A word of caution: any business usually has need for additional capital; therefore, you should not accept a person who merely has money to invest but little else to offer by way of management skills. A wise dictum is not to touch the additional capital till the period of testing the man's abilities is over. Remember that a progressive and profit-making concern can always arrange for funds in other ways. The process of inducting a competent person in business should never be mixed up with the infusion of additional capital by the person.

It would be a mistake if the owner relinquishes all responsibilities after inducting the new person. The owner should occasionally check the progress of various tasks entrusted to the person. We have already seen real-life examples of crises that overtook firms in such cases of over-delegation.

> Let us take an actual example of a company in Ahmedabad. The company's manufacturing unit operated in all the three shifts. Someone asked the managing director of this company, "Do you ever visit your factory during the night?" The MD replied, "Never." He was advised to pay occasional visits to his factory during the night also. Once, when he visited his factory in the night, he found that no less than 11 people, including the watchman and senior officers, were missing from the workplace.

Depending on the scale and complexity of business, you may want to develop not only the second-in-command but also a whole team of managers. Assuming that you select people with the right background and experience, it is important to give them planned on-the-job exposure to responsibilities for which they are being trained, and create in them a sense of belonging.

7.2 AMALGAMATE WITH ANOTHER COMPANY

In a few instances, it may be a good idea to amalgamate two small companies to tide over the third crisis. To help reduce the work load of the two companies, each should complement the other in work. If the activities of the companies, are poles apart, the work load on each company is not likely to diminish. At the most, each owner can entrust to the other those tasks that he finds difficult to tackle.

Let us see how a furniture manufacturer succeeded in business using this approach.

> The furniture shop operated in a town with a population of five lacs and had two branches. This firm amalgamated with another firm in the same city engaged in selling electronic and musical instruments, including TVs, radios, etc.

One of the branches of the furniture company was shifted to the electronic entertainment shop by expanding the facilities there. Similarly, some of the electronic items began to be displayed in the furniture shop by expanding the space there. As a result of the new synergy, the clients of each establishment increased considerably. You will be interested to note that the owner of the furniture shop was a good salesman and knew how to increase his business. The other owner was a good financial man and knew the intricacies of accounts well. Each owner began concentrating on the areas where he had competence and knowledge and entrusted the other with those functions in which he himself was not so competent. Both of them thus started working effectively and were happy with the results of the amalgamation. The furniture company was on a fast-growth track and needed additional funds; the electronics man, being a good financial person, knew how to arrange funds and could sort out the problems successfully.

The companies pooled their resources such as warehouses, trucks and parking places for their vehicles and thus began to utilise these resources more optimally. Advertising and publicity was also organised jointly. Thus, here too, as in so many other instances, two plus two resulted in more than four!

Avoiding Delegation Crisis

- ***Seek out a capable second person to supplement 'you'***
- ***Test him, watch him and start sharing responsibilities***
- ***Consult management experts or colleagues to identify your own weakness and select the second person who is strong in those weak areas***
- ***Be prepared for according a high salary, appropriate status and authority and profit-sharing to retain the key person***

8

Fourth Crisis: Leadership Crisis

When an enterprise reaches a stage when a whole team of managers is required, where two or three supervisors helping the owner-manager simply cannot shoulder the tasks and responsibilities, you can see the fourth crisis looming. Some business units reach this stage much earlier than others. Generally speaking, though, we can say that when the strength of the company's work-force reaches a level of about 150 to 250, you may expect to face the leadership crisis in the firm.

As soon as a growth-oriented company reaches this stage, the founder-entrepreneur has to bring into play an absolutely fresh set of management skills. You can even say that he has to inculcate a new *lifestyle* at work. Some entrepreneurs are simply unable to effect these changes and cannot give up their old habits for the new. The result is that the company's work suffers and goes virtually out of control. Instead of profit, one sees loss in the balance-sheet and where there was once a steady upward growth of business activity, you find all sorts of complications, road-blocks and frustration.

To put it differently, we could say that whenever the owner-entrepreneur of a firm confronts the leadership crisis, he has to learn the ropes of managing the unit afresh, as if from scratch. The entire complexion of his working environment gets so greatly transformed that you can never bet on him succeeding with his old approach to management simply because that approach had yielded success in the past.

To be specific, you must adopt the following changes:

1. Delegate more powers to other people;
2. Instead of doing all tasks by yourself, you should develop into an effective leader; and
3. Exercise control over the unit through efficient paperwork and information.

Let us look at each of these new demands on the entrepreneur.

8.1 DELEGATING MORE POWERS TO OTHER PEOPLE

In the preceding two chapters we have already looked at the need for delegation in order to overcome the third crisis. However, when we talk of delegation now, we are talking about a different cup of tea altogether. In fact, it is more difficult at this stage to succeed in delegating powers. Owners of small units cope with the delegation crisis by handing over a portion of responsibilities to a close relative or a friend. But while facing the leadership crisis, the founder-entrepreneur has to delegate, in a big way, a bulk of his powers and responsibilities to four or five competent managers. In fact, he has to delegate responsibilities for virtually all functions or departments of the unit.

8.2 BECOMING AN EFFECTIVE LEADER INSTEAD OF A DO-IT-YOURSELF MAN

This implies that the founder-entrepreneur should become a guide and leader to others and not a mere do-it-yourself man. He should stop behaving high-handedly as a Chief Executive of the company. A number of enterprises are conceived in the garages or backyards of homes and the owner of such an outfit develops a habit of doing everything himself. Later, when the firm employs more people like machine-operators, maintenance-fitters, packers or even a salesman, the routine does not change much for the entrepreneur, because he is still able to keep a close watch on almost all the functions. He can still talk to the machinist or the maintenance man about what is going on in the unit and get things done his way. And, of course, vital functions of the business such as sales or accounts continue to be handled directly by him.

When he delegates a few administrative responsibilities to another person he at times continues to communicate with some skilled workers or supervisors, He also continues to shoulder direct responsibilities of a few divisions.

However, when he decides to set up a whole team for the management of the unit, the founder-entrepreneur has to be prepared to lose direct contact with many of the company's departments. He has to distance himself considerably from the functioning of the company. Now, he should not give direct orders to the workers, because he has to get the work done by the managers who are paid high salaries. As a result of all these changes, there is a totally new dimension to his relationship with the company's operations. To nurture and develop this new relationship and to ensure that it is effective, he should now graduate into becoming the guiding spirit of the company.

The new pattern of leadership helps to establish a sort of linkage between the directives and instructions of the management and the staff of the company so that these guidelines are followed in a meaningful way. Besides, for the success and growth of the company, a two-way communication between management and people within the company has to be established. This helps to ensure that the policies are communicated effectively to all concerned and the upward flow of information from the workers to the top also exists.

The second important aspect of this new leadership phase is the delineation of the goals and mission of the entire company so that all the managers are clear about the direction in which the company is moving and about their own roles and responsibilities in this overall corporate effort. Each manager has to be motivated to achieve results in his field by cultivating his sense of responsibility. Thus, the founder-entrepreneur is now a corporate-planner and resident thinker for the company. His job is to develop plans for the company's future, months and even years ahead of the present. At the same time he has to keep a watch on the bottom-line of the business. Thus, the leader has to pay attention to two different dimensions of time: the present as well as the future. This is admittedly a difficult task.

8.3 MANAGING THROUGH EFFECTIVE WRITTEN COMMUNICATION

After a certain stage of growth is reached, it is virtually impossible for the founder-entrepreneur to continue to oversee all the operations of the company. Similarly, it is simply not possible for him to go into the nitty-gritty of costing, of accepting new orders, or of assessing the company's competitive performance because he has too much to do. He should run the company through a team of four or five senior managers. If he insists on direct and day-to-day communication with these new managers, that again would be a waste of time. It is also important to recognise the shortcomings of a face-to-face encounter on matters that are sensitive. The best form of communication is to draw up, with the full participation of all levels of management, a business (action) plan and the responsibility of individual managers in attaining it. The relatively poor efficiency of verbal communication with managers has been proven time and again in the past. Each verbal message meant for a particular manager gets filtered through two or three levels. At each level, the meaning of the message gets distorted due to the bias and opinions of the manager. (This is just human!). Sometimes, such distortion in communication can cause havoc.

To manage a company through written communication is at times problematic for the entrepreneurs of small-scale companies. When the units have grown to a level of operations that require a certain amount of paperwork, they fail miserably in this area, even though the company is making good profits. To identify the team members of the management team under him, to weld them into a working team and to motivate this team: this phase of the company's life could be called the 'company's conundrum', because it is precisely at this point that the complexity of company's operations stand revealed to the entrepreneur. The main dilemma for the entrepreneur is to delegate the company's work to a team of senior managers without losing control over the company's bottom line and its steady growth.

This crisis is called leadership crisis mainly because it satisfies all the three criteria of leadership as defined in modern management books. These aspects of a leader's roles are:

1. To communicate effectively with people,
2. To plan effectively, and
3. To control effectively.

Let us look at some actual cases of leadership crisis. Many entrepreneurs do not like to change the working style even if the company is growing. Gradually, they begin to face small difficulties and soon these small problems snowball into full-fledged crisis situations.

> The case of Mr Bhatt is interesting in this context. A firm diversified successfully into manufacturing a range of plastic water tanks. Having established the brand image in three states, the company decided to set up new projects in different states. This decision was taken due to the transport cost of the bulky plastic tanks and because its marketing was feasible only within a specified range of 500 km from the location of the manufacturing plant.
>
> The company had appointed Mr Bhatt as the Chief Executive for the initial project. Bhatt was a person brimming with enthusiasm and cheer and could easily motivate people into doing whatever he wanted them to do including buying the plastic water tanks, which was a new concept then. In fact, so charming was Mr Bhatt that people around him called him a 'born leader'. He was an excellent communicator, but only through words.
>
> The first project of water tanks under Mr Bhatt was highly successful. Similarly, the second and third projects also did well. When the first project was set up, Mr Bhatt resided in the company's premises near the project site. The second and third projects were

established at different locations in another state and Mr Bhatt started visiting these sites frequently even though project managers had already been appointed there. Mr Bhatt used to go to discuss the problems being faced during implementation of the projects and try to personally solve them at these sites. As the number of projects began to increase, the managerial constraints of Mr Bhatt started becoming obvious to everyone. He started to fly from one project site to another and came to be known as the 'Flying Chief Executive' amongst his officers. He never replied to the proposals and suggestions sent by his managers. Many a time, he did not even read the letters sent to him. When the project managers failed to get replies to their letters and proposals, they began to send reminders to Mr Bhatt. This unfortunately resulted in Bhatt's even more frequent visits to sites to 'sort out' the problems directly. The project managers became quite frustrated and coined a catchy, but bitter, slogan: "Don't write: Fly".

As Mr Bhatt's visits became frequent, the pile of letters in his office also began to grow and more and more queries and questions began to pour in from all projects. Mr Bhatt's response was predictable—more flying visits in response to larger numbers of queries—and the vicious circle soon took a grip on Bhatt's functioning as Chief Executive of the company.

When the company inaugurated the fifth plant, the unit began to face problems from the start. Two previous units which were making profits began to make losses. The board of the .company advised Mr Bhatt to manage the company's affairs more through written communication and to delegate a larger share of his responsibilities to the project managers. Mr Bhatt however could not change his deeply ingrained habit of working (himself) and did not delegate any of his responsibilities to the project managers. Whenever there was even a small problem he continued to rush to the site and attempted to rectify the problem himself. Finally, when the company's operations reached a level of 230 workers and had six units at different regions in the country (of which four were now making losses) the board had no choice but to relieve Mr Bhatt from the position of Chief Executive.

There is another telling illustration of how an electrical cable manufacturing firm almost sank because the owners did not pay attention to the leadership issue.

> This is a case of an entrepreneur who served as an electrical engineer in an electricity supply company. He was in charge of the commercial department and he soon perceived the opportunity for independent business in the line of cable manufacture. At that time, many types and sizes of electrical cables continued to be imported into India. The engineer identified a British firm for technical collaboration and to his surprise, the firm was ready to invest in the equity.
>
> Soon, the engineer (let's call him Suresh) established a public limited company to manufacture a variety of cables. Due to his close supervision, and an acute scarcity of cables in the market, the company prospered in the beginning. Suresh kept a close watch on almost all matters relating to the factory including the petrol bill, though the bill amount was a microscopic fraction of the company's income from sales. As a result, the senior managers (who stayed with the company) adopted a passive attitude to work and to responsibility; they 'loyally' obeyed Suresh, the master of the show. Of course, managers with initiative and drive felt uncomfortable and left the job within a year or so.
>
> The booming prosperity of the company encouraged Suresh to embark on the manufacture of XLPE cables, a new product with good profit margins and heavy demand. By then, the company's operations had touched the level of Rs 200 million and the number of workers were around 300. Suresh's son, Naresh, joined his father in the company and soon adopted his father's 'do-it-yourself' style of manufacture. Even with the new expensive project on the way, the father-son team continued to look after the huge company without developing any managers or a managerial team.
>
> The new project, with American collaboration, manifested the first signs of malaise. There was no one who could take effective decisions about the project's implementation because the father-son duo were busy quoting for government tenders for their existing production-line. The Americans became impatient and finally stopped work on the project due to delays and ineffective coordination.

This case shows that good market demand or technology with a cutting edge does not help if there is no effective leadership in the company's management structure.

The third example which is quite representative is that of Shailesh Shah.

Shah invented a device to help in the manufacture of machine-tools. He developed it after working for a few years in his uncle's company. He then set up his own company to produce the device. The activity was started in a small garage-like workshop. Later on, it was shifted to a fairly modern building. For two years, the product found a good demand and the entire production was sold. Later, Mr Shah invented one more product in the same field of machine tools. This new device was also well-received and got good publicity.

For the first six years the company made a good profit. The profit after tax was 3.8% of sales and the company could offer attractive rates of interest to the depositors. Shah obtained the funds from his uncle and his brother, who was for a long time an actor till he was struck by arthritis, and became an invalid. The sales turnover was Rs 50 lacs and the strength of the workers was 45.

Shailesh Shah looked after the entire management himself. His invalid brother also helped him in business though he had no background in business or in .any other administrative activity. However he helped his brother enthusiastically.

During the next six years, the company's sales climbed to Rs 10 million without any formal planning. Two new products were developed in the existing range of manufacture and the company procured a sales agency of an item allied to the company's products.

Two retail counters were also started to sell the company's products. However the profits of the company began to decline year after year and by the end of the fourth year, the profit was 0.3% of sales. Moreover, as the company began to grow, Shailesh started experiencing shortage of funds. He had been managing the company in a highly personalised manner. Of course, he had appointed a few managers in the company as the business grew. But these managers were old family friends or sons and daughters of these loyal friends. When there is such a set-up based on family relations (or nepotism), the allocation of responsibilities is quite hazy. The third and fourth items that were added to the production were not designed properly; the development expenses against these items were exorbitant. As a result, the products were rejected by the customers and the company had to make payment against the goods that were returned. There was, moreover, a feeling that the retail shops were incurring losses but there was no way to check and verify this doubt because the accounts were not maintained separately for different activities.

Due to lack of formal planning and lack of effective leadership, the profit margins of the company got eroded in several areas of activities. However, nobody knew from where exactly the profits had drained away and to what extent.

Leadership Crisis

- ***Single owner or partner unable to manage responsibilities of a large firm***
- ***Failure to delegate authority and to develop a management team***
- ***Failure to adopt the managing style of an effective leader—clinging to the old style of not delegating authority and doing everything by himself***

9

How to Overcome Leadership Crisis

We can well imagine the question that is uppermost in your mind right now. Granted, you say, that there is a likelihood of leadership crisis when the unit attains a certain level of activity. But how can a veteran in his mature forties learn the ropes in management? How can he, you ask a bit impatiently, change his lifestyle at that stage?

The point is well taken. We accept that there are no quick fixes, no fast solutions to this crisis of leadership. Let us talk in figures. About 10-20% of entrepreneurs can imbibe the changes necessary to deter the leadership crisis. They can do it without much difficulty because these lucky few have not 'settled' down into a groove of thinking. They still possess the eagerness to learn and absorb something new. Therefore, the changes necessary to prevent the leadership crisis can be easily made by them.

Then, there is another class of entrepreneurs, which is larger than the first, about 20% or more. This group of people, however hard they try, whatever be the strength of their company, simply cannot change. Perhaps, intellectually they do appreciate the dimensions of the crisis facing them. Unfortunately, they simply do not possess the agility and flexibility to adopt. We believe that if they consult an industrial psychologist, he will advise them to remain small in order to survive.

Now, there is a large group of entrepreneurs between these two categories. Here, we have the owners of small scale industries who are doing well. We are addressing this group of people in the following pages of this chapter. These people possess the potential for change, and if they strive hard, can definitely overcome their own limitations. We would like to draw their attention to the following steps:

1. Develop the qualities of leadership,
2. Be a good communicator,
3. Obtain training in management,
4. Learn to be flexible,

5. Manage time effectively, and
6. Set up a team of managers within the company.

9.1 BE A MORE EFFECTIVE LEADER

Leaders in different fields of human endeavour (business, religion, military, sports, politics) are found to have certain common attributes in varying degrees and combinations. They are people with vision, clarity of purpose, and strong will; they are good at managing people and building teams; they are men of character, courage, integrity, are fair in their actions and decisions, and good at receiving and giving feedback.

Let me illustrate the concept of business leadership with some examples.

