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Organizational challenges in the Indian SME Sector: An Exploration

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ABSTRACT

There has been an increasing level of interest, among government and industry constituents, in the growth of the SME sector in India. There is today a recognized need felt for the transformation of firms in this sector from a hitherto 'family-owned-and-run' orientation to a more 'professionally managed' one. This transformational process unfolds several challenges to the organizations in the SME sector. This exploratory study, on a sample of auto-components firms in the SME sector, located in the Tamilnadu Capital Region of Chennai, has the objective of furthering our understanding of the specific challenges faced by these organizations. The case-study method has been used to carry out this study. Areas in this sector that need immediate attention have been identified. A couple of propositions based on this study, related to the source of organizational transformation and to the major challenge to firms in this industry, have also been put forth.

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1. Introduction

Micro, small and medium enterprises play an important role in the Indian economy, serving as the engines of growth. This sector accounts for about 39% of the manufacturing output, by value, and around 33% of the country's total exports (www.msme.gov.in – web site of the government of India's Ministry of Micro, Small and Medium Enterprises, accessed on Dec 29, 2008). This sector provides employment to an estimated 31 million persons in India. Increasing globalization with its impact on the Indian economy is posing a lot of challenges for the MSME sector (Annual report 2006-07, p. 1). It is important to identify a few concrete challenges so that they provide directions to tackle them and help integrate this sector even better into the Indian economy. Hay (1994) has analyzed the barriers to the growth of SMEs and found that internal barriers play a more deleterious role than the external ones. This study, in keeping with Hay's observation, attempts to unravel organizational-level challenges present in this sector.

2. Research Objective

This exploratory study aims to investigate the nature of the challenges to the further development of one specific sub-sector within the MSME fold – the auto components industry. This identification would facilitate providing certain inputs for a more comprehensive, large sample study that the authors intend carrying out in the future, that could help direct specific aspects of government policy and support to this sector.

3. Method

This paper is based on three case studies of firms. Two of the firms fall within the MSME category as specified by the Government of India Act. One of them, though long within this category, has now grown large enough not to strictly fall into the MSME purview if the categorization criteria are strictly followed. Nevertheless, it being an important player in the auto components sector and having its beginnings and growth as an MSME classified firm provides us several valuable lessons. We are not providing the case studies here due to space constraints.

Certain salient aspects of the functioning of these firms have been highlighted, followed by a discussion of the challenges faced by these firms that are symptomatic of the industry-wide concerns. Two propositions based on our observations and analyses have also been put forward.

These case-studies were written based on in-depth interactions with senior managers/owners of these firms. The interactions took place on the basis of a detailed schedule that carried a list of topics to be discussed and probed. Each of these interviews lasted about three hours and attempted to cover a comprehensive set of issues that the industry and the firm in particular faced in its efforts to survive and grow. The interviews were tape-recorded, transcriptions were carried out and content analyzed to arrive at the case studies.

The three firms are situated in the automotive cluster in the Tamilnadu Capital Region of Chennai. Their names have been disguised in line with the confidentiality conditions set forth by the interviewees.

LEADER is a sheet metal and fabrication company. It is a publicly listed joint venture with its major customer acting as an equity partner. It has two plants, one of which is 23 years old and the other 10. Almost the entire output (98%) of this firm is supplied to its major customer-cum-partner.

LAGGARD ONE was established around the year 1960 and has seven plants across the country. Its major products are rear axle, front wheel hubs, spindles, steering arms, etc. This is a public limited company with 60% family ownership, 30% FI stakeholding and 10% with the public. A majority (90%) of its production is supplied to one customer.

LAGGARD TWO is a private partnership firm set up by two partners. It is a tier-2 auto components supplier of smaller components used in the assembly of axles, bearings, motors, etc. It is 24 years old.

4. Findings Technology

The major customer has helped LEADER get technical assistance from globally renowned firms, the arrangement being contingent on the payment of a royalty.

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The equity stake of the major customer has helped partly relieve the financial burden of getting into such expensive technological arrangements. Technical assistance from foreign companies at the behest of the major customer has been taken only in areas that impact LAGGARD ONE's relationship with the customer. The firm has not proactively attempted to upgrade its technology in the other areas/plants. There is no in-house R&D effort. Similarly, LAGGARD TWO has also upgraded its technologies in a reactive manner after being compelled to do so by its major customer. It is also characterized by the lack of an R&D department.

Information Technology

There is a heightened sense of awareness about the indispensability of information technology in LEADER. This has translated into innovative and intense use of this tool for performing operations efficiently, liaising with other constituents of the value chain such as suppliers and customers, and managing the generation, codification and dissemination of knowledge organization-wide.

