

WHY PROJECTS FAIL?

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Before getting into the discussion on reasons for failure of projects, it would be essential to define what is meant by 'failure'. The term failure may have varying meanings in the context it is used and the criteria that are used for judging performance and success. The criteria differs depending on the viewpoint of the person who judges the performance. For example, a project which services its debt regularly but fails to pay a dividend cannot be viewed as a successful venture by a shareholder. A highly profitable project, which does not care to reduce pollution caused by its effluents would no doubt appear an utter failure to an environmentalist. A financially successful project, which employs a very small labour force, might not be considered a successful project by a certain school of economists. Thus it would be clear it is very necessary to argue on a conscious definition of the term 'failure' for the purpose of this exercise.

Criteria for Project Performance

For the objectives of this paper the definition covers failure or success of projects as viewed by financial institutions. Performance of a project would have to be gauged in relation to the criteria used for determining the viability and the bankability of the project while sanctioning assistance. As far as the financial institutions are concerned, in a large majority of cases, the criteria would be related to the commercial and financial performance, and the success or failure of a project will have to be judged mainly in financial terms as reflected in its ability to service debt and equity.

Be that as it may, in few cases, socio-political objectives cannot be

overlooked and sometimes these objectives do dominate. In such cases, it is futile to look for other causes for financial failure of these projects.

Often it is necessary to provide subsequent support to these projects by way of financial accommodation, protection and subsidies. These are, as it were, the costs that the society and the financial institutions have to pay towards the socio-political objectives.

External Factors

The viability of the project is disturbed in many cases because of entirely external factors outside the control of management. Rapid and unexpected changes in international situations, such as the 1973 oil crisis, can be a major contributory factor. Unexpected and steep changes in parity rates of foreign exchange, political upheavals and sudden shifts in international terms of trade can also nullify the assumptions on which the viability of a project is based.

A time policy changes made by the Government concerned affects the viability of the project. Changes in the structure of imports such as excise and import duties, turnover and corporate taxation, as well as import and export policies can be cited as examples.

Inflation can also sap the viability of projects, since the increase in prices are hardly ever uniform for inputs and outputs. In an inflationary situation, the prices of different sectors rise at different rates and often there are lags with regard to various sectors (for example, agricultural products, manufactured goods, wages) which can squeeze profit margins.

Sometimes the medicine is worse than the disease, and measures taken by Government or monetary authorities to curb inflation can affect the production sector severely. Credit

control, increase in interest rates and wages, or a dividend freeze can affect the demand for goods and also the cash flow of a project.

All the above external factors affecting projects, ultimately result in a cost overrun in the project, substantial increase in working capital requirements, financial stringency and vanishing profit margins. Finally, the health of a project cannot be stronger than that of the economy in general and industrial sickness increases substantially when the economy is not doing well.

In such situations, projects which are inherently weak and those that are managed poorly, cannot cope with the difficult situation. On the other hand, projects with strength and those that have resourceful management, can not only face the situation with confidence but are also able to show substantial increases in profits.

A financial institution, as far as it can influence Government policy, can help matters to a certain extent. More often, its willingness to offer additional finance or to grant accommodation and financial relief or rescheduling of term loans can go a long way in seeing a project through some of these crises.

Internal Factors

While one might feel helpless in the face of external forces, there are several factors well within the control of project management, which if properly attended to, can make a success of projects or at least make them strong enough to weather the storms created by external factors. As a corollary, a project could fail if these internal factors are not properly managed at the

- (i) planning and appraisal stage
- (ii) implementation stage
- (iii) operational stage.

Planning and Appraisal Stage

Major causes would be inadequate project planning with regard to

- market aspects and product mix
- infrastructural requirements
- process technology
- raw material requirements.

These are some of the basic requirements which go into project planning and it is hardly possible to introduce modifications and improvements at a later stage once the commitments are made.

The project planning in the initial stage is not adequately attended to for various reasons. Over optimism of the entrepreneur, a trading boom prevailing at the time of project conception and reluctance to spend time and incur adequate expenditure for planning are some of the major causes.