> Take the case of Jamshetji N Tata. He was fired with a vision to bring industrial revolution in India. He identified three projects that fitted with his vision of making India "an industrial power". These were: production of steel, hydroelectric power and establishing an institute of science for training technical manpower, all of which were far ahead of his times. Here is a case of a business leader whose choice of business was influenced by his vision. He also spelt out his vision of the Steel city in his letter to his son Dorab (1902): "Be sure to lay wide streets planted with shady trees, every other of a quick-growing variety. Be sure that there is plenty of space for lawns and gardens. Reserve large areas for football, hockey and parks. Earmark areas for Hindu temples, Mohamedan mosques and Christian churches".* How much one wishes a business leader of Jamshetji Tata's entrepreneurship and vision is born in our times!
>
> Take the case of Henry Ford, a business leader but of a qualitatively different type from that of Jamshetji Tata. His vision of business was to produce cheap goods that could be within the reach of large numbers of consumers. He toyed with the idea of making cheap wrist watches. But he dropped the idea and went into the business of producing cheap cars by developing the assembly line production system.
>
> Take the case of Jay Patel of Jai Hind Enterprises, a trader turned first generation manufacturer-entrepreneur. Mr Patel was the largest importer of paper in the country. But this traditional business shrank

*Lala R M, *In Search of Leadership,* Vision Books Pvt. Ltd. (1987).

in the face of increasing restrictions on import of paper. From a trader he wanted to become a manufacturer-entrepreneur. His vision of business was that "of producing goods that get consumed in a single-use, thereby guaranteeing repeat demand". Producing paper was a natural choice given his experience as a trader in paper and his vision of business. But he rejected the idea as it would require a large investment and he wanted to limit his initial investment to what he could mobilise from his own resources. His friends in the textile business suggested that he should go into manufacturing textiles. But he rejected this idea also for similar reasons. He settled on the manufacture of oxygen, acetylene, and nitrogen gases that satisfied his constraint of resources and vision of business.

A business leader must have vision to transform his business from what it is to what it ought to be. A successful business leader is one who "sees things in his present picture but which are not yet there". He should make his co-workers see that it is not his purpose that they serve but a common purpose.

In this connection the case of Canbank's growth under the leadership of the late B Ratnakar is relevant. Traditionally, banks are known to be institutions that accept deposits, invest and loan funds and offer other traditional services like remittances' safe-custody and the like. He had the vision of a bank being a financial supermarket. "Canbank under his leadership broke new ground, diversified into a financial supermarket offering a wide range of services and facilities…he instilled in the staff pride to belong to this great institution…people in Canbank were considered not event-takers but event-makers".*

Leadership is to business what oxygen is to human life. Leadership is an umbrella concept, covering many aspects under it, like being sensitive to the capabilities and creativity of people with you, being aware about the personal relationships with everyone in your world etc. If you want to change to a better leader, you have to take stock of how you behave with people around you and how you deal with them. That awareness itself causes change at times or at least gives you pointers about how you can behave differently. It is interesting to take a look at the common errors that owners of

---

*Prabhu N D, *Excellence Through People—The Canbank Way*. Konark Publishers Pvt. Ltd. Delhi, 1991.

small-scale units make in their business as described in a management book*:

- appetite for too many trivial details;
- penchant for holding conferences;
- inclination to indulge in fantasy;
- habit of offering advice to others whether they need it or not;
- predisposition to be funny even when serious matters are being discussed;
- high resistance to listening to others;
- habit of creating .piles of papers on the table as a sort of status symbol;
- notion that one is a super-smart genius;
- practice to keep the office door open and engage in a running conference with people throughout the working day; and
- attitude to allow others to mind their business.

A single item of behaviour indulged in by the owner is enough to upset the assistants. A number of owners of business units engage in these and similar behaviour so frequently that they virtually become their own enemies. Let us explain.

1. Remember the proverb, 'habit is second nature'? That is what happens to these entrepreneurs. These habits become so ingrained in them that they behave like this more or less automatically without being aware of it.
2. The actions that they take reflect their own personality. So even their close friends would hesitate to point out such unwanted behaviour. You surely cannot expect the employees to give any feedback voluntarily.
3. We recognise and accept that it is rather difficult for a mature and seasoned person to change old habits.

You will, therefore, readily concede the point that such people may have to invite outside help to obtain reliable feedback and to seek ways to help change their behaviour.

The question might occur to you: how can I become a good leader? First, we will be candid: this is not a book on leadership. Second, people have different views on what constitutes good leadership. Some say that it is a tough-minded leader who inspires people. Others say that there is nobody who can prove to be a good leader everywhere with a constant

*Summer D Chann, "Organising the Owner-Manager's Job", *Management Aids for Small Manufacturers.* No. 103, Small Business Administration, Washington D.C.

and unvarying 'style. They say that a tough guy is a good leader for people who like to be told at every step what they have to do and who do not have a high degree of motivation. But imagine such a tough person leading a team of research scientists; this could be pure disaster! This is so because scientists engaged in research *know* what they have to do and *are* usually motivated. With such a group, a good leader is a sort of facilitator, lending them a helping hand when they need him and dissolving into the shadows when they don't. Thus, this theory of leadership is about a *match* between the people being led, their degree of motivation, abilities etc. and the behavioural style of the leader.

So, we come to this concept of 'style-flex' in leadership. What this means is that a good leader adopts a flexible style when dealing with different people under him. To the extent that the leader properly senses the situation around him at a given time and selects the correct style, he is likely to be more successful than others, who adopt a fixed style (say dictatorial, benevolent, laissez-faire, etc.)

The message to you is: study people around you, study yourself and experiment with leadership styles that generate results and good feelings.

For those of you who love the check-list approach to management, we offer a simple check-list on leadership here. Study this list occasionally, find out where you are and make necessary changes in your style to be a good leader.

(i) A good leader inspires a vision among those who work with him. He makes them share the overall aims of his enterprise.
(ii) He strains every nerve to inspire confidence among his people and makes them effective through mutual trust.
(iii) He makes the effort to ensure a high quality work environment in his enterprise.
(iv) He listens to the employees and communicates with them effectively.
(v) He leads by example. Personally, he is a *fountainhead of energy, enthusiasm and commitment*. People love to work with him and for him.

No doubt, there are a number of lucid and practical books on the aspects described above. But do you think that just by reading a few books and gaining some tips and hints on behaviour, a seasoned entrepreneur can change his ways of thinking and behaving? Certainly not. So, as a good friend (and wanting to continue that friendship) we would advise him to consider the following suggestions, and take some specific actions about these. Because it is only such an action rather than reading books that can help him programme his psyche and effect changes for the better.

- Conduct a feedback survey among your colleagues and generally find out what they really think of you. Obtain the help of professional experts to conduct this survey. They can do it by holding personal meetings with the employees or through anonymous letters. A good expert in communication can convey to the owner the salient points of the survey without betraying the confidence placed in him by the employees. Moreover, he can also advise the owner on how to utilise the results of this survey.
- You come across many training seminars and programmes conducted by various management associations, management schools, universities and other professional organisations. We strongly recommend that you attend programmes pertaining to your area of interest, whenever you can. One benefit of these programmes is that you are forced to be by yourself, away from your employees. Apart from the value of training inputs that you get, you are free to reflect and take that important look at yourself, especially on how you behave habitually and what the effects are of such behaviour on others. Trainers in behavioural science adopt different techniques to bring about this self-awareness within the participants. For instance, there is the approach of learning through role-play: how do you talk to your employee so that he understands what you say, and is motivated to carry out your instructions, what feelings get generated within you when you behave (in role-play) in your usual manner, and what feelings do others (who are also role-playing) have when they confront your behaviour in specific situations?
- Organise an informal association (group) of three or four owners of business units whom you know. This would help you exchange ideas and opinions on many subjects including business. People who reside near one another can meet over dinner once a week. Or else, have a schedule of visiting one another's business units once a month. This easy and informal communication between friends generates discretion, candour as also expert counsel useful to all. Such an association not only serves as a mirror reflecting how each is doing in his business but can also help generate useful suggestions for improving business.

9.2 BE A GOOD COMMUNICATOR

Leaders who made a name for themselves in history were great communicators. "Swaraj is my birthright and I shall have it", said Lokmanya Tilak. These simple words articulated the resolve of the people of India for political freedom more powerfully than the long memorandum on the subject submitted to the British rulers. "Do or Die", were the simple words used by Mahatma Gandhi on the eve of the Quit India Movement (1942) to galvanise the whole people of India to fight for freedom. Winston Churchill's famous expression, "I have nothing to offer, but blood, toil, sweat and tears" aroused the British people into making supreme sacrifices to defeat the forces of fascism.

It may be asked how relevant these examples are to leaders of business. After all, they do not have to lead or interact with masses. Their communications are with individual managers or smaller groups of people working for or associated with the business. But what is relevant are the insights that these examples offer to becoming effective communicators. The examples cited point to three essentials of effective communication: clarity of purpose; not individual gain but common good was the goal; and that these leaders were men of character, integrity and strong will.

A business leader will fail to communicate if he is vague or ambiguous about the purpose of his communication. Such a communication will be viewed with suspicion or as being manipulative in order to serve personal or sectional interests. Vague communication also leaves people in confusion about what is expected of them and thereby fails to provide clear direction to action.

We have earlier talked of the power of communication. What are the conditions conducive to effective communication in an organisation? First, there must be mutual trust between managers and their co-workers at all levels of organisation. Second, there must be a climate for receiving and giving honest and free feedback. Managers must show, by action and behaviour, tolerance for adverse criticism. Communication will be less open, more filtered, and less authentic unless the organisation's culture meets the above two conditions. It is quite fashionable for top-level management to hold conferences or call group meetings to discuss problems of common concern. Unless the management is perceived to be open to critical feedback and dissent, and is seen to be acting on such feedback, these conferences/meetings will end up as 'annual routines'. People will not communicate openly at such meetings if they fear displeasure from their 'bosses' nor will they be forthcoming with new or creative ideas if the 'bosses' are not seen to be open to them. Responsibility rests with the 'leaders' of any business to encourage open and authentic communication up, down and across the organisation. This is an essential condition for ensuring commitment and support of the co-workers for the policies and action plans laid down by the management.

It is also important to note that communication backed by action builds credibility and trust. Failure to initiate suitable back-up action creates a 'credibility gap' and blocks open communication.

9.3 OBTAIN TRAINING IN MANAGEMENT

If you go and ask a businessman to get trained in management, you are likely to face a barrage of criticism. He will call your advice 'academic' or 'impractical'. Moreover he will say, "I simply don't have time to sit down and study". We have seen that the man who responds in this fashion is himself impractical, even if he believes himself to be a clever, smart and practical man.

The author of this book has studied many entrepreneurs, be they big or small or successful and frustrated. He is convinced that if an entrepreneur of a flourishing small-scale business refuses to study management, he is inviting disaster.

Let us be clear about this: the traditional approach to training in management was to acquire experience and to learn on-the-job from this 'school of experience'. Compare this to today's approach and you will conclude that the traditional approach is lacking in several respects. There is a vast pool of expertise and information about management in these modern times, which simply cannot be acquired with the traditional approach. You have to plan systematically and with care to succeed in management function nowadays. So many people have realised this truth and a large number of owner-entrepreneurs have begun to undergo training in management at seminars organised by universities, chambers of commerce and professional training institutes.

The owner-entrepreneur of a small and successful firm first has to acquire the skill of developing a long-term strategy through effective *business-planning exercise*. This is the fundamental area that he must cover in management. We shall discuss this topic at the end of the book in Chapter 16. For now, we will repeat our view of an owner of a small-scale unit who refuses to learn new management techniques and approaches: he is a person playing with fire and is gambling away the fate of his unit because of his obstinacy. Harsh words these, but better that we say them now and not later, when the owner loses his last shirt. We believe that such a closed-minded person is like a man who insists on travelling by bullock-cart in the jet age. He can never hope to succeed in this era of modern management if he clings to the age-old style of managing his business, which his forefathers followed.

9.4 LEARN TO BE FLEXIBLE

Business today operates in a world of rapid changes in market, technology, communication, government policy, information processing, financial market, and social and political environment. Never before was business leadership tested for its ability to respond to these changes in good time by being flexible and adapting business to the changing environment as today. Business leaders should realise that even strategies that were successful in the past need to be reviewed from time to time. Otherwise they will fall by the wayside and languish. One of the major causes of sickness in Indian industry, particularly in traditional industries of textile and jute, is the management's failure to monitor and adapt to changes in the textile industry scenario. It is the primary responsibility of business leaders to continuously review the strengths and weaknesses of their business and relate them to emerging opportunities and threats in environment.

> Take the case of Arvind Mills, Ahmedabad. In a thorough-going review of its strategies its management decided that its strengths lay in the manufacture of quality cotton textiles, in research and development, and in its manpower. It recognised opportunities for export of cottons but also that it had no strength to compete globally in fashion (cotton) fabrics. This led to their decision to manufacture the basic cotton fabric—denim—and so it mobilised technology, marketing organisation, and human resources necessary to succeed in being globally competitive in denim. Today, it is counted as the fourth (or fifth) largest producer of denim in the world. It could have gone sick had it persisted with its old but successful strategies in the face of competition from the powerloom sector, changing markets and technologies, and export opportunities.

9.5 MAKE A PERIODIC AUDIT OF YOUR TIME MANAGEMENT

Keep a record of how you spend your time for one month. If you study this record it will be an eye-opener for you. For instance, one businessman utilised 75 % of his time only with the sales function. Actually, the sales aspect of his business was a strong point compared to other aspects of his business. Yet, he loved this function, so most of the time he was busy with sales. Another businessman spent a lot of his time with people other than his employees—such as job-seekers, customers, colleagues from the Chamber of Commerce and from Industry Associations, etc. He did not spend even 25% of his time with his employees. As a result, he could not communicate effectively nor build a rapport with them. He was not able to find time to guide and instruct them adequately. So his employees got demoralised.

Surely, we cannot recommend how much time a businessman should spend for each activity. This is because each small business has an individuality of its own. But owners of large companies spend over 50% of their time for long-range planning, that is for plans that are going to be implemented after two years or later. We believe that entrepreneurs of small-scale units should spend time in a similar manner. An owner who constantly chases the daily routine tasks is unlikely to be able to devote enough attention towards this important aspect of long-range planning. We shall discuss long-range planning—the whys and hows of it—in Chapter 16. I have recommended in that chapter that every month, at least one full day should be devoted to long-range planning.

Once you begin to plan your time thus, the record of how much time you spend on each activity will be instructive for you. Are you spending time to beat competition and introducing necessary changes in your working style? Or, are you spending time on matters of daily routine, exchanging pleasantries with your visitors, idling away time on unproductive telephone calls, increasing paper work, or useless arguments with unimportant people?

You should, as an owner, employ someone if you find that you are devoting over 20% of your time for a specific activity and if you are unable to handle all the functions on your own or jointly with one or two relatives. The other rule might be that of "per-hour-cost" of the owner-manager (you). On this basis, find out the cost of routine work that you are doing at present and employ a person to take care of at least 50% of such tasks.

9.6 DEVELOP A TEAM OF MANAGERS

You should carefully set up a team of managers for administration. There is no doubt whatsoever that such a team is essential. A company that is in the midst of a leadership crisis must determine whether all its activities bring profits. The original entrepreneur of the company should keep this aspect in mind when he establishes a team of managers. What we mean is, just as you build a house brick by brick, build your management team in a similar manner by inducting one manager after another. Always keep a close watch on each new person until you are sure that the manager keeps the profit angle always in sight. That is, he is clear about his contribution to the total profit goal of the company, and he will really be able to contribute that amount of profit. Once you are positive about this aspect, delegate the required power and authority to the manager and recommence the process of doing the same for another team member.

Of course, this does not mean that the owner will be engaged in this process of team-formation indefinitely. Unquestionably he should carry out this activity for each manager in a time-bound fashion so that the manager he is inducting for delegation of powers is ready for taking over the responsibilities in that specific time frame. Remember, there is no point in struggling with an incapable person. It is better, both for the company and for the manager, that such a person be relieved from the company. But it would be wrong to mistake a mere collection of managers, each in charge of specialised functions, as a 'managerial team'. A managerial team is characterised by a common primary task, mutual trust, and mutually supportive rather than competitive relations among them. The team has to perform a task that transcends the specialised individual tasks of managers. At the top level, this task may relate to determining future directions and strategies of the whole business as a unit, of communicating these to all levels of the organisation, motivating staff at all levels for the attainment of the corporate plan and creating conditions for individual managers to play mutually supportive roles in the attainment of the corporate objectives.

Teams may be formed on a permanent or on a task-to-task basis. Building an effective managerial team is thus a crucial function of the leader of a business. Mutual trust and open communication among members of the team are essential for its effective functioning.

> Take the case of an engineering enterprise engaged in making steel-tubes in Gujarat which grew into a flourishing company. Its technical strength was considerable. The owner was himself a qualified professional and possessed tremendous insight into the business. He was assisted by a team of professional managers. However, the owner could not muster enough courage to diversify. Many

projects were considered but dropped because of a weak entrepreneurial spirit. The company rewarded its senior managers in a reasonable, routine fashion. The team members knew that rewards were being reaped by the owner. Their own ambitions were aroused. They found ways of amassing personal wealth. It did not remain a secret. The owner resented this. He responded by spending considerable energy on the task of clipping the wings of senior managers. It was not easy since the senior managers "knew too much". The senior managers were eased out in course of time. The owner could secure replacements but failed to weld these into a strong, cohesive team. The company continues to go downhill.

The case shows how lack of growth, mutual trust and authentic communication among embers of a team lead to its break-up and decline.

Facing Leadership Crisis

- ***The entrepreneur must train, discipline and re-educate himself in new management skills and styles for achieving and sustaining growth***
- ***Old habits, outdated knowledge and management by one or two subordinates will not do***
- ***Act like a leader rather than a manager/supervisor***
- ***Constantly evaluate how you spend your time***
- ***Concentrate on business strategies, future plans, competition, government policies, etc.***
- ***Develop a team of executives and give them sufficient authority to create leadership qualities in them***

10

Financial Crisis

Owner-entrepreneurs of most private sector units, particularly those that start as small units) usually organise their requirement of funds from their own resources, right from the start. But businesses that begin doing well reach a certain stage when the original owner cannot possibly afford to provide the required funds for horizontal or vertical expansion. While it is true that every year the business generates a certain amount of profit, almost more than half goes in taking care of taxes and other liabilities. Moreover, the replacement cost of assets increases fast, in which case a business is unable to provide adequate funds from the accumulated depreciation. Therefore, it is difficult for businesses that are growing fast to provide for funds for growth merely from accruals of cash profit, retained earnings and accumulated depreciation.

When existing businesses reach this stage of growth, the following major alternatives can be considered for raising funds:

1. From promoters by increasing authorised and subscribed capital or lending money to the business;
2. From the public through subscription of equity, preference shares, bond debentures or unsecured loans;
3. From commercial banks through term-loan;
4. From suppliers by availing short-term credit;
5. From financing and leasing companies through leasing of equipment;
6. By approaching international markets and offering special instruments known as American Depository Receipts (ADRs). ADRs allow the investor to convert the issued receipt into the company's equity share in future at a predetermined rate;
7. From financial institutions by inviting them to subscribe to equity or term-loan under one of their available schemes;
8. Since the foreign direct investment norms are liberalised, a business also has an option to approach Foreign Institutional Investor (FII) for the purchase of promoter equity through block deals.