On the other hand, in the case of LAGGARD ONE, investments in IT have been a function of customer-demand, rather than the owner's understanding and conviction of the usefulness of IT. LAGGARD TWO also has very little investments in IT. IT is used sub-optimally for jobs such as e-mailing, keeping accounts, and other petty tasks.

Manufacturing

The management team at LEADER has been extremely proactive in seeking out the latest practices in manufacturing strategy and adopting them. The joint venture arrangement is also helpful in providing training to its employees on these innovative manufacturing practices. The differentiating factor here seems to be the effort in this organization to instill in every internal stakeholder a culture and system of values that recognizes, appreciates and internalizes advanced manufacturing techniques.

The manufacturing practices in LAGGARD ONE are dictated by the requirements of the major customer. They are the basic minimum and are in place only due to the fear of the possibility of penalties being imposed on them by the customer in case they are not adhered to. Naturally, advanced manufacturing concepts such as TPM and TQM are unheard of. There is no practice, for example, of preventive maintenance. This has adverse cost and quality implications due to frequent breakdowns. LAGGARD TWO has also not adopted any advanced manufacturing systems and techniques. It has in use only some elementary methods given to it by its major customer.

Organizational Growth

LEADER has now evolved into a divisional structure based on product groups. Each of the product groups is headed by a manager who is responsible for the overall marketing and operations-related aspects of his division.

The revenues of LAGGARD ONE have grown fifteen-fold over the past decade. However, there has not been a commensurate increase in the number of employees in the firm. This points to the increased use of technology as well as the enhanced productivity of the workforce. There has also been a marginal increase in the product portfolio, which consisted of two products at inception and now stands at seven. The company is still highly dependent on sales to the customer that it started business with.

LAGGARD TWO has also grown from employee strength of about five in the beginning to around 400 today. The number of customers has also grown to about nine from

one at inception. The basic product remains the same though variants have been introduced over the past quarter century.

Owner's Involvement

The owner of LEADER is involved in decision-making of a strategic kind that is of utmost importance in determining the future course of the firm. A balance between the levels of centralization and de-centralization of decision-making has been achieved to a great extent. The decision-making process can be categorized into three levels. At the basic level is the shop floor where employees have been given the authority to take operational level decisions. This balance is further accentuated through mechanisms such as the Management Committee Meeting (MCM) and Monthly Review Meeting (MRM). The MCM is held on a weekly basis among unit heads. The objective of this meeting is to share the unit's performance-related data, communicate any new insights obtained and to surface and resolve any issues encountered. Issues related to the business group are discussed by the group heads in the MRMs. There is also an organizational emphasis on implementation of decisions taken.

The owner is involved hands-on with every aspect of the functioning of LAGGARD ONE. Delegation of work is low. This is probably reflective of the mindset of the owner who views professional management suspiciously on account of sub-conscious fears of agency problems such as managers acting in their self-interest rather than in the interests of the firm/owner. The unhealthy results of this attitude are almost no decision-making authority with any employee, restrictions imposed on improvements or organizational changes of any kind, delays, de-motivated and frustrated employees, high employee turnover, and an overall lack of professionalism in the firm. There is no succession plan in place in LAGGARD ONE.

LAGGARD TWO also presents a similar disposition in terms of owner involvement in the day-to-day working of the organization. Decision-making and operational detailing on almost all aspects such as customer interaction, production, technology, marketing, etc. are taken care of by the owner. This high level of centralization of command leaves almost no room for delegation. This might be the result of lack of trust on the part of the owner on the employees, an inability to relax controls, lack of knowledge/qualifications on the part of both the owner and the employees, among other factors.

Strategic Orientation

LEADER follows a structured method of setting the strategic direction for the organization. External consultants are also hired to provide inputs for this process. Called the X-Matrix, it is a form of Management by Objectives (MBO). The organizational objectives are finalized through a process of consultation, debate and brainstorming by the top-management-team consisting of the owner, senior managers and other important stakeholders. These serve as broad guidelines that facilitate objective-setting by the business groups, whose objectives then feed into the same kind of process down to the level of departments within functional areas. Specific action plans for the attainment of the corresponding objectives are also drawn out at every level of the organization. Targets fixed are aggressive. Feedback mechanisms have been incorporated at every stage in order to closely monitor, evaluate, and control the process of achievement of the objectives.

LAGGARD ONE does not have strategic planning or a long-term orientation. There is an absence of strategic objectives. Goals set are operational in nature and generally

revolve around cutting costs or enhancing sales, though no targets are set. Accountability for achieving even these goals is not decided in advance. LAGGARD TWO also exhibits opportunistic behaviour bereft of any strategic, long-term thinking and orientation.

HR Issues

Attracting and retaining top talent is a big challenge. The low pay and the lack of professional HR systems and practices are deterrents to 'good' people joining the organization. The owner's lack of interest in developing human resources can also be attributed to the seriousness of this challenge.

