

Small *and* Medium Enterprise *in the* Changing Economic Environment



Edited by

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Preface

While preparing this book, we have collected the relevant materials from government publications, published and unpublished sources, books, journals and articles by eminent scholars and entrepreneurs to us.

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We are very much thankful and grateful to SSDN Publishers & distributors, New Delhi, who has accepted our proposal on telephone in publishing this book in spite of his heavy pressure during the beginning of this session.

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We request to the colleagues in the teaching profession, students and all others who are interested in the *Small and Medium Enterprise in the Changing Economic Environment* is requested to send their valuable suggestions for the further improvement of this book.

Editors.

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Prospects and Challenges for Small and Medium size Contractors of Assam

**Dr. Chimun Kumar Nath*

Introduction

In India and other countries there seem to be general consensus that small enterprise are the mainstay of economic growth and prosperity. Small contractors can be powerful instruments of generating job opportunities as small contractors can perform small projects at different and remote geographical locations that might be unattractive to big firms or too costly for the big firms; low overheads enable small contractors to work at more competitive prices; large number of functional small and medium scale contractors can help to decentralize the construction industry dominated by established large contractors; the relatively low skills and resources required at this scale can easily lower the entry point for the small and medium size owners to begin to participate in the industry; and a large number of functional Indian owned contractors can develop a platform for growth and

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redistribution of wealth in India. Small businesses represent over 95% of the total number of business organizations in the United States of America (Abdelsamad and Kindling, 1978). However, Thompson (1991) points out those small businesses employ six out of every ten people and have been responsible for more than half of all the innovations developed during the 20th century. Haswell and Holmes (1989) attribute small business failures to the following: managerial inadequacy, incompetence, inefficiency and inexperience in running a business venture. At a time when the public sector and big business are shedding jobs, small businesses are maintaining real employment growth. The paper first outlined the arguments that have been put forward for the development of small contractors in the construction sector in South Africa along with some international experiences on MSMEs. The reasons for utilizing the methodology of the growth of contractors of South Africa is that prior to their development the economic situation in South Africa is somewhat similar to that of India (Ngala et al., 2005) in general and Assam in particular as both were suffering from discernible economic growth. In the second part, the paper described the problems and successes that have been experienced in Assam in relation to small contractor development programme. Lastly, the paper concluded with recommendations for the future which will enhance the success of small and medium size contractors in Assam.

Emerging contractors in South Africa

In South Africa, the contractors enter the market at the lower end and in the general building contracting category, making the sector extremely competitive and unsustainable (CIDB, DPW, CETA, 2005) and the emerging contractor policies intended for black economic

empowerment (BEE) are being used as job creation opportunities, which contributes to the overcrowding of the emerging market. It is common for black businesses to be based on technical skills which are used to satisfy needs of the community. However, technical competence is no guarantee of business success. Operational (e.g. scheduling and ordering) and business (e.g. planning, financial control and budgeting) skills are vital to the success of any enterprise. It is precisely these skills which are often lacking in the black business and it is thus imperative that these skills are developed if the Industry is to expand to accommodate the meaningful black presence that is necessary for economic growth. Small enterprises contribute positively to the economy of the country and to the survival of large numbers of people. However, the success of small enterprise is impaired by the common weaknesses from which many enterprises suffer. South Africa is faced with a large challenge of developing infrastructure in the communities which were previously disadvantaged, and also upgrading the existing infrastructure to cope with the high demand. This category of contractors is the preferred vehicle of delivery of infrastructure to communities (Ngala et al., 2005).

Financial constraints

The high competition among emerging contractors has contributed to increase financial failures of the emerging market, making the market unsustainable. The (CIDB: 2005) states that the large numbers of emerging contractors have moved into higher value public tendering in the R0.5m to R2m market, which is also becoming overly competitive. Emerging contractors should not tender for higher contract values until they have gained enough experience and have financial capacity to handle

the Statistics South Africa (2005) states that from 1995 to 2005, about 5907 construction companies were formally liquidated. The CIDB (2004) states that much more than 90% of the emerging black contractors survive the first five years. The CIDB further highlight that 1,400 construction companies were liquidated over the past three years larger contracts.

Emerging contractors feel that the banks are reluctant to deal with them unless they pay exorbitant interest rates and through compulsory business management services. Complexity, risks involved in the construction industry have led to enormous failures especially in small contractors and those small emerging contractors harboring the wrong impression that there is quick money to be made are the mostly affected (Ngala et al., 2005). Lack of access to finance both during pre-construction which disqualifies emerging contractors from meeting guarantee and performance bond requirements and during construction which leads to cash-flow problems, incomplete work and even liquidation are financial constraints facing emerging contractors.

Relationships between emerging contractors and suppliers

Emerging contractors do not have good relationships with their suppliers. In a functioning relationship, the material supplier provides credit to the contractor (30 - 90 day term), contractor pays on time and the cycle gets repeated. In an emerging supplier relationship, the supplier requires cash upfront and will not deliver the material until payment is made in full. The reason for this is if the supplier provides credit to the emerging contractor, the contractor is often unable to pay on time due to capacity or performance constraints. The reluctance

by suppliers in the relationship with emerging contractors is caused by the following risk factors:

- I. History of emerging contractor's failure to complete projects which is very high.
- II. Systematic contractor payment processing delays, especially for construction works commissioned by the public sector.
- III. The potential for material losses due to theft, lack of appropriate storage and mismanagement by emerging contractor.

Late payment by clients

Emerging contractors run into problems due to late payments by the clients. A problem arises when the local council runs into budget difficulties and is unable to pay. The emerging contractor does everything right, his work is of good quality but the local council doesn't pay on time and the contractor ends up owing the bank and defaulting. The unlucky contractor, failing to repay loans on time had his business put into liquidation.