9. Through private and public venture fund companies. Venture fund companies invest for a stake in a company for an upcoming idea or break-through technology.

Entrepreneurs can resort to any one or more of these options. In most cases, they are tempted to select a source that is cost-effective. But one needs to look into other factors as well, such as, terms and conditions under which finance is provided; their impact on management control and other related issues. Each alternative is fraught with some pitfalls. We are reminded of the typical plight of a young person who selects a life partner. When he/she takes this decision, it affects his/her entire lifestyle and whether he/she is going to enjoy or suffer is also established by the choice that he/she makes. Similarly, the owner of a growing company should carefully weigh the pros and cons of each of these options.

Moreover, an entrepreneur should also recognise that all these options may not be feasible; perhaps only one of the nine, or a combination of them might work.

Let us now study the advantages and disadvantages of some of these options.

10.1 FINANCE FROM PROMOTERS

Funds can be raised from promoters in the form of equity or loans, irrespective of the type of organisation/enterprise.

Through Equity

The biggest advantage of this source of funds is its easy availability. The recent changes in Initial Public Offer (IPO) has made raising funds through equity not only easy but also cost effective. The promoter can use the IPO route by selecting a price band which ensures the sale of the shares at a higher price. Instead of offering equity at a specific price, the promoters are permitted to select a range of price which encourages investors to apply for shares at a higher price. This price band mechanism is called 'book building' and has made easier for promoters and investors to obtain equity and returns respectively.

Advantages It has no cost implications. Interest-free funds are made available to the enterprise and the profit is distributed in case the enterprise earns well and the board of management decides to pass on the profits to the owners of equity.

Another advantage is that the increase in the owner's equity changes the Debt Equity Ratio and therefore, the enterprise becomes eligible for procuring more funds through loans from banks/financial institutions if required in the future. Since increase in equity raises the share of a promoter, he does not have to worry about losing control over the enterprise. Recent changes in the company law act and public offer regulation have made it easy for promoters not only to raise funds but also to protect control of the enterprise.

Disadvantages While in Proprietorship/Partnership firms, fund-raising through increase in promoter's equity does not require any permission from the regulatory authorities, in Private Limited/Deemed Public Limited Companies, an increase in authorised capital followed by a Board Resolution for increasing subscribed capital are required. Various kinds of permissions from the Controller of Capital Issues (CCI) may take three to four months and incur incidental costs.

Although promoter's capital is a good source of funds, at times it is not desirable to resort to it for various reasons. Firstly, a small-scale entrepreneur has limited funds available with him and expansion may require more funds to take care of escalation of cost, change in growth strategy, etc. It is, therefore, advisable to keep some funds in reserve to cater to unforeseen circumstances rather than utilise the entire funds for the purpose of expansion. Otherwise, a cash crisis may emerge, as explained earlier.

Through Loans

Instead of promoter's equity, expansion can be financed by taking loans from promoters, friends and family members.

Advantages The principal advantage of this source is that funds can be brought in and taken out without the permission of any regulatory agency even in Private Limited/Deemed Public Limited Companies.

These funds earn a reasonable market rate of interest and therefore, promoters or their family members are assured of income. Since the lenders are known sources, payment flexibility and default worries do not exist.

From the point of view of tax, it is advisable for the promoter to avail of loans in the names of more family members so that the tax incidence on each member is reduced.

In Limited Companies, loans can be given by promoters with a condition to convert them into equity, thereby earning interest during the initial period on the loan given to the enterprise and, later on, earning a profit by transferring the loan into equity.

Disadvantages The most serious disadvantage of this source of funding, particularly in a Proprietorship Partnership Firm, is that the interest paid to the promoter for such a loan is not deductible expenditure and therefore, it does not qualify as an expenditure from the point of view of income tax. However, in Private/Deemed Public Limited Companies, such interests paid to the promoter are a deductible expenditure and therefore, qualify for deduction from the gross income of the enterprise. This also means that the cost of borrowing is less than the actual rate of interest paid on the loan, as part of the interest cost will be offset by deduction in tax liability.

The second disadvantage is that the loan given by the promoter (whether it is a Proprietorship/Partnership/Private/Deemed Public Limited Company) is always an unsecured loan and under circumstances when the enterprise is experiencing financial problems, the loan given by the promoter will be returned only after meeting the obligations of other creditors; from this angle, this is as good as equity.

Normally, fund needs for growth are quite substantial in nature and therefore, one may find it difficult to raise funds through borrowings from promoters. It is also necessary that a promoter keep some reserve funds for emergency situations; therefore, it is not advisable to resort to this source when the enterprise is heading towards growth.

> Here is a classic example of an entrepreneur who, for fear of losing control over the enterprise, utilized all his personal funds for the purpose of expansion. It was a small company and the owner decided to launch a new product. For fear of losing control over the company, he decided not to go in for equity subscription or borrow money from financial institutions. The owner-entrepreneur invested all retained earnings and personal funds for launching the new project. He installed equipments and initiated trial production.
>
> In the beginning, he faced some technical problems, which delayed the production of the new product by about four months. Initially, he was successful in manufacturing the product, but it failed to perform as per market expectations and customer specifications, which again took up four to five months. The entrepreneur sought the help of a technical consultant for incorporating some modifications in the existing facility, for which he needed some funds. He approached the bank for finance but in vain as the balance sheet of the company indicated a deteriorating performance.

Had the entrepreneur approached the bank in the beginning itself, he could have used his personal funds for meeting the uncertainties.

It is, therefore, advisable to keep some funds in reserve to meet unforeseen circumstances.

10.2 FROM PUBLIC THROUGH SHARES AND DEPOSITS

Funds can be raised from the public through subscription of equity shares and public deposits. If the growth plans of a firm involve investment of large funds, it might be beneficial to raise funds through subscription of equity as this does not involve any interest incidence and funds are available for a longer duration.

If it is an existing firm (Private Limited or Deemed Public Limited) earning substantial profit which is not distributed as dividend and has remained with the enterprise as a retained earning, then the company has good chances of charging premium when it floats shares for subscription by the public. Reputed companies will have funds in general reserve and therefore, the net worth of the company will be high; this will allow them to charge premium on shares offered to the public, which can be from Rs 10 to Rs 100 or even more, depending on the net worth of the company and market price of the share.

Recently, foreign direct investment norms were revised for banking, infrastructure and IT. It has become easier to attract investment from Foreign Financial Institutions and individuals. They can participate through public offering or even block deals on the stock exchange. It has become easier for a business to raise funds through equity shares. The revised norms and procedures related to the capital market have made it easier for promoters to offer shares through IPO by using the price band mechanisms enabling them to raise resources easily.

Advantages The company will get more funds without increasing equity substantially. If a Rs 10 share is to be subscribed at Rs 35 on account of premium granted by regulatory authorities, the enterprise will get Rs 35 by adding equity of Rs 10 and thus, the entire Rs 35 has no interest cost involvement. The premium charge while offering the share goes to the share premium account and thereby raises the reserves of a company. Increase in reserves enables a company to offer bonus shares in the future. Such an offering increases equity participation of the promoter without allocating funds.

Many a time, it is thought that subscription of equity offered to the public might result in loss of control. This is a wrong notion. Experiences of Indian business houses indicate that a majority of such enterprises are able to keep control by retaining even 5 to 10 per cent of the total equity.

Share prices reflect the performance of the company. This, in turn, encourages the entrepreneur to always remain alert and function more efficiently.

Having acquired the status of a public limited company, the entrepreneur gets an opportunity to invite experts to join the board of management.

Subscription of shares through the public increases the total equity of the company and makes the company eligible for borrowing more funds as the Debt Equity Ratio gets diluted the moment equity flow is maintained.

As mentioned earlier, if a business is considering making a break through with a new product or technology, it can invite venture capital companies by offering a stake in the company to secure funds.

Alternatively, one can raise funds through public deposits, through FII and VCs by inviting the public to place deposits for a period of one to three years at the prevailing market rate. This can be done effectively, however, if the company's net worth is good and the Credit Rating agencies give a high rating to the company which means that the company is sound enough to receive public deposits. Though it has interest incidence, it is deductible expenditure from gross profit; therefore, the actual interest cost will be less than what is being paid. Another advantage in obtaining funds through this process allows the lender to convert the loan amount into equity at repayment, thus reducing the immediate burden on the business.

These will be non-secured deposits, so assets owned by the company will be free from any attachment. This enables the company to raise funds from financial institutions through long-term borrowings.

Disadvantages Though the above makes it appear much easier to raise funds from the public, it is not all that simple. It requires permission from CCI (these procedures are now being simplified/revised) and also from financial institutions if any loan has been taken from them in the past and remains pending. Though there is no interest cost involved, raising funds through the public has its own expenditure component which, at times, is quite substantial. It requires declaration of one's financial position, printing of prospectus, application form, listing with the stock exchange, appointment of underwriters/stock brokers/managers of issue, brokerage, banks for collection, promotional activities, etc.

Thus, one will not find this source substantially beneficial unless the equity issue is of, say, Rs 10 million or more. Though the capital market in our country is now well developed, response to subscription depends not only on the soundness of the existing enterprise, the quality of the project on hand and its likely performance in future, but also on the standing of the promoters, i.e. the reputation of the industrialists.

Once a company becomes Public Limited and gets listed in one of the stock exchanges (Company Law requires that a share be listed in at least one stock exchange), there is a danger of getting affected by speculation. Besides, another lingering danger is 'take over' which has recently begun in our country. If the project is sound, the company small, its net worth good and the future bright, someone with substantial funds can start acquiring shares and force the board to take a resolution on taking him or his nominee on the Board or can even take over the company by cornering 40 to 45 per cent of equity shares. Under such circumstances, the entrepreneur's attention gets diverted and this may affect the performance of the company.

In the instance of raising funds through public deposits, success will depend on the credit-worthiness of the company, the promoter's prestige, rate of interest offered, etc. The RBI has prescribed guidelines according to which a company cannot raise funds that are more than a certain portion of its equity through public deposits. Secondly, the interest is required to be paid regularly. Moreover, such funds are available only for a shorter duration, say for a period of three years. Thus, if the requirement for funds is for a longer time, this avenue is not all that useful. By and large, funds are raised through this source for building up working capital.

> Many small companies in America became 'public limited' in the fifties and early sixties. A number of such companies had not even started their activities. Thousands of dollars worth of shares were subscribed by the public in such companies and the brokers were paid handsome brokerage. Added to it were the legal expenses, publicity expenses, registration charges, etc. The market for new public issues was bullish those days. So the prices of shares of small companies which were floated to market innovative products sky-rocketed in a short time. The owners of these small companies thus became millionaires overnight, at least on the basis of their shares prices in the market. Moreover, they were flush with funds for the expansion projects of their companies. The institutions which had advanced loans and the share brokers to these issues felt that they had struck a gold mine.
>
> But the bubble burst soon after. By the end of 1961. many small companies faced hurdles as soon as their projects were commissioned. The result was that in May and June of 1962, the share

markets crashed. The share prices of small companies, too, hit the bottom; from a peak of four to five times the par value, the share prices now touched the ground level.

A similar phenomenon took the investors by storm in the late 90s in the tech boom experienced in the Silicon Valley, USA. Many companies went public without a proven business model and product. Young technopreneurs and venture capital companies in the lure of money avoided due diligence as companies went public. Investors saw the prices of such listed companies trading at 5-6 times their PE ratio. Though reality set in around early 2000, the market corrected these inefficiencies and rewarded the old economy companies with solid fundamentals.

This is not an unusual situation as the Indian stock market has found out during the last few years. However, small companies do not face these troubles perennially. In fact, this example serves as an eye-opener for the entrepreneur of small-scale units to guard against the following three pitfalls:

1. The owners of small business units who have not yet crossed over the third crisis (of delegation) and the fourth crisis (of leadership) successfully would face a grave risk if they continue to exercise 'complete control' on the management of the company. It would prove to be a curse rather than a boon for the future well-being of the company.
2. The public issue of shares should not be done in haste because this would block the other avenues of obtaining finance for the company. If a company has made a public issue and if, due to some problems, the share price of the company goes down, the company will not then be in a position to raise money from anywhere else.
3. The responsibilities of the companies that make public issues of shares are many, as per the Companies Act. They have to be accountable to the shareholders and government departments. Moreover, if a company's performance fluctuates even due to reasons beyond its control, the management still has to face the wrath of the shareholders. And such discontent amongst the shareholders can cause a lot of anxiety as also waste time and money.

Now let us take a look at some more illustrations.

I have referred to the case of the owner of a precision instruments company earlier. He came under the spell of share-brokers, floated a public issue of shares and raised Rs 100 lacs. He had promised 2.5 per cent brokerage to the share-brokers. No doubt, he could implement the expansion projects of his company with these new funds. But as the company expanded to a much bigger size than the original venture, he strove hard to look after the day-to-day administration, production management as well as the marketing functions. This was obviously impossible in the new context of expanded activities. As a result, the company began to make losses from the very year of the public issue.

The example of Mr. Thakor is especially tragic and disappointing.

He was 35 years of age and was a highly motivated and enthusiastic person. He had established himself well in the defense department as supplier of engineering items. But in 1960, two merchant bankers virtually brainwashed him into believing that a person of his capability should establish a huge industrial empire rather than mind a single line of business. Soon, a proposal to buy two companies was offered to him and he floated a public issue of shares worth Rs 98.5 lacs to acquire these companies.

Unfortunately, Mr. Thakor had no experience or insight into the business lines of two new firms. The operations of one of the firms were so complex that unless one had long years of actual experience in that particular business it would be very difficult to manage it.

To make matters worse, neither Mr. Thakor nor his new merchant bankers were skilled in the acquisition of new companies, so they suffered a loss right at the time of acquisition because of their ignorance of the rules of the game.

At present, both the new companies have been in liquidation and Mr. Thakor is back to his defense business; but his ownership in his original company is a mere 51 per cent now and the company is heavily burdened with the liabilities of the two acquired companies.

Before you make a public issue of the shares, therefore, pay careful attention to the following.

- Go in for public issue only if the project is large and requires a substantial amount of fixed capital.
- In case of an established firm, public issue should be timed after checking the dividend paid out during the past three to four years and the dividend likely to be declared in the future.
- The board of directors of your future company should be such as to inspire confidence in the investing public.

- It would be advisable to approach financial institutions, mutual fund companies, Foreign Financial Institutions, and encourage them to participate in IPOs. It is also advisable to work out an appropriate price range so that market-friendly bid offers can be invited.
- It is advisable to get the shares underwritten by investment banking firms/merchant bankers such as the Life Insurance Corporation, Unit Trust of India, IDBI, IFCI, and ICICI.

10.3 FROM FINANCIAL INSTITUTIONS

In our country, we have state as well as national financial institutions. Both sources can be tapped for raising funds for equity or for availing loans. State financial institutions (e.g., IIC, IDC) can be involved when the project size is, say, Rs 30 million and national financial institutions (e.g. SIDBI, IDBI, ICICI, IFCI) when the project size is above Rs 30 million. Similarly, just as it offers shares to the public, a company can offer subscription to financial institutions, also. This can be done even in the case of Deemed Public Limited Company, in which case printing of the company's prospectus, application etc. is not required. Raising funds through subscription of equity from financial institutions has all the advantages described earlier besides increasing the marketability of equity offered to the public.

Advantages The distinct advantage of raising funds through financial institutions is that in most of the cases, financial institutions provide a longer duration for repayment of loans and also a moratorium period to enable the project to settle. Longer duration reduces repayment liability in terms of quantum, thereby reducing the pressure on the company's cash flow.

If the company is in a position to generate good cash flow, it can also use the same for financing working capital. Moreover, the amount paid during a ten year period (tenure of loan) will have lesser value and thus, the real benefit is more.

In the case of temporary problems, financial institutions are not very reluctant about rescheduling moratorium and repayment periods.

Before granting the loan, financial institutions work out a detailed feasibility report, which assures the entrepreneur about his project's viability and prospects.

Disadvantages One of the disadvantages of borrowing funds from financial institutions is that the loan agreements have a clause—all existing and future assets of the company are mortgaged with them—and therefore, it becomes difficult to raise funds from sources other than financial institutions. However, this has become a standard practice now and is acceptable to almost everyone.

Basically, you should contact one or more of the term-lending institutions when you need funds.

Besides, the scheduled banks in India also advance term loans. Under the circumstances, it is advisable to obtain long-term funds from these agencies rather than from some other outside parties.

10.4 FROM COMMERCIAL BANKS

Normally, commercial banks provide funds for working capital. However, entrepreneurs can approach commercial banks for long-term finance as well. But they do not participate in equity. Borrowings through commercial banks for long-term needs have all the advantages and disadvantages mentioned above except that longer duration lending of a commercial bank means five to six years and not eight to ten years as in the case of financial institutions. This way, quantum of repayment is higher than the same amount borrowed from financial institutions and the moratorium period is shorter.

The other specific advantage with commercial banks is that they are spread all over the country and have outlets in almost every place, so entrepreneurs can liaise with them frequently. Their operational advantage is greater when the project is not very large; if an entrepreneur needs some minor adjustment in the repayment schedule, interest payment or even in the moratorium period, it gets approved.

Unlike financial institutions, commercial banks do not insist that the loan be converted into equity and that their representative be nominated on the board of management. But the cost of borrowing from commercial banks is higher than that from financial institutions.

10.5 FROM SUPPLIERS

This source of funds has not become popular in our country, but it has good scope and a company that is expanding can tap this source, provided the need is for a temporary period and the expected cash flow from the enterprise is very good in the initial period. A company can tap suppliers' credit for equipments, heavy machinery, technical know-how, construction of building, etc.

Recently, in the case of a large petrochemical project, an initial tie-up of suppliers' credit was worked out and the supplier agreed to provide credit to the company for supplying equipment. There are almost no formalities involved in this and the advantages are many, provided the fund requirement is limited to installation of a few equipments or for technical know-how.

Another big advantage is that if the equipment paid for through suppliers' credit does not perform well, the suppliers have to look into the problem as the payment is spread over a period of three to four years.

Since the equipment is purchased under suppliers' credit, the company can claim depreciation.