It is up to the financial institutions to spot such weaknesses, in the planning during appraisal stage and persuade the entrepreneur to take the necessary steps to remove or reduce the weakness and shortcomings. But it has to be admitted that project appraisal and decisions regarding financial assistance have to be based on a set of assumptions. Nevertheless it is essential that uncertainties involved in these assumptions are concretised and cogniscance is taken of them by building safety factors in financial projections and in determining the pattern of financing.

It is essential that a project under implementation receives adequate funding at the appropriate time. A project could get straved of funds at times, inspite of sanctions and commitments by the financial institutions of the promoter, for various reasons such as inability of the promoter to bring in his contribution, unfavourable capital market conditions and the time taken by the promoter to



fulfil certain essential pre-disbursement conditions and complicated legal requirements.

Implementation Stage

During the implementation period two major factors responsible for the ultimate failure or weakening of a project are long delays in completing the project and overrun in capital cost. However, it should be appreciated that these are but symptoms of a deeper malaise stemming from various causes. In addition, inadequate project planning; wrong selection of consultants, contractors and equipment suppliers; inadequate follow-up and supervision of their scheduling; wrong planning of delivery schedules, inadequate liason with authorities providing infrastructural facilities, and failure in fixing responsibilities can be some of the major causes.

Many a time, the promoter is keen to undertake construction and supply activities departmentally without adequate organisation and such misplaced ambition can often lead to disastrous consequences.

It is often necessary to maintain flexibility in project planning to overcome problems on one hand and to take advantage of new opportunities on the other. However, there are instances where the promoters have changed the scope of their project without adequate planning and without taking into account the consequences, resulting in large overruns and delays.

Delays in completion of a project, not only increase the preliminary and pre-operative expenses, but can cause the project to be a victim of inflation and cost escalations. Moreover, delays in commissioning the plant can be met in the project missing out on good market opportunities and / or tax concessions.

Overrun in the cost of the project can firstly eat into contingency provisions, and then into the working capital margin provided in the financial plan. Secondly only a few avenues are available with regard to means of financing the cost overruns. These are mostly expensive, inconvenient or downright dangerous, in as far as they eliminate several options for future management action. While discussing causes of overrun, one cannot omit a reference to questionable practices adopted by certain promoters who make it a channel for diversifying project funds to personal coffers.

Operational Stage

It is often essential to build an organisation and train a managerial team during the construction period which can subsequently undertake operational responsibilities. Failure to build such an organisation and a team can often cause irreparable loss to a project.

Initial technological and process problems, shortage in supply of materials of desired quality, problems in availability of power, water, transport, technicians and effluent disposal are some of the operational factors which can bring down the viability of a project. Inadequate attention to production, maintenance of equipment, marketing, inventory and credit control can also affect viability of projects.

The above factors can push up the break-even point of a project. This can result in cash losses, which have to be generally financed by interest bearing funds, further adding to the fixed cost burden. Depleted working capital margins cut into the ability of a

project to buy raw materials at the best price or to give credit to expand sales.

Complex as these factors are, it is often found that correct diagnosis of the problem and prompt corrective management action can bring about a turn-around of the project's fortunes. However, this presumes that the promoter would accept advice and implement solutions. Further it requires mutual confidence between the promoter and the financial institutions. In such instances, the financial institution is often required to inject additional funds towards the project.

Management

Satisfactory planning, implementation and operation of a project calls for good management. Ability of a project to overcome problems and to ride through a crisis totally depends on the strength of its management.

Management, as far as the term signifies Chief Executive Officer and Board of Directors, is generally determined by the promoter. Others in the promoter group seek positions on the Board. Thus various demands are made for satisfying the ego, aspirations and ambitions of the promoters irrespective of their ability to lead or manage. In this practise, professional and capable management is often left out.

Atrophied management structures and heavy overheads can prove to be the bane of established concerns. Insulation from realities and inability to respond to changing economic, social and political ethics can lead to severe problems and failure. Managements are often lulled into satisfaction through non-competitive situations, overprotection, and government controls. Many well-run companies are weakened over a period by inadequate attention to the market process, technological developments and needs for diversification and modernisation.