Difficulties when running a business

The Construction Industry Development Board (CIDB) has presently concluded a reform measure which is used to grade the contractors, which are to a certain extent being contested at some quarters (CIDB, DPW, CETA, 2005). All these reform measures tend to concentrate on how to make projects accessible to the black contractors. They do not change the complex conditions of the contract performance procedure; they do not equip the contractors with the required capacity or competency that can achieve success.

In South Africa, problems facing small emerging

contractors in the contractor development programs according to CIDB, DPW, CETA (2005) are as follows: usually open adverts are placed in the media calling on people to come out and participate; it is very difficult for a selection process to capture those with the proper drive, passion and ability to work as contractors; this brings wrong people in the programs and drives them easily on the way; the required academic qualification is usually matric or less; no prior technical and managerial skills or experience in construction related fields are required; few matric holders make rare success; most successful contractors have degree or diploma in construction related field, with 5 - 10 years technical and managerial work experience; inadequate training done at short period's inbetween projects; unsuitable for the contractor's time and project need; inappropriate trainers; clear-cut grading criteria had been elusive; recently CIDB graded and categorized the contractors.

Due to lack of collateral, any one that gets credit from banks is subjected to high interest and financial risk management charges that make contracts unprofitable; in the ambition to grow big and make big profit, most of them take projects they do not have the necessary skills and financial resources to execute; the contractors tend not to employ qualified workers; they consider them expensive, but they fail while doing things all by themselves or with cheap, incompetent workers; they lack skills to properly program projects resources in monthly segments for healthy cash flow; they are not allowed front load due to lack of trust; they do not know how to prepare documents for timely payment; delayed payment; they do not seem to understand terms of contract conditions; do not know how to use applicable contract performance procedures to deal with clients;

they do not get properly trained in this. They are usually considered incapable of doing competent work, which imperils their relationship with the client's agent; they do not seem to know how to use applicable contractual instruments regarding instruction, demand for specific performance, and payment; they are not properly trained; where they know these rules they fail to use them due to fear of being 'red listed'; in an attempt to make huge profit they cut specified quality, do bad work that falls short of the design standards and specifications. Rejection of such work usually leads to non-payment, conflict and in most cases collapse of the contractors; and those that manage to win profitable contracts get only 2% profit if they are able to successfully complete the project; the situation seems discouraging.

International experience with regard to small and medium enterprise

In order to get a broader perspective of the environment and conditions within which contractors or Small Medium and Micro Enterprises (SMMEs) operate, it is imperative that we look at similar situations of small enterprise development in other countries. Bangladesh, Singapore and Malaysia have grappled with similar situations as far back as the post Second World War reconstruction period. These countries in different ways have a longer history and applied experience with regard to the development of a small business strategy. However, it must be recognized that different circumstances supported their initiatives, despite common experiences of the war devastation. In spite of positive circumstances in the above economies for Small Medium Micro Enterprises (SMMEs) to prosper, the strategies took at least ten years to unfold. This provides us with

the opportunity to learn from other countries' experiences, both useful and harmful, for Swaziland's unfolding small business strategy.

All three countries add a different perspective about 'international best practice'. International best practice in these countries suggests that a strong institutional framework displays the following characteristics: a combination of financial and non-financial services delivered by separate institutions in close co-operation as part of a national strategy; targeted finance programmes i.e. broad based, industry based and sector based schemes with focused assistance e.g. machinery, factory premises, raw materials, training programmes and technology; a detailed and comprehensive 'economic umbrella plan' with targets i.e. an overall vision and the inputs to be invested with clear detailed outputs within particular time frames; avoidance of ad hoc and disconnected Small Medium and Micro Enterprises (SMME) programmes. Programmes are part of the larger strategy or plan (Jaafar and Abdul, 2005). A rapid delivery of programmes and an ability to rapidly shift programme focus and resources; ease of access to users; demand driven support; and a platform for interaction between public and private sectors with a strong emphasis on the planning role of the state.

Methodology

This was a descriptive survey of the current challenges and problems facing small and medium size contractors in Assam. 87 respondents were interviewed which includes consultants, contractors, financial institutions representatives and government officials. The respondents were distributed all over the state. Contractors and consultants were chosen by judgmental

sampling and analysis, and partly purposive decisions in order to have a wide representation of contractors and consultants in the sample. Two methods were mainly employed in primary data collection. These are in-depth interviews and questionnaire methods. Data was collected between the 1st of June 2010 and 30th July 2010 and 87 respondents were interviewed.

Findings

The problems facing small contractors are not unique to Assam. The vast majority of construction firms are small enterprises that rely on outsourcing personnel as required. This has severely affected skills training and the retention of expertise in the industry as construction workers become highly mobile, walking in and out of the industry, depending on performance in other sectors of the economy. The impact can be seen in the rigid adherence to management techniques and construction practices handed down from colonial times which, which result in inadequate skills and capacity. Delays with interim and final payments, as well as onerous contract conditions faced by construction firms, can also impose huge constraints on the industry. Many construction firms have suffered financial ruin and bankruptcy because of delays in payment, which are common with government contracts. Contemporary research that was conducted in 2010 by the author revealed the current reasons for the failure of small and medium size contractors in Assam. 87 owners of the small and medium size contractors were interviewed. 68% of the contractors were less than four years; 20% were between 5 and 9 years; and 12% had operated for more than 10 years. There was no contractor that had operated more than 15 years. 63% of the respondents believed that the four major banks in