Sometimes, the profit margin under a certain category of machinery is so high that it is possible to avail of suppliers' credit without any interest clause.

Another version of suppliers' credit is deposit from distributors, which means that if the product has a potential market and the company has an established network for its distribution, the agent distributors deposit a certain amount with the company such that they become its franchisee. This works well in the automobile industry, as in the case of Bajaj Auto and Maruti cars.

However, this source can help only marginally. It cannot fulfill the expansion need, but can ease working capital requirement.

10.6 FROM LEASING COMPANIES

In the past few years, the Indian capital market has experienced a boom in leasing companies prepared to finance the expansion needs of small/ medium enterprises. Lease finance is available for the installation of equipments, creation of R&D facilities, purchase of computer facilities, transport, infrastructure, etc.

If the major part of growth requirement is for investment in equipment, this is probably a good source as, by investing 15 to 20 %, one can create the necessary manufacturing facilities.

It has all the advantages of securing a loan from financial institutions besides a very simple procedure for availing credit and entering into agreement.

High-tech equipment or products become obsolete faster. When the company creates facilities through leasing, the lease is for three to four years, on completion of which the company will be in a position to acquire equipments with the latest technology.

Another distinct advantage is that all assets of the company other than leased equipment remain free from hypothecation and therefore, the company's strength to borrow from other sources remains intact.

Financial Crisis

- ***Failure to choose the right source of funding for expansion (excessive dependence on borrowed funds)***
- ***Failure to go public***
- ***Overambitious and unrealistic expansion plans using surplus funds***
- ***Psychological problems of losing control—100% ownership of declining unit vs 80% of a large successful firm***

11

How to Avoid Financial Crisis

Let us consider how we can save our business from the fifth crisis.

11.1 ALL AUTHORITY IN YOUR HANDS? NO!

Do not insist that you have a tight grip on the power to take all decisions within your business unit. First, you should realise that even if, as owner of a small-scale industry, you are highly competent, you would still need someone to assist you in managing the unit. Secondly, the fear that power will slip out from your hands once you begin to delegate is an illusory one. In fact, two experts of small-scale units have this to say: "It is rather unfortunate that owner-managers are afraid to delegate effectively. These owners must realise that they are solely in charge and responsible for the entire capital invested and for the responsibility to run the business well. So long as they perform their tasks well, the real control of the business will always be with them."

11.2 EXERCISING CAUTION IN TIME

When you need more funds for business, do not delay getting the necessary funds from the term-lending institutions against shares of the company. This is because such a delay results in the cash crisis. In turn, this affects production. But worse still, the creditors may go to court. So investors in the company or term-lending institutions who are ready to advance loans are afraid to help. Many bankers sound a warning in this regard. They say that well before the cash in your bank account gets depleted and you begin to ask for overdraft, it is better to talk to your banker and get his advice on what you should do.

11.3 HOW TO OBTAIN FUNDS

The description of various sources of funds in the previous chapter highlights specific advantages and disadvantages of each. However, which source is more advantageous to a company would depend on the size of the company, the product manufactured, investment requirement for growth (expansion), period of requirement, time factor (how soon the fund is required), status of the entrepreneur, etc. Therefore, one must consider the following major factors:

1. Cost of raising funds
2. Cost for retaining funds
3. Time taken for raising funds
4. Tax implications and
5. Terms and conditions for getting funds—duration, instalment structure, moratorium period, and other specific conditions such as nominating a member on the board, etc.

After a careful evaluation of all these factors and the specific situation at hand, one can select the source required. It may be a good strategy to use more than one source as it gives a financial leverage in terms of the cost of raising and retaining funds. Sound financial planning at the beginning of the expansion process is a key factor for the success of the enterprise—an entrepreneur should always keep this in mind.

Excellent books are available that offer guidance on financial structuring of business units. We recommend that owners of small scale business not neglect this rich resource of study and experience. They should thoroughly familiarise themselves with the ways and means of financing their industries. It is better to consult financial experts before committing oneself to a specific mode and source of finance—more so while exploring international funding (e.g. ADRs), which we have referred in the beginning of Chapter 10.

Preparing for Financial Crisis

- ***Sufficient delegation, good team work and constant monitoring help avoid financial crisis***
- ***Consult experts and bankers to choose the best source of funds and the time and mode of expansion***
- ***Do not be afraid to go public***
- ***Remember: 80% ownership of a growing firm is better than 100% ownership of a stagnant/ declining one***

12

Prosperity Crisis

Have you not known of firms who make good profits for a period of time, then get complacent and relax vigil over the very factors that contributed to their past success? Entrepreneurs of such firms tend to spend less time on the success of their business while pursuing speculative or other personal interests. They become overconfident, which often prompts them to overreach, to take a giant leap forward in pursuit of a desire to become 'big business' but without sufficient preparedness to manage the leap forward. An MIT (U.S.A.) trained engineer-entrepreneur made the point at a recent seminar on Innovative Turnaround Strategies that past success blinds many an entrepreneur to early signals of decline in business until it becomes too late to rehabilitate it.

Let us look at few examples of how some of these successful firms have come to grief by being overtaken with this crisis.

12.1 COMPLACENCY

Many owner-entrepreneurs of new small-scale business units have a natural inclination to become complacent after having crossed many hurdles and crises in the business and after having established their fledgling unit on a strong foundation. They attain their affluence after a hard uphill struggle and then they are eager to enjoy their new-found wealth. They are proud of their achievements because, by successfully employing their business acumen and insight, they have been awarded with the certificate of 'victory in business'. But later, competition inevitably enters the scene and the market structure no longer remains the same as before. Yet the entrepreneur basks in the temporary glory of outmoded business insights and continues to depend upon .his senior deputies, even though these deputies might have become outdated in the meantime.

A telling illustration in this regard is that of the Harshad-Ravindra company.

> Harshad was a self-taught design engineer. He had embarked in the plastics industry in an early phase of the industry. Ravindra, his brother-in-law, had good experience in sales and sales organisation

prior to the second world war. He had worked as a contractor to the navy during the Pakistan war and was determined to start his own business after the war.

In 1967, Harshad and Ravindra together started a company in the garage of a building. They made and sold a specially-designed plastic container. The design of the container was evolved by Harshad and it was a highly versatile product. He also developed a new process of moulding plastics and, as a result, the container was attractive in appearance compared to similar plastic items. The product became popular in the market and was particularly stocked by gift shops, where it sold in large quantities.

The two partners themselves managed the entire business. There were about 60 workers in the unit. Later, they appointed an accountant who was working under them as the manager and delegated substantial power to him. After some time they appointed one of the three salesmen of the company as the sales manager and he was given responsibilities for additional sales. New salesmen were appointed to work under him. Gradually the company had an effective management team, consisting of heads of various sections. Ravindra continued to function as a General Manager and Harshad was the so-called Chairman of the Board, though he continued to look after the design work.

In 1976, the number of workers increased to 210 and the annual sales was of Rs 500 lacs, profit after tax on sales was over 4% and the value of the assets of the company on the books was Rs 125 lacs. At that time, a fund of Rs 80 lacs was raised by pledging 40% of the company's shares in the market. Half of this amount was shared between the partners and the other half was utilised to meet the shortage of funds in business.

Over the years, Harshad had made a number of changes in the production of the original container. By evolving different styles, he had established two grades of containers at different prices. He also invented a number of accessories that could be used with the container. However, the entire company depended on the production and sales of only one product: the plastic container. Harshad now spent his leisure time in gardening and photography, which had become his hobbies. Ravindra was not keeping well and though he continued to be the General Manager, his attention inclined more towards the practice of his religion and he devoted his time and energy in serving on several temple committees.

In the meantime, many people took notice of the success achieved by the Harshad-Ravindra company. They began to imitate their activities. Some of these people began to sell their products (similar to the container) in the market and did penetrate the market to some extent. Yet none of them achieved success in the production of the item to the extent that the Harshad-Ravindra company did. But slowly and surely the science and technology of plastics was making progress and new designs of containers that served household applications more efficiently began to appear in the market. Finally, when the Harshad-Ravindra company amalgamated with another company in 1983, its sales turnover was Rs 137 lacs even though there had been a steady growth in the plastic industry as such. The profit of the company had almost disappeared. The share value was Rs 3.10 against its par value of Rs 10.

The case of Mac company was a somewhat different one. They did not concentrate on the production of a solitary item as in the case of the Harshad-Ravindra company. They manufactured a variety of products. But they did not improve the production quality of their items. This was despite the continuous improvement in manufacturing equipment and processes. The final outcome can be easily guessed. Let us study the details of this case.

Mac was established by two brothers in 1969. They used to manufacture items for children such as cradles, car cushions, commodes for children and toys that can be attached to these items. In 1971, the younger brother was mobilised and joined the army. He was later killed in action. The elder brother sustained the company by carrying out the subcontract work of manufacturing small metal parts from the defence contractors. The company got well-established in the market because of the spurt in demand for children's items. The company remained active during the China war by selling children's accessories and toys and similar items. During this period, Mr Mac had formed a team of managers for the company. The sales turnover of the company was Rs 75 lacs and 320 workers were employed. But he did not groom anyone to the Chief Executive's position because he wanted his son to occupy that post after his graduation.

The company enjoyed a good reputation in the market when the China war ended.

The profit after tax on sales was of the order of 6%. Mr Mac was quite satisfied with this profit level. Even though his sales manager tried to persuade him to replace metal parts with plastic ones in their products, wherever possible, he did not heed this advice. Mr Mac thought that metal parts impart greater strength to the products and that he would have to install new machinery to utilise plastics components. Besides, he felt that he would have to invest additional capital to effect this change.

After some time, in 1980, the sales manager resigned and left the company. He joined a competitor's firm. Mr Mac suffered a heart-attack about this time. His son had gained only a couple of years experience by then. The products of his factory were no longer as popular as before, because they were heavier and more costly than their competitors' products. The machinery of the company as well as the manufacturing process were outmoded. The managerial team had lost its sparkle. The sales turnover was steadily declining. The son tried his best to bring about a turnaround in the company but he could not succeed. He made a wrong choice of an incumbent for the position of General Manager. The performance of the company after it was taken over by him was below par. Finally in 1985, the company was in the midst of such a grave financial crisis that he had to sell the company to his erstwhile sales manager, who began a speedy revamping of the company.

The case of Aero Industries of America is a similar one. The company committed a mistake similar to that made by the Harshad-Ravindra company. But to add to the gravity of the final crisis, Aero Industries declared hefty dividends so that it could get high prices for its shares in the market. The mistake was thus compounded twice over. Let us look at the details.

Three partners established a company prior to World War II to manufacture various ancilliary items for airlines. Two of them had some experience in a large aeroplane manufacturing company. The third partner had worked as a salesman of a company that supplied goods to the same firm that manufactured aeroplanes.

The new company manufactured rivet-guns, clamp holders and some other items used in the manufacture of aeroplanes. In the initial stages, the company manufactured only one item and used to act as a selling agent for other items. Gradually, it began to manufacture all the products in its factory.

The company saw good progress during the Second World War. There were sizeable cuts in government expenditure after the war, yet the company thrived during the Korean war. At that time, there were 85 workers in the company. The company had declared heavy dividends two years prior to public issue of its shares. Therefore, the prices of shares ruled high in the market. The partners were really glad about this and felt that they were managing the affairs of the big company with the same care as they would have had it remained a family business.

In 1957, the government cut down the expenditure on defence and the emphasis then shifted from planes to missiles for defence; by 1959, the trend was towards manufacturing a few but highly sophisticated planes. So products of companies (like that of 'Mac') that were making goods for ordinary planes were no longer in demand and began to accumulate in the market. The company had paid taxes to the extent of 61% (of profits) and had declared heavy dividends. So, there were no funds left to develop new products. In fact, the company should have initiated development of new products much earlier.

Several cases of textile mills are illuminative in this regard. All those mills who took care to change the product-mix or to modernise their plants in response to emerging competition from the power loom sector, to export opportunities, and to changing technology, are working profitably even today. All the rest (a large number) have either become sick or closed down permanently.

Take also the case of a textile mill belonging to a reputed business house with large textile interests. The mill was showing clear signs of decline. The Chief Executive of the mill drew the attention of the group's top management to it. But they ignored his advice, saying: "This must be a temporary phase, we know our textile business too well, we have managed it successfully for a long time; how can this unit fail?". The unit has ultimately become sick.

Under certain circumstances, the smugness of an entrepreneur encourages economy in new capital investment. For instance, a company manufacturing electrical items postponed all repair and development activities during the phase when the profit was low. During this phase, projects of research and development on which work was being carried out were shelved. Thus, those R & D projects that were going on for the previous two years got postponed by another two years. The company therefore was four years behind the times as compared to other leading companies in this line. This happened particularly in a field where the progress all around was rapid. Due to this decision of the company (to prune expenses of the R & D projects), it could, of course, tide over the immediate financial problems, but after two years, it began to lose ground in the market because of its outdated and obsolete tools.

12.2 THE GREAT LEAP FORWARD

The owner of a small firm becomes quite proud because of his achievement and success. He begins to overestimate his own as well as his management team's capabilities. Of course, any first-generation entrepreneur is always optimistic because he has had to struggle hard and overcome a lot of obstacles before he succeeds. When he resolves all the difficulties, he becomes optimistic and confident. Besides, his workers usually flatter him; the salesmen visiting him also indulge in 'apple polishing' and persons who aspire to start new business ventures (or who want to motivate others to do this), too, sing his praises. Therefore, it is easy to persuade an entrepreneur to expand his small 'Opel Nuts manufacturing company', which he has nurtured to success, to 'Opel Industries'.

> Mr Amritlal Panchal was a bright and energetic owner of a successful engineering company. A lender of funds explained to him that he should place his shares in the market and raise 8.5 million rupees and also acquire two other firms; He was advised that the two new companies and his original firm could together be amalgamated to set up a big 'Panchal Industries Incorporated'. He was also told that the new venture would be a mega-industry and a strong and successful complex. Unfortunately Mr Panchal and his team were not equipped to run the two newly acquired firms. The result was that both the firms became sick and went into liquidation.

Mr Panchal had not undergone formal management training nor obtained any training at work before he had embarked on his venture. His education was confined to mechanical engineering. The success he attained in the beginning resulting from the exceptional skills and administrative acumen that he displayed in some of the engineering orders was due to innate insight alone. He and other businessmen like him tend to neglect the following:

1. In every business, specific skills and insights into its intricacies contribute to its success in a large measure. This insight could belong to one person or to many associates of the entrepreneur. What helps in the success of a particular business may be of no use in contributing to a totally different business. This is because the skills and the insight required for success are different in different lines of

business. Therefore, Mr Panchal's capability in the areas of engineering or sales in his first unit or the capability of his main deputy in grasping Mr Panchal's ideas and designs and translating them into a product in an economical manner were not useful in achieving success in the two new companies. The two companies required additional skills to obtain government contracts in open bidding for supply of materials and stores to government agencies.

2. Some managers are more effective when the business is a small-scale one. They are not so comfortable managing the business when its scale of operations becomes bigger. We have already discussed this aspect in Chapter 7.
3. At times, an entrepreneur achieves success purely by chance. For instance, the market situation may be favourable at that time or there may not be much competition. The owner and his team then mistakenly attribute this success to their capabilities and presume that they will be able to handle any business whatever be its size. However, it is risky to expand the company based on such presumptions.
4. There are qualitative and quantitative dimensions to acquiring other companies. Before the entrepreneur plunges into such an expansion, it is necessary to plan the entire strategy carefully. It is also necessary to pay careful attention to the implementation of this plan as well as to the technical know-how and other details. The following example is illustrative in this regard.

Two owners of firms dealing in musical instruments had long experience in retail selling of their goods. One of them was the owner and manager of such a shop in a large city. The other ran three medium-sized stores in towns located nearby.

Both these entrepreneurs placed the shares of their companies in the open market in order to raise Rs 50 lacs to set up a new company. Their ambitious plan was to establish a chain of musical instrument shops all over the country.

It was confirmed in a short time that neither of these entrepreneurs had any experience in acquiring established shops. They also did not have the necessary insight for integrating originally autonomous enterprises into an effective network and resolving the various issues that inevitably crop up during this effort. Four out of six owners of the newly acquired shops did not continue as the managers of their shops for even one year after the acquisition.

Therefore, difficulties began to arise right from the start. The main assumption made by the two entrepreneurs while planning and negotiating for the new chain was that the original owners of these shops would continue to function as managers of their shops after acquisition.

As a result of these complications they began to face many new problems. Expenses soared and the whole business went out of control. The latest report mentions that the entire activity of setting up the chain of retail stores is now at a standstill after the acquisition of the six new stores and the four stores previously owned by the entrepreneurs. The owners are now slogging to consolidate the operations of these ten firms.

Let us look at another example in this context.

Two ambitious electrical engineers set up their own company in 1992 after having served as electronics designers with defence contractors. Since they had begun their enterprise by obtaining subcontracts from their previous employers, they began to earn good profits at the start of the activity. They also developed three highly complicated technical items that were used in electronics equipment by the defence.

They earned good profits continuously for the initial five years and they formulated plans to manufacture non-defence items by expanding the factory, which already employed 43 workers. This plan was based on the possible threat of cut-backs on defence expenditure by the government.

Therefore, they bought over a firm manufacturing medical electronics items, employing 14 workers. After six months they acquired another company employing 29 workers and making one product in addition to marketing a number of other products. All these products were sold through retail stores.

The first lesson that these two entrepreneurs learnt was that none of the managers of the small companies which had been sold out liked to continue under the new owners. The other lesson was that the standards followed in design and manufacture of defence items were quite different from those of consumer durables in the open market.

The third insight was that marketing defence items and selling routine items in the market were two different pieces of cake altogether.

Let us take another case.