LEADER has attempted to break the monotony of a manufacturing job through job rotation of professionally qualified management graduates across different functions. This has helped bring down the attrition rate among employees, especially the MBAs.

Human resources appear to be a neglected area in both LAGGARD ONE and LAGGARD TWO. There is no HR system, department or policy. This has an adverse fallout over employee safety, incentives, motivation, training, recruitment and retaining. The workforce appears to be dispirited, and not updated in accordance with current industry practices and knowledge levels.

Marketing

There is no marketing function or department in LAGGARD ONE. It is considered too expensive and redundant to invest in marketing capabilities. The owner is content with the status quo. The few 'sales' employees present are required to ensure fulfillment of the consumer orders. The same neglect of marketing can also be seen in LAGGARD TWO. On the other hand, LEADER has in place a well-developed marketing function.

5. Discussion

All the firms have only one major customer. LEADER, the one which has appeared to have successfully surmounted challenges, is a joint venture with its major customer. Even though it is an equity strategic alliance, the day-to-day operations are managed by the owner and his management team. The major customer only gets involved in decisions about product markets to venture into. LAGGARD ONE and LAGGARD TWO, on the other hand, are intensely centered on their major customer. Developments in almost all areas in these two firms may be attributed to the demands placed on them by their major customers. This leads us to our first proposition:

P1: Customers, rather than competitors, are the agents of organizational transformation in the Indian auto-components SME sector.

Technological developments are not easily accessible to the companies in this sector. Awareness levels are low. This deficiency can be overcome through developing a mechanism to network with other such clusters either in the country or globally. The government can help bring about this enhancement in contacts. The sector is also plagued by non-availability of basic infrastructure and high-tech machinery required. The government needs to introduce policies that encourage phasing out of obsolete machinery and replacing them with the latest, as is done in the more developed markets through discounts. A number of multinational firms are now bringing their auto component suppliers with them into this country due to the unpredictable quality and supply of the Indian counterparts. This is a very real threat that needs to be addressed.

Funding for technological upgradation appears to be difficult to secure due to its being extremely costly. LEADER has not faced this difficulty to a large degree due to its joint venture with its major, large-sized customer.

On the manpower front, the industry is of the view that the availability of top-notch talent has stagnated over the past few years. This makes firms rely on hiring raw or partially-trained personnel and investing in a little bit of their training to help perform tasks. Imparting specialized training on a regular basis and upgrading talent is not generally considered a worthwhile investment since the industry is finding it tough to retain talent due to the low pay scales and foreign competition which pays higher. It has been found to be especially difficult to retain management graduates in the organization for a considerably long period of time. A negative outfall of this is the low employee productivity in this sector as compared to global standards. Wages and salaries form only a minor fraction of the costs of the auto components sector. Perhaps, an increase in the salaries/wages by inculcating a professional management mindset may help stem the attrition of talented employees from the workforce. A need was also expressed to revamp the archaic and unduly tough labour laws in this sector which are hampering human resource development.

There is an urgent need to professionalize this sector. Being family-owned, the owners are more interested in short-term gains. Immediate returns are sought after, while long term investments are not high on the list of priorities. The government needs to impart firm-wise training to bring about a change in this mindset. We have found that inadequate professional management or technical educational qualifications have also played a role in shaping such a detrimental mindset. The training imparted should address these skill gaps. Our second proposition thus is:

P2: Inadequate managerial capacity is the most important constraint to growth in the Indian auto-components SME sector.

The government also needs to step up its efforts to provide access to convenient financing facilities to these units. It also needs to provide intensive training in financial management to the owners and top-level managers in this sector.

Marketing orientation of the firms appears to be low. There is an urgent need to professionalize marketing and customer relationships. This will lead to the firms not being overly dependent on only a major buyer which in turn will hedge risks considerably in case of a downturn in the economy.

6. Conclusion

This study, based on three case studies of firms in the auto components sector, has pinpointed areas in which urgent attention is required to bring about changes. Government support is needed to professionalize the management of organizations in this sector. We suggest that business schools introduce programs devoted to the management of family-run micro, small and medium enterprises, which might be of specific help to entrepreneurs who have not had the opportunity to undergo such courses of study earlier. These programs might also serve as refresher courses for practicing managers in this sector. These programs should ideally not be very expensive since a majority of the firms in this sector are extremely cost-conscious and need a lot of cajoling in order to make investments of any type.

Issues related to human resources, technology, financing, etc. have also been highlighted with a view to providing some

inputs on what to address. Suitable policy changes have to be brought about to tackle challenges on all these fronts. This industry is set to grow in the near future. The entry of foreign competition is going to pose several more challenges to these firms. There is an urgent need to understand these challenges further and overcome them.

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