A successful Ahmedabad-based pharmaceutical company diversified into disposable medical products. The investment was influenced by "temporary boom and supposedly ambitious government-funded healthcare programmes". Since the new venture was not related to their core business, the company made errors in the selection of technology; it also did not build the right organisation to launch and successfully run it. A senior manager of the existing pharmaceutical company was put in charge of most (but not all) operations of the disposable medical products company. It faced technical snags and the pricing policy was faulty. Later, a retired insurance manager, well known to the owners, was recruited as Chief Executive of the company. He could not cope with the challenge of mastering the intricacies of the new business, intra-group power politic, and unrealistic expectations of the owners. He was sacked within a few weeks. In his place, three heads, each in charge of production, marketing and procurement respectively, were appointed but none was made responsible for overall business results. The four owners reviewed the operations of the company at weekly meetings with these three heads. But this degenerated into a 'passing the buck game' among the three functional heads. The owners relied on sledge-hammer techniques—reprimands, humiliation and threats. The marketing head buckled under pressure and flooded the distribution channel with goods to show good performance. The middle man was saddled with defective and unsaleable goods and returned these. This resulted in strained relations between the company and the middle man. The state of no-man-at-the-helm continues and the company is in dire straits. It is a case of a successful company venturing into a new line for making seemingly good profits without adequate preparedness to launch and buy it. Management by proxy cannot do.

Let us take a look at an instance where new companies were acquired in a careful and systematic manner.

A rich engineering graduate, who passed from a reputed engineering college with honors, established a company to manufacture machine-tools. The company began to earn good profits from the manufacture of an industrial machinery item. This industrial item was a forerunner of automation, which was to take roots in the following decade.

The owner persuaded two of his rich friends to invest in the company and become partners; he planned to develop many similar industrial products with these newly acquired funds. Each industrial product was virtually guaranteed to succeed in the market place. However, the entire programme was beyond the competence of the six technicians working for the company. Within a short time, the owner realised that the ten research and development projects that he had initiated were only half-done. When he tried to employ more designers to complete the projects, the six technicians went on a sit-down strike. They did not want any outsider to join the company and encroach on their 'territory'.

Finally, four programmes had to be abandoned at a heavy loss and the other programmes that were half-finished had to be sold off. After three years of continuous losses, the company attained a sort of equilibrium when one of the two remaining programmes began to earn profits.

Prosperity Crisis

- ***Satisfaction with current success—caught napping***
- ***Failure to watch out for new competition, technological changes, raw material substitutes, new products and consumer tastes***
- ***Loss of market share and declining profits***
- ***Overconfidence, a cockiness arising out of prosperity, ambitious expansion moves, and intoxication of success***

13

How to Avoid Prosperity Crisis

We will analyse the ways to avoid the sixth crisis under two heads:

- Becoming complacent (or smug)
- Taking a giant leap in business

13.1 PROBLEM OF COMPLACENCY

In the past, businessmen in India could easily get breathing space (high tariff wall, restrictive license/permits) for a few years after achieving a certain stability in their industries. This is not possible any longer.

The biggest of all hurdles to be crossed by a businessman is that, with the global liberalised economic policy, the nature of competition has changed rapidly and across the industry. Most entrepreneurs may be quite aware that technological innovations in new equipment, process and designs are growing at a rapid pace. But many may not have fully comprehended the implications of economic reforms on marketing and financial structures and strategies of business.

Take the case of rapid developments in the Electronics and Communications fields. Earlier, it took years before a new item got known throughout the country and before its name became a household word. Nowadays, this can be achieved within a week, thanks to advertisement over radio and television, faster communications and more efficient modes of transport.

> A small businessman set up a strong marketing network in two states for his food product. But towards the end of 1980, within two months, his sales dropped by 30%, because a large company having a nation-wide marketing network promoted a new brand of food product. The company created a favourable image of its branded product through advertisements on television, newspapers and by exhibiting actual samples in many shops. Owners of other brand names felt threatened and brought out free-gift schemes and reduction sales to counter the new brand of the national company. But the local man did not bother at all about this new threat and finally

his sales level went down to such an extent that he was unable to recover production costs out of his income from sales. It is important to monitor and adapt to the emerging marketing environment and not remain smug in the belief that what sold in the past will also sell in the future.

Earlier, a business house took years to reach the front rank in the market-place. Today, however, any company can achieve higher growth by raising money from the capital market, or borrowing (term-loans/deferred credit) funds from development banks, or by leasing equipment/building. Though there is definitely an element of risk involved in this approach, there are a large number of success stories too. For instance, in the past decade, a powerful and large company has entered the field of office furniture and allied items. This company has driven a number of small firms out of business. The point is, in today's world, it is imperative for a small-scale firm to continually strengthen all aspects of the business to beat competition and grow. By remaining vigilant and active throughout, the firm can continue to be competitive and growth-oriented.

An author had this perceptive observation to make after he studied all these business phenomena. "Today", he said, "it is false to conclude that there is competition between the products of one firm with those of another. In real terms, the competition is between the quality and depth of management (that is, its organisation and administration) of one firm with that of another." What he meant was that the owners of all companies—big and small—have to be constantly alert on two fronts: cope with emerging competition through improvements and upgradation in their existing lines of activities by watching the quality and cost parameters and, go on augmenting their lines of business by adding new products and services so that if the competition attacks a particular product line, the entrepreneur can survive on the basis of other products. It is quite risky to rest content with only one successful product. It is vital to keep one's product-line in tune with changing markets and emerging marketing opportunities.

Let us quickly summarise the above points by advising entrepreneurs on two actions.

Be Aggressively Competitive

Planning and execution as per plans must continuously move forward towards two main goals.

(1) Improve the existing products so that they can meet ongoing competition effectively and, (2) introduce a measure of variety in the production lines so that it is possible to withstand competition (and prosper) in the long-term, and benefit from new marketing opportunities.

Do Not Vote for Status Quo

Where the owner of a company decides to retire for a while, he should not be content with an administration that ensures 'status quo'. He should entrust the affairs of the company to a competent and effective manager who is capable of translating the strategies and plans for business development into reality and who has the ability and courage to take vital decisions at the right time about the progress of the company. Nowadays, it is risky to be satisfied with the day-to-day administration of the company. Profits are made in the marketplace. It is vital to know the consumer and what he wants. This is so because, as we mentioned earlier, there are such rapid advances in production technologies and markets so that to halt for a while is to virtually court disaster for the business.

13.2 THE GIANT LEAP FORWARD

The way to resolve this problem is to ensure adequate preparedness and capability to manage the leap forward successfully. Do not undertake a leap forward driven by ego to become a 'big business' or by speculative desire to make quick profits. It is advisable to draw the action plan for new business activity and have it meticulously checked by in-house and outside experts.

By their upbringing, training and temperament, entrepreneurs of small-scale business units do not operate within the framework of a well-defined plan. Still, the only way to resolve the crisis that we have been considering here is to formulate a comprehensive strategy of business. The way to formulate such strategic plans is outlined in the final chapter.

It is worthwhile to recapitulate the advice offered earlier on how to tide over the leadership crisis. The owner of a small-scale firm, after handling the leadership crisis successfully, should continue to be an avid student of the art and science of management. There are opportunities and challenges at every stage of a company's growth when members of the board of directors, deputies, owners of similar companies and other experts can provide much support. At this stage, over and above ambition and aggressiveness, it is also recommended that the entrepreneur display real humility. This humility not only implies recognising the importance of suggestions and advice from others regarding the management of the company's affairs but also actively seeking out such advice and utilising it for the progress of the company.

Some owners of small-scale units argue that there would be long delays in grabbing worthwhile opportunities (such as acquiring a new company or obtaining new product-lines from outside) if they go on seeking advice in every area of the company's activities. It takes a long time, they say, for the owner to first study and arrive at a firm conclusion as to whether such decisions dovetail properly with the company's long-range plans. Then, once they are found to be acceptable prima facie, to go out and seek advice and opinions and to discuss these plans with many people would involve even more time.

There can't be a more incorrect and harmful argument than this. In real life, such people who want to sow today and reap tomorrow usually meet with snags. There is more chance of failure than success if business or technologies are acquired in haste. Besides, when such a newly acquired business undergoes liquidation, the parent company's foundation receives a heavy jolt and the entire bedrock of business starts to shake or even gets destroyed.

At times, when there is a proposal to buy over a company, the proposal looks so attractive that the entrepreneur believes that, with the expertise and skills, he can take over the company and run it properly. This is despite the fact that the original owner of the company could not run the company effectively. Besides, to the extent that you may lack experience in the line of business of the new company, you are quite likely to miss out on the problems and dilemmas that the new company faces.

Please review the example of the two electrical engineers in the preceding Chapter 12, section A. They could not manage the two newly acquired companies. In fact, they were advised to obtain guidance from another existing company dealing in medical electronics items. But the main partner replied, "If I go to seek their advice, would they not buy the company themselves?" Later on, though, he got to know that many other companies in the field had declined the offer to purchase the firm when they were approached to take them over because they had enough insight and experience to know that it was impossible to make the company's operations profitable.

In-house Development Programme

It is possible to expand one's business by adding new lines of activities and thus diversifying over and above expanding the ongoing business. However, one study carried out in this context has shown that unless a company has been set up by a team of specialists, small firms are usually not so successful in developing their business through diversification without professional help. Therefore, it is advisable for small firms to join hands with a team of professional innovators to establish new products rather than manufacture such products on their own. It is beneficial to such professional innovators and new entrepreneurs also that an existing company is prepared to manufacture products developed by them. This has been made possible by the setting up of science and technology parks in different states.

The Science and Technology Department of the Government of India has recently set up such parks at local universities or technical colleges in several states. These parks provide assistance to small- and medium-scale industrial units in the area of research and development and also offer help in tackling some of their management problems.

External Development Programme

By external development programme we mean the progress that a company achieves by acquiring other running firms and amalgamating them with their existing activities. There are both advantages and pitfalls in such a development strategy.

The principal company (who is the buyer) gets all the advantages of the years invested in the nurturing and developing of the seller firm just by signing the legal documents of transfer. At the same time, the company inherits all the long-term problems and decisions taken by signing the same document. There are, for example, a number of 'people-problems' associated with such takeovers. Before you begin to get the targeted results after the acquisition, a lot of restructuring and renovation has to be done.

We have mentioned 'people-problems' in the above paragraph. These occur between the owner of the buyer company and the chief executive of the bought-out firm who may have to work together after the merger. Both these persons are usually well-experienced and mature and it becomes difficult for them to change their patterns of working: So, the compromises and the inevitable give-and-take that have to be done are often a big nuisance.

There are many other problems associated with this strategy of growth. It would be a rare case where the owner of a small-scale business who, after acquiring other firms, has the required experience to resolve all these issues. Some of these problems pertain to self-analysis. We have already cited some examples in earlier chapters pertaining to entrepreneurs who have bought new companies and were not able to manage them well. There are other technical aspects, too, to such an acquisition. For instance, how to determine the value of the firm, negotiate to minimise the incidence of tax on both the firms, and formulate the legal documents so that only certain specific liabilities devolve on the buyer, etc.

There are good books available on the aspects to be kept in view during such take-overs. Detailed instructions are given in these texts. For instance, audit the balance-sheet of the firm independently, estimate the company's worth after capitalising at the right multiple the net profit (projected and past), analyse the books of the company carefully, check and verify the assets, and find out the incidence of (balance) taxes and contingent liabilities to be paid, etc. Moreover, meticulously check the status of the competitiveness of the firm's products, what the potential growth of the relative product-market is, agreements made with the labour unions, the various pending legal matters, the liabilities, debts, etc., availability of convenient postal and communication facilities, status of the supply of utilities, transport facilities for the goods and rates of transport, whether any of the assets have been mortgaged, at what prices the goods of the company are sold in comparison to those of the competitors, and especially the motivation of the owner in disposing of his firm.

Dealing with Prosperity Crisis

- ***Always keep your eyes and ears open; do not relax even in prosperity***
- ***Always remain firmly aggressive and not passive***
- ***Do not be overconfident. Do not enter into an unknown project or overambitious expansion***
- ***Remember, success today is no guarantee of success tomorrow***

14

Management-Succession Crisis

14.1 THREE PROBLEMS

This crisis descends on the firm when the founder-owner of the firm dies, remains ill for a long time or gets incapacitated. At such a point of time, the following three problems arise.

The first problem is about who will look after the management of the firm. There should be a person at such a time who can take over the function of management smoothly. Not only should the person have the capability for such an efficient take-over, he should also be well-acquainted with the firm, its working and its competitiveness. It normally takes some time to select such a person and train him for succession. Therefore, if a firm does not prepare the groundwork for such a succession, it could prove to be a hazard.

The second problem arises from a split of voting rights/control and consequent loss of unified control. Family feuds for control of the business can bring disaster to an otherwise successful company. There should be a well thought-out plan to avoid such disaster. If the shareholding/interest of the founder-owner of the company gets divided amongst more than one successor, the voting rights/control also get divided; hence, even if the successor-manager is a capable and well-trained person, he will not be in a position to handle the company's affairs effectively. All the voters/inheritors would always poke their noses in the company's working; more so in a successful company.

The third problem is that of winning loyalty and trust from co-owners/shareholders, staff and employees and winning the confidence of financing agencies, clients and suppliers dealing with the firm.

Any thoughtful owner of the company realises right from the start that his firm or industrial unit will have to face these problems sooner or later. He is also probably aware that there are tried ways of resolving such problems. But many owners are not willing to consider their permanent departure from this world, and hence from their business. They avoid tackling the seventh crisis head on. During a survey of 100 small business enterprises carried out through interviews, their owners were asked about their principal worries. None of them mentioned the problem of choosing and appointing a successor after them. However, when, during the survey, their attention was drawn to this stumbling-block (of management succession) each one of them accepted that it was really a big issue.

There is a natural and inborn resistance to resolving this problem and there is lack of readiness to give careful thought to the succession aspect. As a result, many owners who successfully cross the first six crises without any hitch, do not make plans for this seventh crisis. There are instances galore of sound and prosperous companies set up after many years of hard work, which were ruined within two years after the founder got incapacitated or died.

14.2 SOME COUNTER ARGUMENTS

Some owners put up this argument before us: "Fine, you have described the three problems, but the task is not quite easy. If you sit down and think about these problems, you cannot find a straightforward answer". Some owners also offer a counter-argument that runs somewhat as follows: "Large companies can afford to groom big managers for succession; how can small firms like ours bear such costs?" Others point out, "In a small company, there can be only one chief. Even if there is another capable person, he may take years to occupy the top seat. Certainly, this person cannot just sit and wait for that event (of the owner's permanent departure from business)". Other owners have a different point to make: "Our business line is different from other lines. I was successful because I possessed design skills and moreover, I could manufacture products at low cost. It is rare to get such experts having both these skills in the market. Also, no one can be 'trained' in these skills without a certain amount of innate qualities. We shall have to just wait and watch till we can get such a person in the market. Only after we locate such a person can we appoint him as our employee. Of course, this depends on whether we can afford him in the first place".

In this chapter we would like to establish that you simply cannot neglect your responsibility of grooming a successor. The people who argue as above may think that they are endowed with practical wisdom but if they do not prepare for this future crisis, there cannot be more impractical, complacent persons than them. Let us present a concrete case to support our views.

> We may as well revert to the example of the 'Mac' company at this point. That company began to grow complacent after achieving

> a fairly dominant status in its business line. It did not make any improvement in its products or in its equipment. Also, the company did not reduce the prices of the products or did groom a successor to the owner, who would look after the management of the company. The owner planned to entrust the management of the company to his son, who was studying at that time. But surely, you cannot ask death to wait till the son had acquired adequate experience and got trained in the management functions of the company! Therefore, when the father died, the son had barely two years of experience in the business; and he was not capable enough to absorb the skills required in management during this short period.
>
> Now, the son and his mother had all the powers (due to majority share-holding) to take decisions and there was no outside interference. But there was no one who could have helped him in his efforts. During his business experience, the element of keen competition had entered and the equipment of his unit was obsolete. There was no spark in the team of managers of the company. Besides, as we saw above, he had no strength to overcome all the problems. As a result, he had to sell off this once-prosperous company to another person at a distress sale price.

We cannot offer you a simple solution to the problem of how to groom a successor to your enterprise. Once the actual need of this successor is recognised and accepted, it will not be difficult to solve the problem—particularly for a person who has built up a big company from scratch.

The point is, it has become important in this age and time not to rest on your laurels merely on the fact of having set up a company or an industry on your own and keep all the reins of power in your hands. Simultaneously, it is vital to ensure that a second line of defence consisting of competent managers or at least one capable and trusted person is groomed to take charge of the unit. The entrepreneur should know his people well to be able to identify such a successor. He should generate enough trust in his close managers. He should, moreover, continue to delegate current management problems to either one or to a group of two to three of these potential successors. He should train them to resolve business issues through a planned career path under his overall guidance and thus develop self-confidence in them and offer opportunities to them to interact with financing agencies, suppliers, and clients dealing with the firm. It is not right to think that by training others, you will be creating a competitor to yourself. It is not easy for everyone today to establish an independent business. But it is quite feasible for managers to devote all their energies to serving with dedication, an entrepreneur who trusts them. To close all doors of your mind on this matter is to invite disaster.

All these problems are interwoven like warp and weft. Yet, to comprehend this subject adequately, we would divide the subject under four headings as indicated here.

14.3 TAX AND LEGAL ISSUES

The tax and legal aspects of a unit could prove to be a complicated maze after the departure of the founder entrepreneur. Besides, there are some modifications continuously taking place in these tax and legal areas. In every session of the Lok Sabha or Rajya Sabha, there are always some changes proposed and debated on tax-related subjects. Then, the law-courts of the nation, too, give new rulings on wills, estates and trusts. Their attempt is to clarify the legal implications and meanings of the relevant laws. In addition, every state has different laws on trusts and on taxes. So, we would merely suggest here that the reader realise the gravity and the coercive nature of these laws and seek advice of a competent advocate or a chartered accountant in time to sort out these problems or to avoid them before they occur at all.

14.4 PROBLEMS OF CONTROL

Even though the successor to the company's owner is a well-trained, dynamic person and is ready to take over, all efforts to bring in such a person will come to nought if the owner had no prudence in ensuring a smooth transfer of control. There is the instance of an owner-entrepreneur who had divided his shares in the company equally among the five successors. He was assured by these persons that the management control of the company would be in the hands of his son, whom he had also trained properly for the managerial functions. Unfortunately, it so happened that the other four successors got jealous of the son and never allowed him to function effectively.

Even if management control was to be decided by tossing a coin, it would be preferable to a useless and frustrating arrangement comprising five equal votes. Let us look at another example.

> In a company, a majority share-holding partner worked together with the other partner for many years in peace and amity. But the company's financial situation worsened due to severe competition in the market and consequent investment by the company in new

equipment and process of manufacture. Unfortunately, the majority partner had given his share and voting rights to his widow. The lady had no experience of business. So, she began making unreasonable demands on the other partner for cash and for her share in profits. Finally, she even appointed a private detective to watch the activities of the partner. As a result of all this harassment, the fellow died of heartattack a few days before the second death anniversary of his partner.

After all this, the creditors and clients of the company lost trust in the credibility of the company, which was without an effective leader, and the company began to face acute difficulties.

In some companies, control over voting rights is in the hands of a few persons and all of them take an active part in the management of the company. When this group of people pass on their voting rights to their successors or sell these rights to outsiders, the company begins to face rough weather. This happens because the company was successful precisely due to effective mutual cooperation between these helmsmen. To resolve this crisis, there should be a contractual obligation that the equity shares of the retiring/deceased partners will automatically be converted into preference shares. These shares earn a fixed percentage of dividend, but normally, preference shareholders do not enjoy any voting rights. Or, the executive of a company may be helped in the purchase of the company's shares from the retiring partners by giving him advance loans for the purpose. The point is to plan continued, unified and effective control of business for its smooth functioning.

14.5 PROBLEMS RELATING TO VALUATION

It is difficult to estimate the value (or worth) of a private business. If the government sets the value of the assets too high, and this is what usually happens, the estate will attract a heavy tax liability and the successor then has to go in appeal against the assessment, and this is time-consuming.

If this problem is resolved through well thought-out steps taken prior to the death of the owner, it becomes much easier to resolve the difficulty. The recent case of the battles for division between Mukesh and Anil Ambani of Reliance Industries, after the death of the founder and patriarch Dhirubhai, is too well known for further elaboration.

We would like to cite here, an example in which the company suffered because none of these steps was taken.

Mr. Randhir was originally an actor. He set up a unit to manufacture items used in the show business and that were invented by him for make-up and similar activities on the stage. Initially, his objective was to fill the gap in his time between two acting assignments and get some income from the manufacturing unit's activity. Some of the items were, however, of such excellent quality that, in no time, the business became brisk. When one of his products was taken up for marketing by famous beauty-aids firm on a sole-selling basis throughout the country, the annual sales reached a figure of Rs 200 lacs.

During these years, a number of people had offered to invest in the capital of the company. Similarly, a number of companies offered to sell their units to the company or to amalgamate their activities with that of the company.

Some brokers also offered to place the company's shares in the market for subscription. Mr Randhir never rejected any of these offers, but neither did he approve of any of them. Many competent persons working with him were sorely disappointed by his attitude of maintaining close secrecy about his business and delay in taking decisions.

He went against the advice of his chartered accountant and withdrew small portions from this income, so that his tax liability got reduced. He had invested a large portion of his income in government bonds on behalf of his company.

In the year 2000, his car collided with a steel pole of a fencing near the bend of a road. He had to be hospitalised immediately. There was no one within or outside the company to help him in running the business. Therefore, the company's affairs started deteriorating. Six months after the accident, he died in the hospital. His wife and daughter became the beneficiaries of his entire wealth. Neither of them was interested in running the business. To realise the estate-duty amount*, the value of the assets of the company was determined. A heavy tax was slapped on the cash invested by Mr Randhir in the company by the income tax department. This cash was invested from the retained profits of the company. The end result of all this was that Mrs Randhir and her daughter had nothing of value left except the sick factory.

*Estate-duty was payable at the date of the case. Now estate or death duties are completely abolished.

14.6 PARTNERSHIP AND OWNERSHIP RIGHTS

A number of legal issues crop up around partnership and ownership rights after the death of the principal owner of a company. These issues are in addition to those related to the routine management of the company. An expert on small-scale professional firms is of the opinion that the administrators of a firm have no right to continue running a business after its owner's death if the owner has not explicitly recorded such continuation in his will or without permission from a court of law. Besides, he says that if there is no partnership deed, the remaining partners should voluntarily liquidate the business after the death of one of the partners. It is best to obtain competent legal and financial counsel and guidance beforehand.

Management-Succession Crisis

- ***Long illness, accident, unexpected death or incapability of the entrepreneur***
- ***No one groomed to takeover management responsibilities in such a case***
- ***The second key person does not have sufficient shares in the firm***
- ***Failure to delegate, lack of planning, over-confidence—all taking their toll***

15

How to Avoid Management-Succession Crisis

We shall discuss the approaches to resolving the seventh crisis under the following seven points.

The Seven Points

- Remove all doubts and inhibitions regarding grooming a successor
- Identify and groom your successor
- Prepare a team of two or three instead of training one person only
- Groom a person with general management skills and abilities
- Keep your doors open for advice and counsel
- Write down and review your plans for the company and succession
- Take external advice regarding transfer of voting rights

15.1 SUCCESSION MUST BE PLANNED

Remove all doubts and inhibitions in your mind about grooming a successor who would be the person to steer your company's ship. Those who have managed to tide over this instinctive reluctance (to groom a successor) and have planned beforehand have been able to cope with this crisis successfully. That is, the companies of such entrepreneurs continued to function smoothly even after the demise, or permanent disability, of the main owner. But the companies in which the owners had not thought through the succession plans were invariably caught up in difficulties and there was no way left to rescue them.

15.2 SUCCESSOR HAS TO BE IDENTIFIED AND GROOMED

It is really difficult to keep tabs on all aspects of management of a small-scale unit. The diversity of functions and responsibilities handled by dozens of professional experts in a big firm have to be shouldered initially by the owner of a small-scale unit single-handedly. As the competitors gain experience in and knowledge of the intricacies of the business and as competition and the number of innovations in the manufacturing process increase, this task of managing the business single-handed becomes even more arduous. The task of grooming a manager-successor or developing a team from which one person can be selected as a successor is a time-consuming one because the business mission of a small-scale entrepreneur calls for multi-faceted skills. It is indeed improbable that, all of a sudden, he will come across a person who can quickly take up all his responsibilities. Besides, death does not wait for to be fully ready; it can come at any moment. Therefore, it is all the more vital to assume that the manager-successor to the main owner is ready to take charge at any time as per the needs of the hour.

The Estate Duty Act is now scrapped. In the Wealth Tax Act, too, there are far-reaching changes. All productive assets have now been taken out from the definition of 'Assets' for the purpose of wealth tax. Consequently, all business assets such as shares and debentures of Indian companies, deposits with business firms and companies, and immovable and movable assets owned by business enterprises are now exempt under the Wealth Tax Act.

As a result, tax planning for wealth tax will have to be considered from this new angle. Dividing the equity holding to minimise tax incidence is no more a wise step. Instead, it may be good business prudence for the owner to retain control over voting rights by holding a majority of equity shares in his name.

Moreover, during his lifetime he should select one of his heirs who has adequate aptitude, experience and capacity to run the show and should bequest the controlling interest in the equity shares to such an heir through execution of a will. This will ensure that the voting right of the enterprise is not diluted and at the same time no tax is paid at the time of transfer of the business assets to his heir.

To protect the interest of the widow and minor child of the deceased partner, suitable provision should be incorporated in the partnership deed to provide that on death of any of the partners, the firm shall not dissolve but shall be continued by admitting the legal heir of the deceased partner in the firm in place of the deceased partner. The partnership deed is not only a legal document but also a tool to provide for all contingencies that can be envisaged by the partners; for this, legal advice will help.

We would put it as a thumb-rule that when a person approaches the age of 50 years, he should organise the transfer of his property to his heirs. Further, he should begin to groom another dynamic person in his business. If the firm is a sole proprietorship concern, he should groom his son or relative or a trusted manager. If it is a partnership concern, he should begin to train his partner for taking over. A provision should be incorporated in the partnership deed to the effect that if the main owner dies, his heirs do not face any hurdles in obtaining their regular income from the firm. If the enterprise is a limited liability company, a suitable clause should be incorporated in the Articles of Association whereby the legal heir of the owner can be inducted as a director to the company. This will ensure continuation of all monetary benefits.

Therefore, it is advisable to get such an insurance policy beforehand.

Perhaps the best and most successful approach to training a successor is to go on assigning the various development tasks to a manager who is engaged in the company's regular functions. During such a period, the manager develops capability as a Chief Executive; he would also continue to function as a manager and the expense of his training (as a potential Chief Executive) will not be a burden on the company's kitty. The owner, of course, should be well aware of his personal responsibility in imparting meticulous training to this man and grooming him as a successor. The owner should also have the courage and insight to delegate authentic power and authority related to specific assignments in accordance with a well-planned career route. Someone has put it rather well: you cannot buy the trust and affection of people under you. Trust begets trust and affection spawns affection. The successor whom you have chosen might commit some errors in the beginning. But such errors should be considered a part of the learning process.

15.3 DEVELOP A TEAM

If the process of training the successor-manager is dovetailed with the day-to-day work of the company, the person continues to look after his assigned functions and responsibilities and also assimilates vital management information; thus, he gets trained appropriately. The same procedure could be adopted for training two to three competent persons in firms employing, say, 150-300 workers by training them for the entire management functions while they go on doing their day-to-day regular assignments. The fact that these two or three persons would be engaged in displaying their grasp of the important management functions is in itself an advantage.

An expert who has studied this subject in depth, is of the firm view that it is much better to prepare a two- to three-man team than to train one 'successor-prince'*. The reason is, with this mode of organising for

*See '*Management Succession in Small and Growing Firms*'. C.R. Christenson, Division of Research, Graduates School of Business, Harvard University, 1953.

the successor, these two to three persons face the challenge of showing their true competence. Usually, everyone knows that only one person is going to occupy the prized throne but before such a person gets selected and even after he is appointed, the entire team continues to take up and execute responsible tasks and everybody wins! Moreover, as the company's operations expand, the individual members of the team get first priority in acquiring independent charge of the company's new activities. Some companies begin to groom a manager-heir right from the beginning. In such instances, succession is a predecided issue. But even if such companies develop a core team for top management functions, the effort will not be wasted because the manager-heir, too, would need a successor after him.

15.4 GROOM A PERSON HAVING GENERAL MANAGEMENT SKILLS

It is good to bear in mind that the manager-successor may not necessarily be able to scale the high peaks of performance that the original owner did, however successful the owner might have been during his tenure. This follows from the fact that as the firm's business develops, the complexion of its activities too changes and the status of the competition also gets altered. When an owner of the firm is endowed with excellent capabilities in diverse fields (for example, he may be a highly competent engineer and a tough salesman), it does not automatically follow that the successor will have similar expertise. Such multidimensional competence is rare to find. Therefore, a correct way to resolve this issue is to groom a person with good managerial skills and abilities and to complement his strengths by developing different people possessing the owner's remaining skills.

15.5 ALWAYS BE READY TO RECEIVE EXPERT ADVICE

We have been insisting throughout this book that small-scale business firms should keep their doors open rather than closed. For example, you should induct persons in the board of directors whose advice and counsel could be obtained or would be available when needed. It is also good to set up an association of chief executives of firms similar to yours, in order to have an ongoing dialogue and discussion about economy and business. Establish close rapport with your bank manager so that you may obtain helpful advice about the relevant issues of financial management from him. Be friendly with the officials of the financial corporations and with the association of merchant bankers so that they will be ready to help you with guidance about the management of your company as well as financial matters. The point that we want to make with all emphasis is that competition in business is bound to get aggravated as time passes, so it is disastrous for a small firm to be circumscribed by a single individual's limited technical, managerial or personnel manage-ment capabilities. You may take it for granted that the days of the owner-manager who wants to run the show single-handed like some old-time movie star making films with himself as producer, director, hero, editor, financier, etc., are now over.

The counsel that you normally obtain from outside is probably most useful in resolving the issue of choosing a successor. The directors of the board are neither employees of your firm nor are they your relatives. Therefore, they can offer valuable help in overcoming the natural resistance in the owner's mind about grooming a manager-heir to the firm. Besides, as they have a wide network of contacts, they can also be of assistance in the search for a dynamic person. In some instances, such help is valuable in a crisis situation. If the outsiders have been appointed as trustees especially with voting rights on behalf of the deceased owner's group, they bring immense succour to the son-heir of the owner in the area of handling the company's affairs in the initial years. In an instance where the sons are minors and the affairs are entrusted to a manager-successor, if the successor proves to be incapable of managing the company's affairs, the trustee can remove him from his position and thus save the company from total annihilation. Moreover, when the voting rights are with the trust instead of with one individual, it serves the purpose of an insurance cover and guards against paralysing the company's operations due to internal dissension.

15.6 PREPARE WRITTEN PLANS FOR THE COMPANY AND SUCCESSION

We will discuss the need to have written documents pertaining to all the plans of the company (including the succession plan, even if in a tentative manner), in the subsequent chapter on planning. The reason for such advice is that rather than keeping all the plans in the head of the sole owner, it becomes easier to implement them if they are documented. What is more, implementation can be done accurately. These documented plans should be reviewed systematically and regularly at definite intervals of time. The succession plan should be reviewed once in six months.

This plan should not be publicised among many people while it is in a tentative, raw form. But at least one person (other than the owner) should know the details of that plan and its exact location.

When the main person dies all of a sudden, you can well imagine how useful the written documents of various plans would be to the successor. Especially the causes of the firm's success in the past and the perceptions of the earlier owner about the strengths and weaknesses of the company prove to be very useful to the successor when they are in a well-documented form. It is not necessary, of course, that all such views, perceptions and information be binding or serve to put brakes on the successor's efforts. But, it is essential that he become fully aware of how and where his perceptions differ from the basic recipe of his company's earlier success. He would thus be forewarned on this vital aspect.

15.7 TAKE EXPERT ADVICE ON TRANSFER OF VOTING RIGHTS

Each owner-entrepreneur must get sound outside counsel on whether he should entrust his voting rights in the hands of his wife, son, trustee (in case the children are minors) or someone else and whether he should permanently hand over his power to his son. When the owner treats all his offspring in an even-handed manner, it sounds nice and just. But, to scatter the voting control rights in this manner is sheer foolishness. In all such family-related decisions, strong administrative insights alone ensure the healthy growth of the company; then it becomes possible for all members of the family to obtain their shares from the profit of such a healthy firm.

We would recommend that you get expert legal advice on planning and management of assets (from the tax angle) as we have repeatedly mentioned in this chapter, because these are highly technical areas.

It is also recommended that, if you plan to set up a trust, you obtain expert legal advice in drawing up the trust deed.

Planning for Management-Succession

- ***Succession has to be planned—remove all doubts and apprehensions***
- ***Take advance action in selecting and grooming a management successor***
- ***Have one person with general management skills and few others with special skills***
- ***A team is better than a single "prince"***
- ***Invite competent persons on the board of directors***
- ***Develop a club of like-minded businessmen***
- ***Constantly interact with bankers and investors***
- ***Prepare a will, transfer shares***
- ***Brief your family about assets, liabilities and other key elements of your business***

16

Planning for Survival and Growth

Can a small enterprise owner aspire to introduce planning in his unit even though he normally does not have the necessary resources for it: expertise, scale of business, etc?

We have sifted through sufficient evidence about the running of business enterprises and firmly believe that planning is essential for all business ventures, irrespective of scale. Of course, the degree of sophistication in planning will vary. Small-scale enterprises cannot afford to neglect planning if they wish to survive against the onslaught of competition or new technology and market changes. This is one important reason for careful business planning. The other reason is that, somehow, the marketplace is not very 'forgiving' to small-scale units making unplanned moves, and such enterprises do not have adequate resilience to survive after committing a lot of mistakes. Therefore, such units have to make all business moves carefully and with a lot of calculation about the possible outcome of these moves.

Further, you can reap the same basic benefits as big, professionally managed firms if you formulate and implement a business plan rather than leave the business totally to the vagaries of fate (and stars!) by neglecting planning. Of course, as mentioned earlier, the actual process of planning could be somewhat different in small business units from that in bigger units.

16.1 GOOD PLANNING ENSURES SUCCESS

If a business unit has defined its business objectives and planned for achieving these with requisite thoroughness, it can also begin to learn many lessons from its mistakes and achievements. On the other hand, a company that does not plan for the future just wanders aimlessly and never learns any lessons to help it to grow and prosper.

Planning is Essential to Cope with Rapid Changes in Business Climate

In the past, it was okay if you did not innovate or develop the process of manufacture or technology to defeat competition, until your competitor developed your process equally successfully or a more competitive process of his own. Not so any longer. Now, if a company waits for competition to catch up with it, that company is on a path of self-destruction. So many rapid changes are taking place in society and in the global economy today that a company has to display a measure of entrepreneurial excellence. The risk inherent in fighting against competition can be minimised only with continual planning, follow-up and re-casting of the plan with the ultimate goal of succeeding in your business.

Effective Work is Accomplished through Planning Alone

Planning within limits of reasonable detail (and not obsessing about it) is certainly effective. Of course, you can also indulge in over-planning, and splitting hair over trivia, but as a prudent businessman you should know the fine line between a reasonable plan and a trivia-infested plan. So, we shall talk only about the practical approach to planning, where the ultimate emphasis is on *achieving planned results.* Through careful and meticulous planning, you can actually see the lacunae in your projections of production, your proposed new approach to marketing your products, or the new process of manufacture that you may like to introduce in your unit. And you can visualise these 'effects' of your proposed action at a low cost, because the only major expenses involved are that of your time (for thinking through the plan) and paper (on which you simulate these proposals) or the computer time for developing some simple mathematical models.

Imagine the consequences of implementing your proposals *without* such simulation and planning: the results may not be as you anticipated (they may be just the opposite of your somewhat rosy projections), and the outcome of it all is that you end up wasting your hard-earned money. If you plan, you will observe that a plan based on cold realities and hard facts of the market has greater chances of success than functioning on the basis of fancies, imagination, prejudices, ego-satisfaction, or just faith in astrology or god. It is true that there have been cases of total flops in forecasts based on market research. But in the majority of the cases, it is better to base our actions on systematic knowledge (of the market/technology) than on intuitive assessment. To express it differently, it is better to hold the torch of analysis and walk confidently than to stagger in the darkness of incomprehension.

Planning Augments Management Function

If the owners of small business firms do not plan their business activities, they succumb to one of the two delusions:

1. Some of them get tossed around like a shuttlecock and begin to assume that since they 'survive at the mercy of big (supernatural) powers, they cannot take any decisive steps on their own.
2. Some merrily gamble away their fate in business and depend totally on chance without planning for results.

   But once an owner of a small-scale business learns through experience that a systematic business-plan helps him take charge of his future even to a limited extent, he gets transformed into a sharp and confident entrepreneur.

Mounting Evidence in Favour of Planning

There has not been much research into the possible contribution of business planning towards success against competition, mainly because the very idea that small-scale firms should plan their activities is a bit novel. But, such evidence is now mounting rapidly. A survey carried out among successful small-scale business firms identified ten characteristics of such firms. Among these, the first three are:

1. They carried out overall business planning;
2. They planned for diversification in their product lines; and
3. They worked assiduously on new product planning.

Let us look at what a research report compiled by a university says about the causes of success and failure of entrepreneurs in the small-scale sector:

> The successful entrepreneurs adopt a decision-making style that is markedly different from that adopted by the unsuccessful ones. Successful entrepreneurs study and analyse as many probable outcomes of a decision as they can; they scrutinise a variety of feasible working processes in their line: they carefully weigh the pros and cons of different points of view. As the research study progressed, the data on success of those who carefully analysed various aspects of business and data on failure of those who neglected to examine such alternatives began to accumulate.*

**An Analysis of Environmental and Managerial Factors in the Success or Failure of Small Manufacturing Enterprise.* University of Iowa. Bureau of Business & Economic Research. p. 111, (1963).

Another institution which studied the causes of success as well as failure of small-business entrepreneurs has come to this conclusion:

> The vital difference between successful and ineffective industrial units lies in their approach to managing their activities. A study and analysis of the process adopted for management of the enterprises led to the conclusion that only those who manage their business systematically and intelligently, succeed. There was ample evidence to prove that these successful entrepreneurs plan their business activities well ahead and they carefully evaluate the probable results of the various options available to them.*

16.2 DIFFERENT APPROACHES TO BUSINESS-PLANNING

Some owners of small-scale business units believe that they can never plan their business activity ahead of time. The reason they give for this (wrong) belief is that only large business houses can afford the resources needed for such business plans, for instance, towards research laboratories, databases, scientists, economists, market researchers and other professionals, etc. They, the small business owners, simply cannot afford these 'luxuries'. All entrepreneurs say planning deals with the future, and it is too uncertain. What is the use of planning in the face of too many uncertainties! But, once the owners of the small business units realise what kind of planning they need for their own units and the methods with which they can really 'afford' to put this planning process on steam, they begin to implement business-planning for their firms for an increasingly longer duration of time. During a recent research project conducted by EDI, a number of owners of small-scale units declared that their top priority was to seek how to beat competition. When they were asked by the research team if they had evolved any plan to tackle the crucial problem, over 75 % had not formulated any concrete plan for this!

We have discussed the seven main crises in this book and these crises cover such aspects of a business unit's working as prudent management of finance, improving production planning, achieving growth through diversification, grooming a successor fully capable of managing the affairs of the company, etc. In fact, a common thread running through all the recipes for resolving these crises is the paramount need to plan well ahead of time. So, we strongly believe that even small business firms should implement the following two plans:

---

*E.J. Chambers and R.L. Gold, *A Pilot Study of Successful and Unsuccessfull Small Business Enterprises within Montana*, Research Bureau. Montana State University, P. 49, (1963).

The first plan:
Evolve a strategic plan to compete successfully in business so that the business rests on a strong foundation.
The second plan:
Through wise diversification strategies, reduce the risk to business, and through a carefully prepared succession plan, ensure a long-term continuity to the enterprise. Let us discuss these two plans in detail.

The First Plan: Beating the Competition

Under this plan you have to take basic decisions regarding the mission of your business and the strategies and policies of your company to win against competition. This is at the heart of business-planning and, as you would have guessed, it is also the most difficult. We call it the heart of the plan because here you have to use your discretion and choose those competitors whom you would like to 'take on' and also those whom you do not consider as a threat to your growth and prosperity. Besides, this choice could prove to be a lifeline for your unit or it may turn out to be a kiss of death. We have described it as difficult because, often, it is really a problem to get authentic data about your line of business and the opportunities and threats inherent in that line.

At the same time, you do not have to cling to the decisions about commercial strategy and policy once taken by you. Remember that success does not always repeat, and that even successful strategies have to be reviewed periodically. The need for determining the objectives and basic policies exists because these decisions serve the purpose of signs at cross-roads; they point out the roads that you have to take to reach your destination. They help to avoid confusion and chaos in the working of your business. It is obvious that if you are not decisive and go on changing direction, there will be no progress in any direction. Thus, progress and growth along a definite direction is possible only if there is a carefully prepared business strategy, comprising of well-defined objectives and basic policies governing your business. But, if there is stark and crystal-clear evidence before your eyes that shows the need to change the basic policy, there is no point in being fanatic by sticking to the old policy: it can do you more harm than good. The advantage with small business firms, compared to the big ones, is that the small firms are generally agile enough to implement changes quickly whereas the bigger firm cannot do so with a similar speed. So small-scale units should follow the middle path and remain flexible. They should carry out the necessary changes swiftly, if the need to do so is visible.

A small-scale unit has to remain competitive but has limited financial and technological resources. If we combine these two aspects, a strategic plan of a small-scale unit should have the following elements:

1. Avoid direct confrontation with larger firms, unless you can find a niche for your products or fiscal incentives, which make you competitive.
2. Concentrate the use of limited energies and resources of the company on a few key performance areas. Peter Drucker has put this aptly: "The pertinent point is not how to do things right but how to find the right things to do, and to concentrate resources on them".*
3. Compete with others from a position of strength. That is, evolve a strategy for competition in that specific area where the company has definite strengths. If we put this advice on its head, evolve your competitive strategy against bigger firms in those areas where they are weak.

These three points have been expressed by Henderson in the following words. "The majority of the companies waste their energies and resources after trifles to achieve miniscule change in the profit. But companies who achieve significant increase in success of their operations take charge of a few and fundamental aspects of business and scale peaks of success. These aspects are those where the company can enter the battlefield with the best armory of (business-related) weapons. These companies certainly do not fight competition in areas where the competitor excels. Moreover, they choose the place and time for battle in such a manner that they have a clear edge over their competitors. It is no doubt true that the decision about the ultimate strategy to be adopted depends upon the owner's insight, intuition and intelligence as well as his whole personality. But the alternative strategies must be examined and evaluated on the basis of careful analysis and thinking".**

A clever owner of a small-scale firm should decide and select a niche (a special place in the market) for his company skillfully. He should not blindly imitate big companies in matters such as choosing the fashion or styling of his products, determining the price of his products, or in any other area of competition. Besides, he should not be happy merely if the stocks increase. What we mean is that he should not enhance the production capacity of his line of business just to give an equal fight to bigger competitors through increased stocks. He should really follow the

---

*Peter Drucker, *Managing for Results*. New York; Harper & Row, 1964, p. 6.

**Bruce D. Henderson. "Strategy Planning", *Business Horizons*, Winter, 1964, p. 21.

advice given by the editor of a leading business magazine to small-scale units:

> Determine an area of activity where you can work more flexibly, with greater impact and where you can concentrate all your efforts in that particular area more effectively.
>
> This certainly does not mean that you should begin to manufacture a costly product or provide an expensive service. But it does imply that amongst all the clients for a specific product, there are a few who will prefer to go in for a sophisticated version of that product than buy the usual run-of-the-mill variety. Provide such a product to them. This further implies that you should make the best efforts to provide the items quickly. Cater to the demand of those special products that are in demand for a short time or during certain seasons. Give technical support to clients to resolve their problems. Take advantage of the geographical location of a site. Put more simply, if the market of your product is concentrated in a specific region or is only at a specific location, you can sell your products more economically. Briefly, therefore, take maximum advantage through careful planning, of the inherent flexibility of being small, your capability to enter into a particular market or exit from it or the facility that you possess to cater to a specific need or demand in the market.*

The niche (special place) that you select for your business activity should be such that some segment of clients would pay you for catering to that niche product-market segment. That is, there should be careful product planning to help your business exist in the market place. Many small firms are born just because the owner, at some point of time, had decided to 'become his own boss', or thought that he would earn a lot of money by starting his own business. It is certainly good to think like this, but this sort of dreaming alone cannot provide a sound foundation for the enterprise. A much more realistic and strong foundation can be laid by asking yourself time and again, just as the market researchers ask: why should anybody support this company or business? Which is that specific need of the people that it actually fulfils so that these clients can support the firm?

Professionals investing in small firms, for example, study four key aspects of a small firm and one of the important one of these is whether

*Bursk Edward, "*Pointers on Meeting Competition*", Management Aids For Small Manufacturers, No. 134 (Washington, D.C.: SBA, 1961), p. 2.

the firm has created a special niche in the market that can help it compete effectively.

We have cited the instance of Mr Shailesh Shah in an earlier chapter. Mr Shah manufactured and sold implements invented by him during the initial six years which were useful in the building-construction industry. He had designed these implements so skillfully that bigger instruments of a similar kind were not as effective.

The market for these small implements was not really big enough to attract large companies to enter that line of business; but the size of the demand was big enough to ensure that Mr Shah's firm got good business continuously. As long as Mr Shah continued to make modifications in the designs of these implements, there was no other small company that could compete with his firm.

But, later, some of his friends persuaded him to enter into business lines related to retail marketing of an implement for building construction as well as those related to the wholesale trading of other building construction items. Mr Shah could not develop a management team, and he had no experience or insight in the business lines that he had ventured into. So, his attention and money began to get wasted in these new activities. As a result, he could not devote adequate attention to his successful business line of two implements. Moreover, the production of the third and fourth items proved to be uneconomical because their basic design was faulty. Thus, during the subsequent six years, the profits of his company got drastically reduced.

The case of Reliable Steel Company, which selected a special niche for its products to guard well against competition is just the reverse.

The company, which was founded in 1967, had 250 workers on its payroll in 1976. It had created a special niche in the market by manufacturing stainless steel sheets and plates used in the production of stampings for aeroplanes, cars, refrigerators, hospital and dairy equipment and in the production of kitchen utensils. The competitors to the firms were giant steel companies and yet it had secured a 25% market share in the area of stainless steel sheets having a thickness less than 49 s.w.g. (standard wire gauge). The result was that the original investors of the company had already recouped their investment from the dividends of the company and the share prices had climbed to five times the par value.

Take again the case of Nirma, the soaps and detergent manufacturer. It has created a niche for its products and has competed successfully with multinationals like Hindustan Lever.

The case of Harshoday Company is different; this company created a special profitable niche for itself, lost that niche and then retrieved it again.

The company was set up by two brothers, Harsh and Uday, for the wholesale trading of fruits and vegetables. The original understanding between the brothers was that Uday would look after the outside activities of the company while Harsh would concentrate on the internal operations. The company began to make good profits right from the start and, after two years, they added a new line: transporting of goods by trucks. These trucks were leased to farm-owners, who supplied fruits and vegetables to the business. The new business was also lucrative. During the subsequent two years, the company began to transport items other than fruits and vegetables provided by the farm-owners. They also began to trade in engineering equipment. These equipment were sold to some of the farm-owners dealing in fruits and vegetables and also to other industrialists.

But as the volume of business grew, the profit began to decline. Though the company's original line of fruits and vegetables was the biggest revenue earner, the quantum of sales turnover as well as profit had begun to slide down; this caused anxious moments for the two brothers. Therefore, the company appointed a consultant to study and analyse their operations and to identify causes as well as to suggest remedies for this worrisome phenomenon. The consultant discovered that the main contributing factor for the success of the fruits and vegetable business was the wide network of Uday's contacts and the trust that the clients had in the company regarding the high quality of its goods as well as the basic integrity of the firm. But as Uday started paying more attention to the purchase of trucks and equipment, he paid less attention to his clients of fruits and vegetables. Besides, he had not introduced his salesmen to his established clients and thus had not imparted the advantage of his reputation as well as his business policy to his salesmen.

The professor-consultant recommended that Harshoday company quit all other lines of business except that of fruits and vegetables and the transport business. Besides, he proposed that the transport business be delegated to a general manager, who should be a person well-experienced in the line. As a result, Uday was once again able to devote more time to the fruits and vegetables business. He began to escort his salesmen whenever they visited the customers.

Before the year was out, the clients' trust in Uday's business policies was revived and the new salesmen started to see to it that the confidence was never shaken. Consequently, the sales turnover and profits began picking up instead of going down.

We have suggested earlier in this chapter that when you evolve your competitive strategy, you should take care to avoid direct confrontation with large and powerful competitors. We would like you to recall at this stage the case study of the tools manufacturing company.

An affluent engineer, who had recently graduated with honours from his engineering college had established a manufacturing company. He developed an industrial equipment, soon after the war with China, which was a forerunner to the equipment based on automation developed in the subsequent decade.

The owner perceived an excellent business opportunity in the manufacture of automation-based equipment and he launched an ambitious programme of developing other kinds of equipment in the company by inviting two of his rich friends to invest in the company. Each new item was likely to succeed in the market. But, the entire programme was beyond the capabilities of the six technologists working in the company. Soon, the owner discovered that the ambitions plan to develop ten new equipments was only half-done and in a haphazard manner. When he tried to induct more designers to help in the completion of the development project, the six technologists of the company went on a sit-down strike. They were not ready to welcome any 'outsiders' to the company. Finally, the owner decided to cut losses and wound up the project for development of four equipments. The other four equipment-designs were sold at a throwaway price. The company suffered losses for three years. At last, one of the remaining two projects was completed and the company began to earn profit out of that project. The company's operations stabilised and came back to normal.

The remaining component of competitive strategy comprises initiating special campaigns. These campaigns should be conducted as suggested here.

- Take up those tasks for implementation that are essential from the point of view of staying competitive. Some of these programmes could be for implementing new activities related to the competitive strategy; other programmes may focus on those competitive aspects that are to your advantage and continuously enhance such aspects.

- Then, you should take up tasks related to overcoming the first six crises (out of seven). Any firm on the growth-path will notice that it should begin to mobilise action partly for improvement and partly for prevention of some of these crises overtaking the business. We have already suggested in earlier chapters of the book, how you can cope with or prevent the different crises.

The following example is illustrative of the fact that the owner-executive of a company should constantly attempt to develop sound competitive strategy.

A company manufacturing tasty fast food items had a loyal clientele in Madison City of USA. The company's main plank to fight competition was to preserve the aroma of the food items and their freshness. The company achieved these qualities through constant improvements in the production of these items.

The president of the company believed that if enough effort and imagination were applied to work, there would be no limit to enhancing these quality aspects (aroma, freshness) in their products.

With such a corporate philosophy and strategy the company was quite successful in keeping the local, state-level competitors at bay. But a national-level giant company set up a plant in the region and began producing fried potato chips having an unrivalled aroma and fresh taste. The old company doubled its efforts and soon attained parity in terms of quality with the giant company.

Having attained this parity, the local company's innovative chief executive devised a strategic plan of competitive attack on the big company from a totally different angle. He assembled all his employees, their family members, and even his friends and challenged them to think of new innovative ideas that could be applied to potato chips.

As a result of this brainstorming process, he got many novel ideas about potato chips and began to develop ruffled chips, ultra-thin chips, extra-thick chips, tube chips, and chips having a variety of flavours. Out of the same process of creativity, an idea of 'non-potato' chips was developed. It was different from potato chips in taste and appearance and its sale skyrocketed in no time.

Even today, that old firm continues to occupy the first rank in the food products market. Besides, it is earning handsome royalties from three companies against licences given for manufacture of puffed chips in several big cities.

The Second Plan: Bracing up for the Future

We have discussed at length in Chapter 15 the need to groom a successor to ensure smooth running of the business after the owner's death. But over and above all this, there should also be a concrete plan to make certain that the company will survive in the future and be able to ward off any unexpected shocks in business.

Many entrepreneurs do not realise this need in time. We have already noted earlier that these are times when cut-throat competition can deal fatal blows to your company. In the good old days, it took a long time before an established business had to contend with a powerful competitor. But this is no longer so. With the suddenness of a meteor, a strong competitor appears in the business-sky. Earlier, a new competitor had to scale the same rungs of the ladder as the old one; therefore, nothing happened in a flash. In these modem times, though, a new competitor with far more punch in his competitive edge is born right in front of the old businessman, largely because of the advances in communications and new developments in technology as well as the availability of financial assistance. There have been so many breakthroughs in production processes, in manufacturing equipment and in launching new products that you often get a feeling that a new, powerful business is born before you can say the word 'competition'.

Many entrepreneurs of small-scale units believe that only big business ventures can afford to diversify, or rather, that such large business houses alone can indulge in it. Now, however, times have changed and events have been happening in such a manner that a company can survive only if there is a measure of diversification or improvement in its product-line. There are three ways in which established units can accomplish diversification:

1. They can expand the lines of business in related areas so that even if competition exerts pressure on the main line of business, the remaining lines remain unaffected.
2. They can acquire a second and related line of business, which can be easily handled by the managers of the original company.
3. They can amalgamate the unit with another business group.

It may appear at first sight that the advice given by us earlier about creating a niche in the market for your products and the above advice for a heavy dose of diversification are contradictory; in fact, they are not. If you treat the diversification effort as a sort of insurance against risks of putting all eggs in one basket, then you would be able to draw that fine line between diversification and creating a niche in the market. Diversification is to be undertaken only to safeguard against risks.

If you acquire another business, it is possible to achieve diversification but that route is full of landmines; it is hazardous and the usual background or experience of small-scale entrepreneurs normally does not equip them to safeguard against those hazards. We have already discussed this issue in detail in the last portion of Chapter 12 and will not repeat those comments here.

To amalgamate your unit with another is an even more complicated and difficult route to diversification than to acquire a new business.

However, if the exercise of amalgamation is planned thoughtfully, the small company not only achieves diversification but also tests the business acumen of its senior managers; amalgamation also helps to broadbase the marketing and financial structure of the company. If the owners of small-scale units can keep a check on their ambitions to become 'king-emperors' of their units, there is a lot to be gained by merging in ancilliary fields of activities with bigger established companies.

> We had cited an example of a furniture manufacturing company. That company joined hands with a musical instruments manufacturing company. Both the companies got a lot of benefits as a result. They could get the advantage of new sales outlets at a low cost. Moreover, one of the owners was good at developing business while the other was skilled in financial matters and accounts. Therefore, each of them entrusted to the other the area of activity where he was weak and thus was free to take up jobs that he could do well. Since the two companies had amalgamated into one company, they could utilise more effectively common facilities like warehouses, trucks and parking space for the vehicles. They also combined advertising and publicity and business development. Thus, each company got the advantage of extra facilities at a marginal cost. Consequently, each company grew stronger and could counter competition.

The lesson here is that you should not overshoot the budget of expenditure for any diversification or expansion programme. What you should aim at is that such a programme of diversification quickly pays for itself, that is, it stands on its own feet without drawing financial or other support from the parent unit. If you do not budget expenditure for such projects, you are likely to lose control over them soon. In the latter part of Chapter 12, we referred to some cases where the production of goods was increased and new units acquired. Such programmes for diversification and expansion of companies can be perceived as insurance for the future. If these measures are adopted at the right time, the company is not likely to experience financial problems. Often, it happens that when there is an urgent need for such expansion and diversification, the company faces shortage of funds at that very juncture. When the going is good and the business is running well, that is the point of time when the company should diversify thereby even availing of tax-shields.

16.3 NINE PROCESSES AND PRINCIPLES FOR BUSINESS PLANNING

Let us emphasise right away two important issues in business-planning.

Any Written Plan is Better than no Plan

A document pertaining to a business plan, however short and brief it might be, is much better than having no written document at all.

Make a Beginning

The only bottleneck in implementing a business plan is to initiate it; once started, it surely and easily gathers its own momentum and does not present difficulties in continuous formulation and implementation.

Till such time that you have begun to plan your business activities, such planning will appear to you to be somewhat unimportant and something that you can always do tomorrow (and you know that tomorrow never comes!). But once you begin to plan even in a small way, after having spent some hours on thinking through the plan carefully and putting it down on paper, you will soon realise that it is essential to plan your business activities more widely and deeply. This fact is established beyond any doubt and therefore we suggest that the owner of a small-scale unit plan for the future in the following manner.

1. Draft a brief and concise statement containing responses to the issues relating to competitive strategy posed at the beginning of this chapter.
2. Prepare a work-sheet with a time-bound action plan pertaining to the seven crises to the extent relevant to your business. Of course, there is no guarantee that a plan is properly drafted just because it is in a written form. But the reverse is certainly true: unless the plan is put on paper, it does not have any meaning. There is a third aspect closely related to these two aspects.

Do it Yourself

Ensure that a large part of the homework of formulating the business plan is done by you, the owner of the firm. It is no doubt true that the owner of a small-scale unit should get all necessary help from his assistants and advisers. But unless the owner has put in hard work in the conceptualisation and preparation of the business-plan, the plans will be without any teeth, because he will not have any real emotional attachment or commitment to the plan; the plan would not be his baby after all!

We strongly believe, based on our study and observations of hundreds of units, that a small-scale business owner, who cannot devote even one hour per week to think quietly over his present and future had better quit business; he should hand over his business to someone else to look after. An owner who does not care to formulate the two plans (competition and survival) described in this chapter is like the head of a family who postpones taking insurance on his life.

It is Not About Playing with Figures Alone

Don't just play around with numbers in your business plan, please. Some owners believe that once they decide on a few figures, the planning is over! For instance, they determine that by such and such a year, the sales turnover will reach a particular figure; the production cost of the goods sold will be a certain figure and the profit will touch this point on the graph, etc. It may be that assigning such precise numbers to your goods is somewhat satisfying but it is most certainly not effective in the overall sense. For, what is more important is to chalk out carefully how you are going to steer your business, to plan the different activities; only then will those 'precise numbers' help you and become meaningful.

For instance, there are programmes of enhancing production, of expanding product-markets, setting up retail outlets and ensuring that your products reach those outlets. Careful thought about these programmes would facilitate taking big, small as well as routine decisions and, what is more, the owner would then have a yardstick by which to measure the progress. A seasoned business-planning expert goes to the extent of advising businessmen not to assign any numbers to the goals of their business, till they have resolved, crystallised, and, in the words of Peter Drucker, 'thought through' all the basic programmes and plans. Only after the various programmes have been finalised do such numbers take on valid and useful meanings in the minds of the entrepreneurs.

Plan must be Based on Relevant Information

There is no doubt that a business-plan founded on the analysis of relevant internal and environmental information is much more valuable than a plan formulated without such a basis. Many owners of small-scale businesses get frightened by the word 'research' and immediately react by refusing to have anything to do with it. "We have no time for research" they exclaim, "and neither do we have any experts for research work." But, we assure you that if you exert a little effort for research, it will strengthen your plans. Moreover, research is not as time-consuming as many people think. Research is persevering to know.

There is a large reserve of data and information with raw material suppliers about the industries to whom they provide. The owner of a small-scale unit can obtain useful information about these industries if he really works at it. Trade associations and professional groups, too, have a lot of useful information. Local universities, libraries and government agencies (especially the Industries Department) have an astonishing fund of vital information virtually 'on-the-tap'. A junior assistant of your own company can also dig out a lot of preliminary and basic data for you. A consultant or adviser can, after only a few days of concentrated work, begin to provide such a valuable flow of information to the small-scale businessman that, for a long time thereafter, the businessman continues to utilise that reserve for the growth of his business. At times, it pays a lot just to subscribe to journals in your own line of business or 'information service'. It may also be necessary at other instances to organise regular opinion polls and surveys to know which way the wind is blowing in the market. The national TV network now brings out good programmes on the economy of the country. These are rich sources of information and present different points of view as well as statistics in a professional manner. The new boom of DVD's and CD's by private agencies has encouraged reputed institutions such as EDI to bring out new audio-visual material on business and industry. These, too, are worth studying.

Soon, small-scale business units will be able to obtain valuable facts and information for effective business-planning at low cost. Many a time, the money spent on such an effort pays back many times over due to result-oriented planning and control of shares.

Once you begin to formulate a business-plan and start putting on paper the competitive strategy decided on and fill up the work-sheet on the survival plan, you will surely begin to get a clear idea of what information and facts you need to finalise the plan. This step (your being aware of the information needs for your activities) is in itself a giant one. The second vital step that you may take is to engage the services of a knowledgeable person to dig out facts and figures periodically.

Get Your Business Plans Checked by Outside Experts

If you want the business-plans to be realistic, you should have a clear idea about the strengths and weaknesses of your company. In that context, an outside person usually displays objectivity about your company's affairs, compared to the owner of the firm (that is, yourself) and persons who are connected with the company's business affairs. Self-analysis and introspection are difficult processes. This is especially so in the case of the founder-owners of small-scale units, who are self-confident, self-centred and, at times, smug individuals. To refuse to see yourself as others perceive you contributes heavily to the drafting of business-plans, which resemble an imaginary, fairy-tale-like situation; such a plan has no basis in reality.

Moreover, to plan effectively, a lot of new creative concepts and constructive ideas are essential and as it happens many a time, the possibilities that an outsider can see in your company may not be so easily visible to you and your people.

Therefore, in light of these two reasons, get your business-plans checked and evaluated by outside experts. Of course, they should be persons who will guard the confidentiality of the information.

All Plans May Not Materialise; Plans May Change

Even if the long-range action plans of your company are not implemented word-for-word and even though changes might have to be made in the plans, this does not in any way dilute their value and importance. For, such plans help the owner and others in the company to keep in view the basic mission and goals of the company when taking routine day-to-day decisions. Thus, the company does not get entrapped in a complex and confusing maze of alternatives but stays on a straight, well-defined track. If the period of long-range plans extends well into the future, you can go on checking and verifying the goals and the objectives of the plans at shorter intervals. Equally important, you can actually make the necessary changes and do the 'fine tuning' based on the experience that you gain and the changes that have occurred in the business environment in the interim period.

Don't Allow Planning to Become a Routine Exercise

Here is a word of caution: the person who formulates the business-plan should keep away from the heavy burden of administrative tasks involved in the process or from the fancy notions of a 'complete and perfect' plan. Whenever you find that the work of drafting the plan assumes the shape of a fat pile of documents, when the activity of planning is 'taken over' by the 'assistants to' the chief executive in his absence, or when that spark and vigour is absent in the business-planning activity, you can take it for granted that instead of effective planning, the phenomenon you see before you is routine targeting based on historic trends.

Planning Without Control is Meaningless

Planning without proper control over the process is like flying on the wings of imagination; it is meaningless. The owner who wants to achieve results as per plan, should check the progress achieved from time to time and correlate it with the plans, religiously and formally. If the long-term plan had projected that the business unit would attain a certain goal at the end of four years, it should be feasible to retrace one's steps and check where the unit is now, in terms of that goal. Moreover, short-term goals (in relationship to long-term ones) should be included in one year's or two years' budgets and in the list of priority tasks. This has two positive outcomes:

- You begin to accrue funds for the initial milestone of the business plan.
- You get a chance to compare the assumptions made in the business-plan with the actual events in the marketplace from time to time. And thus, when you begin to systematically compare the assumptions with hard facts emerging in the present, the chances of your achieving success as per your business-plan begin to improve.

Besides, when this systematic process of review begins as an integral part of planning, you grasp the validity of your business-plans and underlying assumptions and the extent to which you should modify them.

16.4 CAN THE LONG-RANGE (OR STRATEGIC) PLANS OF SMALL FIRMS SUCCEED?

In the earlier chapters of this book, we saw a number of real-life cases of firms who ran into deep trouble because they went ahead with their work with smugness. With the benefit of hindsight, we can clearly trace out the events leading to the dire straits in which these companies found themselves. But, in some of these instances, if even a normal degree of forethought had been exercised, a number of blunders could have been avoided initially itself.

Had the owners followed with care and discipline the process of planning, they would have been able to rescue their firms from the blunders fairly easily without help from market research specialists, experts or consultants on planning and other areas.

Finally, let us take a look at two cases: the first, of a company that had prepared its business-plan without any outside help and had also implemented it, and second, of a company that had obtained assistance from outside consultants.

> Two brothers acquired a company engaged in credit rating of firms, in 1980. At the time, five persons were working in the firm. By 1985, the company was well-established in the region and business began to thrive.
>
> After five years of steady income and profits, both the brothers took up the work of preparing a long-range plan to give shape to their concepts and ideas. They began to execute this planning on their own without any help from customers or market researchers or business planning advisers.
>
> At the core of their plans were two intentional actions which would actually reduce the operating profit of their firm. Thus, they could avoid payment of corporate (and personal income-tax) amounts and utilised these amounts, to a certain extent, towards investment in the development programme of their business allowable for tax deductions.
>
> One of these two steps taken by the brothers was: out of 38 employees, they assigned the work relating to the future of the company to two of them. That is, these two persons had to apportion half of their working time to think about the company's future programme and ways to realise these programmes. The other step taken by them was to invest in equipment and instruments to help in the identification of persons, in investigation and in 'security' matters. This equipment had only recently started being sold in the market and the company did not actually need those items for their routine activities. Whenever possible, the cost of these items was written off from the company's books so that there would be no burden on the company's books of accounts in the future due to

these purchases. In other words, all these purchases were made on the basis of saving in tax and thus, it was a revenue expense.

The assignment given to the two persons who were asked to devote half their time for the company's future projects was to find out different wide range applications of the above equipment. In two instances, the company could obtain some income from the results of these efforts and thus could provide a degree of support to the effort. In another case, the company could develop a new and modern line of business as an outcome of these activities: to carry out special investigations.

Both the brothers were convinced that this new activity was sure to blossom into a new business line, and that after some time, it would be possible to sell the new business as a sound activity. And when this happened, they knew that the net profit after paying capital gains tax (which is the tax on profit accruing when you sell an asset) would be many times the amount of net profit after tax, which they had sacrificed for implementing the project.

Once this business (of methodical special investigation) had been sold, they would try and rotate the wheel once again. In fact, they already had a clear idea of a further novel business activity which could be a spin-off from their existing business.

A fall-out of such an effort is the development of executives of the firm itself; that takes place almost inevitably. The two persons who were assigned the task of building future projects and especially the one who was assigned to develop the special investigation business has learnt a lot of new things from the assignment. Actually, out of fifty employees, they have now these two persons who can take charge of the unit, if one of the brothers is not present.

Let us look at another example: an account of how a company having a sales turnover of Rs 13 lakh formulated a proper system of business-planning and implemented it.

After the boom following the war with Pakistan, Sovereign company's activities were confined to the strait-jacket of flexible shafting and concrete laying equipment. These two business lines were, in turn, dependent solely on two customers: the Navy, which used the shafting for remote-controls and a large chain-store, which utilised the shafting for household equipment.

In 1973, the company launched its first phase of business development. It was mainly related to finding new applications in their current lines of business and to identifying new clients for their existing business by becoming more competitive.

In the second phase, the company began a market research programme. They administered a questionnaire through their dealers among their clients to find out the defects perceived by the clients in their concrete-laying machinery. From this study, it was concluded that a rotary trowel for laying concrete would be useful in practice.

The management of the company immediately commissioned a market research agency to find out the following:

- What is the USP (unique selling proposition) of the new concept, what are the likely disadvantages and which new features could be added to it?
- What would be a reasonable selling price of this item in the market? How to ensure that the patent or designs and concept of the item are not violated?

The market research experts submitted their report after 11 months at a cost of Rs 1,40,000.

In 1980, the company reported that their sale had touched a figure of Rs 40 lacs, the number of their clients had increased and the newly designed machine was selling so well that the expense incurred for innovating it could be recovered in just one year.

Planning for Survival and Growth

- ***Entrepreneur's attitude, psychology and behaviour are more important than functional knowledge of management***
- ***Crises primarily due to internal causes (the entrepreneur)***
- ***Planning is a prerequisite of success, especially for small-scale enterprises***
- ***Do not entertain the myth that entrepreneurs are high risk-takers, always in a hurry and never plan***

A FORM FOR PLANNING IN INDUSTRY

	1st Year First 6 Months	1st Year Next 6 Months	2nd Year First 6 Months	2nd Year Next 6 Months	3rd Year First 6 Months	3rd Year Next 6 Months	Remarks
1. Planning for competition							
A. Action required to improve capability in the current competitive situation: Improvement in production, advertisement, sales distribution, etc.		Mr A	Mr A		Mr A		Enlarge the traders network selling your production; improve the quality and level of such merchants; increase advertisement so that new traders are helped.
B. Next step in improving competitive capability: introduce new production, undertake market research, develop new markets.	Mr A			Mr B	Mr A	Mr B	Market research to determine the nature and characteristics of new production; designing and testing of new product; production and marketing of new product.
C. Actions to avoid the various crises affecting the firm:							
(I) *Starting crisis:* Inadequate	Mr B						Attend various seminars during summer holidays

	1st Year		2nd Year		3rd Year		Remarks
	First 6 Months	Next 6 Months	First 6 Months	Next 6 Months	First 6 Months	Next 6 Months	
managerial experience, inadequate arrangements for accounts, insufficient capital investment, etc.	Mr A						on planning and management.
(II) *Cash crisis:* Determine how much cash is required: arrange for short term capital before the crisis comes.			Mr C				Recruit a key person for accounts and train him.
(III) *Delegation crisis:* Developing an able person for the second line or making arrangement so that the key person can be released.					A new person		Making a list of sources of funds. Make a plan; evaluate.
(IV) *Leadership crisis:* Grooming key executives, monitoring and							

	1st Year First 6 Months	1st Year Next 6 Months	2nd Year First 6 Months	2nd Year Next 6 Months	3rd Year First 6 Months	3rd Year Next 6 Months	Remarks
managing by paper or communication, effective use of time.							
(V) *Financial crisis:* Learn to assess what kind of financial arrangements are required and explore ways and means for implementing them.						Mr C	Appoint experts and evaluate the capability of the existing team for handling the problems of planning.
(VI) *Prosperity crisis:* Restrictions over complacency, controlling over ambitious steps.							
D. Actions for improvement not covered in A, B and C above.					Mr C		Collect information about productivity of your workers. Compare with current standards. Prepare a programme for improvement in productivity (see options in Chapter 8).

	1st Year		2nd Year		3rd Year		Remarks
	First 6 Months	Next 6 Months	First 6 Months	Next 6 Months	First 6 Months	Next 6 Months	
2. Strategy for future survival and management-succession crisis							
(a) Recruit and groom management successor					Mr C and Advocate		In financial planning, include maximisation of liquid assets (see actions proposed in Chapters 8 and 12).
(b) Plan how much estate to keep after death, control over votes, taxation.							
(c) Diversify							

Index

Accounts 6, 11
ADR 79
Amalgamation 54, 140
Assumption 25

Bidding 6
Break-even 14
Business environment 2
Business performance 3

Capital 6, 9, 14, 35
Cash 26, 41
Cash flow 41
Cash management 34
Cash-in-hand 32
Communication 59
Competition 8, 137
Competitive 107
Complacency 95, 106
Controller of Capital Issues (CCI) 81
Credit 26, 36
Crises 1

Debt equity ratio 80, 84
Debts 34
Decision-making 50
Default 39
Delegation 46, 57, 58
Deposits 83
Diversification 37, 139, 140
Dividend 87
Entrepreneur 3
Equity 79, 80
Estimates 6, 14, 15, 16, 23
Expansion 34
Expert advice 124

Failure 8
Financial institutions 88, 89
First generation entrepreneur 100
Fixed assets 32

Gestation period 15
Goodwill 40
Grooming 50, 120, 124
Growth 79, 128
Growth path 1, 138

Indispensable 47
Inflow and outflow 33, 42
Intoxication 105
Investors 27

Large-scale operations 1
Leader 57, 58, 67, 78
Leadership 62
Leasing 79, 90
Lender 3
Liquidity-profitability 26, 31

Management 10, 76, 127
Market plan 7
Market-place 2, 108
Monopoly 30
Mortgage 27
Multi-faceted 8, 122

Non-secured deposits 84

Optimism 20, 21
Overshooting 140

Patriarch 117
Planning 128, 129
Preference share 79
Production 27

Profit 8
Profit margin 34
Profit-orientation 1, 32
Project ideas 10
Promoter 79, 80, 82
Proprietor 47
Prosperity 95
Public 79, 94

Root-cause 6

Sales 8
Short-term and long-term 34, 35, 89
Small-scale 21
Spurt 7
Stagnation 6
Status quo 108
Strategic 10, 13
Succession 113, 114, 121
Successor 115, 121
Suppliers 89
Symptoms 3

Taxes 7, 17
Team 123
Term loan 79

Underestimate 17, 19, 26
Underwriters 84
Unsecured loans 79

Valuation 117
Voting rights 121, 126

Work-in-progress 35